'Insider giving' less regulated, infamous than insider trading, yet research shows it's widespread, harmful

March 16 2021, by Jeff Karoub

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Insider trading grabs headlines, gets the Hollywood treatment and garners plenty of investigations. Yet a far less notorious and scrutinized

activity known as "insider giving" similarly damages markets and the broader society despite its nicer-sounding name, according to new research.

Cindy Schipani and Nejat Seyhun, professors at the University of Michigan's Ross School of Business, have co-authored a study that finds insider giving—in this case, shareholders who donate stock to a charity and take a tax deduction before bad news sends the share price tumbling—is "worryingly widespread." It's also far less likely to be detected or prosecuted than the insider trading made famous in films such as "Wall Street" and shows like "Billions."

Schipani, Seyhun and their co-authors—Sureyya Burcu Avci of the Sabanci University School of Business and Andrew Verstein of the University of California, Los Angeles, School of Law—used a database of all gifts of common stock by large shareholders in all publicly listed U.S. firms from 1986 to 2020. The 9,000 actions represent about 2.1 billion shares with a value of $50 billion.

What they found: The donations "are suspiciously well-timed." The stock prices rose about 6% during the year before the gift date and dropped about 4% during the year afterward. In other words, "Large shareholders tend to find the perfect day on which to give," they write.

So is it talent or luck? Most likely neither. The results, according to the authors, are likely primarily due to the sharing of "material nonpublic information" by corporate executives to time the gift and secondarily to backdating—a misreporting of the true date of the gift to further increase the tax deduction.

"The fact that large shareholders can determine or choose—with pinpoint accuracy—the average maximum price over a two-year period when they give gifts is surprising," Seyhun said. "The magnitude of the

price decline from the gift date is not large. Nevertheless, this is consistent with our previous work that insiders will stoop to borderline ethical standards even for small dollar amounts."

The study directly builds on their research regarding stock gifts by executives, which itself was built on stock-option backdating work. In the latter, executives were found to manipulate their compensation by picking stock option grant dates that gave them the biggest windfalls.

Schipani said she was disappointed by the "opportunistic behavior of corporate executives," for whom "greed seems to prevail over ethical behavior and integrity." The latest study "extends that disappointment."

"These behaviors appear to be more widespread than previously contemplated—that is, the insiders are either trying to curry favor with their shareholders, or are succumbing to pressure from them, by handing off material inside information," she said. "It is also disappointing that the shareholders would use charities as a way to mask greedy behavior."

In several variations of what the researchers call "manipulative giving," the insiders snag a tax deduction that exceeds the value of the donated gift. Giving $1,000 to charity and getting more than $1,000 in tax benefits is, according to the study, bad tax policy and "simply a form of valuation abuse."

Insider giving runs afoul of state and federal laws, but those statutes are "less clear and developed" than those pertaining to insider trading, the study says. The practice also benefits from lax regulation and oversight—insider gifts can be reported more than 400 days after donation, as opposed to two days for insider sales. Insider giving also comes with lower risk of enforcement or prosecution than its more infamous kin.

Researchers acknowledge the inclination of some to give insider giving a pass. Indeed, what's the harm of giving in general, especially when the charities are better off? The SEC believes such giving is less likely to be the vehicle for abuse.

The researchers cite many problems beyond bad tax policy. On a larger scale, it damages the societal, ethical and moral value of philanthropy by granting an outsized tax deduction for a tainted, trivial gift. Then, there's the downstream effect on other taxpayers and those "unlucky enough to buy the doomed shares from the charity." Moreover, a charity might not be seen in a better light as the "bearer of bad stock," regardless of whether it's in the dark about the shares' ultimate fate.

"I see this as a societal issue as well as a fraud on investors," Schipani said.

Executives and shareholders should be setting high standards, not skirting them, Seyhun added.

"By stooping to pick up extra dollars here and there, they are not setting good examples of corporate governance," he said. "Furthermore, when investors and other parties lose confidence in top management, ordinary shareholders lose."

Schipani, Seyhun and their colleagues make several recommendations, including calling on regulators to ensure gifts are subject to the same reporting requirements as sales and extending all prohibitions on insider trading to cover gifts. They also say the tax code should not be encouraging gifts of stock to charities.

The research has been accepted for publication in the Duke Law Journal.

More information: Insider Giving (February 25, 2021). 71 Duke Law

Journal (Forthcoming 2021), UCLA School of Law, Law-Econ Research Paper No. 21-02, Available at SSRN: ssrn.com/abstract=3795537

Provided by University of Michigan

Citation: 'Insider giving' less regulated, infamous than insider trading, yet research shows it's widespread, harmful (2021, March 16) retrieved 11 May 2024 from https://phys.org/news/2021-03-insider-infamous-widespread.html

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