



## Module 3

### The Role of Global Capital Markets

Fairness, Integrity and Transparency  
(Trust)

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## Efficient markets

Efficiency requires market participants' confidence in fairness and equity.

Fairness requires a *level playing field*.

That includes equal information –  
reducing information asymmetry enhances efficiency:

- Mandatory disclosure of material nonpublic information
- Regulation Fair Disclosure.



## Material information

Material if its disclosure is likely to impact the price of a security.

- Specificity of the information (link)
- Extent to which it differs from public information
- Nature of the information
- Reliability of the information.

Insider trading is the purchase/sale of asset while in possession of material nonpublic information – or tipping that information, breaching a fiduciary duty or duty arising from trust.

## Insider trading

### **Classical**

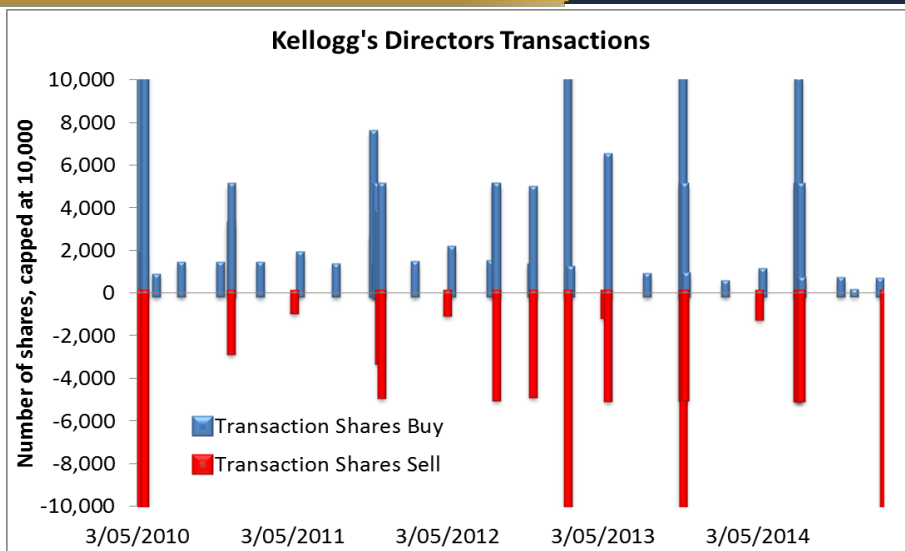
Insiders who learn material nonpublic information in the course of their employment and owe fiduciary duty to the issuer of the asset subject to insider trading.

### **Misappropriation**

Outsiders who learn material nonpublic information in the course of their employment and owe a fiduciary duty to someone else than the issuer of the asset subject to insider trading.

Some jurisdictions have much stronger interpretations of misappropriation!

## Trading by insiders ≠ Insider trading



## Insider trading

Anecdotally, illegal insider trading is on the rise:

- Earnings surprises
- Mergers, acquisitions, joint ventures
- Restructures
- Innovative products
- New licenses, trademarks, patents
- Changes in management
- Issues of new securities
- Bad debts, bankruptcies
- Legal disputes.
- Government reports
- Key macro statistics (monetary policy, labor statistics).

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## Insider trading evidence

*Do insiders exploit non-public information?*

Evidence of leakage to some traders before public announcement – e.g. dividend (earnings) increase announcements are often preceded a few days by a share price increase...

When insider buyers (sellers) exceed insider sellers (buyers), the stock subsequently performs well (poor)...

*Could that be a confidence signal?*

## Manipulation

Transactions that deceive market participants by distorting price discovery:

- Artificially distort prices or volume to give impression of activity or price change
- Securing a controlling position in an asset to exploit and manipulate its price or related (derivative) price.

Dissemination of false or misleading information:

- Rumourtrage.



## Manipulation examples

**Pump-and-dump** – spread exaggerated statements.

**Short-and-distort** – spread unverified bad news.

**Fictitious trades** – bucketing, cross trading give an appearance of trade.

**Ramping, churning, wash trades** – appearance of activity/volume.

*And where does the LIBOR manipulation fit?*

## Manipulation examples

**Corner and squeeze** – commodity examples.

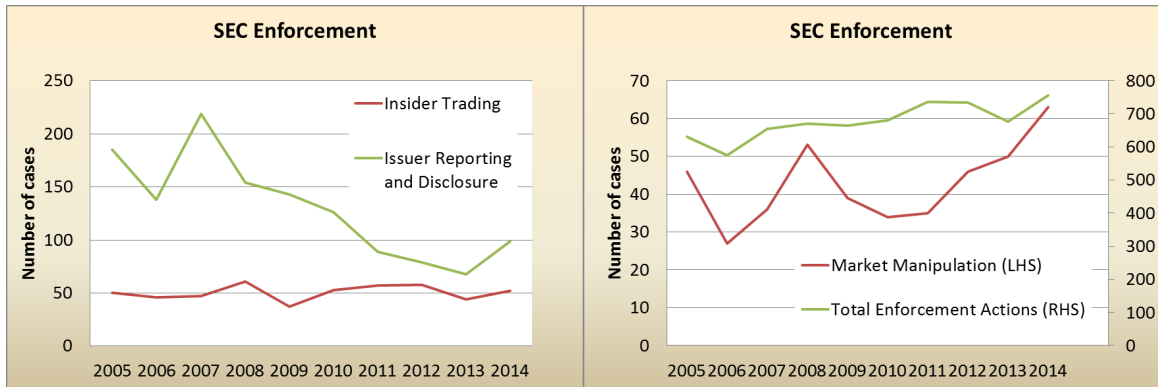
*“The situation worsened...when a corner in corn futures victimized the president of the Board of Trade, ... ruining him financially and prompting his resignation from office.”*

Hard to hide when successful!

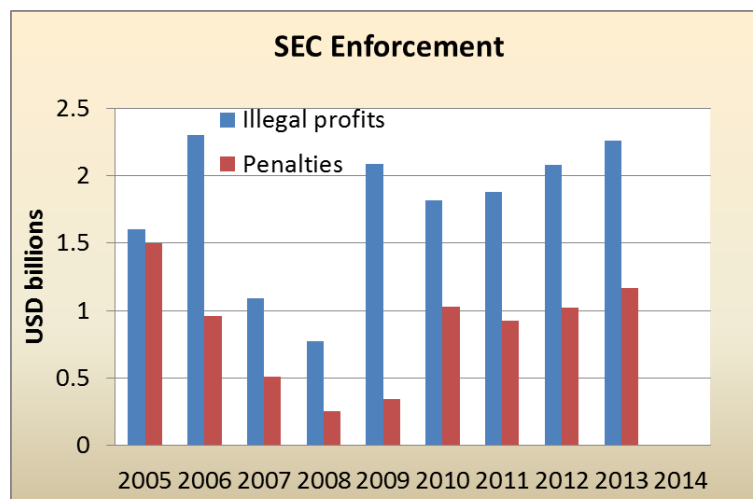


## The watchdog – frequency

### Securities and Exchange Commission



## The watchdog – recovering illegal profit and penalties



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## Market integrity challenges

- Front-running, tailgating, and dual trading are difficult to detect, and not all illegal
- OTC markets are more vulnerable
- Self Regulatory Organizations may “settle” rather than prosecute
- Unregulated market platforms
- Dark pools

*And how does it affect corporations?*

## Source list

### Slide 5:

Kellogg's Directors Transactions graph. Prepared by Paul Kofman sourced from data from Real-Time Insider Trading Data, U.S . Securities Insider Trading Information ([http://insidertrading.org/?sort\\_by=acceptance\\_datetime&asc=&symbol=K&date\\_from=2010-05-08&date\\_to=2015-05-10&submit=+GO+](http://insidertrading.org/?sort_by=acceptance_datetime&asc=&symbol=K&date_from=2010-05-08&date_to=2015-05-10&submit=+GO+)). © The University of Melbourne.

### Slide 11:

SEC Enforcement graphs; (a) cases by year: insider trading and issuer reporting and disclosure and (b) cases by year: market manipulation and total enforcement actions. Prepared by Paul Kofman from data sourced from Year-by-Year SEC Enforcement Statistics <<http://www.sec.gov/news/newsroom/images/enfstats.pdf>> and Year-by-Year Monetary Sanctions in SEC Enforcement Actions (<http://www.sec.gov/news/newsroom/images/enfstats2.pdf>), U.S. Securities and Exchange Commission. © The University of Melbourne.

### Slide 14:

SEC Enforcement graph; Illegal profits and penalties by year. Prepared by Paul Kofman from data sourced from Year-by-Year Monetary Sanctions in SEC Enforcement Actions (<http://www.sec.gov/news/newsroom/images/enfstats2.pdf>), U.S. Securities and Exchange Commission. © The University of Melbourne.

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