



PROFIT FROM LEGAL INSIDER TRADING? SUSTAINABILITY REPORTS IN THE CONTEXT OF EXECUTIVES' STOCK TRADING



Ass.-Prof. Dr. Nadine Georgiou, Financial Accounting, University of Innsbruck
Prof. Dr. Janine Maniora, Financial Accounting, Heinrich Heine University Düsseldorf



Regulatory Background & Prior Literature

Market Abuse Regulation

- Prohibits stock trading (so called insider dealings) of corporate insiders (e.g. CEO, CFO) based on not publicly available, precise and price-relevant (inside) information (Art. 7 MAR).
- Issuer shall ensure that the inside information is made public as soon as possible (Art. 17 MAR).
- Obligation to notify insider dealings no later than 3 business days after the transaction date (Article 19 MAR).

Why do companies report on sustainability?

- Increasing demand from a company's stakeholders.
- In our sample: *Voluntary* disclosure of sustainability-related information by companies via sustainability reports.
- New disclosure requirements for the sustainability reporting of certain companies through the CSR-RUG (CSR-RL 2014/95/EU) since 2017.

What are consequences of disclosing sustainability information?

- Reputation and revenue enhancement, easier talent acquisition, higher employee satisfaction (Lev et al. 2010, Robert/Dowling 2002, Banker/Mashruwala 2007).
 - On the capital market: Value relevance, reduction in information asymmetries and cost of capital, better financial analysts' earnings forecasts (Grewal et al. 2020, Dhaliwal et al. 2011, Dhaliwal et al. 2012).
- ⇒ **Sustainability information qualifies as inside information.**



Sample

- Insider trading information for German public firms listed in the CDAX.
- Only firms with (voluntary) publication of stand-alone sustainability reports.
- Insider trading activity from 2012 to 2017:
 - ⇒ 33 firms, 69 firm-years,
 - ⇒ 69 sustainability reports,
 - ⇒ 291 trading transactions on firm-day level,
 - ⇒ 16,884 observations on firm-day level.



Examples of price-relevant sustainability information



Ad hoc announcement of Biotest AG on December 20, 2012:

"[...] Its launch provides a new product to our community, helping to assure continued access to this *lifesaving therapy* for people who live with *primary immunodeficiency* diseases. We welcome BivigamTM as a valuable option to help *members of our community* live healthy and productive lives. [...]"



Ad hoc announcement of Daimler AG on April 22, 2016:

"[...]The U.S. Department of Justice (DOJ) has requested from Daimler AG on April 15, 2016, by pointing out the strict confidentiality of the matter, to review its certification and admissions process *related to exhaust emissions in the United States* by way of an internal investigation in cooperation with the DOJ. [...]"



Firm Characteristics



Firm size (mean, in millions)

€ 8,800 m



Sustainability committee

53.70%



Audited sustainability report

52.20%



Higher proportion of financially material information in the sustainability report compared to the annual report

76.72%



Optimistic textual tone in the sustainability report

91.31%



Sustainability performance (≥ median)

50.01%



Executives' compensation linked to sustainability indicators

21.72%



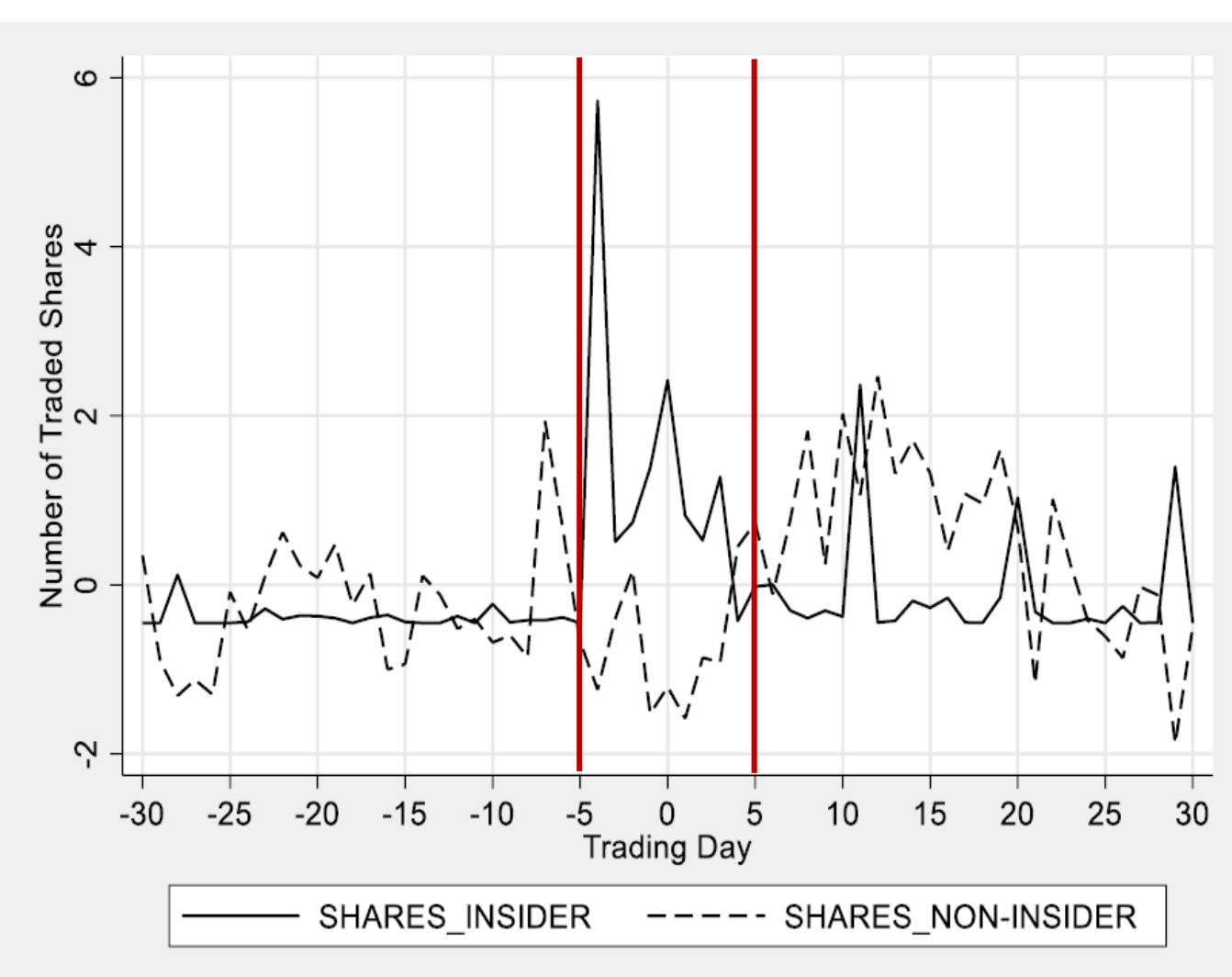
Contribution

- Potential cost that has not been explored in prior literature:** Generation of abnormal returns by corporate insiders due to unregulated trading environment of sustainability reports.
- Key determinant of trading before the disclosure of sustainability reports:** Sustainability indicators in executives' compensation.

Research Questions



Do executives trade around (t=-5, t=+5) the disclosure date (t=0) of the sustainability report?



What incentives explain this trading behavior?

Estimation model	OLS (Ordinary Least Square) with firm and quarter fixed effects			
	Sustainability indicators in executives' compensation		Material information in the sustainability report compared to the annual report	
Incentive	Yes (1)	No (2)	More (3)	Less (4)
Dep. Variable: INSIDER (0/1)	Coeff. (t-value)	Coeff. (t-value)	Coeff. (t-value)	Coeff. (t-value)
Day [-5, +5]	0.0523** (2.407)	-0.0045 (-1.027)	0.0171* (1.842)	-0.0116 (-1.099)
Control variables	yes	yes	yes	yes



Do executives benefit from higher abnormal returns when they buy stocks around sustainability reports?

≈ +2.5%