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Do an Insider's Wealth and Income Matter in the Decision to Engage in Insider Trading?^a

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Abstract

We explore why insiders engage in informed trading, given the surprisingly small average insider returns reported in the literature and the potential costs involved. We begin by proposing a model of an insider's decision to engage in insider trading. We then empirically test the model's predictions using archival data of corporate insiders in Sweden. Consistent with the model, we find that less wealthy insiders are more likely to time their insider selling, and to sell in greater magnitudes, prior to abnormal price declines than wealthy insiders. We also find that less wealthy insiders with lower risk aversion as measured by their criminal behavior are particularly prone to timing their selling to avoid price declines.

JEL classification: G12, G14, G34, K42

Keywords: Insider trading, Wealth, Income

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