



# M&A and Insider Trading Issues

AIJA Conference Madrid  
November 19, 2010

Christian Leuenberger  
Dr. iur., LL.M., Attorney-at-Law  
[christian.leuenberger@pestalozzilaw.com](mailto:christian.leuenberger@pestalozzilaw.com)

[pestalozzilaw.com](http://pestalozzilaw.com)

Pestalozzi Rechtsanwälte AG  
Löwenstrasse 1  
CH-8001 Zürich  
T +41 44 217 91 11  
F +41 44 217 92 17

Pestalozzi Avocats SA  
Quai du Mont-Blanc 5  
CH-1201 Genève  
T +41 22 999 96 00  
F +41 22 999 96 01

# Overview

- Definition
- Problem: Uncertainty Regarding Purpose of Insider Trading Regulation
- Possible Solution: Law and Economics Approach
- Conclusion

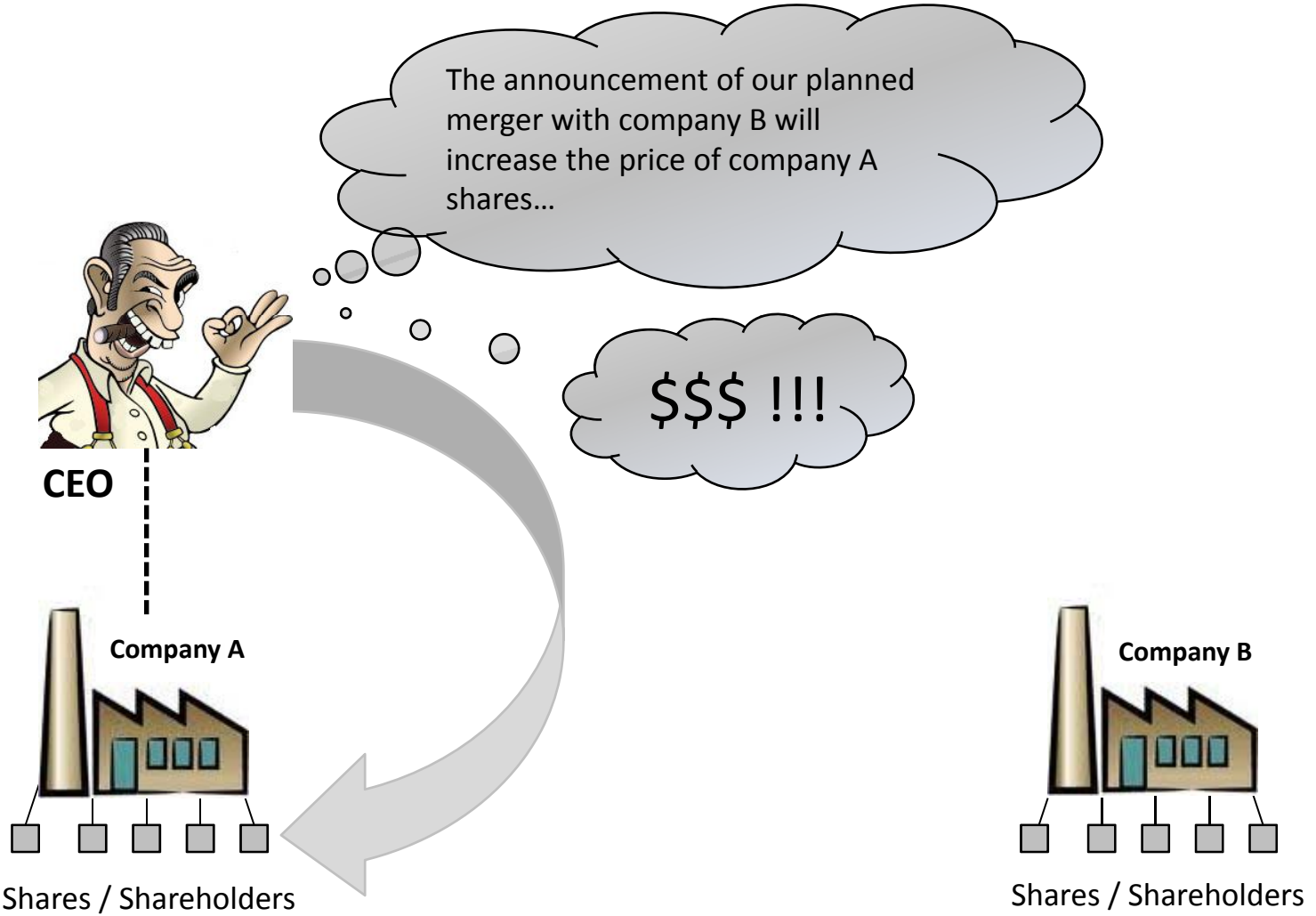
# Definition of Insider Trading

- Broad v. Narrow Definition
- Broad Definition
  - Trading in a company's securities by persons who know that company from the inside („Insiders“)
  - Example: CEO buys shares of his company
  - Includes „Legal“ insider trading
- Narrow Definition
  - Trading in securities of company by insiders only if trading is based on secret, price relevant information
  - Example: CEO buys shares of his company because he knows about a price relevant merger (to be announced)

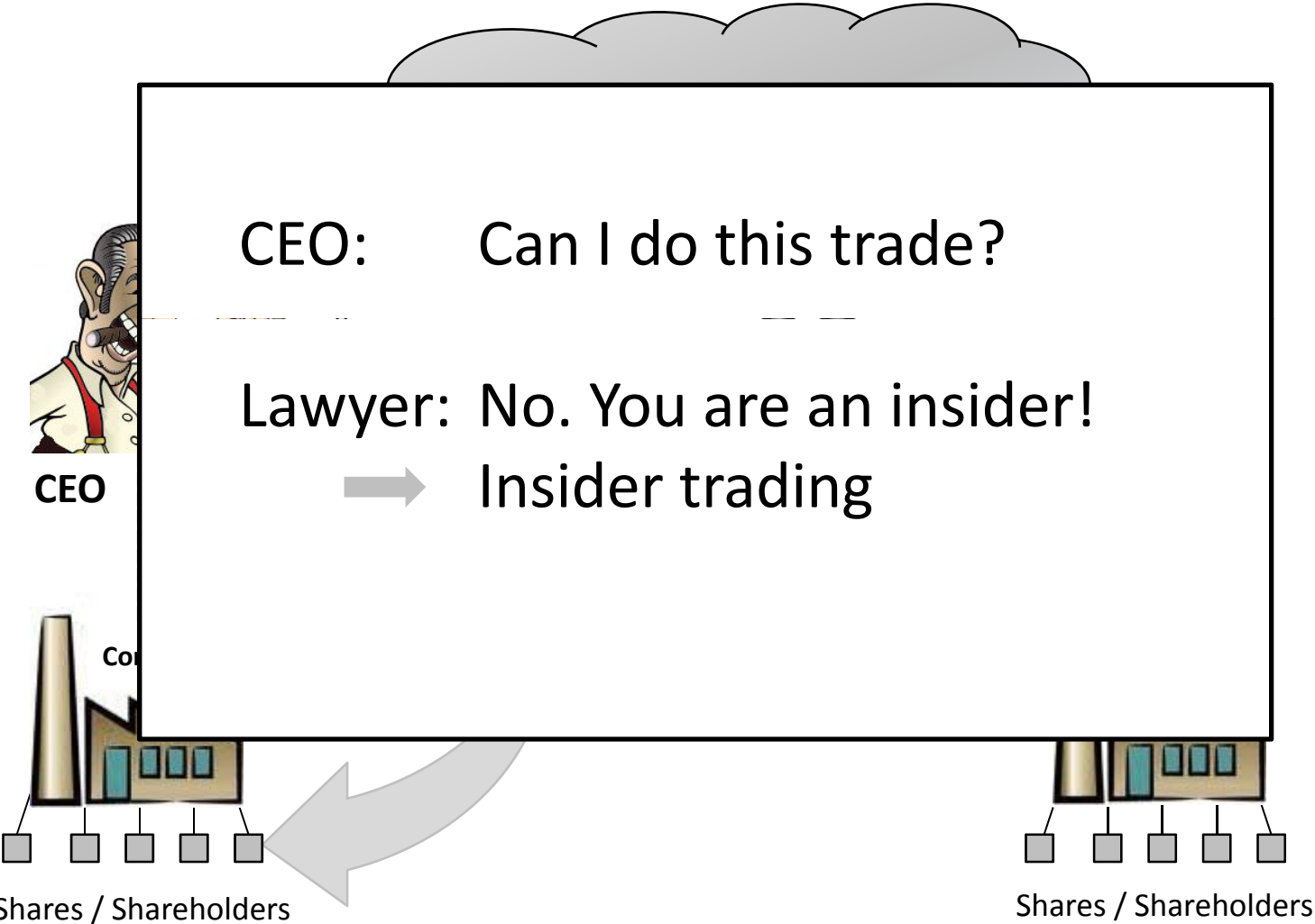
# Difficulties when Advising on Insider Trading

- Traditionally Criminal Law (Europe)
- Lack of Secondary Sources
- Uncertainty: What is the Purpose of Insider Trading Regulation?

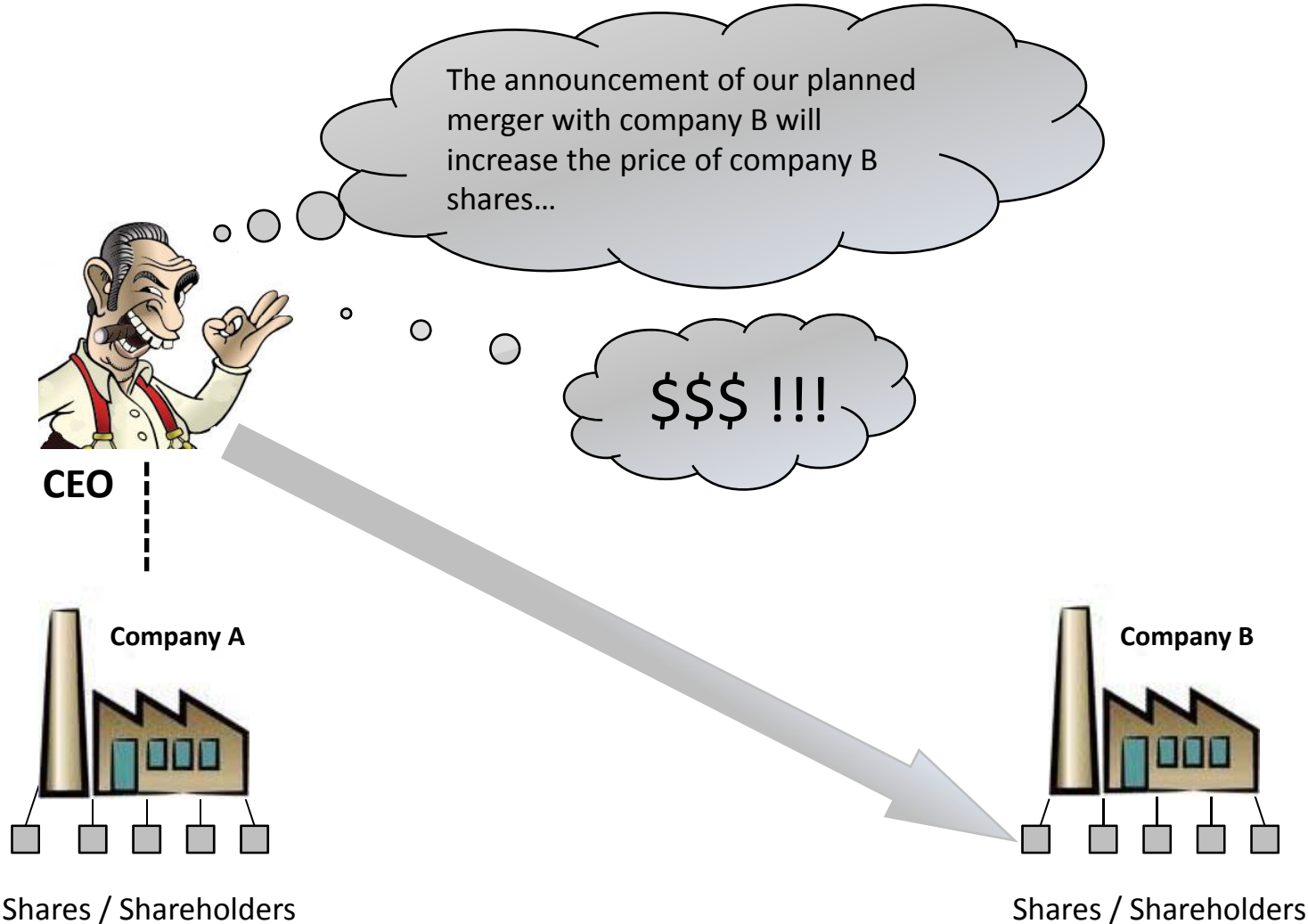
# Example 1: CEO buys A-Shares



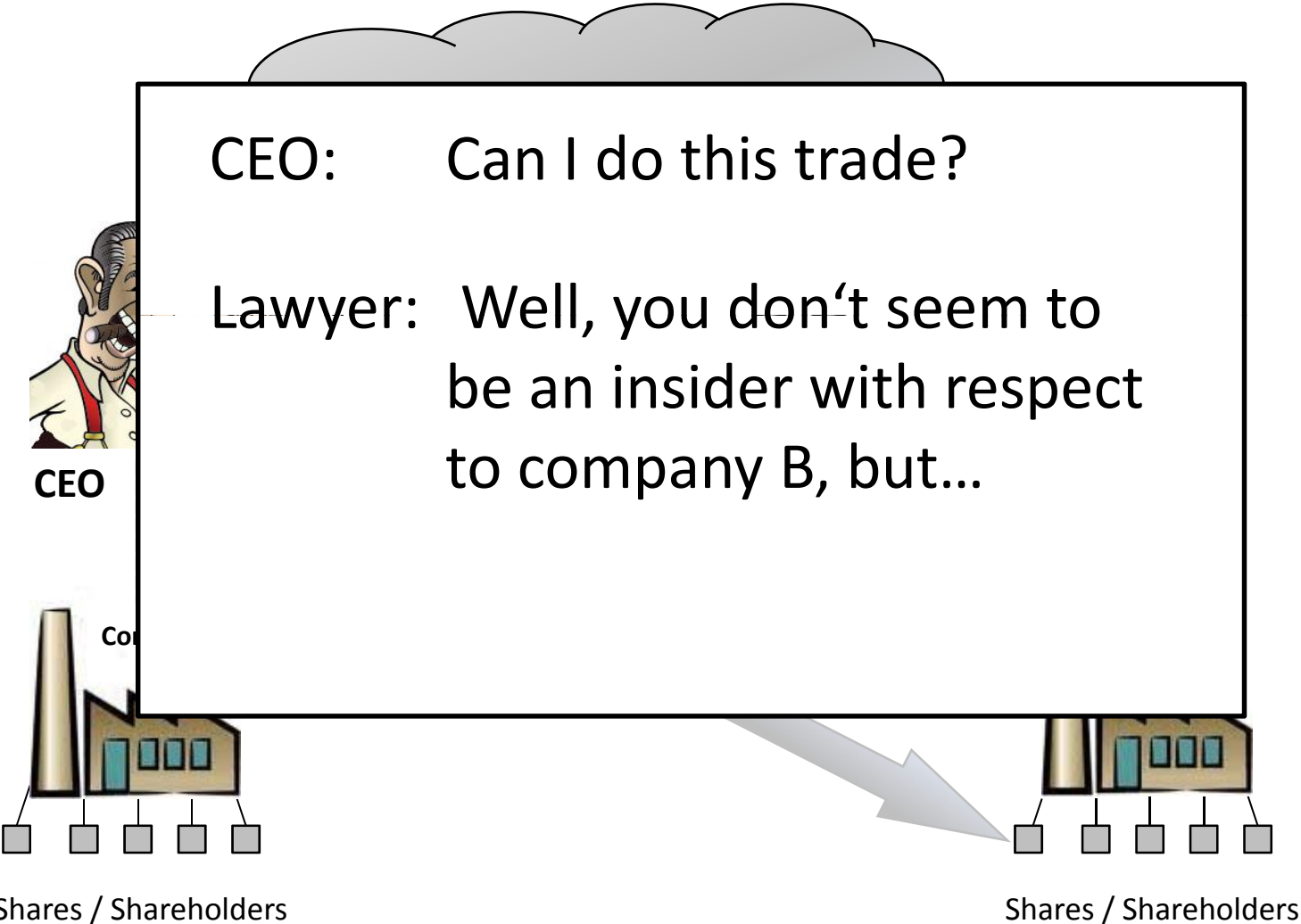
# Example 1: CEO buys A-Shares



# Example 2: CEO buys B-Shares

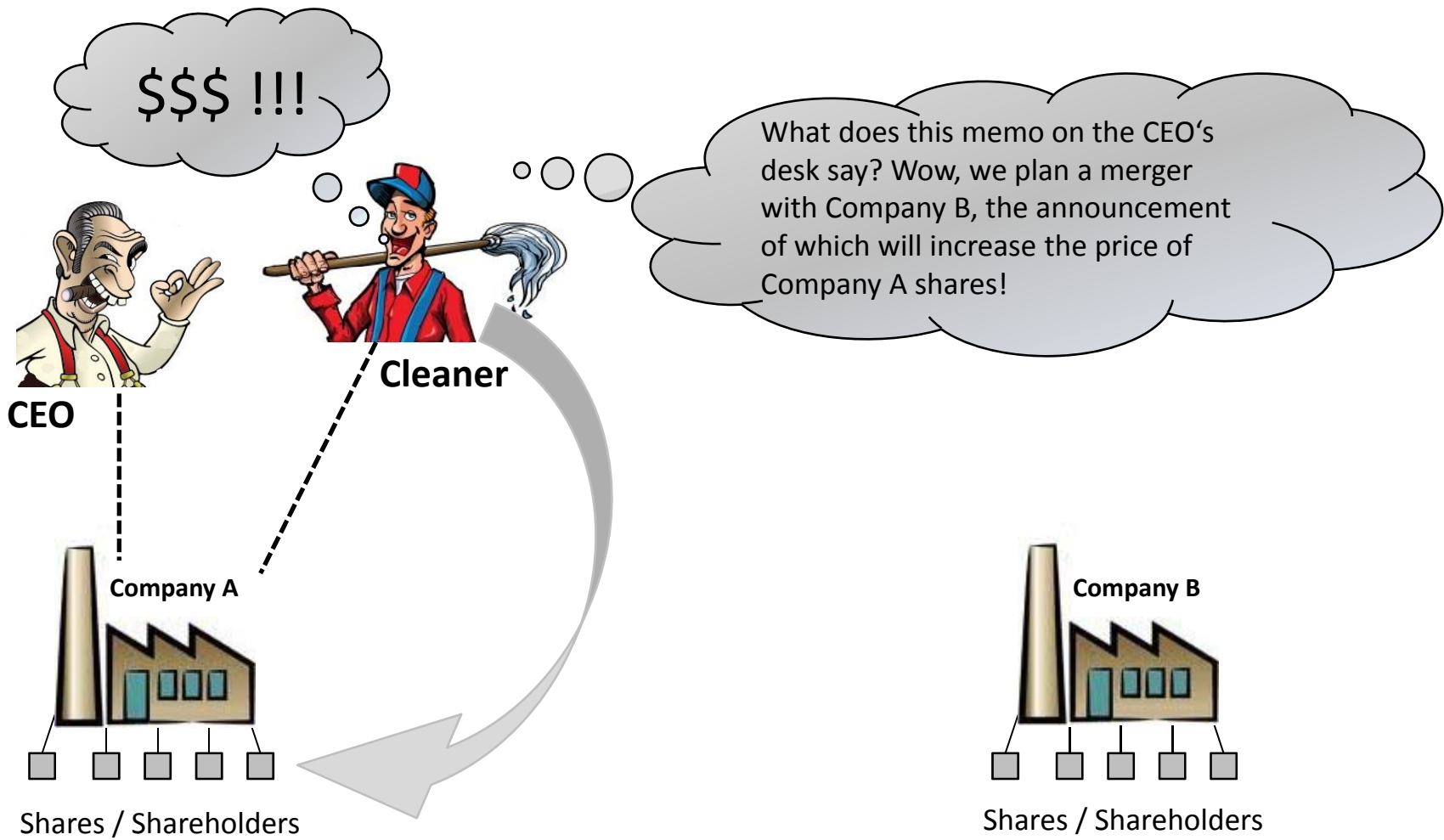


# Example 2: CEO buys B-Shares

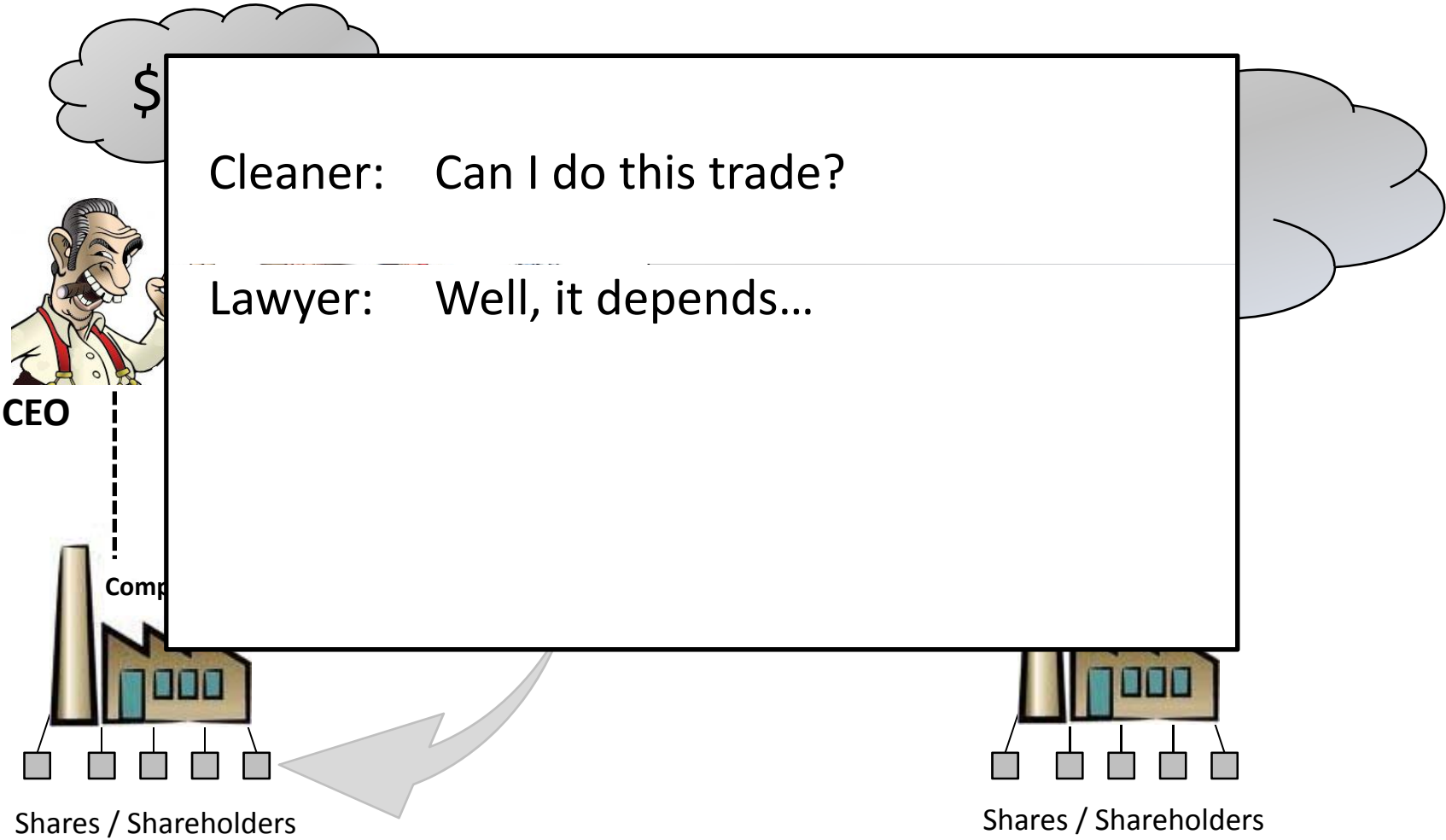




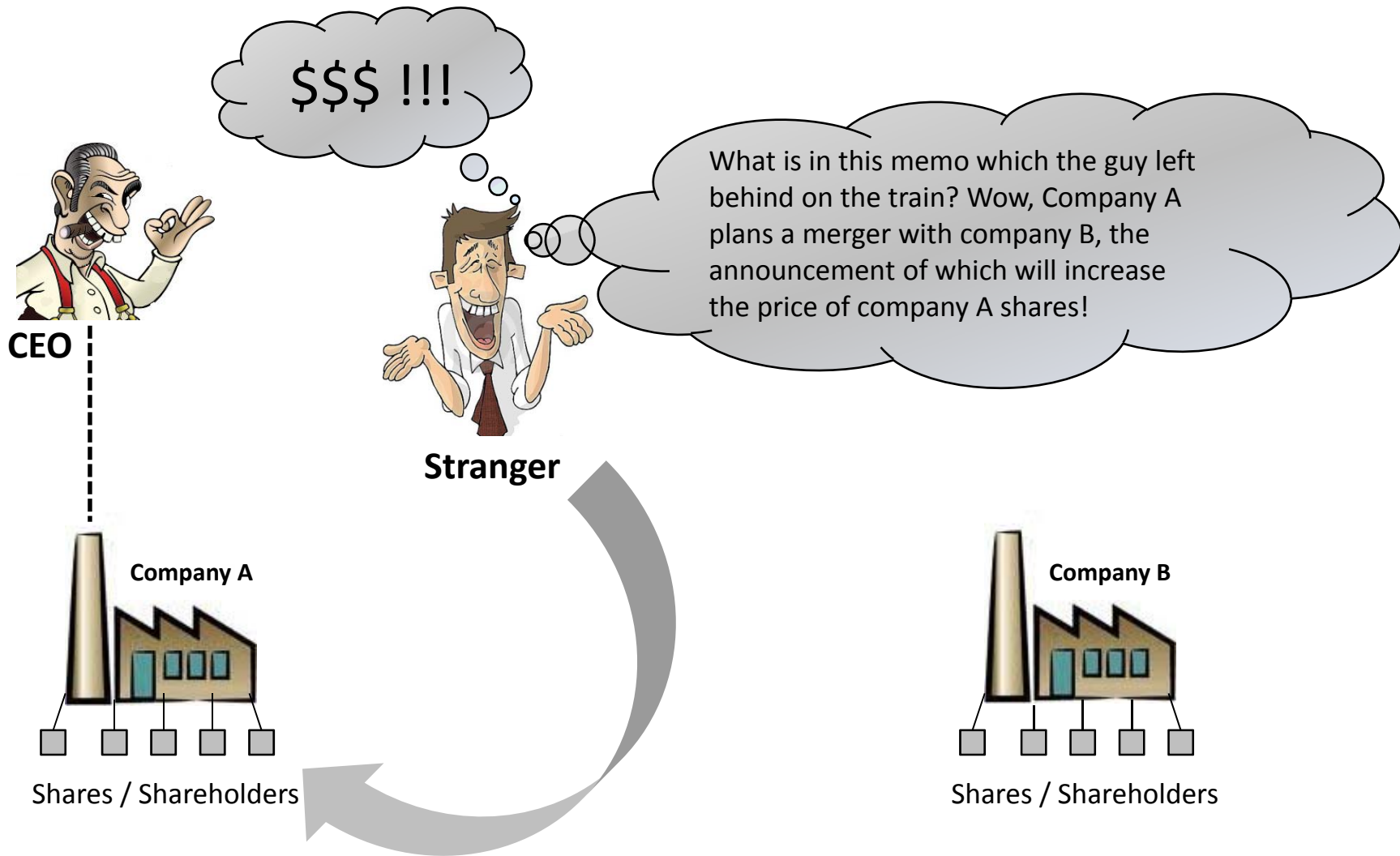
# Example 3: Cleaner buys A-Shares



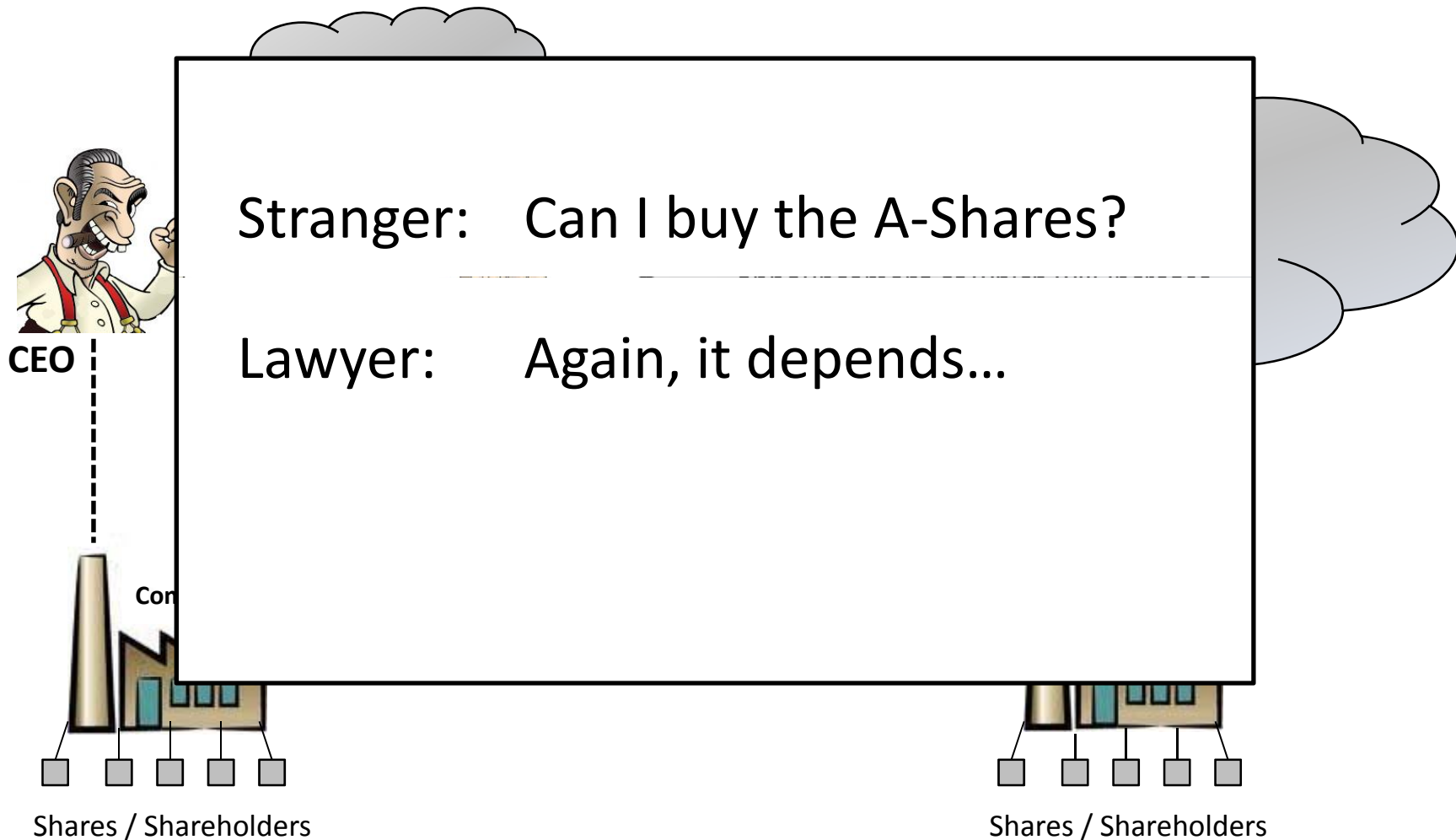
# Example 3: Cleaner buys A-Shares



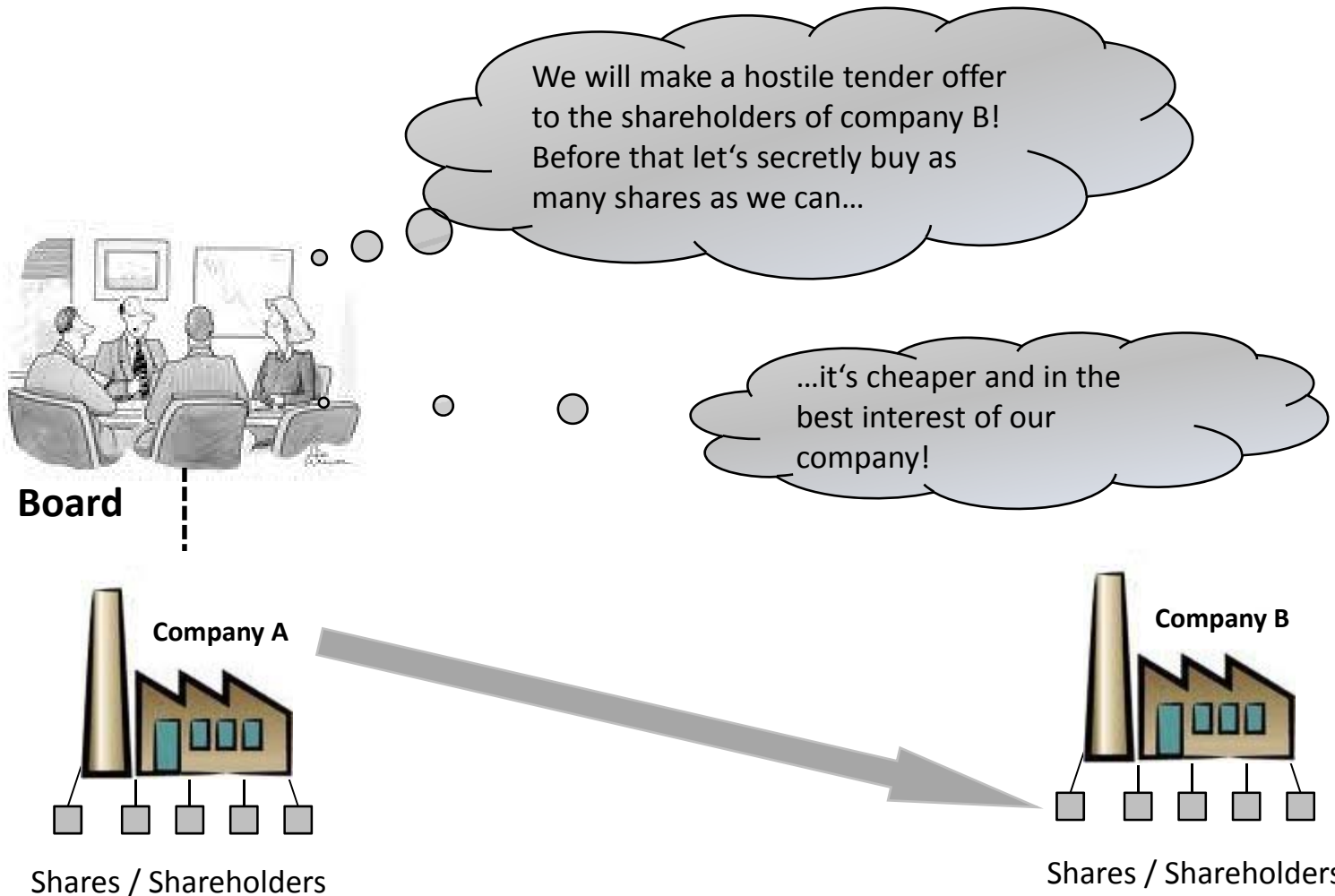
# Example 4: Stranger buys A-Shares



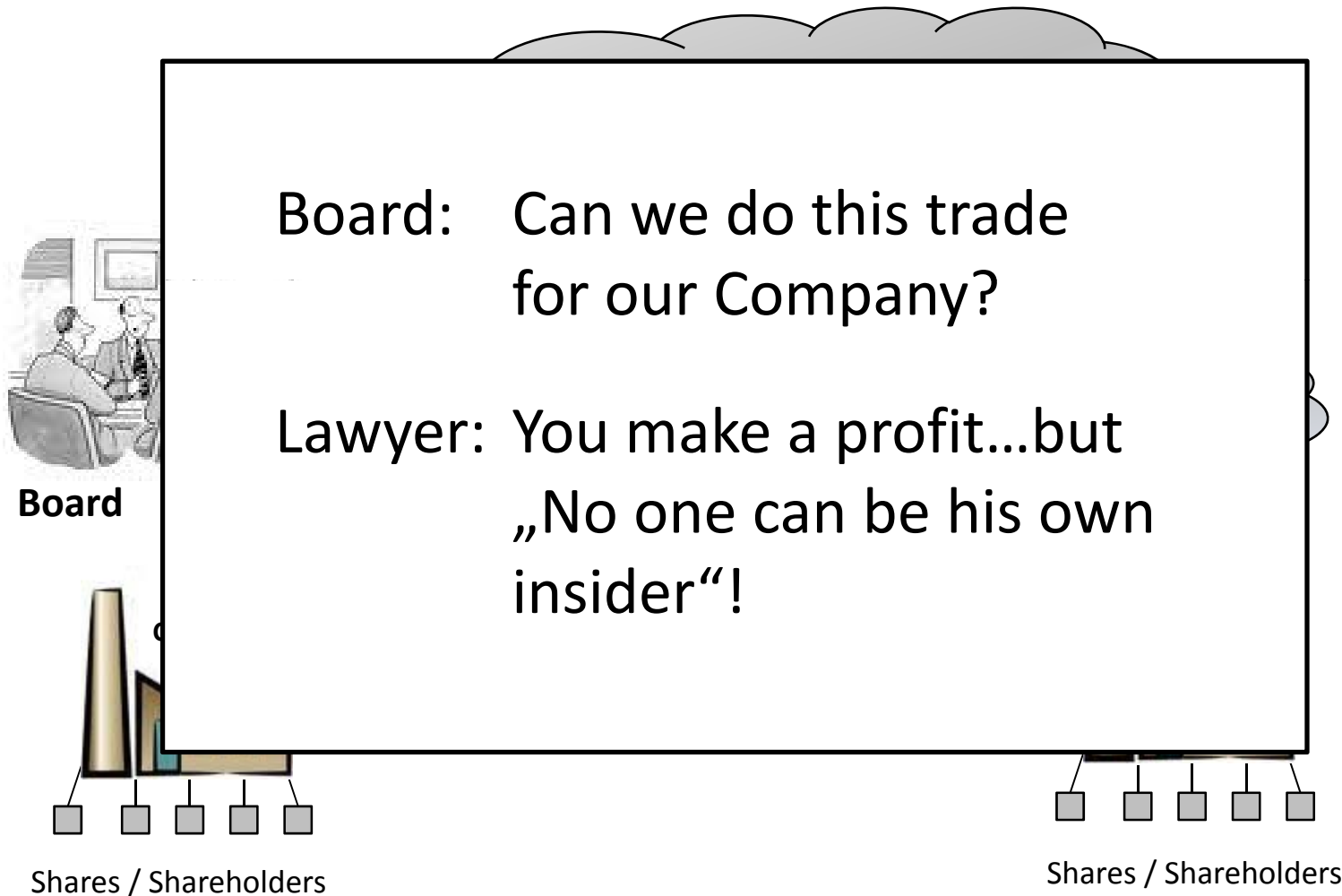
# Example 4: Stranger buys A-Shares



# Example 5: Company A buys B-Shares



# Example 5: Company A buys B-Shares



# What is the Purpose of Insider Trading Regulation?



- Different Conceivable Approaches
- Law & Economics Perspective: Overview
  - Efficiency (i.e., allocational efficiency)
  - Market model / individuals as profit maximizers / Pareto efficiency
  - Perfect market as benchmark: More and less efficient markets
  - Question: Does insider trading make capital market more or less efficient?
  - Most frequently discussed: Insider trading's influence on stock price accuracy and stock market liquidity

# Insider Trading & Stock Price Accuracy (I)

- **Meaning & Significance of Stock Price Accuracy**
  - Stock price: Reflects all publicly available information
  - Intrinsic value: „Value justified by the Facts“ or „true value“
  - The closer to the intrinsic value the stock price gets, the more accurate the stock price becomes
  - More accurate share prices = more efficient capital market



# Insider Trading & Stock Price Accuracy (II)

- Insider Trading's Influence on Stock Price Accuracy
  - Opponents: Insider trading increases stock price accuracy
    - Efficient substitute for traditional disclosure
  - Proponents: Insider trading reduces stock price accuracy
    - Distorts managers' incentive to disclose the information
    - Insider trading detection would be expensive
    - Whatever advantage insider trading might have over traditional disclosure is small
  - Empirical evidence suggests that proponents are right

# Insider Trading & Stock Market Liquidity (I)

- **Meaning & Significance of Stock Market Liquidity**

- „Slippery Concept“ because it has various dimensions → here we focus on transaction costs
- The more liquid a market is, the lower are the transaction costs
- More liquid = more efficient

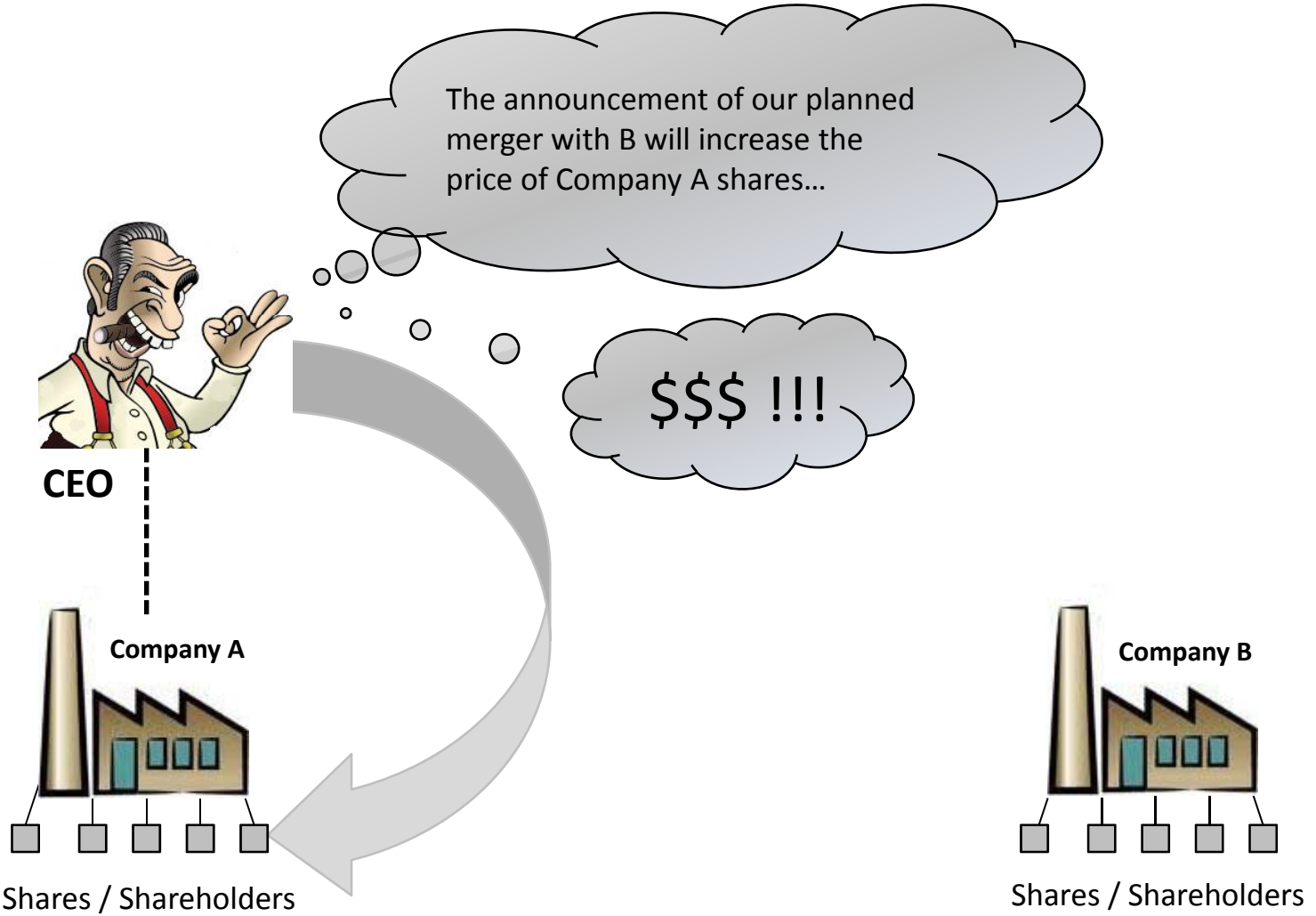
# Insider Trading & Stock Market Liquidity (II)

- Insider Trading's Influence on Stock Market Liquidity
  - Proponents: Insider trading reduces stock market liquidity
    - Insiders' premiums are a Cost to other market participants
    - At a certain point other market participants refrain from trading altogether
  - Opponents: Insider trading has no negative effect on liquidity
    - Uninformed traders do not care
    - Only redistribution from analysts to insiders → Competition discussion
  - Empirical evidence suggests that proponents are right

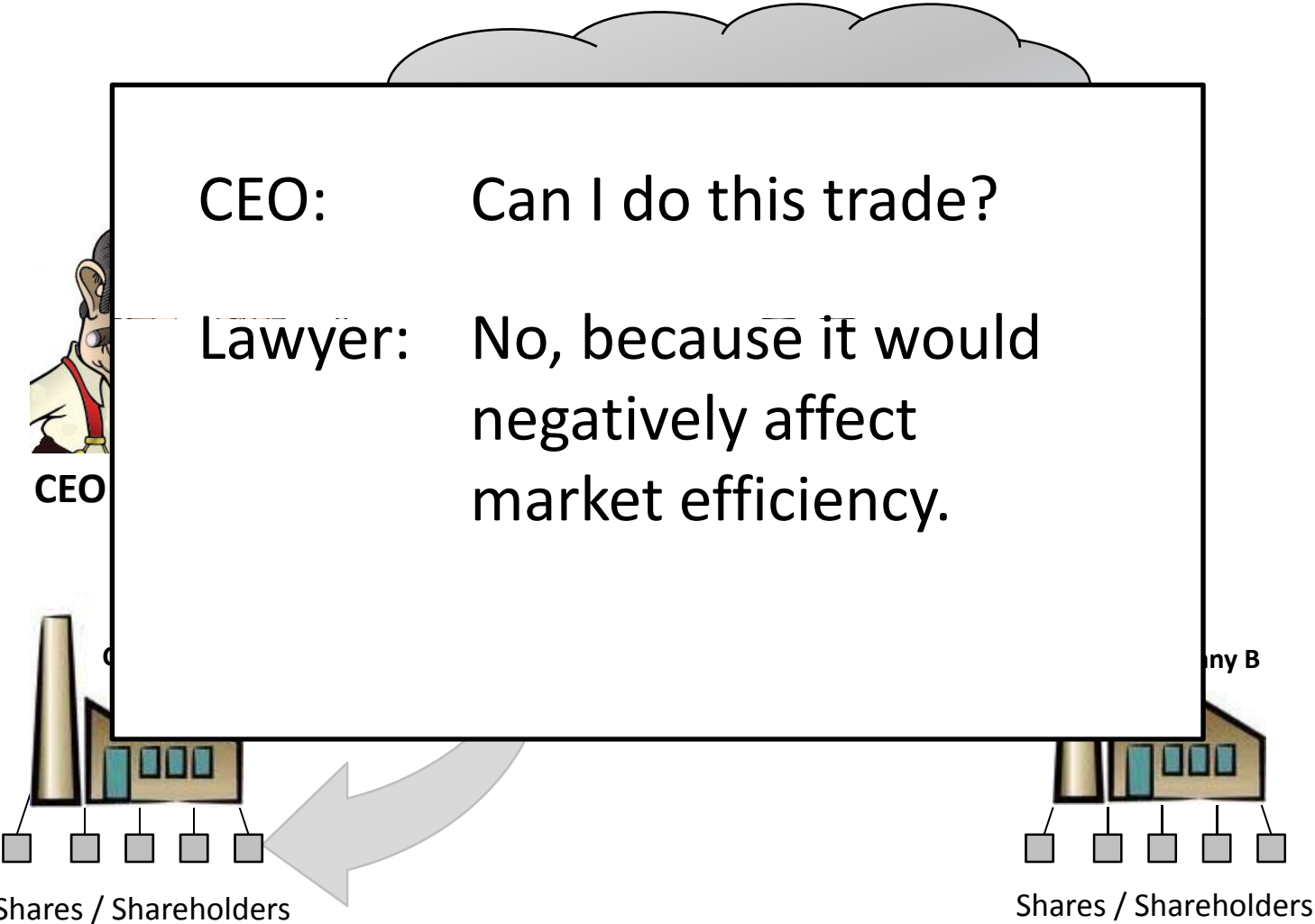
# Conclusion

- Law & Economics Approach Demands that Insider Trading be Banned Because it Reduces Capital Market Efficiency
- In Other Words: The Purpose of Insider Trading Regulation is to Prevent Negative Effects on Capital Market Efficiency
- Examples 1 – 5 can be Answered Clearly (also „Tipping“-Question, etc.)

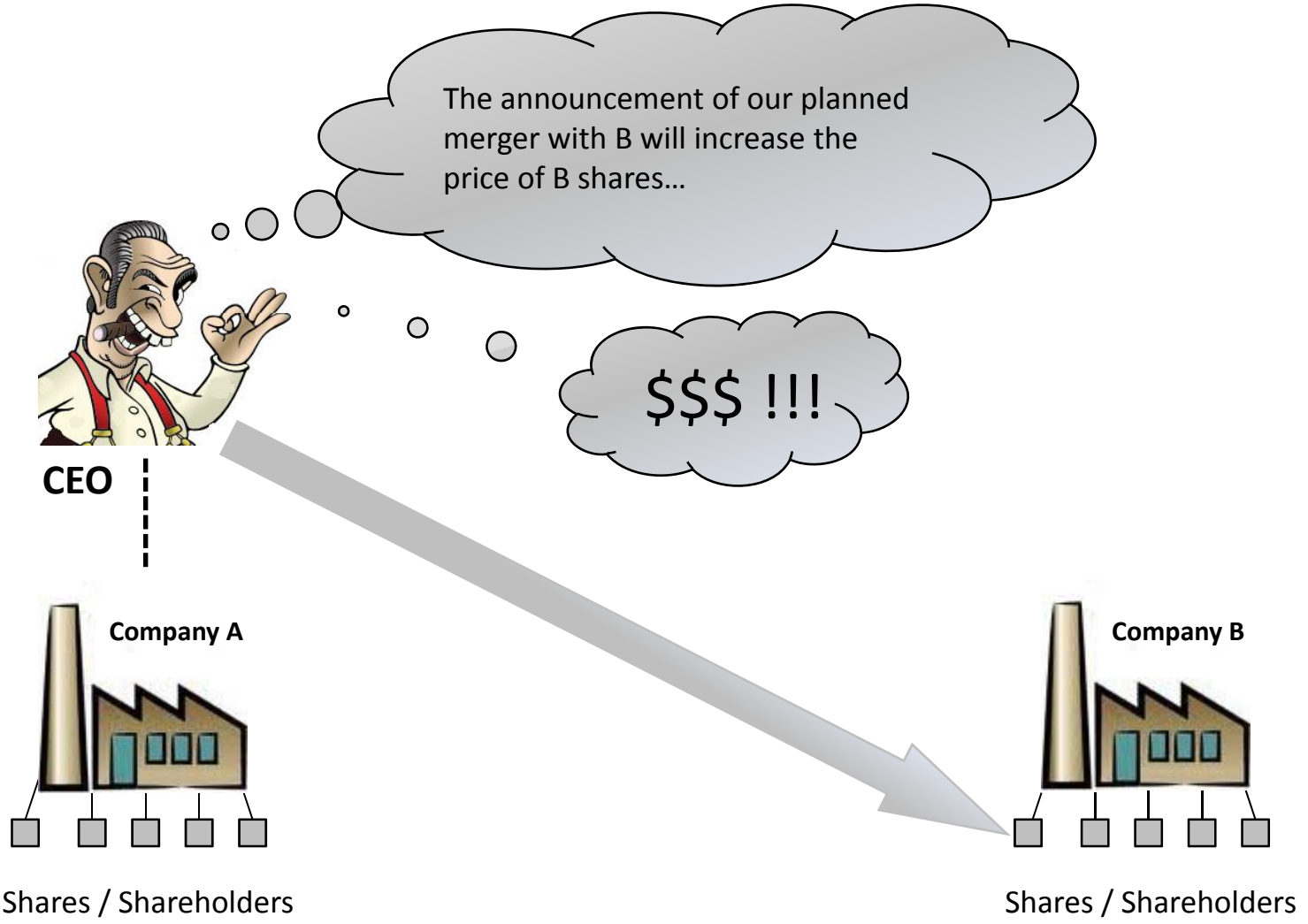
# Example 1: CEO buys A-Shares



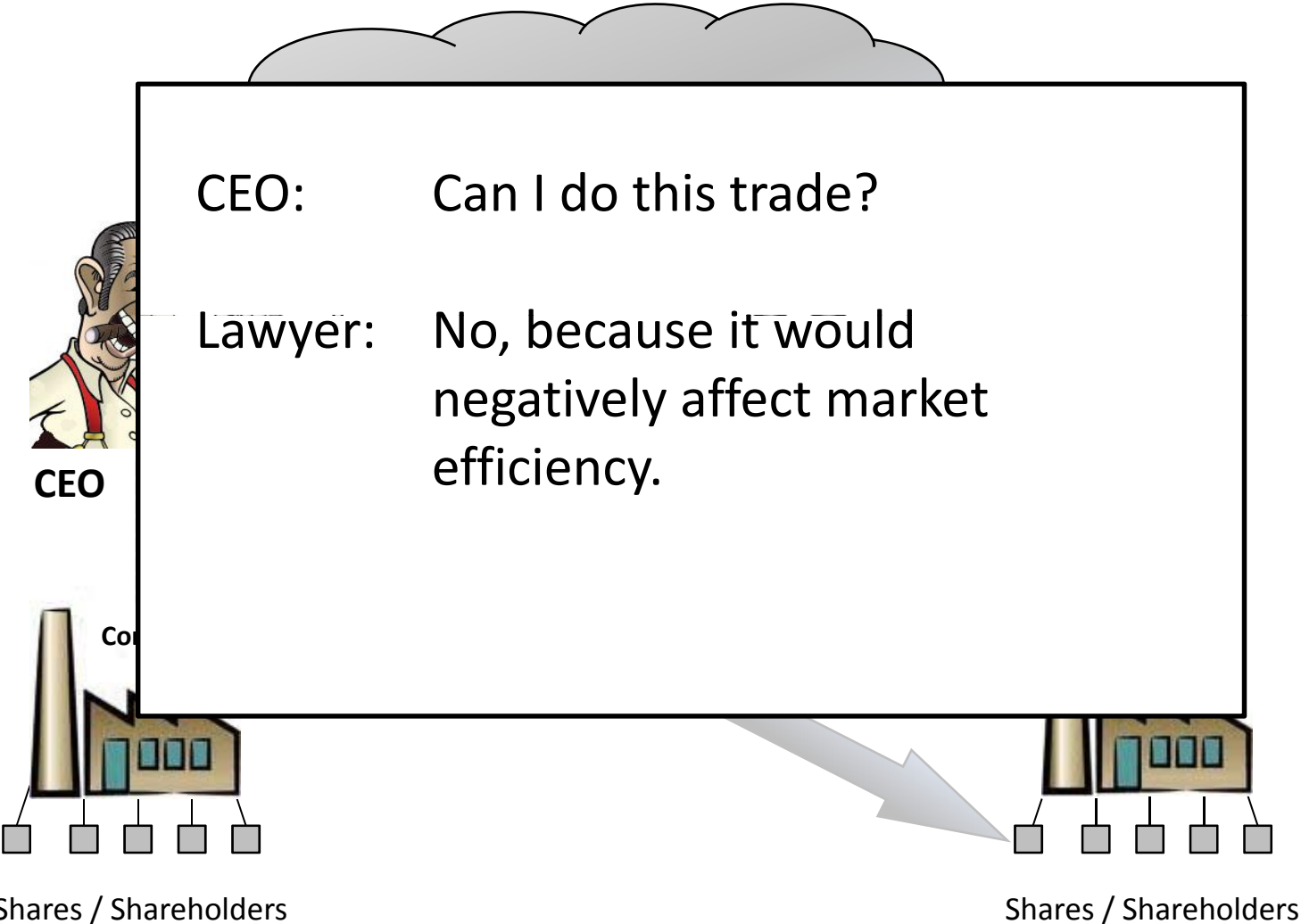
# Example 1: CEO buys A-Shares



# Example 2: CEO buys B-Shares

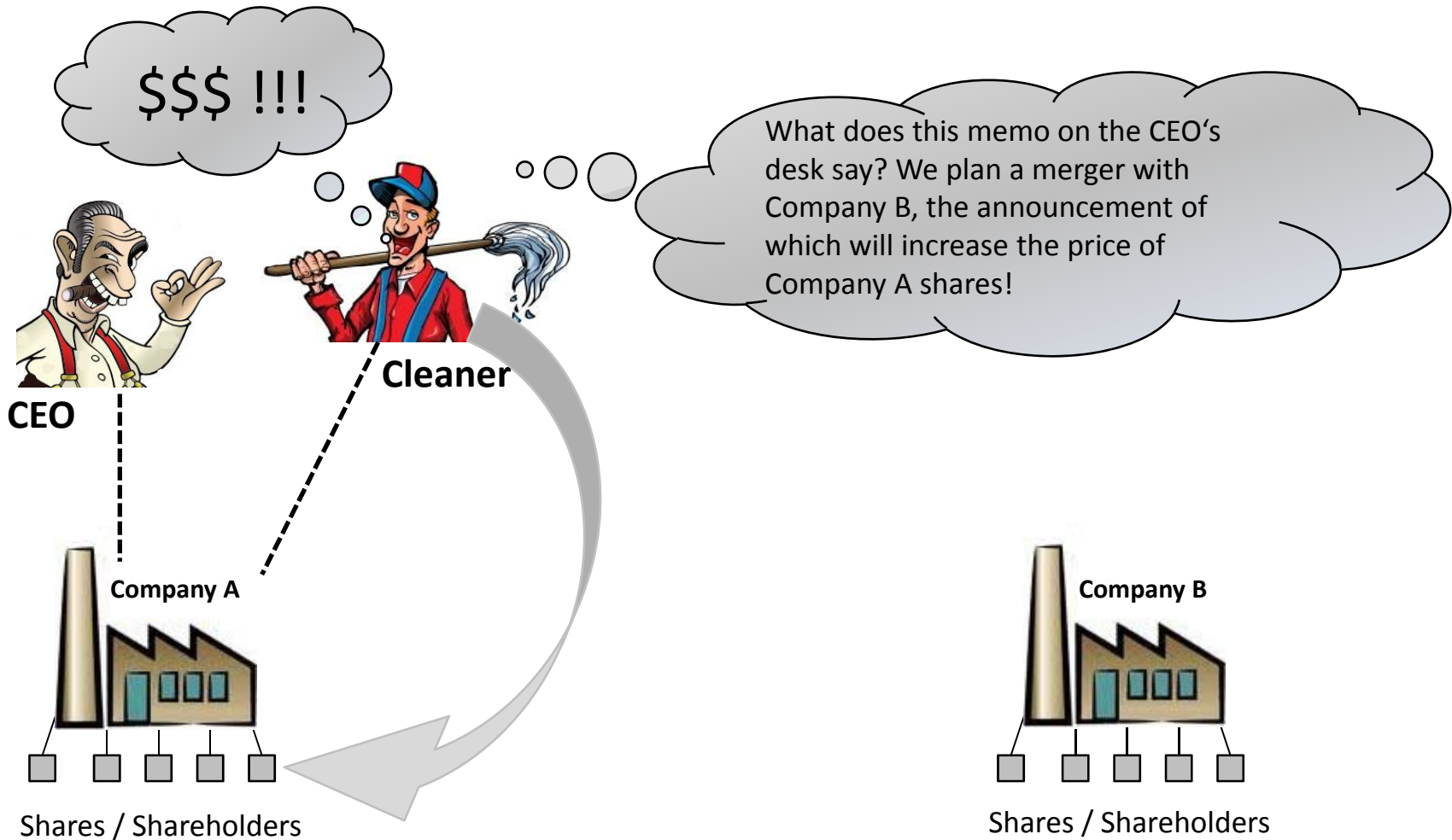


# Example 2: CEO buys B-Shares

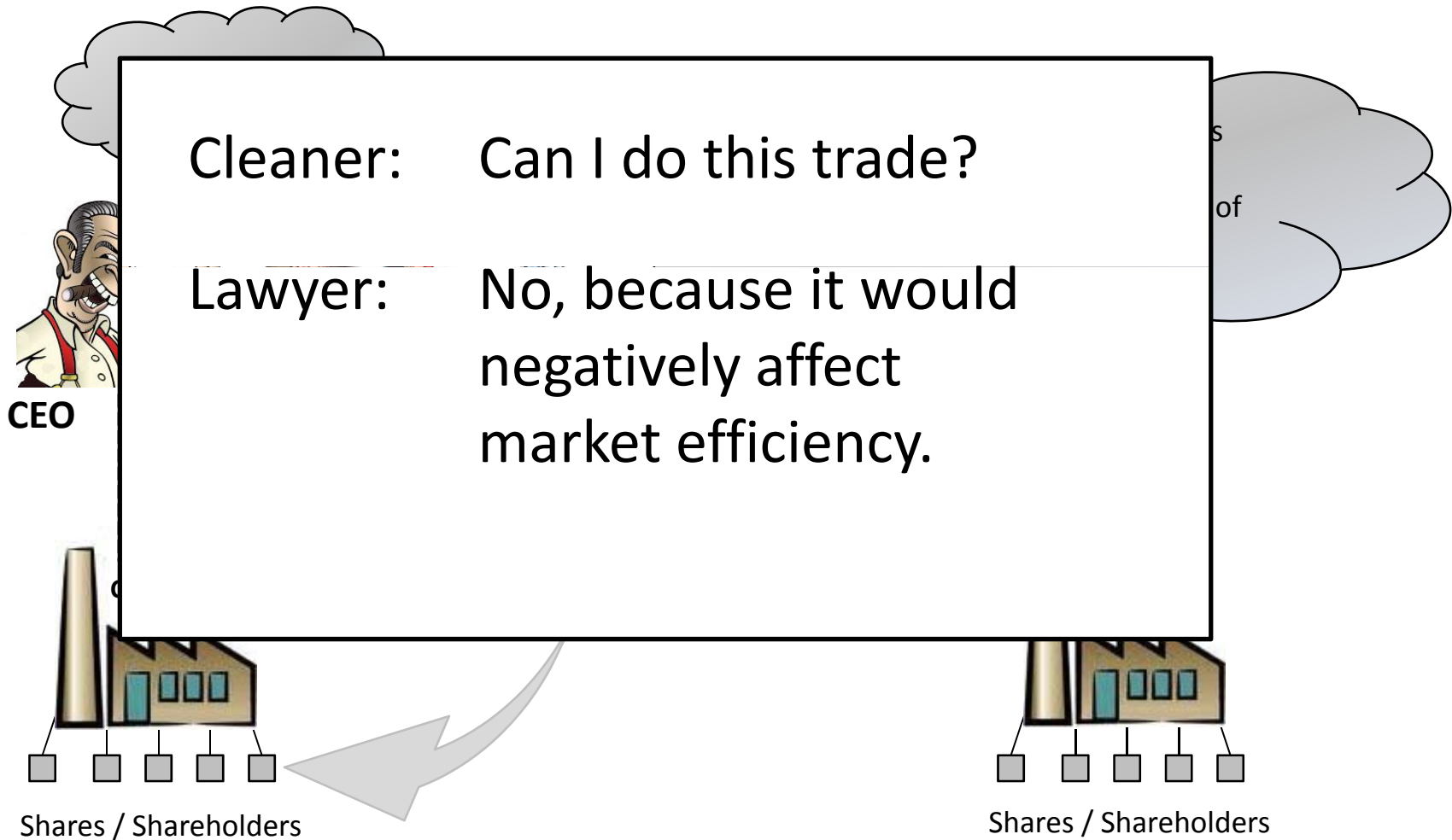




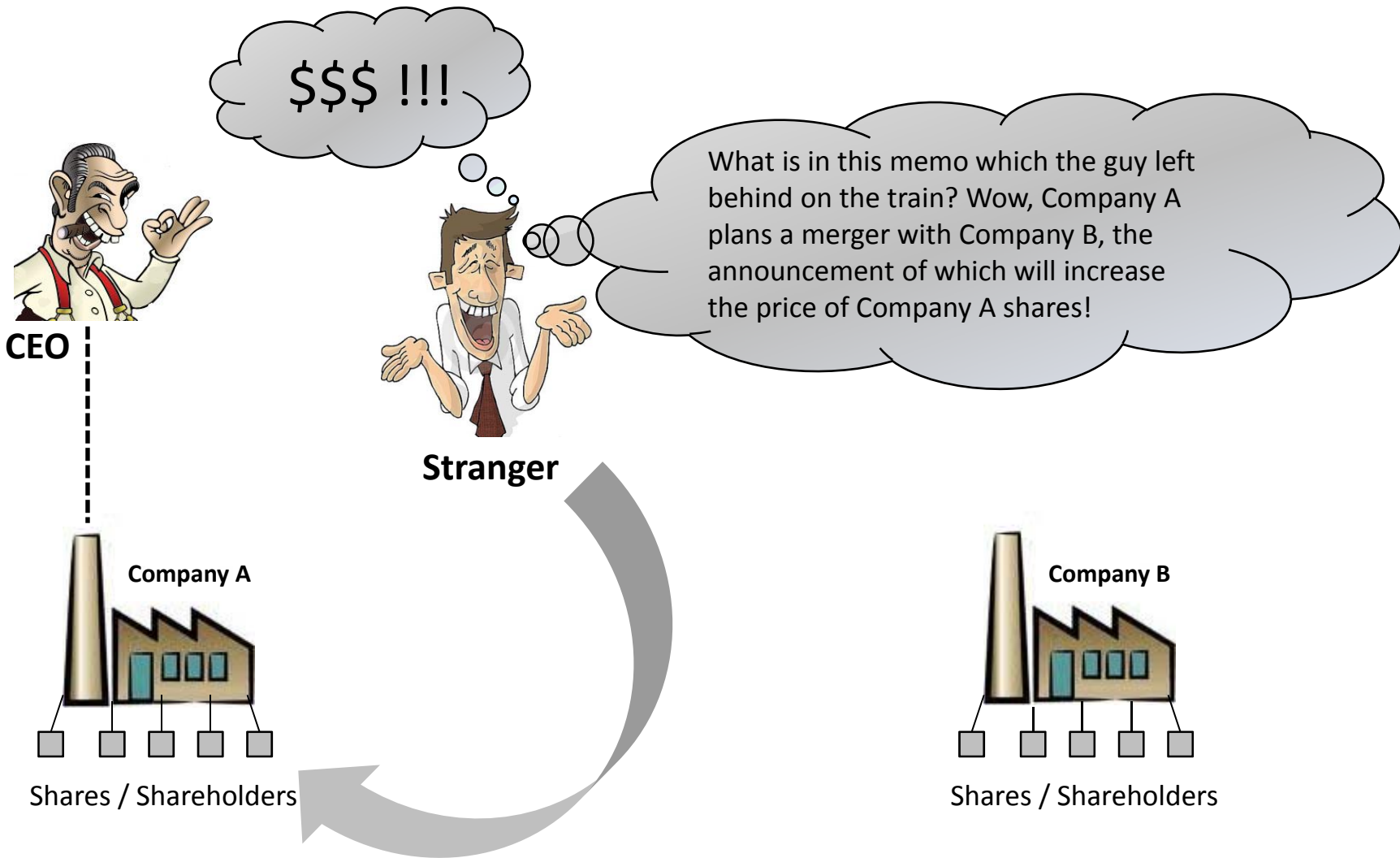
# Example 3: Cleaner buys A-Shares



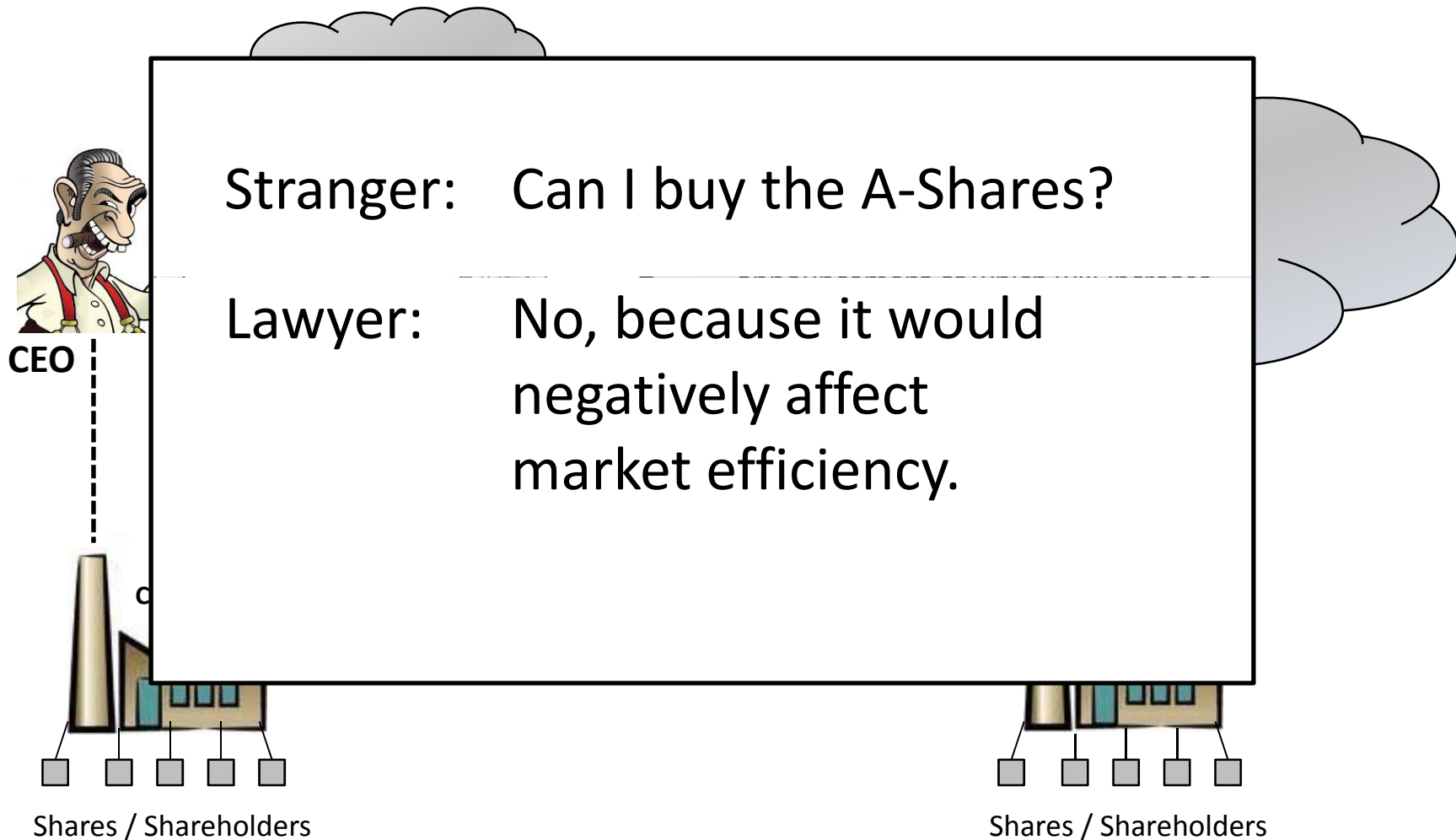
# Example 3: Cleaner buys A-Shares



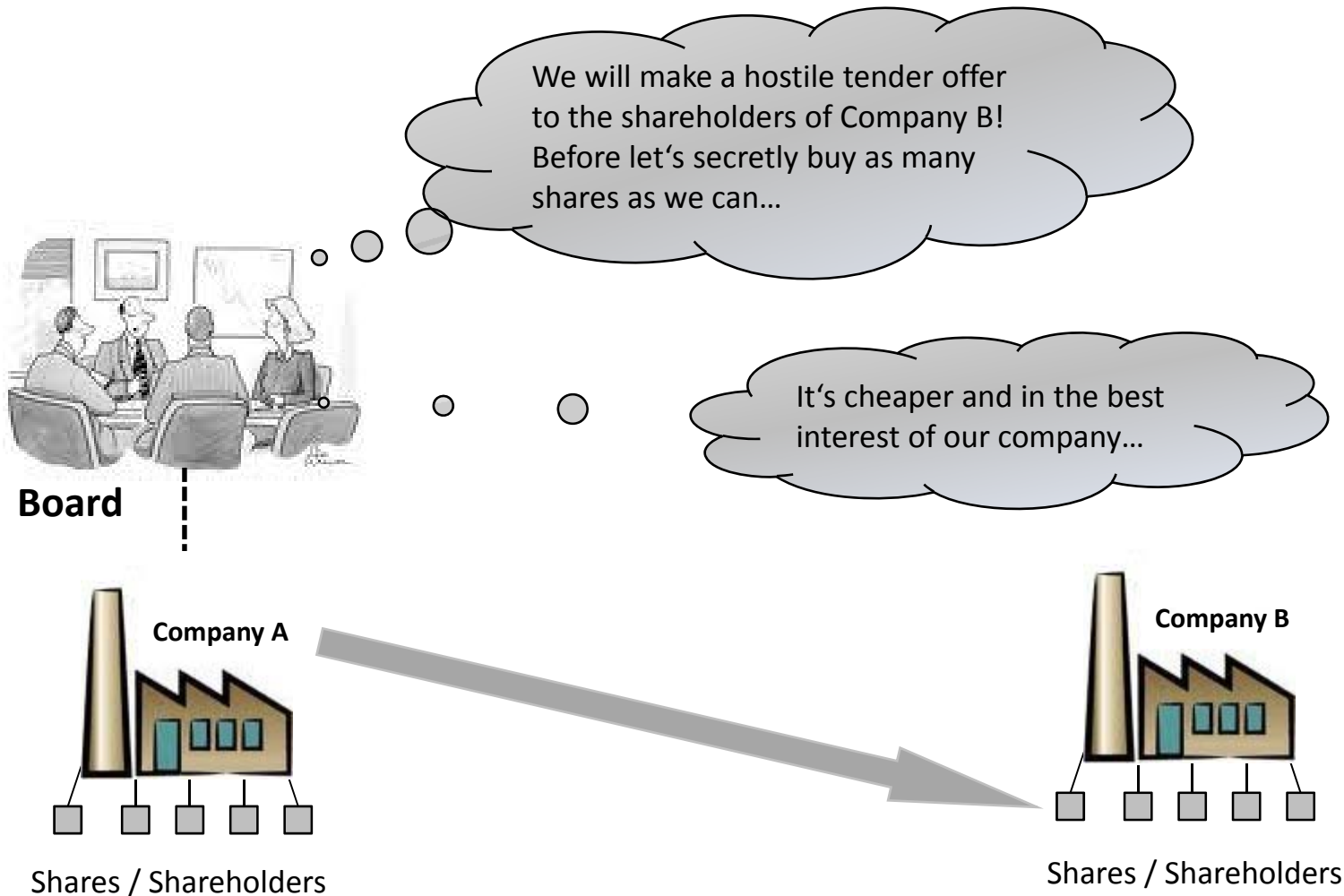
# Example 4: Stranger buys A-Shares



# Example 4: Stranger buys A-Shares



# Example 5: Company A buys B-Shares

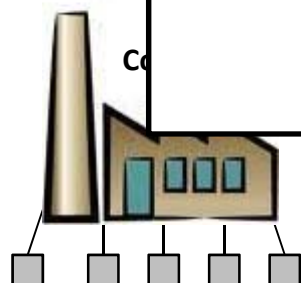


# Example 5: Company A buys B-Shares



Board

Board: Can we do this trade for our Company?  
 Lawyer: In principle, you could not because of its negative effect on market efficiency. However, it might be possible for the legislator to provide for an explicit exception for this, if the legislator believes that the positive effect of a well-functioning M&A Market (i.e., sneaking-tactics) outweighs the negative effect of insider trading on the market...



Shares / Shareholders



Shares / Shareholders

# Insider Trading Regulation: Overview Different Countries and EU

## ■ EU

- Directive on insider trading and market manipulation
- Efficient insider trading regulation

## ■ Switzerland

- Art. 161 Swiss Criminal Code → Currently being revised
- My expectation: As efficient as EU regulation

## ■ USA

- Rule 10b-5 under SEA 1934 → Fraud concept
- Inefficient insider trading regulation



## **Pestalozzi Attorneys-at-Law**

Loewenstrasse 1

CH-8001 Zurich

Switzerland

T: +41 44 217 91 11

F: +41 44 217 92 17

[www.pestalozzilaw.com](http://www.pestalozzilaw.com)

Christian Leuenberger

T: +41 44 217 92 13

[christian.leuenberger@pestalozzilaw.com](mailto:christian.leuenberger@pestalozzilaw.com)