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Exploitation of Private Information: A Comparison between Swiss Branches

Bachelor Thesis in Banking and Finance
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Abstract:

This thesis examines insider trading activities within the Swiss stock market 1.5 years after the introduction of the new insider trading regulation. The thesis analyses abnormal returns from 1,602 reported purchase and sale transactions of the executive members of the board of directors, members of the executive committee and non-executive members of the board of directors between January and December 2015. Sub-samples for firm size, price-earnings ratio, transaction volume and industry classification are included in order to investigate the respective effects on abnormal returns. Results show that overall the new regulation served its purpose, restricting informed investors to capture abnormal returns from their trades.

Executive Summary

Problem
Insiders, like other investors trade securities or related products of listed firms. However unlike other investors, insiders have access to private and confidential information about the company for which they work. Therefore, insiders may execute purchase and sale transactions to obtain higher returns by exploiting their superior knowledge. Many past studies have provided evidence for such insider trading activities. It is questionable whether insiders also exploit their superior knowledge in the Swiss stock market. Additionally, the Swiss state recently revised insider trading regulations which has implication for potential insider trading practices in Switzerland.

Aim
With an empirical analysis this thesis aims to investigate insider trading activities in a modern context in Switzerland. Furthermore, sub-groups for price-earnings-ratio, firm size, transaction volume and industry classification are formed to detect such activities for the case they are not observable from an aggregate perspective. Moreover, this study provides opportunities to assess the efficiency of the new regulatory environment.

Method
In order to analyse opportunities to exploit private information using the data on reported management transactions an event study methodology is applied following the procedure of MacKinlay (1997) and Holler (2012). The event study involves stock returns from 136 firms of the Swiss Performance Index (SPI) which represents Switzerland's overall listed companies and includes small, medium and large firms. From those companies 1,602 sale and purchase transactions are analysed within January and December 2015. Subsamples are then defined in order to analyse different characteristics between industries, firm sizes, price-earnings ratios and trade volume. The computation of abnormal returns using a market model regression and the respective average and cumulative abnormal returns provide the data to investigate possible insider trading activities. Statistically significant cumulative abnormal returns prior to the event (the management transaction) and a reversed trend after the event give insights for such trading activities. The T-Tests used to assess the statistical significance refers to the variant proposed by Mikkelson and Partch (1988).

Results
The data on purchase and sale transactions does not show any insider trading activity for the aggregate sample in Switzerland. The data indicates that investors in Switzerland are not able to exploit private information to generate higher returns than other uninformed market participants. This supports the view that the new

regulatory rules on insider trading in Switzerland have served their purpose. The data is consistent with the idea that the Swiss stock market exhibits strong form market efficiency. The results from the sub-samples, mainly reflect the results for the total sample. This thesis has found no relationship between abnormal returns and firm size, transaction volume, price-earnings ratio or industry effects. Interestingly, statistical evidence for insider trading activities seems to be given for discreet groups in the sub-samples of this study. Insiders of the largest transaction volume group seem on average to be able to obtain abnormal returns when selling their own shares. Similar results have been found for insiders of firms in the industrial sector which are able to earn abnormal returns (or avoid losses) up to 2.2% 30 days from the sale transaction. Overall it seems that new regulatory rules on insider trading in Switzerland are performing well, by stopping the average informed investors to capture abnormal returns through their superior knowledge. However as shown for the sub-samples, it seems that there are still opportunities to exploit confidential information.