

# **Disclosure on Open Market Repurchase Transactions in the U.S.:**

## **Does it create a conflict of interest?\***

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### Abstract

Firms in the U.S. are not required to disclose the amount, timing, and prices of open market repurchase transactions. This paper suggests that such insufficient disclosure increases information disparity between insider shareholders and outside shareholders, creating a potential conflict of interest between them. Insiders of a firm may sell their holdings at a time when the firm is supporting its stock price by repurchasing its shares. At any point in time, however, whether the firm is actually buying back its shares or not is unknown to outside shareholders, due to insufficient disclosure. Consistent with this conflict-of-interest hypothesis, we document evidence that insiders tend to sell more or decrease net purchases (purchases – sales) in a fiscal quarter when the firm is in the market actively repurchasing its shares.

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## 1. Introduction

In recent years, open market share repurchase has become an important corporate payout mechanism in the United States (Grullon and Ikenberry (2000), and Fama and French (2001)). The regulatory environment governing open market share repurchases in the U.S. is unique in that reporting of repurchase activity to the regulatory authorities is not required. This is in stark contrast to relatively stringent Securities and Exchange Commission (SEC) reporting and disclosure requirements that usually accompany other corporate events such as tender offer repurchases, insiders' trading activities, and equity offerings.

SEC Rule 10b-18, the Rule that regulates open market share repurchases in the U.S., does not make any references regarding disclosure. A typical open market share repurchase announcement contains only a rough estimate of number of shares to be repurchased and an approximate period of the planned buyback program.<sup>1</sup> Also, the management is not bound by the buyback announcement, since the announcement is not a firm commitment. Often, specific implementation of the buyback program is left to the discretion of the firm's managers. Included in the 10Q or 10K reports filed with the SEC is a dollar amount spent on repurchases of common stock and preferred stock lumped with other types of transactions.<sup>2</sup> Specific information such as on which day, at what price, and how many shares the firm actually bought back is not usually disclosed. Thus, unless the firm volunteers such detailed information, only the quarterly aggregate dollar amount is publicly available ex-post. On any given day or even a month after the announcement, an outsider investor in general does not have the knowledge of whether the announced buyback program is underway or not.

In this paper, we hypothesize that a lack of mandatory disclosure of actual buyback activity by a repurchasing firm can create opportunities for insiders to time their trades with actual firm buyback activity. At the same time that a firm is buying back its own shares, the firm's insiders can be selling their holdings of the firm's stock. In other words, corporate insiders can be selling their shares on one hand, while on the other hand these insiders can be making a decision that the corporation undertake a buyback of its shares in the open market. Other things being equal, insiders have incentive to sell their holdings when the firm supports its share price by repurchasing its shares. Assuming a locally downward sloping

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<sup>1</sup> Open market buyback announcement is not an SEC requirement. Major stock exchanges including NYSE and NASDAQ require listed firms to make open market buyback announcements.

<sup>2</sup> The data item is 'Purchases of Common and Preferred Stock,' and it is an aggregate measure of many types of transactions. Compustat provides the list of items included in 'Purchases of Common and Preferred Stock.' They are (1) conversion of class A, class B, and special stock into common stock, (2) conversion of preferred stock into common stock, (3) purchase of treasury stock, (4) repurchase of warrants when combined with repurchase of common or preferred stock, (5) retirement or redemption of common/ordinary stock, (6) redemption of preferred stock, and (7) retirement or redemption of redeemable preferred stock.

demand curve for a firm's shares, the firm's repurchase activity increases the demand for the firm's shares, increasing its price or preventing a price fall.<sup>3</sup> Hence, firms' actual buyback activity can provide opportunities for insiders to sell their shares at a price higher than a price that would prevail if the firm were not repurchasing its shares.

However, at any given point in time, due to insufficient disclosure, outside shareholders have no knowledge of whether or not firms are actually buying back their shares. Thus, insiders have an information advantage relative to outside shareholders. The lack of disclosure on the specifics of magnitude, timing, and prices of the firm's actual buyback trades contributes to the information disparity between insiders and outside shareholders, and can result in a conflict of interest.

To empirically investigate the conflict-of-interest hypothesis, we examine insiders' trading activity in conjunction with firms' actual buyback trading activity. Results show that in a fiscal quarter when a firm repurchases its shares actively, insiders of the firm tend to increase their sales or decrease their net purchases (purchases – sales), consistent with our conflict-of-interest hypothesis. This association between insiders' trading activity and firms' buyback trading activity exists, after controlling for book-to-market effects well documented in previous studies.

Whether or not mandatory disclosure or increased regulation creates value is a controversial issue (Healy and Palepu (2001)), and we do *not* imply that stricter disclosure requirements for open market share repurchases in the U.S. should be in place.

We do suggest, however, that outside shareholders should have access to detailed and specific information as to repurchase dates, the number of shares repurchased or to be repurchased, and the repurchase prices. This will reduce information asymmetry between less-informed outsiders and better-informed insiders, mitigating the problem of a potential conflict of interest between them.

In Section 2, we examine U.S. open market share repurchase regulations. Section 3 contains a description of the sample and data, followed by the empirical results in Section 4. And Section 5 concludes.

## **2. Open market share repurchase regulations in the U.S.**

The regulation that governs open market share repurchase in the U.S. is SEC Rule 10b-18 enacted in 1982. Before SEC Rule 10b-18 was adopted in 1982, open market share repurchases were subject to

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<sup>3</sup> Kim (2002a) finds evidence consistent with this price support rationale for share repurchases: a share repurchase-announcing firm engages in buyback trading when its share price falls. As a result, both daily return standard deviation and CAPM beta go down. When the firm is not buying back its shares, neither daily return standard deviation nor CAPM beta goes down.

significant uncertainty regarding potential liability under the anti-manipulation provisions of Sections 9(a)(2) and 10(b) and Rule 10b-5 of the Securities Exchange Act of 1934. Without explicit rules or guidelines, a firm undertaking open market share repurchases faced the possibility of being charged with illegal price manipulation.

In the 1960's, several rules including SEC Rule 10b-10 and Rule 13e-2 were proposed to regulate open market repurchases. Each of these rules, if it had been adopted, "would have been a proscriptive rule with disclosure requirements, purchasing limitations and general anti-fraud liability," according to the Supplementary Information provided for the 1999 amendment to Rule 10b-18.<sup>4</sup>

Instead, in the middle of the deregulation wave of the early eighties, the SEC adopted Rule 10b-18 that gave safe harbor to open market share repurchase firms. Rule 10b-18 makes compliance with its conditions voluntary and disclosure of the repurchase activity non-mandatory. According to Grullon and Michaely (2002), this rule is a major factor behind the recent upsurge in open market share repurchases in the United States. Grullon and Michaely (2002) document evidence consistent with the hypothesis that the widespread fear of legal liability deterred firms from actively engaging in open market buybacks despite their tax advantage relative to dividends before the 1982 enactment of Rule 10b-18. Cook, Krigman, and Leach (2002) provide a comprehensive review of the history of repurchase regulation in the U.S. Cook, Krigman, and Leach (2002) contend that conformity to Rule 10b-18 is essentially unverifiable and present evidence that repurchase firms do not comply with the conditions set forth by the rule.

As aforementioned, SEC Rule 10b-18 gives repurchasing firms immunity from the anti-manipulation provisions of the Securities Exchange Act of 1934, provided that certain conditions are satisfied.<sup>5</sup> The four conditions are listed below.

- (1) (*Manner of purchase*) Repurchases are made through only one broker or dealer in a given day.
- (2) (*Timing condition*) No repurchase is made as an opening transaction or during the last half hour of a trading day.
- (3) (*Price condition*) No repurchase is made at a price exceeding the highest current independent bid price or the last independent sale price, whichever is higher.
- (4) (*Volume condition*) Non-block repurchase volume does not exceed the higher of: (A) one round lot, or (B) the number of round lots closest to 25% of the average daily trading volume for the preceding four calendar weeks.

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<sup>4</sup> Federal Register, Vol 64, No.188, Rules and Regulations, SEC, 17 CFR Part 240. [Release No. 34-41905; File No. S7-27-98]

<sup>5</sup> Rule 10b-5 has comprehensive provisions against fraud and price manipulation related to the purchase or sale of any security, and has been interpreted broadly by the courts.

A common misunderstanding by both practitioners and academics regarding these provisions is that even if a repurchase firm does not abide by the provisions, this alone does not make the firm's action illegal or in violation of anti-price manipulation laws. By not conforming to the provisions of Rule 10b-18, the firm no longer has the safe harbor protection or immunity. However, the firm is not subject to legal liability, solely based on this non-compliance. Paragraph (d), the last paragraph of Rule 10b-18, explicitly states this. Therefore, buying back shares at the opening of a trading day, for example, is a legitimate transaction.<sup>6</sup>

Hence it is noteworthy that repurchasing firms are not required to conform to the Rule 10b-18 provisions and that because of no disclosure, even the conformity itself is not readily verifiable. In fact, nowhere in SEC Rule 10b-18 is there mention of the reporting or disclosure of actual share repurchase transactions.

Various sections of the Securities Exchange Act of 1934, the Investment Company Act of 1940, and the Public Utility Holding Company Act of 1935 regulate purchases and sales of officers, directors, and large block holders (10 % or more), and specify disclosure requirements and trading restrictions on insiders. But, without the specific knowledge of when and how many shares a firm repurchased, whether or not insiders sell their holdings of the firm's shares at the same time the firm is repurchasing its shares cannot be determined even with detailed disclosures of insider transaction records. Insiders' trading activity in relation to firms' buyback activity is not mentioned in Rule 10b-18. The number of repurchased shares can be reported in financial statements, but it is an ex-post quarterly or yearly aggregate value, which is not detailed enough to track insiders' trading activity as related to the firm's share repurchase trading activity. The entire text of SEC Rule 10b-18 is given in Appendix.

Kim, Schremper, and Varaiya (2003) survey open market share repurchase regulations of the ten largest stock markets around the world, and conclude that the U.S. is the country with the most lenient regulations, particularly in terms of disclosure. They note that in many nations other than the U.S., firms conducting open market share repurchases have separate reporting obligations, in addition to basic standard disclosure in the financial statement. Once actual repurchase transactions are made, details of these transactions have to be reported to either stock exchanges or other supervisory authorities. In Japan, the U.K., the Netherlands, and Hong Kong, reports have to be filed immediately or within a one-day period. In Canada and in France, separate disclosure is required on a monthly basis.

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<sup>6</sup> Rule 10b-18 was amended in 1999 so that the timing conditions are relaxed when there is a market-wide trading suspension. For example, a buyback transaction at the re-opening after a market-wide trading suspension, which is legitimate even without the amendment, also gets safe-harbor protection.

### **3. Sample and data**

To examine the hypothesis of a conflict-of-interest between insiders and outside shareholders of share repurchase firms, we obtained data on insider transactions come from the SEC Ownership Reporting System (ORS) that we acquired from the National Archives and Records Administration (NARA). Based on SEC report dates, the most recent available ORS data from NARA end in January, 1998. We obtained ORS data files for the period of October 1992 – January 1998. The 15 data files of the SEC ORS Official Summary of Securities Transactions and Holdings contain transactions and holdings records of persons having an “insider relationship” or beneficial ownership as defined by various sections of the Securities Exchange Act of 1934, the Investment Company Act of 1940, and the Public Utility Holding Company Act of 1935. We refer to these individuals with insider relationship or beneficial ownership as ‘insiders.’ The insiders include officers, directors, and large block holders (10 % or more), and other beneficial shareholders whom the law specifies as having a special relationship with the company. The ORS data are compiled from Form 3, Form 4, and Form 5 that these insiders are required to file with the SEC.<sup>7</sup>

We acquired open market common stock repurchase announcements from the Thomson Financial SDC Platinum database from January, 1990 to May, 2002. As will be explained in the following section, we examine four fiscal quarters or one calendar year after the firm buyback announcement to estimate actual buyback trading activity of the firm. In case a firm makes more than one announcement, we require that adjacent announcements should be one year apart to be treated as separate announcements. The share repurchase announcements that have corresponding ORS transaction records are as early as January, 1990 and as recent as May, 1997, resulting in the sample size of 1,759 announcements.

### **4. Empirical results**

Do insiders time their trades with the firms’ actual buyback trading activity? To answer this question, we estimate the actual buyback trading activity of a repurchasing firm, and examine whether insider net purchases (purchase – sales) increase or decrease with an increase in the actual buyback trading activity of the firm. If we observe more insider selling or less insider net purchase in a period when the firm is buying back its shares actively, that is, if insiders’ trading activity is closely associated

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<sup>7</sup> The SEC recently amended the Rules so that, effective 8/29/02, these insiders are required to file Form 4 within two business days once they make transactions. Before the amendment, insiders were required to report their transactions roughly monthly (before the tenth of the month) or in a maximum of one year in case they sell shares back to the company.

with their firm's buyback trading activity, then this will be evidence supporting our contention that open market share repurchases can be unfairly used by insiders. Such evidence will also be consistent with Fried (2002) who argues that managerial opportunism is one of main motives behind open market repurchases. We first define variables for our empirical analyses.

#### *4.1. Variable definitions*

In contrast to disclosure of insiders' trading activity, there is no publicly disclosed record of firms' share repurchase transactions, because SEC Rule 10b-18 does not mandate such disclosure, as we discussed in the previous section. Thus, to measure the magnitude of firms' actual buyback activity or buyback intensity (INTENS), we use 'Purchases of Common and Preferred Stock,' reported in the Statement of Cash Flows. This is also the data item used by Chan, Ikenberry, and Lee (2001), Grullon and Michaely (2002), Kim (2002a, 2002b), and Stephens and Weisbach (1998). Year-to-date dollar amounts for this data item are available in Compustat (quarterly data item number 93). Using this information, first, a quarterly dollar amount spent on share repurchase is calculated for each of the four fiscal quarters that follow the announcement quarter. That is, we examine actual buyback activity quarter by quarter for the four-quarter period or one calendar year following the announcement quarter. Each of the quarterly dollar amounts is subsequently divided by the average of the three monthly closing prices of the quarter to estimate the number of shares repurchased in that quarter. We then define the variable INTENS, the actual buyback intensity, as the estimated number of shares repurchased in a quarter divided by the average daily trading volume in a quarter.<sup>8</sup> Daily trading volume is defined as the number of shares traded on a given day, and is obtained from CRSP.

The relation between insider trading activity and book-to-market ratio is well documented. Rozeff and Zaman (1998) find that cross-sectionally, there are more frequent insider buying trades relative to selling trades for value stocks (high book-to-market ratio stocks) relative to growth stocks (low book-to-market ratio stocks), and that insider buying increases as an individual stock becomes a value stock from a growth stock across time. They argue that these findings are consistent with the overreaction story that value stocks tend to be undervalued and growth stocks tend to be overvalued. These results are re-confirmed by Jenter (2002), who also finds that these empirical results are robust to controlling for non-information motivated trading. Jenter (2002) asserts that managers time their trades to take advantage of

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<sup>8</sup> Without the knowledge of the actual prices firms paid to repurchase shares, INTENS is not a noise-free measure. Besides, 'Purchases of Common and Preferred Stock' is an aggregate data item including preferred shares repurchased and common shares repurchased via private negotiation among many other kinds of transactions. Grullon and Michaely (2002) deduct preferred stocks from this data item to proxy share repurchase activity, and state that the difference in results is insignificant.

the perceived mispricing. That is, insiders in value firms tend to increase their purchase as they perceive the shares are undervalued, whereas insiders in growth firms tend to sell the shares more frequently and aggressively as they perceive the shares are overvalued.

We measure market value of equity quarter by quarter, just as we measure INTENS. For the first quarter following the announcement quarter, we measure market equity by multiplying the announcement day price with the number of shares outstanding. As for the second quarter, the price is measured three months after the announcement day, and this price is multiplied by the number of shares outstanding to get the market value of equity for the second quarter. Market values of equity are similarly measured for the third quarter and the fourth quarter. Total common equity (Compustat annual data item number 60) divided by the market value of equity is the book-to-market value, and is denoted as B/M.

#### *4.2. Results*

Table 1 shows insiders' trading activity, book-to-market values (B/M), and actual firm buyback trading activity (INTENS). NETBUY is defined as the number of shares bought by insiders minus the number of shares sold by insiders in a fiscal quarter for which INTENS is measured. NETBUY\$ is defined as the dollar amount of insider purchases minus the dollar amount of insider sales in a fiscal quarter for which INTENS is measured. We also use normalized version of NETBUY and NETBUY\$. NETBUY\_N is the normalized NETBUY, computed by dividing NETBUY by the quarterly average of daily trading volume. Similarly, NETBUY\$\_N is the normalized NETBUY\$, computed by dividing NETBUY\$ by the quarterly average of daily dollar trading volume. The reason for this normalization is to check the robustness of the empirical results, by controlling for cross-sectional differences in trading volume of insiders relative to trading volume of the firm's stock.

Panel A of Table 1 shows the mean values of NETBUY, NETBUY\_N, NETBUY\$, and NETBUY\$\_N.<sup>9</sup> In a given quarter, insiders of the sample firms on average sold more shares than they purchased by 174,029 shares. In terms of dollar amounts, insiders' sales exceeded the purchases by 4,441,565 dollars. Also, the normalized variables, NETBUY\_N and NETBUY\$\_N, show that net purchases are significantly negative. Under the null hypothesis that the mean value is zero, the t-statistics for NETBUY\_N and NETBUY\$\_N are -3.49 and -3.43, respectively. The results of median tests (Wilcoxon Signed-Ranks Tests) show that the null hypothesis of zero median is rejected with the t-statistic more than -20. There are 2,608 firm-fiscal quarters (N).

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<sup>9</sup> The maximum and the minimum values of NETBUY are about 15 million shares and -161 million shares with the standard deviation of 4 million shares. The maximum and the minimum values for NETBUY\$ are about \$659 million and -\$3,448 million with the standard deviation of \$91 million.

The results in this panel are consistent with the findings of previous studies in that insiders on average sell more than they buy in a given period. Insiders, *ceteris paribus*, want to diversify their relatively undiversified positions by selling their firms' stocks, as significant portions of their wealth are tied up to their own companies.

In Panel B of Table 1, insider's NETBUY is shown across quartiles of book-to-market values (B/M) and quartiles of firms' buyback trading intensity (INTENS). B/M1 is the quartile with the lowest book-to-market value (growth stock) and B/M4 the highest (value stock). INTENS1 is the quartile with the smallest actual buyback intensity and INTENS4 the highest actual buyback intensity. Panel C, Panel D, and Panel E contain results for NETBUY\_N, NETBUY\$, and NETBUY\$\_N, respectively.

As shown in Panel B of Table 1, for INTENS1, NETBUY is insignificant across B/M quartiles, whereas in INTENS2 – INTENS4, the values of NETBUY are significantly negative in the majority of cases. That is, when firms are actively buying back their shares (rows corresponding to INTENS2 – INTENS4), insiders buy relatively less shares or sell relatively more shares. When firms do not buy back their shares actively, insiders buy relatively more shares or sell relatively less shares. This supports our conflict-of-interest contention.

Note that the number of observations in INTENS1 is disproportionately large. This is because all of the observations in this group are zeros, indicating no actual buyback transactions in INTENS1. For example, for B/M1 column, there was virtually no actual buyback trading in 228 (INTENS1) out of the total 652 firm-quarters. In INTENS1, in which the firms are not engaged in buyback trading at all, insiders sell less (buy more). On the other hand, insiders sell more (buy less) when the firms are actually engaged in buyback trading (INTENS2 – INTENS4).

Panel B of Table 1 also shows the empirical pattern well-documented in previous studies: Insider NETBUY tends to increase as B/M increases (Rozeff and Zaman (1998) and Jenter (2002)). In other words, insiders of value firms tend to buy more, compared to insiders of growth firms who tend to sell more. None of the values of NETBUY is significant in B/M4 column (value firm), whereas in the lower B/M quartiles, the majority of the values of NETBUY are significantly negative. In sum, controlling for insiders' tendency to sell more when they perceive overvaluation (low book-to-market value), there is a positive relation between firms' buyback activity and insiders' selling, consistent with our conflict-of-interest hypothesis.

In Panel C of Table 1 for the normalized NETBUY or NETBUY\_N, the results are similar to those of Panel B, although overall significance of the test statistics is lower compared to Panel B. None of the values belonging to INTENS1 is significant, consistent with our conflict-of-interest contention. Also, most of the observations in B/M4 are insignificant, consistent with the findings of previous studies.

The results in Panel D for NETBUY\$ are almost identical to those of Panel B for NETBUY. In INTENS1, insiders' net dollar purchases are not significantly different from zero across all B/M quartiles. In other INTENS quartiles in which firms are buying back shares actively, insiders tend to buy relatively less or sell relatively more in dollar term. Again, this supports the conflict-of-interest hypothesis.

In line with the results of Rozeff and Zaman (1998) and Jenter (2002), Panel D shows that as book-to-market value increases, insiders tend to buy relatively more or sell relatively less. Compared to largely significant negative observations in B/M1 – B/M3, none of the observations in B/M4 is significantly different from zero. In Panel E for NETBUY\$\_N, the results are similar to those of previous panels. Normalized net dollar purchases by insiders are insignificant in INTENS1, while they are relatively more significantly negative in other INTENS quartiles.

Table 2 shows the results of multiple regression analyses. NETBUY\_N (Panel A) and NETBUY\$\_N (Panel B), respectively, are regressed on INTENS, B/M, and RETURN. Both Rozeff and Zaman (1998) and Jenter (2002) find that insiders sell more or buy less, following positive stock returns. Thus, the previous return, RETURN, enters the regression along with INTENS and B/M. RETURN is the average monthly return measured over the 12 month period prior to the announcement.

In Table 2, the coefficient for INTENS is significantly negative in both of the regressions. This confirms the univariate finding in Table 1 that when firms buy back shares more intensely, insiders tend to decrease net purchases or increase sales both in terms of number of shares and in dollar terms. Consistent with the results of previous studies and the univariate results above, B/M is positively and significantly related to insider net dollar purchase in Panel B. The coefficient for RETURN, however, is not significant. The correlation coefficient between INT and B/M is 0.0462, and the correlation coefficient between INTENS and RETURN is 0.0268. Not surprisingly, the correlation coefficient between RETURN and B/M is -0.2588. Regression results do not change with or without RETURN: INTENS is significantly negatively associated with NETBUY\_N or NETBUY\$\_N.

In summary, both the univariate results in Table 1 and the multiple regression results in Table 2 are consistent with our conflict-of-interest hypothesis in that insiders do tend to increase sales or decrease net purchases in a period when their corporations are buying back their shares in the open market. This positive association between insider sales and firm buyback activity is robust to inclusion of well-documented book-to-market effects that insiders tend to sell more when they perceive overvaluation of the share price (low book-to-market value). This evidence suggests that insiders can unfairly exploit the inside information that their firms are in the market buying back shares, by selling their own holdings of the firms' stock at the same time. Whether or not their firms are engaged in share buybacks is inside information because outside shareholders do not have such information.

#### 4. Conclusions

While a repurchasing firm will publicly announce the intention of an open market share repurchase program, most repurchase programs are executed over varying periods following the repurchase program announcement. SEC Rule 10b-18 which regulates firms' open market share repurchases does not mandate disclosure of the magnitude, timing, and prices of actual buyback transactions. Thus, while insiders have knowledge of firms' actual buyback activity, outside shareholders cannot detect such activity from publicly available information. This information advantage insiders have relative to outside shareholders can result in a conflict of interests between insiders and outside shareholders. This is because insiders of a firm may sell their holdings, while the firm itself is supporting the price by repurchasing its shares. We thus hypothesized that a lack of mandatory disclosure of actual buyback activity by a repurchasing firm can create opportunities for insiders to time their trades with the actual firm buyback activity.

The evidence we find is consistent with the conflict-of-interest hypothesis. We find that insiders do tend to increase sales or decrease net purchases (purchases – sales) in a fiscal quarter when the firm is in the market actively repurchasing its shares.

We wish to emphasize that we do *not* argue that more stringent regulation will resolve this potential conflict-of-interest issue. The debate as to whether or not mandatory disclosure increases economic efficiency is inconclusive (Healy and Palepu (2001)). We contribute to the literature by suggesting that investors be made aware of the possibility of conflict of interests between insiders and outside shareholders of share repurchasing firms. Outside shareholders aware of this issue can request that management disclose detailed buyback activity, without having to have additional regulation that mandates such disclosure.

A more thorough empirical examination, including the examination of whether insufficient disclosure actually leads to a wealth transfer between insiders and outsiders, would be possible only if actual buyback transaction data were available. Such data are not publicly available because of insufficient disclosure, the very issue addressed in this paper.

## Appendix

The following is the full text of SEC Rule 10b - 18, downloaded from the Lexis-Nexis Academic Universe.

TITLE 17 -- COMMODITY AND SECURITIES EXCHANGES  
CHAPTER II -- SECURITIES AND EXCHANGE COMMISSION  
PART 240 -- GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934  
SUBPART A -- RULES AND REGULATIONS UNDER THE SECURITIES EXCHANGE ACT OF 1934  
MANIPULATIVE AND DECEPTIVE DEVICES AND CONTRIVANCES

### 17 CFR 240.10b-18

§ 240.10b-18 Purchases of certain equity securities by the issuer and others.

(a) Definitions. Unless the context otherwise requires, all terms used in this section shall have the same meaning as in the Act. In addition, unless the context otherwise requires, the following definitions shall apply:

(1) The term affiliate means any person that directly or indirectly controls, is controlled by, or is under common control with, the issuer;

(2) The term affiliated purchaser means:

(i) A person acting in concert with the issuer for the purpose of acquiring the issuer's securities; or

(ii) An affiliate who, directly or indirectly, controls the issuer's purchases of such securities, whose purchases are controlled by the issuer or whose purchases are under common control with those of the issuer;

Provided, however, That the term "affiliated purchaser" shall not include a broker, dealer, or other person solely by reason of his making Rule 10b-18 bids or effecting Rule 10b-18 purchases on behalf of the issuer and for its account and shall not include an officer or director of the issuer solely by reason of his participation in the decision to authorize Rule 10b-18 bids or Rule 10b-18 purchases by or on behalf of the issuer;

(3) The term Rule 10b-18 purchase means a purchase of common stock of an issuer by or for the issuer or any affiliated purchaser of the issuer, but does not include any purchase of such stock

(i) Effected during the restricted period specified in § 242.102 of this chapter, during a distribution (as defined in § 242.100 of this chapter) of such common stock or a distribution for which such common stock is a reference security, by the issuer or any of its affiliated purchasers;

(ii) Effected by or for an issuer plan by an agent independent of the issuer;

(iii) If it is a fractional interest in a security, evidenced by a script certificate, order form, or similar document;

- (iv) Pursuant to a merger, acquisition, or similar transaction involving a recapitalization;
  - (v) Which is subject to Rule 13e-1 under the Act [§ 240.13e-1];
  - (vi) Pursuant to a tender offer that is subject to Rule 13e-4 under the Act [§ 240.13e-4] or specifically excepted therefrom;
  - (vii) Pursuant to a tender offer that is subject to section 14(d) of the Act and the rules and regulations thereunder.
- (4) The term Rule 10b-18 bid means (i) A bid for securities that, if accepted, or (ii) A limit order to purchase securities that, if executed, would result in a Rule 10b-18 purchase;
- (5) The term plan has the meaning contained in § 242.100 of this chapter;
- (6) The term agent independent of the issuer has the meaning contained in § 242.100 of this chapter;
- (i) The agent is not an affiliate of the issuer; and
  - (ii) Neither the issuer nor any affiliate of the issuer exercises any direct or indirect control or influence over the times when, or the prices at which, the independent agent may purchase the issuer's common stock for the issuer plan, the amounts of the security to be purchased, the manner in which the security is to be purchased, or the selection of a broker or dealer (other than the independent agent itself) through which purchases may be executed;
- Provided, however, That the issuer or its affiliate will not be deemed to have such control or influence solely because it revises not more than once in any three-month period the basis for determining the amount of its contributions to the issuer plan or the basis for determining the frequency of its allocations to the issuer plan, or any formula specified in the plan that determines the amount of shares to be purchased by the agent;
- (7) The term consolidated system means the consolidated transaction reporting system contemplated by Rule 11Aa3-1 [§ 240.11Aa3-1];
- (8) The term reported security means any security as to which last sale information is reported in the consolidated system;
- (9) The term exchange traded security means any security, except a reported security, that is listed, or admitted to unlisted trading privileges, on a national securities exchange;
- (10) The term NASDAQ security means any security, except a reported security, as to which bid and offer quotations are reported in the automated quotation system ("NASDAQ") operated by the National Association of Securities Dealers, Inc. ("NASD");
- (11) The term trading volume means:
- (i) With respect to a reported security, the average daily trading volume for the security reported in the consolidated system in the four calendar weeks preceding the week in which the Rule 10b-18 purchase is to be effected or the Rule 10b-18 bid is to be made;
  - (ii) With respect to an exchange traded security, the average of the aggregate daily trading volume,

including the daily trading volume reported on all exchanges on which the security is traded and, if such security is also a NASDAQ security, the daily trading volume for such security made available by the NASD, for the four calendar weeks preceding the week in which the Rule 10b-18 purchase is to be effected or the Rule 10b-18 bid is to be made;

(iii) With respect to a NASDAQ security that is not an exchange traded security, the average daily trading volume for such security made available by the NASD for the four calendar weeks preceding the week in which the Rule 10b-18 purchase is to be effected or the Rule 10b-18 bid is to be made;

Provided, however, That such trading volume under paragraphs (a)(11) (i), (ii) and (iii) of this section shall not include any Rule 10b-18 purchase of a block by or for the issuer or any affiliated purchaser of the issuer;

(12) The term purchase price means the price paid per share

(i) For a reported security, or an exchange traded security on a national securities exchange, exclusive of any commission paid to a broker acting as agent, or commission equivalent, mark-up, or differential paid to a dealer;

(ii) For a NASDAQ security, or a security that is not a reported security or a NASDAQ security, otherwise than on a national securities exchange, inclusive of any commission equivalent, mark-up, or differential paid to a dealer;

(13) The term round lot means 100 shares or other customary unit of trading for a security;

(14) The term block means a quantity of stock that either

(i) Has a purchase price of \$ 200,000 or more; or

(ii) Is at least 5,000 shares and has a purchase price of at least \$ 50,000; or

(iii) Is at least 20 round lots of the security and totals 150 percent or more of the trading volume for that security or, in the event that trading volume data are unavailable, is at least 20 round lots of the security and totals at least one-tenth of one percent (.001) of the outstanding shares of the security, exclusive of any shares owned by any affiliate;

Provided, however, That a block under paragraphs (a)(14) (i), (ii) and (iii) of this section shall not include any amount that a broker or a dealer, acting as principal, has accumulated for the purpose of sale or resale to the issuer or to any affiliated purchaser of the issuer if the issuer or such affiliated purchaser knows or has reason to know that such amount was accumulated for such purpose, nor shall it include any amount that a broker or dealer has sold short to the issuer if the issuer or such affiliated purchaser knows or has reason to know that the sale was a short sale.

(15) The term market-wide trading suspension means either:

(i) A market-wide trading halt imposed pursuant to the rules of a national securities exchange or a registered national securities association, in response to a market-wide decline during a single trading session; or

(ii) A market-wide trading suspension ordered by the Commission pursuant to Section 12(k) of the Act, 15 U.S.C. 78l(k).

(b) Conditions to be met. In connection with a Rule 10b-18 purchase, or with a Rule 10b-18 bid that is made by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange, an issuer, or an affiliated purchaser of the issuer, shall not be deemed to have violated section 9(a)(2) of the Act or Rule 10b-5 under the Act, solely by reason of the time or price at which its Rule 10b-18 bids or Rule 10b-18 purchases are made of the amount of such bids or purchases or the number of brokers or dealers used in connection with such bids or purchases if the issuer or affiliated purchaser of the issuer:

(1) (One broker or dealer) Effects all Rule 10b-18 purchases from or through only one broker on any single day, or, if a broker is not used, with only one dealer on a single day, and makes or causes to be made all Rule 10b-18 bids to or through only one broker on any single day, or, if a broker is not used, to only one dealer on a single day; Provided, however, That

(i) This paragraph (b)(1) shall not apply to Rule 10b-18 purchases which are not solicited by or on behalf of the issuer or affiliated purchaser; and

(ii) Where Rule 10b-18 purchases or Rule 10-b18 bids are made by or on behalf of more than one affiliated purchaser of the issuer (or the issuer and one or more of its affiliated purchasers) on a single day, this paragraph (b)(1) shall apply to all such bids and purchases in the aggregate; and

(2) (Time of purchases) Effects all Rule 10b-18 purchases from or through a broker or dealer

(i) In a reported security, (A) such that the purchase would not constitute the opening transaction in the security reported in the consolidated system; and (B) if the principal market of such security is an exchange, at a time other than during the one-half hour before the scheduled close of trading on the principal market; and (C) if the purchase is to be made on an exchange, at a time other than during the one-half hour before the scheduled close of trading on the national securities exchange on which the purchase is to be made; and (D) if the purchase is to be made otherwise than on a national securities exchange, at a time other than during the one-half hour before the termination of the period in which last sale prices are reported in the consolidated system;

(ii) In any exchange traded security, on any national securities exchange, (A) such that the Rule 10b-18 purchase would not constitute the opening transaction in the security on such exchange; and (B) at a time other than during the one-half hour before the scheduled close of trading on the exchange;

(iii) In any NASDAQ security, otherwise than on a national securities exchange, if a current independent bid quotation for the security is reported in Level 2 of NASDAQ; and

(3) (Price of purchase) Effects all Rule 10b-18 purchases from or through a broker or dealer at a purchase price, or makes or causes to be made all Rule 10b-18 bids to or through a broker or dealer at a price.

(i) For a reported security, that is not higher than the published bid, as that term is defined in Rule 11Ac1-1(a)(9) under the Act, that is the highest current independent published bid or the last independent sale price reported in the consolidated system, whichever is higher;

(ii) On a national securities exchange, for an exchange traded security, that is not higher than the current independent bid quotation or the last independent sale price on that exchange, whichever is higher;

(iii) Otherwise than on a national securities exchange for a NASDAQ security, that is not higher than the lowest current independent offer quotation reported in Level 2 of NASDAQ; or

(iv) Otherwise than on a national securities exchange, for a security that is not a reported security or a NASDAQ security, that is not higher than the lowest current independent offer quotation, determined on the basis of reasonable inquiry; and

(4) (Volume of purchases) Effects from or through a broker or dealer all Rule 10b-18 purchases other than block purchases

(i) Of a reported security, an exchange traded security or a NASDAQ security, in an amount that, when added to the amounts of all other Rule 10b-18 purchases, other than block purchases, from or through a broker or dealer effected by or for the issuer or any on that day, does not exceed the higher of (A) one round lot or (B) the number of round lots closet to 25 percent of the trading volume for the security;

(ii) Of any other security, in an amount that (A) when added to the amounts of all other Rule 10b-18 purchases, other than block purchases, from or through a broker or dealer effected by or for the issuer or any affiliated purchaser of the issuer on that day, does not exceed one round lot or (B) when added to the amounts of all other Rule 10b-18 purchases other than block purchases from or through a broker or dealer effected by or for the issuer or any affiliated purchaser of the issuer during that day and the preceding five business days, does not exceed 1/20th of one percent (0.0005) of the outstanding shares of the security, exclusive of shares known to be owned beneficially by affiliates.

(c) Conditions following a market-wide trading suspension. The conditions of paragraph (b) of this section shall apply in connection with a Rule 10b-18 bid or a Rule 10b-18 purchase effected during a trading session following the termination of a market-wide trading suspension, except that the time of purchase condition in paragraph (b)(2) of this section shall not apply, either:

(1) From the reopening of trading until the scheduled close of trading; or

(2) At the opening of trading on the next trading day, if a market-wide trading suspension is in effect at the scheduled close of a trading session.

(d) No presumption shall arise that an issuer or affiliated purchaser of an issuer has violated the anti-manipulation provisions of sections 9(a)(2) or 10(b) of the Act, 15 U.S.C. 78i(a)(2) or 78j(b), or § 240.10b-5, if the Rule 10b-18 bids or Rule 10b-18 purchases of such issuer or affiliated purchaser do not meet the conditions specified in paragraphs (b) or (c) of this section.

**HISTORY:**

[47 FR 53339, Nov. 26, 1982; 62 FR 520, 543, Jan. 3, 1997, as corrected at 62 FR 11321, 11323, March 12, 1997; 64 FR 52428, 52433, Sept. 29, 1999]

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**Table 1**  
**Share Buyback Trading, Insiders' Trading, and Book-to-Market Variable (U.S.)**

NETBUY is defined as the number shares bought by insiders minus the number of shares sold by insiders in a fiscal quarter for which INTENS is measured. NETBUY\$ is defined as the dollar amount of insider purchases minus the dollar amount of insider sales in the fiscal quarter. NETBUY\_N is the normalized NETBUY, computed by dividing NETBUY by the quarterly average of daily trading volume (number of shares). Similarly, NETBUY\$\_N is the normalized NETBUY\$, computed by dividing NETBUY\$ by the quarterly average of daily dollar trading volume. Daily trading volume is the daily number of shares traded, and daily dollar trading volume is calculated by multiplying the daily trading volume by the closing price of the day. INTENS is an estimate for actual buyback trading activity or intensity as measured by the number of shares repurchased divided by average daily trading volume in a given quarter. INTENS1 is the quartile with the smallest actual buyback intensity and INTENS4 the highest actual buyback intensity. B/M is the book-to-market value as measured by the total common equity (Compustat data item number 60) divided by the market value of equity. The market value of equity is measured by multiplying the announcement day price with the number of shares outstanding. B/M1 is the quartile 1 with the lowest book-to-market value and B/M4 the highest. Panel A shows mean and median values for each of the four variables, NETBUY, NETBUY\_N, NETBUY\$, and NETBUY\$\_N. Panel B through Panel E show breakdowns of insiders' trading activity across quartiles of B/M and quartiles of INTENS. Panel B, Panel C, Panel D, and Panel E are for NETBUY, NETBUY\_N, NETBUY\$, and NETBUY\$\_N, respectively. \* denotes the significance level 10 %, \*\* 5 %, and \*\*\* 1 %, based on a two tailed T test or Wilcoxon Signed-Rank test with the null hypotheses of zero mean or zero median. N stands for the number of observations, or the number of firm-fiscal quarters.

<b>Panel A: Total</b>				
	<b>NETBUY</b> (Shares)	<b>NETBUY_N</b>	<b>NETBUY\$</b> (Dollars)	<b>NETBUY\$_N</b>
<b>MEAN</b>				
	**-174,029	***-1.64	**-4,441,565	***-1.50
<b>T-stat</b>	-2.25	-3.49	-2.48	-3.43
<b>N</b>	2608	2608	2608	2608
<b>MEDIAN</b>				
	***-7,000	***-0.07	***-142,676	***-0.07
<b>T-stat</b>	-26.70	-21.83	-28.52	-22.20
<b>N</b>	2608	2608	2608	2608

<b>Panel B: NETBUY</b>				
	<b>B/M1</b>	<b>B/M2</b>	<b>B/M3</b>	<b>B/M4</b>
<b>INTENS1</b>	-818,672	-607,476	-92,802	-3,437
<b>T-stat</b>	-1.16	-1.27	-1.18	-0.34
<b>N</b>	228	228	256	298
<b>INTENS2</b>	***-113,039	-62,716	***-19,668	8,532
<b>T-stat</b>	-5.25	-1.21	-4.43	0.52
<b>N</b>	141	141	132	118
<b>INTENS3</b>	***-79,458	** -31,296	** -28,757	-1,513
<b>T-stat</b>	-4.01	-2.26	-2.33	-0.08
<b>N</b>	142	142	132	118
<b>INTENS4</b>	** -72,575	-358,571	** -40,274	69,963
<b>T-stat</b>	-2.49	-1.10	-1.99	0.74
<b>N</b>	141	141	132	118

<b>Panel C: NETBUY_N</b>				
	<b>B/M1</b>	<b>B/M2</b>	<b>B/M3</b>	<b>B/M4</b>
<b>INTENS1</b>	-3.86	-4.09	-0.86	0.07
<b>T-stat</b>	-1.39	-1.21	-1.64	0.14
<b>N</b>	228	228	256	298
<b>INTENS2</b>	***-0.56	-0.20	*-0.49	-0.40
<b>T-stat</b>	-3.34	-0.73	-1.88	-0.66
<b>N</b>	141	141	132	118
<b>INTENS3</b>	** -0.49	0.00	***-0.53	-1.25
<b>T-stat</b>	-2.43	0.03	-3.26	-1.46
<b>N</b>	142	142	132	118
<b>INTENS4</b>	-1.16	*-8.65	-1.05	** -1.98
<b>T-stat</b>	-1.45	-1.93	-1.20	-2.12
<b>N</b>	141	141	132	118

<b>Panel D: NETBUY\$</b>				
	<b>B/M1</b>	<b>B/M2</b>	<b>B/M3</b>	<b>B/M4</b>
<b>INTENS1</b>	-18,251,166	-12,705,530	-2,528,682	-242,777
<b>T-stat</b>	-1.21	-1.41	-1.13	-1.36
<b>N</b>	228	228	256	298
<b>INTENS2</b>	***-4,828,702	-1,716,482	***-420,797	274,712
<b>T-stat</b>	-4.27	-1.61	-4.35	0.70
<b>N</b>	141	141	132	118
<b>INTENS3</b>	***-2,406,929	-995,000	*-752,864	768,256
<b>T-stat</b>	-3.72	-1.52	-1.73	0.97
<b>N</b>	142	142	132	118
<b>INTENS4</b>	***-3,062,764	-16,055,198	** -1,399,525	4,342,236
<b>T-stat</b>	-3.04	-1.02	-2.33	0.94
<b>N</b>	141	141	132	118

<b>Panel E: NETBUY\$ _N</b>				
	<b>B/M1</b>	<b>B/M2</b>	<b>B/M3</b>	<b>B/M4</b>
<b>INTENS1</b>	-3.66	-3.71	-0.77	0.09
<b>T-stat</b>	-1.39	-1.24	-1.57	0.15
<b>N</b>	228	228	256	298
<b>INTENS2</b>	***-0.51	-0.32	-0.38	0.30
<b>T-stat</b>	-3.47	-1.46	-1.56	0.23
<b>N</b>	141	141	132	118
<b>INTENS3</b>	** -0.50	0.00	***-0.55	-1.15
<b>T-stat</b>	-2.37	-0.01	-3.39	-1.38
<b>N</b>	142	142	132	118
<b>INTENS4</b>	-1.24	*-7.87	-1.07	** -1.98
<b>T-stat</b>	-1.41	-1.88	-1.20	-2.11
<b>N</b>	141	141	132	118

**Table 2**  
**Multiple Regressions**

Table 2 shows the results of multiple regressions in which NETBUY\_N (Panel A) and NEBUY\$\_N\$ (Panel B), respectively, are regressed on INTENS, B/M, and RETURN. INTENS is the estimate for actual buyback trading intensity as measured by the number of shares repurchased divided by average daily trading volume in a given quarter. B/M is the book-to-market value as measured by the total common equity (Compustat data item number 60) divided by the market value of equity. The market value of equity is measured by multiplying the announcement day price with the number of shares outstanding. RETURN is the average monthly return measured over 12 months prior to the announcement. \* denotes the significance level 10 %, \*\* 5 %, and \*\*\* 1 %, based on a two tailed test. N stands for the number of observations (firm-quarters).

<b>Panel A: NETBUY_N</b>			
	<b>coefficients</b>	<b>t-stat</b>	<b>p-value</b>
<b>Intercept</b>	*-1.5300	-1.89	0.0594
<b>INTENS</b>	***-0.0070	-7.26	0.0000
<b>B/M</b>	1.1478	0.95	0.3420
<b>RETURN</b>	-15.9967	-1.06	0.2880
<b>R<sup>2</sup></b>	0.0208		
<b>N</b>	2608		

<b>Panel B: NETBUY\$_N\$</b>			
	<b>coefficients</b>	<b>t-stat</b>	<b>p-value</b>
<b>Intercept</b>	***-1.9982	-2.64	0.0083
<b>INTENS</b>	***-0.0068	-7.53	0.0000
<b>B/M</b>	**2.2455	1.99	0.0463
<b>RETURN</b>	-14.1355	-1.01	0.3141
<b>R<sup>2</sup></b>	0.0234		
<b>N</b>	2608		