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The market response of insider transferring trades and firm characteristics in Taiwan

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ABSTRACT

This paper reports the announcement effects of insider transfer trades and relates these with firms' characteristics. Regulations in Taiwan specify that insiders give three days prior notice to the competent authority of stock transfers and this news can stimulate market participants' investment decisions. We find both the positive and negative abnormal returns exist following insider transfer trade announcements, especially for smaller firm. However, smaller firm sizes associate with larger magnitudes of negative abnormal returns. Furthermore, the connection between smaller firms and those with higher book-to-market ratios strengthens for larger negative abnormal returns.

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1. Introduction

Pope et al. (1990) find a positive abnormal return after insider purchases and a negative abnormal return after the insider transferring trades. This provided empirical support for the information effect; a widely accepted but intuitive phenomenon. Signaling theory discusses both the positive (e.g., Walsh, 1999; Barclay and Dunbar, 1996) and negative (e.g., Penman, 1982; Webb, 1999) effects of insider trading. There are different market responses to insider buying or buying holding shares and selling or transferring trades. Cheuk et al. (2006) finds the persistence of abnormal returns relating to insider sales, as opposed to insider purchases. Lei and Wang (forthcoming) show that insiders buy (sell) more before positive (negative) announcements. However, there is no research to investigate both the positive and negative abnormal returns simultaneously related to the same direction of insider trading, such as insider sales. Both the positive and negative responses that exist may cause the insignificant total responses. Gurgul and

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Majdosz (2007) find no evidence that the sale of stocks by insiders conveyed information to market participants, although they found that the return and trading volume increases where there is a purchase of stock.

Unique regulations in Taiwan mean that investors receive the news of insider's transfer trading[1] or sale of holding shares (not including additional shares bought[2]) from the news media. Investors, following the assumptions of asymmetric information, consider if the insider trading enhances or diminishes the value of their holding. The unique disclosure regulations in the Taiwan Security Exchange (TSE) require a disclosure of insider transferring trades three days prior to the transfer and so enable a special examination of the relationship between abnormal returns on the announcement of insider transferring trading and the firm's characteristics.

This paper addresses three significant research objectives. First, we examine the hidden impact of insider trading. The disclosure regulations for insider transferring trades are provided for in the Securities and Exchange Act in Taiwan. According to Articles 22-2 and 25, insiders[3] are required to register with the Competent Authority at least three days prior to the transfer of their stock holdings, whether trading on the open market or by means of a private placement. These regulations require insiders to declare a reduction but not an increase in their share holdings and particularly apply to glitter stocks.[4] Those without privileged information must wait for the regular monthly reports about insider holdings and these do not include insiders' trades. The news of insider transfers draws other market participants' attention and the news may stimulate their investment decisions. Since individual investors tend to trade in glitter stocks we can expect that these will yield significant abnormal returns.

Secondly, while the connection between corporate performance and insider trades is well understood, little research has discussed the positive abnormal return to insider transfer trades. To the best of our knowledge, no study discusses the entire distribution of abnormal return from the announcement of the insider's selling or transfer activity. We model these returns using OLS and quantile regression to observe the entire abnormal returns. We observed that there is not always a downward movement in the stock price after insider transferring announcement.

Third, there is minimal literature on the connection between insider transfer trading and the firm's characteristics, especially in relation to behavior under an entire conditional distribution of abnormal returns. This differs from estimating how, on average, firms' characteristics affect the abnormal returns of insider transferring trades. The quantile regression allows us to explain the different effects of the explanatory variables at the different quantiles of the distribution of abnormal returns. Investors' thinking is often complex and difficult to rationalize but includes consideration of the firm's characteristics. The modeling also enables us to reveal the magnitude and direction of the impacts of firm size or value on the abnormal returns from insider transferring trades.

In summary, we focus on the connection between the abnormal returns of insider transfer trades and firm characteristics. This is distinct from previous studies that only focus on insider trading and stock returns.

Our analytical approach (i.e., quantile regression) provides an explanation of both negative and positive abnormal returns, from insider transfer trades as relates to firm characteristics that is not often captured in previous studies. We find that the smaller the firm size is or the larger the B/M ratio is, then the larger the magnitude of negative abnormal returns after the announcement of insider transfer trades for lower quantiles of abnormal returns. However, we observed the reverse relationship for the higher and those quantiles with positive abnormal return on the announcement day. The larger the firm size is or the smaller the B/M ratio is, the larger the magnitude of positive abnormal returns for an announcement of insider transfer trades under high quantile abnormal returns.

[1] The "transfer trade" means the holding shares of insider decrease rather than increase, for example, from the sale from the centralized securities exchange market or from disposal by other means.

[2] This is not an immediate declaration of the related information, as the changes to insider's stock holding including buying and selling are reported in the following month.

[3] Insiders are defined to include the directors, supervisors, managerial officers, or shareholders holding more than 10% of the total shares under the Securities and Exchange Act in Taiwan.

[4] Barber and Odean (2008) point out that small or retail investors are drawn to stocks which have attention-grabbing activity, and consequently known as "glitter stocks". These stocks are characterized by high trading volume or are very visible in the media.

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