Pittsburgh Post-Gazette

DECEMBER 5, 2016

Len Boselovic's Heard off the Street

By Len Boselovic / Pittsburgh Post-Gazette

Eight years after the federal government showered $205 billion on banks in order to stabilize the industry during the depths of the financial crisis, a group of academicians has uncovered some interesting findings regarding the trading activities of politically connected bankers whose employers received money from the U.S. Treasury's Troubled Asset Relief Program.

After examining the stock trades of 7,300 bank executives and directors at about 500 banks, the researchers concluded that the politically connected bankers did pretty well for themselves.

Politically connected bankers significantly increased trading in their bank's stock in the 30 days prior to the bailout.

Those who bought shares during that period were rewarded with a 4.4 percent return on their investment in the first three days after the bailout money arrived. Those who sold shares in the 30 days before their bank was bailed out avoided a three-day loss of 5.1 percent after the TARP money arrived.

"Our findings suggest that political connections provided corporate insiders with an important information advantage during the financial crisis, that a significant portion of this advantage related to knowledge about government intervention, and that some insiders traded to exploit this advantage," the researchers wrote.

The bankers were in a position to know how much the government intended to intervene, how the assistance would affect their bank, and details about how much TARP money their bank might receive, the researchers wrote.

The researchers stopped short of saying the bankers were guilty of insider trading — profiting from nonpublic information.

“It is likely to be the case that the trades we study fall into a growing legal gray area,” the researchers wrote in a footnote.

The researchers defined “politically connected” bankers as those who worked for a bank where at least one member of the board or executive team had worked for the Federal Reserve, the U.S. Treasury, Congress or a federal banking regulator such as the Federal Deposit Insurance Corp.

They said that in the 12 months leading up to the financial crisis, the trades of insiders gave no indication of how a bank’s stock would perform in the future. But the ability of trades by politically connected insiders to predict future stock performance increased significantly while the TARP program was being launched.

The study was done by Stanford University’s David Larcker, Alan Jagolinzer of the University of Colorado, Gaizka Ormazabal of the University of Navarra in Spain, and Daniel Taylor of the University of Pennsylvania.

While the U.S. Securities and Exchange Commission is charged with making sure securities markets and the people who operate them are on the up and up, the agency provides a secondary service as a tax collector, according to a study published in **The Accounting Review**, the journal of the **American Accounting Association**.

Researchers found that when the SEC sent written inquiries to about 500 public companies asking them questions about their taxes and financial statements, the companies ended up paying about 1.5 percent more in income taxes. They estimated that the SEC’s inquiries put an extra $3 billion in the tax collection boxes of federal, state and foreign governments.

The study was done by Thomas Kubick of the University of Kansas, Daniel Lynch at the University of Wisconsin, Michael Mayberry of the University of Florida, and Thomas Omer of the University of Nebraska.

The SEC is required to review a public company’s financial statements at least once every three years. If the agency finds the statements lacking in detail or has questions, it sends comment letters to the company — asking questions that the targeted company has to answer within 10 days. The letters are made public once all the issues have been resolved.

The researchers found that the more companies obscure information about taxes in their filings, the more likely they are to receive a comment letter from the SEC asking questions about their handling of tax issues.

The researchers also found that even if the SEC didn't send a company a tax-related missive, if multiple competitors in the same industry got a tax-related letter from the agency, companies that didn't receive a letter increased the amount of taxes they paid the following year.