

Insiders and Their Trading Games in China: Law, Enforcement Data, and a Puzzling Question

Chien-Chung Lin,^{*} Huan-Ting Wu^{**} & Yang Li^{***}

We conducted a comprehensive, up-to-date observation of the enforcement of insider trading law in China. Our observation has a twofold goal. First, we examine how a key component of modern securities law—insider trading law—is enforced in a rapidly growing economy where both regulators and market participants are relatively lacking in experience and must learn to communicate with one another and establish an effective model of law enforcement. Second, we use this observation as a lens for understanding how corporate information flows in a concentrated ownership environment. In theory, controlling shareholders can either voluntarily push for corporate information flow to the general public to win investor confidence, or they can trade for their own private benefit with an informational advantage and keep that information private as long as possible and bet that law enforcement does not detect it. Alternatively, company controllers may opt for a third option, which is to tacitly allow corporate managers to trade with undisclosed corporate information as a form of managerial compensation without conducting any insider trading themselves. Which scenario is more likely is unclear, but China’s concentrated ownership environment makes it a good setting for testing these possibilities.

We first discuss Chinese law against insider trading and then provide both quantitative and descriptive accounts of the law’s enforcement. Quantitatively, we run an event study with a measure called pre-announcement degree of run-up as a proxy for overall insider trading in China. We then compare this result with a comparison group and data from other countries.

We initially found a 65.8% pre-announcement stock price run-up in tried cases of insider trading in China, which is comparable to results in other countries with a dispersed corporate ownership structure. If insider trading in

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China occurs at a rate similar to that of other countries, then ownership structure would seem to play no significant role in it. However, after running our test again with a comparison group—a sample composed of 330 random major merger and acquisition events in China from 2007 to 2017—we discovered, contradictorily, that the degree of information leakage in the comparison group increased up to 83.9%. These disparate results highlight China’s puzzling enforcement of insider trading law.

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I. INTRODUCTION: INSIDER TRADING IN A CONTROLLER-DOMINATED ENVIRONMENT ...	718
II. INSIDER TRADING LAW IN CHINA	719
A. <i>Substantive Law</i>	719
1. <i>The Definition of Insider and Inside Information</i>	720
2. <i>Types of Proscribed Activities</i>	721
3. <i>Legal Consequences of Violation</i>	722
4. <i>Supplementary Explanation and Guidance</i>	723
B. <i>Comments From Legal Academia</i>	725
III. WHAT HAPPENED IN THE REAL WORLD: CRIMINAL INSIDER TRADING CASES, 1997–2019	726
A. <i>Empirical Literature Review</i>	726
B. <i>Our Data and Method</i>	728
1. <i>Descriptive Data</i>	728
2. <i>Beyond Those Being Detected: The Cumulative Abnormal Returns and Event Study</i>	730
3. <i>Sample</i>	731
C. <i>Result: Cumulative Abnormal Returns and Pre-Announcement Run-ups</i>	733
D. <i>Comparison Group: M&A Events in China from 2007 to 2017 and the Puzzle the Results Create</i>	734
IV. CASE STUDY AND REFLECTIONS	736
A. <i>Qualitative Analysis of Notable Cases</i>	737
1. <i>Nantong People’s Procuratorate of Jiangsu Province v. Liu Baochun</i>	737
2. <i>Chengde People’s Procuratorate of Hebei Province v. Liu Zhiqiang</i>	737
3. <i>Taiyuan People’s Procuratorate of Shanxi Province v. Zhou Haijun</i>	738
4. <i>The Second Branch of Beijing People’s Procuratorate v. Huang Guangyu</i>	739
5. <i>Wuxi People’s Procuratorate of Jiangsu Province v. Du Lanku</i>	740
6. <i>Questions Remained</i>	742
B. <i>Reflections: Empirical Research and Its Limitations, Methodology of Comparison, and Implications of the Contradicting Data</i>	743
1. <i>Limitations of Traditional Approach and Quantitative Approach</i>	743

2. <i>Methodology Enhanced: Multi-Layer Comparison</i>	744
3. <i>Summary of Observations and Takeaways</i>	744
V. CONCLUSION.....	746

I. INTRODUCTION: INSIDER TRADING IN A CONTROLLER-DOMINATED ENVIRONMENT

This Article delves into two components of corporate law and securities law—concentrated ownership structure and insider trading—and studies their interaction. Specifically, we analyze how insider trading is carried out or prevented in the Chinese context, where concentrated ownership of businesses is prevalent. In theory, controlling shareholders could conduct insider trading (as they enjoy an informational advantage from which benefits can be gleaned if legal enforcement is weak) or not (as they may choose instead to maintain their reputation by treating minority shareholders or trading parties fairly). This dynamic is compounded if adding the existence of professional managers is taken into calculation. Therefore, the question is, do controlling shareholders have an incentive to stop their managers from misappropriating undisclosed corporate information for profit? Or should controlling shareholders allow some use of inside information as a form of bonus compensation, as suggested by a prominent academic?¹

To answer these questions, we gathered empirical data from China to see how insiders trade in an environment where corporate controllers dominate. We survey court decisions of insider trading criminal cases since the prohibition of insider trading (1997–2019) to gather details about trading activities. We use a technique developed by two of the authors to gauge the potential gap between spotted insider trading (cases tried) and those that remained undetected. We calculated a cumulative abnormal return (CAR), or the price movement for a company before a major announcement adjusted to the market situation, to measure the magnitude of insider trading across the board. We used this method to estimate the overall amount of insider trading in China.

To check the validity of our findings, we compiled another randomly selected sample of companies that experienced merger and acquisition (M&A) events from 2007 to 2017. These two samples provide contradictory findings that pose a conundrum when considering the interplay of concentrated ownership, insider trading, and the enforcement of insider trading law in China.

This Article proceeds as follows. In Part II, we trace the twenty-plus-year history of Chinese insider trading law to the present. In Part III, we use CAR to estimate informational leakage and after-announcement price movement to gauge market reaction. We then test our first and second samples. In Part IV, we survey the characteristics of individual criminal cases of insider trading. We examine how inside information is used (or not) in a

1. Using inside information as a form of compensation for entrepreneurs was first suggested by late Professor Henry Manne in his book *Insider Trading and the Stock Market*. See generally 2 HENRY G. MANNE, *Insider Trading and the Stock Market*, in THE COLLECTED WORKS OF HENRY G. MANNE: INSIDER TRADING 3, 129–56 (Stephen M. Bainbridge ed., Liberty Fund 2009) (1966) (“Insider trading meets all the conditions for appropriately compensating entrepreneurs.”).

controller-dominated corporate environment and then reflect on the implications of this for the existing theoretical discourse. Part V concludes.

II. INSIDER TRADING LAW IN CHINA

A. Substantive Law

China's first comprehensive regulation prohibiting insider trading was the Interim Provisions on the Management of the Issuing and Trading of Stocks, promulgated in 1993 by the State Council Securities Commission (predecessor to the China Securities Regulatory Commission, or CSRC).² It stipulated that insider trading is an illegal activity³ and provided a set of definitions for enforcement, such as the definition of "insiders"⁴ and the information prohibited.⁵ Furthermore, it provided statutory grounds for the administrative agency to enforce a prohibition against insider trading.

However, the actual effect of the interim provisions was questionable. In 1997, an amendment to the Criminal Code attached criminal sanctions to insider trading.⁶ At that time, insider trading was rampant, and one commentator remarked, "In the [Chinese] stock market, about 80 percent of all securities cases are connected with insider trading, and about 80 percent of the amount of money in all securities cases are connected with inside

2. Gupiao Faxing Yu Jiaoyi Guanli Zanxing Tiaoli (股票发行与交易管理暂行条例) [Interim Provisions on the Management of the Issuing and Trading of Stocks] (promulgated by the State Council Sec. Comm'n, Apr. 22, 1993, effective Apr. 22, 1993) [hereinafter *SCSC's Issuance and Trading Regulation*].

3. *Id.* at art. 72 (providing that insider traders shall be fined from 50,000 to 500,000 Chinese yuan). The value of Chinese currency was approximately 5.8 to 1 U.S. dollar in 1993. *Historical Rates*, FXTOP.COM, <https://fxtop.com/en/historical-exchange-rates.php?A=1&C1=USD&C2=CNY&DD1=&MM1=&YYYY1=&B=1&P=&I=1&DD2=10&MM2=02&YY2=1993&btnOK=Go%21> (last visited Feb. 10, 2022).

4. *SCSC's Issuance and Trading Regulation* at art. 81(14) (defining "insiders" as any person who has access to or can acquire inside information because they hold the issuer's shares, or because of their position as a director, supervisor, or senior manager of the issuer, or because of a close connection between enterprise and issuer, or because of their membership, managerial position, supervisory role, or professional connection, or because they perform duties as an employee or professional advisor).

5. *Id.* at art. 81(15) (defining "inside information" as non-public information that has the potential to influence market price).

6. Zhonghua Renmin Gongheguo Xingfa (1997 Nian Xiuding) (中华人民共和国刑法 (1997 年修订) [Criminal Law of the People's Republic of China (1997 Revision)] (promulgated by the Nat'l People's Cong., Mar. 14, 1997, effective Oct. 1, 1997) [hereinafter *Criminal Code*] art. 180. Article 180 was revised in 2009 by Amendment VII to the Criminal Law and is still effective. It provides: "Any person in possession of insider information about stock or futures transactions, or any person who illegally obtains such information, prior to the publication of such information as relates to the issuing of stocks, or stock or futures transactions, or as has a vital bearing on the transaction price of stocks or futures, buys or sells that stock, conducts futures transactions related to that insider information, divulges that insider information, or causes others to conduct the aforementioned transactions expressly or impliedly shall, if the circumstances are serious, be sentenced to a fixed term of imprisonment of not more than five years or criminal detention, and be concurrently imposed with a fine, or shall be subject to a fine alone of not less than one time but not more than five times the amount of the illegal gains; if the circumstances are particularly serious, such person shall be sentenced to a fixed term of imprisonment of not less than five years but not more than ten years, and be concurrently imposed with a fine of not less than one time but not more than five times the amount of the illegal gains." See Zhonghua Renmin Gongheguo Xingfa Xiuzhengan (Qi) (中华人民共和国刑法修正案(七)) [Amendment VII to the Criminal Law of the People's Republic of China] (promulgated by the Standing Comm. of the Nat'l People's Cong., Feb. 28, 2009, effective Feb. 28, 2009) [hereinafter *Amendment*].

trading.”⁷ Nevertheless, the 1997 Criminal Code did not stipulate the range and the components of insider trading but instead delegated its substance to administrative lawmaking, such as defining the scope of “inside information” and the definition of “insiders.”⁸

In 1999, China’s first non-interim securities law, Securities Law of the People’s Republic of China, filled the gap.⁹ The law proscribed insider trading, along with general securities fraud and market manipulation, as one of three types of fraudulent acts in the securities market.¹⁰ The statute’s substantive content mainly includes (a) a long list of who is subject to insider trading restrictions and what constitutes proscribed information; (b) three types of insider trading violations; and (c) the civil penalty and liability for insider trading.

1. The Definition of Insider and Inside Information

Article 51 of the Securities Law set out nine types of persons (*zhìqingren*, meaning persons holding inside information) whose trading would constitute violation:¹¹

- (1) the issuer and its directors, supervisors, and senior executives;
- (2) shareholders holding 5% or more of shares of the company and their directors, supervisors, and senior executives, and the actual controller of the company and its directors, supervisors, and senior executives;
- (3) the company that holds controlling shares or that is actually controlled

7. See Hui Huang, *The Regulation of Insider Trading in China: Law and Enforcement*, in RESEARCH HANDBOOK ON INSIDER TRADING 303 (Stephen M. Bainbridge ed., 2013). This oft-cited quote comes from a preface written by Professor Wu Zhipan (吴志攀), who later became the dean of Peking University Law School and the vice president of Peking University. ZHEN SHUNYAN (郑顺炎), ZHENGQUAN SHICHANG BUDANG XINGWEI DE FALU SHIZHENG (证券市场不当行为的法律实证) [LEGAL ANALYSIS ON MISCONDUCT ON THE SECURITIES MARKET] (2000).

8. Two major sets of administrative rules heavily influence the regulation of insider trading in China. The first was promulgated by the CSRC in 2007, officially titled Zhongguo Zhengquan Jiandu Guanli Weiyuanhui Guanyu Yinfu “Zhengquan Shichang Caozong Xingwei Rending Zhiyin (Shixing)” Ji “Zhengquan Shichang Neimu Jiaoyi Xingwei Rending Zhiyin (Shixing) de Tongzhi” (中国证券监督管理委员会关于印发《证券市场操纵行为认定指引(试行)》及《证券市场内幕交易行为认定指引(试行)》的通知) [Notice of the China Securities Regulatory Commission on Issuing the Guidelines for the Determination of Manipulation in the Securities Market (Trial) and the Guidelines for the Determination of Insider Trading in the Securities Market (Trial)] (not promulgated but distributed internally by the China Secs. Regul. Comm’n, Mar. 27, 2007) [hereinafter *Guidance*]. The second was promulgated by the People’s Supreme Court in 2012. Its official title is Zuigao Renmin Fayuan, Zuigao Renmin Jianchayuan Guanyu Banli Neimu Jiaoyi, Xielu Neimu Xinxi Xingshi Anjian Juti Yingyong Falv Ruogan Wenti De Jieshi (最高人民法院、最高人民检察院关于办理内幕交易、泄露内幕信息刑事案件具体应用法律若干问题的解释) [Interpretation of the Supreme People’s Court and the Supreme People’s Procuratorate on Several Issues Concerning the Specific Application of Law in the Handling of Criminal Cases of Engaging in Insider Trading or Leaking Insider Information] (promulgated by the Sup. People’s Ct., Sup. People’s Procuratorate, Mar. 29, 2012, effective June 1, 2012) [hereinafter *Interpretation*].

9. Zhonghua Renmin Gongheguo Zhengquan Fa (中华人民共和国证券法) [Securities Law of the People’s Republic of China] (promulgated by the Standing Comm. Of the Nat’l People’s Cong., Dec. 29, 1998, effective July 1, 1999) [hereinafter *Securities Law*]. After its enactment in 1999, it was amended in 2004, 2005, 2013, 2014, and 2019. Our discussion of it is based on the version of *Securities Law* revised in 2019.

10. *Securities Law* art. 5.

11. *Id.* art. 51(1)–(9).

- by the issuer and its directors, supervisors, and senior executives;
- (4) the personnel who have access to the inside information of the company by virtue of their positions held in the company or their business exchange with the company;
- (5) the acquirer of a listed company or parties to material asset transactions, and their controlling shareholders, actual controllers, directors, supervisors, and senior executives;
- (6) the relevant personnel of stock exchanges, securities companies, securities depository, and clearing institutions and securities service institutions who may have access to inside information by virtue of their positions or work;
- (7) staff members of securities regulatory authorities who may have access to inside information by virtue of their duties or work;
- (8) staff members of competent departments and regulatory authorities who may have access to inside information in their performance of statutory duties of administering securities offerings and trading or listed companies and their acquisitions and material asset transactions; and
- (9) other personnel who may have access to inside information as provided for by the securities regulatory authority of the State Council.

In Section 1 of Article 52, China's Securities Law defines inside information as any undisclosed information that may have a material impact on the issuer's business, financial condition, or stock price.¹² In section two of the same article, it refers to Articles 80 and 81 for all 23 itemized incidences considered to be proscribed information, including information about significant changes to the business strategy and scope of business, any investments, sales of assets, or mortgages exceeding 30% of a company's total assets, or major personnel changes or litigation.¹³

2. Types of Proscribed Activities

Three types of activities are proscribed by the Securities Law. The first is traditional insider trading: that is, company insiders cannot trade an issuer's securities while possessing undisclosed material information.¹⁴ The second is trading by those who obtain inside information through illegal means.¹⁵ This enjoins trading by anyone who breaches the duty owed to any party by using material non-public information for personal gain; this proscription is an outgrowth of "misappropriation" theory originated in the United States.¹⁶

12. *Id.* art. 52(1).

13. *Id.* art. 52(2), 80(2), 81(2).

14. *Securities Law* art. 50, 53(1).

15. *Id.*

16. The origin of misappropriation theory can be traced to Chief Justice Burger's dissent in *Chiarella v. United States*, 445 U.S. 222, 240 (1980). The judgment was later upheld by the Supreme Court in *United States v. O'Hagan*, 521 U.S. 642 (1997). See Nicholas Calcina Howson, *Enforcement without Foundation?—Insider Trading and China's Administrative Law Crisis*, 60 AM. J. COMPAR. L. 955, 965–66 (2012) for a brief discussion of how the Chinese insider trading regime absorbed the misappropriation theory.

The third type of insider trading is identified in Article 53, which prohibits anyone, either an insider or someone who illegally obtains inside information, from passing on this information or recommending, implicitly or explicitly, purchasing or selling relevant securities.¹⁷ This provision covers what is generally referred to as “tipper” or “tipping” liability. In such a situation, a tipper-defendant can be liable for insider trading even when the defendant has not engaged directly in securities trading.¹⁸

3. Legal Consequences of Violation

A violation of insider trading law incurs three sets of liabilities. Civil and administrative liability are based, respectively, on Articles 54 and 191 of China’s Securities Law; criminal liability is set forth in Article 180 of China’s Criminal Code.

For civil liability, Article 54 of the Securities Law says that a violator of insider trading law shall be responsible for compensating any loss suffered by those with whom he or she transacts with. For administrative liability, Article 191 of the Securities Law requires that persons who violate the provisions of Article 53 (a) dispose of their illegally held securities; (b) have their gains from insider trading confiscated; and (c) be subject to a fine ranging from one time to 10 times the amount of the illegal gain.¹⁹

Criminal liability is assigned on the premise of severity. According to Article 180 of the Chinese Criminal Code, if the violation is “serious,” the defendant shall be sentenced to imprisonment of no more than five years and can be fined up to five times the amount of the illegal gains. If the violation is “extremely serious,” the defendant faces imprisonment of five to ten years and a fine up to five times the amount of the illegal gains.²⁰

However, Article 180 of the Criminal Code does not stipulate what constitutes a “serious” or “extremely serious” circumstance. In 2012, the Supreme People’s Court provided an interpretation to clarify the matter, which is summarized below in Table 1.²¹

Table 1. Definitions of “Serious Circumstance” and “Extremely Serious Circumstance” in the Supreme People’s Court’s *Interpretation*.

	Serious	Extremely Serious
Trading Amount	When the trading amount reaches RMB 0.5 million	When the trading amount reaches RMB 2.5 million yuan

17. *Securities Law* art. 53(1), 54(1).

18. See Howson, *supra* note 16, at 999 (distinguishing tipper liability from traditional insider trading).

19. *Securities Law* art. 191. When there is no illegal gain or the amount of illegal gain is less than RMB 500,000 yuan, a fine ranging from RMB 500,000 to RMB 5 million yuan will be imposed. If an organization engages in insider trading, the person(s) in charge and other accountable personnel shall be given a warning and also be subject to a fine ranging from RMB 200,000 yuan to RMB 2 million yuan. *Id.*

20. *Criminal Code*, *supra* note 6, art. 180; see also *Amendment*, *supra* note 6, art. II (detailing the prescribed punishments).

21. *Interpretation*, *supra* note 8, art. 6–7.

	yuan or more the amount of margin used for futures trading is RMB 0.3 million yuan or more	or more; the amount of margin used for futures trading is RMB 1.5 million yuan or more
Gain or Losses Avoided	RMB 0.15 million yuan or more	RMB 0.75 million yuan or more
Number of Transactions	Three or more	Not mentioned

4. Supplementary Explanation and Guidance

The insider trading rules introduced do not complete the picture. To fill any potential gap in the Securities Law, the CSRC promulgated an internal supplementary explanation of insider trading in 2007,²² substantially reshaping the contours of Chinese insider trading law in practice. Although, as an internal document, its statutory authority was questionable,²³ administrative agencies and stock exchanges did adhere to the issued *Guidance* which influenced court decisions substantially. Nonetheless, its expansive approach to defining insider trading beyond the prohibitions in the Securities Law attracted much criticism.²⁴ The *Guidance* expanded punishable insider trading activities to include

22. *Guidance* was not officially promulgated in a government gazette but was widely distributed by the CSRC to lower agencies and enforced. It can be retrievable from a privately run database. See China Sec. Regul. Comm'n, *Notice of the China Securities Regulatory Commission on Issuing the Guidelines for the Determination of Manipulation in the Securities Market (Trial) and the Guidelines for the Determination of Insider Trading in the Securities Market (Trial) [Expired]*, PEKING UNIV. L. **Error! Hyperlink reference not valid.**http://www.pkulaw.cn/fulltext_form.aspx?Db=chl&Gid=80b4e927d5cfdb62bdfb&keyword=%e5%86%85%e5%b9%95%e4%ba%a4%e6%98%93%e8%a1%8c%e4%b8%ba%e8%ae%a4%e5%ae%9a%e6%8c%87%e5%bc%95&EncodingName=&Search_Mode=accurate&Search_IsTitle=0 [https://perma.cc/52XT-JBA5] The CSRC repealed it on Oct. 30, 2020. China Sec. Regul. Comm'n, *Decision of the China Securities Regulatory Commission to Amend or Repeal Certain Documents or Securities and Future Rules*, PEKING UNIV. L., **Error! Hyperlink reference not valid.**http://www.pkulaw.cn/fulltext_form.aspx?Db=chl&Gid=347342 [https://perma.cc/WCS5-KXA9]; see also Howson, *supra* note 16, at 962 (“While the Insider Trading Guidance Provisions appear to be ‘available’ . . . they are not ‘public’ in the legal sense because the CSRC does not issue them to the public (but instead to CSRC staff, local securities regulatory bodies, and the two Chinese exchanges), are not posted on the CSRC website, and have never been included in any form of legislative or regulatory gazette.”).

23. Critics pointed out that the CSRC is an organ of the central government (and therefore an organ of the Communist Party of China). Although capable of drafting substantive provisions and self-enforcing them, the agency is not equivalent to the four levels of Chinese courts and the corresponding prosecutor’s office. See Nicholas C. Howson, *Protecting the State from Itself? Regulatory Interventions in Corporate Governance and the Financing of China’s “State Capitalism,”* in REGULATING THE VISIBLE HAND? THE INSTITUTIONAL IMPLICATIONS OF CHINESE STATE CAPITALISM 49 (Benjamin L. Liebman & Curtis J. Milhaupt eds., 2015) (differentiating the agency from the structure of Chinese courts).

24. The CSRC created a broader concept of “insider” and covered more defendants than were covered by the Securities Law. This expanded definition makes anyone who “gains information through other channels” an implicit defendant. See Howson, *supra* note 16, at 970. However, a similarly expansive approach was adopted in *Interpretation*. For example, Article 1 of *Interpretation* followed the definition of *zhiqingren* in Article 74 of the Securities Law of 2005. *Interpretation*, *supra* note 8, art. 1. But in Article 2 of *Interpretation*, the court extended the range of prohibited defendants (persons who unlawfully obtain inside information) to include “a close relative or any other person, who is closely related to the *zhiqingren*.” *Id.* art. 2(2).

“trading during the price-sensitive period of the inside information.”²⁵ It sidesteps the causal link by presuming the possession of inside information and presuming that trading at certain sensitive times invariably constitutes misconduct, which may not always be true. Additionally, in Article 26,²⁶ the *Guidance* stipulated that a “preponderance of evidence” is the required standard of proof, which created doubt regarding whether this low evidential standard would similarly apply when a criminal sanction is at issue. All these flaws presumably led to its repeal in 2020. At the same time, the attempt to supplement criminal sanctions with private enforcement mechanisms faced additional challenges of its own.²⁷

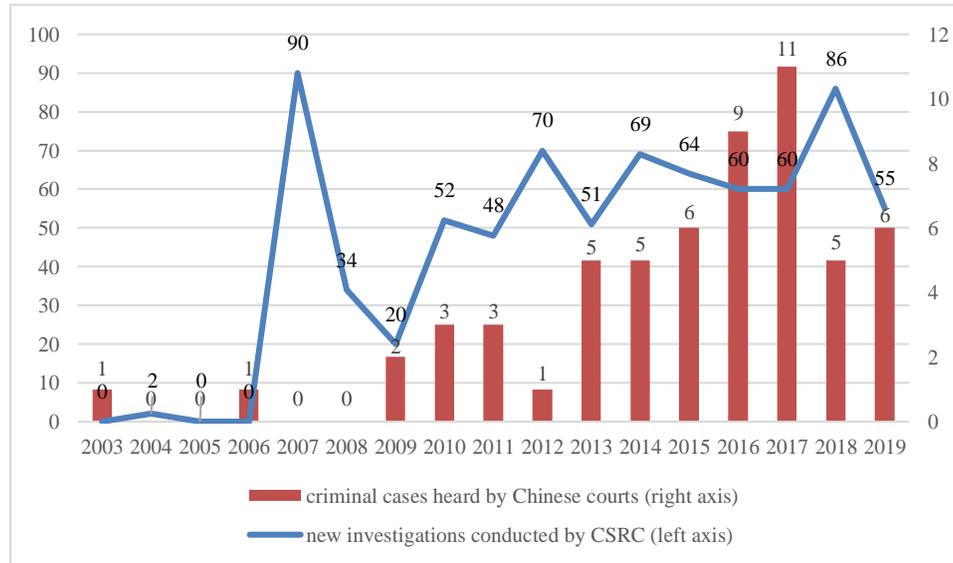
Figure 1 plots the number of criminal insider trading cases and the CSRC’s enforcement actions from 2003 to 2019—note that no administrative or criminal lawsuit occurred between 1997 and 2002. The figure shows explosive administrative actions since 2007—from zero to a high of 90 cases from 2006 to 2007. This spike can be attributed to the introduction of the CSRC’s *Insider Trading Guidance*. Likewise, the issuance of *Interpretation* from the Supreme People’s Court and Supreme People’s Procuratorate, effective as of 2012, also likely contributed to the increased number of insider trading criminal cases from nearly null to an average of 6.7 cases per year (from 2013 to 2019).

25. *Guidance*, *supra* note 8, art. 12(3).

26. *Id.* art. 26.

27. Private-party litigation against insider trading is also under legislative restraint and not encouraged by the authorities of the Communist Party of China because of the potential for social unrest brought about by such lawsuits. For instance, the strongest restriction on private securities litigation is Article 6 of a provision issued by China’s Supreme Court on January 9, 2003, which provides that without the CSRC’s penalty decision or the effective judgment of a court, individual investors are not qualified to proceed. *See* Zuigao Renmin Fayuan Guanyu Shenli Zhengquan Shichang Yin Xujia Chenxu Yinfa de Minshi Peichang Anjian de Ruogan Guiding (最高人民法院关于审理证券市场因虚假陈述引发的民事赔偿案件的若干规定) [Some Provisions of the Supreme People’s Court on Trying Cases of Civil Compensation Arising from False Statement in Securities Market] (promulgated by the Supreme People’s Ct., Jan. 9, 2003, effective Feb. 1, 2003), art. 6 (establishing that individual investors are generally not empowered to begin litigation).

Figure 1. Insider Trading Cases Handled by the CSRC and the Criminal Courts from 2003 to 2019.²⁸



B. Comments From Legal Academia

The modern securities market was established in the early 1990s with the opening of the Shanghai Stock Exchange and the Shenzhen Stock Exchange, and ever since, legal academics in China have watched how relevant laws and institutions have responded. As an overall impression, Wu Jinglian, former head of the Development Research Center of the State Council, openly condemned China's stock markets in 2001 for being "worse than a casino."²⁹ Similar comments pointed to weak enforcement of anti-insider-trading laws in China, resulting in relatively small administrative penalties and minimal civil liability punishments.³⁰ Two comparative studies in the late 2000s found that administrative and

28. The data for the CSRC's insider trading actions from 2007 to 2018 came from the annual report of the CSRC. But because the CSRC does not post annual reports made before 2007 on its website, we calculated the number of insider trading cases from its online case database. From 2003 to 2006, only 2 of 110 written decisions for administrative penalty disposed of by the CSRC involved insider trading. To access the CSRC's online database, see *Publications*, CHINA SECS. REGUL. COMM'N, http://www.csrc.gov.cn/csrc_en/c102062/list.shtml [<https://perma.cc/H4EN-7DZ5>].

29. Qiao Liu, *Corporate Governance in China: Current Practices, Economic Effects and Institutional Determinants*, 52 CESIFO ECON. STUD. 415, 415 (2006).

30. Michael D. Greenberg, Yong Kang & Elizabeth D. Brown, *Corporate Governance in China: A Tale of Rapid Change*, 13 CORP. FIN. REV. 5, 5 (2009); see also HUI HUANG, *INTERNATIONAL SECURITIES MARKETS: INSIDER TRADING LAW IN CHINA* 37–46 (2006) ("As the interviews have shown, a vast majority of interviewees commonly felt that insider trading is widespread in China."); Chenxia Shi, *Protecting Investors in China Through Multiple Regulatory Mechanisms and Effective Enforcement*, 24 ARIZ. J. INT'L & COMPAR. L. 451, 491 (2007) ("[R]egulatory enforcement in China has been weak despite the CSRC's enforcement efforts."); Laura E. Hughes, *The Impact of Insider Trading Regulations on Stock Market Efficiency: A Critique of the Law and Economics Debate and A Cross-Country Comparison*, 23 TEMP. INT'L & COMPAR. L.J. 479, 491 (2009) ("China prohibits

criminal enforcement in China was significantly less strict than that in the United States.³¹

Similarly, Hui Huang examined 39 insider trading cases (administrative and criminal) nationwide through May 2011 and found a significant increase in the number of insider trading cases, including the use of criminal sanctions.³² Nonetheless, Huang argued that inadequate resources and a lack of regulatory independence impeded CSRC's integrity and efficacy of public enforcement.³³ In another study, Huang empirically studied the private enforcement of securities law in China.³⁴ He showed that there had been "a much lower number than expected of securities civil suits in China during the ten-year study period, but the percentage of recovery in China [was] significantly higher than that in the United States."³⁵ However, another viewpoint attributed the surge of CSRC's enforcement actions to the questionable introduction of *Guidance*.³⁶

The rules of prohibition alone do not constitute the whole picture. It is true that the administrative agency is involved in the whole process, but the actual effect of the law is jointly determined by the courts, which are subject to more scrutiny. Moreover, the ways that insiders (corporate managers and large shareholders) actually think and act, and how the market responds to their decisions, is crucial for understanding how the "market v. law" dichotomy functions in China and is pertinent for painting a complete picture of the three-way law-insider-market dynamics. We examine enforcement actions in the next Section to demonstrate how this three-way dynamic works.

III. WHAT HAPPENED IN THE REAL WORLD: CRIMINAL INSIDER TRADING CASES, 1997–2019

A. Empirical Literature Review

One line of research focuses on the pervasiveness of insider trading in China. In 2003, Zhang and Zhu examined 1,078 M&A announcements in China and confirmed that the announcements' effect on stock prices in China (13.78%) was much lower than it was in the United States (44.98%), the United Kingdom (105.03%), Japan (30.88%), and other developed markets, which implies a high possibility of insider trading.³⁷ Taking a smaller group of samples, Yan and Zhao selected 45 listed companies that were part of the first and

insider trading, nevertheless it occurs frequently and remains largely unchecked.").

31. See Han Shen, *A Comparative Study of Insider Trading Regulation Enforcement in the U.S. and China*, 9 J. BUS. & SEC. L. 41, 63–72 (2008) (discussing China's more lenient enforcement of insider trading regulations compared to the United States); Liu Duan, *The Ongoing Battle Against Insider Trading: A Comparison of Chinese and U.S. Law and Comments on How China Should Improve Its Insider Trading Law Enforcement Regime*, 12 DUQ. BUS. L.J. 130, 160 (2009) (analyzing the Chinese enforcement framework in comparison to the American approach).

32. Hui Huang, *The Regulation of Insider Trading in China: Law and Enforcement*, in RESEARCH HANDBOOK ON INSIDER TRADING 303, 322. (Stephen M. Bainbridge ed., 2013).

33. *Id.* at 326.

34. Robin Hui Huang, *Private Enforcement of Securities Law in China: A Ten-Year Retrospective and Empirical Assessment*, 61 AM. J. COMPAR. L. 757, 757 (2013).

35. *Id.*

36. See Howson, *supra* note 16, at 955 (arguing that *Guidance* was the cause of increased enforcement).

37. Zhang Xin (张新), Zhu Hongmei (祝红梅), *Neimu Jiaoyi de Jingjixue Fenxi* (内幕交易的经济学分折) [*The Economic Analysis on Insider Trading*], 3 JINGJIXUE JIKAN (经济学季刊) [CHINA ECON. Q.] 71, 90 (2003). The announcement effect denotes the ratio of $CAR_t(-1, -1)$ to $CAR_t(-90, 1)$.

second batches of China's split-share reform in 2005³⁸ and showed frequent insider trading in the course of the reform.³⁹ A more recent study, which examined 1,011 large shareholders' transactions in the A-share market in China before and after the trading ban period in 2015, showed that active insider trading was not evident during the trading ban but was pervasive before it.⁴⁰ This study also revealed that insider trading before the ban period was 2.83 times more profitable than non-insider trading and that the CSRC's trading ban regulation caused a change in large shareholders' trading patterns.⁴¹ Similarly, another study on private placement in China showed that investors who bought before the private placement announcement could receive abnormal returns.⁴²

A second line of research investigates the effectiveness of insider trading law enforcement in China. Zhang and Li examined 315 of the CSRC's administrative penalty decisions and 79 decisions that ban companies from market entry. They concluded that the enforcement intensity of the CSRC was weak in deterring violations.⁴³ Another study claimed that cases of inside trading in China were accompanied by a low probability of discovery and weak punishments.⁴⁴ Furthermore, most of the punishments were administrative penalties, with few criminal punishments and even fewer civil liabilities.⁴⁵

A third line of research explores insider transactions and profitability and their relation to company traits, such as political connections and ownership concentration. Zeng and

38. China's split-share structure refers to the existence of about one-third of the non-tradable shares in China's domestically listed firms before 2005. To make all the state-owned and legal-person shares tradable, the companies or major shareholders should compensate about three shares per 10 shares to tradable shareholders. See *What Is the Split Share Reform?*, CHINA DAILY (Mar. 17, 2006), https://www.chinadaily.com.cn/bizchina/2006-03/17/content_543440.htm [<https://perma.cc/TL29-H96L>].

39. Yan Yanyang (晏艳阳) & Zhao Dawei (赵大玮), *Woguo Guquan Fenzi Gaige Zhong Neimu Jiaoyi de Shizheng Yanjiu* (我国股权分置改革中内幕交易的实证研究) [*The Empirical Study on Insider Trading in China's Split-share Reform*], 4 JINRONG YANJIU (金融研究) [J. FIN. RSCH.] 101, 106 (2006). In their study, CAR before the announcement was 10 times higher than that of the announcement, and the effect of the announcement was -4.31%.

40. Chafen Zhu & Li Wang, *Insider Trading Under Trading Ban Regulation in China's A-share Market*, 8 CHINA J. ACCT. RES. 169, 176-79 (2015).

41. *Id.* at 189-90. The relevant rule is Shangshi Gongsi Jiechu Xianshou Cunliang Gufen Zhuanrang Zhidao Yijian (上市公司解除限售存量股份转让指导意见) [Guiding Opinions on the Listed Companies' Transfer of Original Shares Released from Trading Restrictions] (promulgated by the China Secs. Regul. Comm'n, Apr. 20, 2008, effective Apr. 20, 2008), art. 5 ("The controlling shareholder of a listed company shall not transfer and release the restricted stock shares within 30 days before the announcement of the company's annual report and semi-annual report.").

42. See Menglu Zheng, *The Empirical Study on Stock Price Effect of Private Placement Announcement in China's Main Board Market*, in PROCEEDINGS OF THE 7TH INTERNATIONAL CONFERENCE ON EDUCATION, MANAGEMENT, INFORMATION AND MECHANICAL ENGINEERING 639, 643 (2017), <https://www.atlantispress.com/proceedings/emim-17/25879341> [<https://perma.cc/GY6U-X538>] (detailing the phenomenon of investors receiving abnormal returns after investing prior to a private placement announcement).

43. Zhang Fang (张舫) & Li Xiang (李想), *Dui Zhengjianhui Zhifa Qiangdu de Shizheng Fenxi* (对证监会执法强度的实证分析) [*Quantitative Analysis of CSRC Enforcement Intensity*], 38 XIANDAI FAXUE (现代法学) [MOD. L. SCI.] 173, 175 (2016).

44. Li Shouxi (李寿喜) & Tang Yuanping (汤鸞平), *Woguo Neimu Jiaoyi Anjian Teheng Yu Jianguan Quexian—Jiyu 1998 Zhi 2016 Nian Zhifa Anjian de Sikao* (我国内幕交易案件特征与监管缺陷—基于 1998 至 2016 年执法案件的思考) [*Characteristics of Insider Trading Cases and Supervision Defects in China—Reflections on Legal Cases from 1998 to 2016*], 35 SHANGHAI DAXUE XUEBAO (上海大学学报(社会科学版)) [J. SHANGHAI U. (SOC. SCI.)] 107, 118-19 (2018).

45. *Id.*

Zhang's work demonstrates that corporate insiders' net purchase ratio in China can predict a stock's future return in the medium or long term. However, this predictive ability is affected by a company's political connections and nature of ownership. The more politically connected a company is, the higher the predictive ability.⁴⁶ He and Rui studied the market reaction to insiders' transactions for companies with different ownership structures. With samples from 2007 to 2011, they found that the CAR of insider purchases was a convex function of the percentage of shares owned by the largest shareholder, and the CAR of insiders' transactions was lower when the largest shareholder was government-related.⁴⁷

In sum, the empirical evidence suggests that insider trading in China is rampant; insiders in the Chinese market can obtain significant abnormal returns; and law enforcement is rather weak. Furthermore, political connections and the degree of ownership concentration also affects behavioral patterns for insider trading. However, as most existing studies focus on the first decade of this century, an examination of newer data is needed, especially in light of the rapid changes taking place in China's securities market today.

B. Our Data and Method

1. Descriptive Data

From the first time insider trading was criminalized in July 1997 to December 31, 2019, we collected 58 criminal cases (with 68 defendants) of insider trading from China Judgments Online (Tables 2-1–2-6),⁴⁸ after removing two cases (Li Qihong and Xiao Shiqing) with incomplete information. Appendix A presents a complete case list and summary. The keywords for our data collection were *neimu jiaoyi zui* (insider trading crime), *xielu neimu xinxi* (divulging inside information), and *jianyi taren jiaoyi* (suggesting that others trade).

Table 2-1. Criminal Insider Trading Cases

	1997–2002	2003–2008	2009–2014	2015–2019	Total
Number of Cases	0	2	19	37	58

46. Qingsheng Zeng & Yaozhong Zhang, *Political Connections, Analyst Following, and the Informativeness of Insider Trading in China*, 15 CHINA ACCT. & FIN. REV. 97, 124–25 (2013).

47. Qing He & Oliver M. Rui, *Ownership Structure and Insider Trading: Evidence from China*, 134 J. BUS. ETHICS 553, 570–72 (2016).

48. "China Judgments Online is the uniform platform for the issuance of the People's Courts across the country." Zuigao Renmin Fayuan Guanyu Renmin Fayuan Zai Hulanwang Gongbu Caipan Wenshu de Guiding (最高人民法院关于人民法院在互联网公布裁判文书的规定) [Provisions of the Supreme People's Court on the Issuance of Judgments on the Internet by the People's Courts], art. 2 (2016 Revision) (promulgated by the Supreme People's Ct., Aug. 29, 2016, effective Oct. 1, 2016).

Table 2-2. Type of Defendant (determined by the primary defendant when multiple defendants were involved)

	1997– 2002	2003– 2008	2009– 2014	2015– 2019
Corporate Insider	0	2	11	22
Temporary Insider	0	0	3	9
Person Who Illegally Obtained Information	0	0	3	3
Spouse or Relative	0	0	2	3
Total Defendants	0	2	19	37

Table 2-3. Type of Information

Type of Information		Percentage
M&A and Other Major Transactions	49	74.24
Earnings and Financial Reports	3	4.55
News Regarding Business Operation	7	10.61
Large New Stock Issuance	6	9.09
Other	1	1.52
Total Number	66	100

Table 2-4. Illicit Gain (calculated for all 68 defendants)

Illicit Gain	Number of Defendants	Percentage
Less Than or Equal to RMB 1 Million	30	44.12
RMB 1–5 Million (incl. 5 million)	22	32.35
RMB 5–10 Million (incl. 10 million)	8	11.76
More Than RMB 10 Million	8	11.76
Total Number of Defendants	68	100

Table 2-5. Sentence: Term of Imprisonment

Term	Number of Defendants	Percentage
Less Than or Equal to 36 Months	37	67.27
36–60 Months (incl. 60 Months)	9	16.36
More Than 60 Months	9	16.36
Total Number of Defendants	55 ⁴⁹	100

Table 2-6. Sentence: Criminal Fines

Fine	Number of Defendants	Percentage
Less or Equal to RMB 1 Million	32	52.45
RMB 1–5 Million (incl. 5 million)	17	22.95
RMB 5–10 Million (incl. 10 million)	7	11.47
More than RMB 10 Million	5	8.19
Total number of the Defendants	61	100

49. According to Chinese court judgments, 68 insider trading defendants were on record. Table 2-6 notes fewer than 68 defendants because not all defendants received a sentence of imprisonment.

2. *Beyond Those Being Detected: The Cumulative Abnormal Returns and Event Study*

We use an event study, a widely accepted application of econometrics in financial and accounting empirical research,⁵⁰ to observe the price impact of undisclosed material information before and after its announcement. Specifically, our interest is in the price movement of the companies whose stocks were illegally traded, as shown by the 58 Chinese criminal insider trading cases. Our method is similar to the ex-post approach adopted by Professor Meulbroek,⁵¹ as opposed to more traditional event studies.

An event study investigates the difference between the expected returns (the returns presumed to be observed but for the influence of the event) and the actually observed returns. Then, if a statistically significant difference is observed, researchers may attribute this difference (i.e., the abnormal returns (AR), or when aggregated over the observation period, the cumulative abnormal returns (CAR)) to the influence of the event they are investigating—for us, that is the leakage of confidential inside information and the trades based on this information.⁵²

In the case of insider trading, significant corporate events (undisclosed material information) might lead to substantial price adjustment, and such movement is empirically observable in theory (the observable ARs). However, if and when the leakage of the information takes place and when insiders act on it (use the undisclosed information to trade), their trading will, to various extents, reduce the size of abnormal returns. To test these assumptions, we follow the same method developed by Lin and Wu,⁵³ where the CAR of stocks and their pre-announcement degree of run-up is used as a proxy of the plausible size of insider trading (direct and derivative) and thus, is a way of gauging informational leakage for that event in a specific security.

$$\text{Degree of run-ups} = \frac{CAR_{-1} - \text{Min}(CAR_{-30}, CAR_{-1})}{\text{Max}(CAR_1, CAR_0) - \text{Min}(CAR_{-30}, CAR_{-1})} (\%)$$

Here, the model applies a 30-day event-period window where $\text{Min}(CAR_{-30}, CAR_{-1})$ indicates the lowest CAR acquired in the period between day -30 and day -1 . This calculation sets the floor of CAR before the announcement day. And $\text{Max}(CAR_{t=1}, CAR_{t=0})$ indicates the larger CAR of either day 0 (announcement day) or day $+1$,⁵⁴ which represents the after-announcement of the stock price run-up. This pre-announcement degree of run-up measures the degree of influence of the material

50. See generally Ray Ball & Philip Brown, *An Empirical Evaluation of Accounting Income Numbers*, 6 J. ACCT. RSCH. 159 (1968) (exemplifying the event study framework); Eugene F. Fama, Lawrence Fisher, Michael Jensen & Richard Roll, *The Adjustment of Stock Prices to New Information*, 10 INT'L. ECON. REV. 1 (1969) (providing an example of an event study); A. Craig MacKinlay, *Event Studies in Economics and Finance*, 35 J. ECON. LIT. 13 (1997) (discussing the use of event studies in the fields of economics and finance); Sanjai Bhagat & Roberta Romano, *Event Studies and the Law: Part I: Technique and Corporate Litigation*, 4 AM. L. ECON. REV. 141 (2002) (analyzing event studies in the context of litigation); Charles J. Corrado, *Event Studies: A Methodology Review*, 51 ACCT. & FIN. 207 (2011) (explaining the methodology of event studies).

51. Lisa K. Meulbroek, *An Empirical Analysis of Illegal Insider Trading*, 47 J. FINANCE 1661, 1665 (1992).

52. Chien-Chung Lin & Huan-Ting Wu, *How to Test an Insider Trading Law and Its Effectiveness: Price Movements and Comparative Empirical Data from Taiwan*, 57 INT'L REV. L. & ECON. 22, 34–35 (2019).

53. *Id.* at 35–36.

54. *Id.*

information incorporated into the stock price *in advance of* announcement day.⁵⁵

To summarize, our method worked as follows. We first searched records from the criminal court system to collect all criminal insider trading cases from 1997 to 2019 in China. Then we identified each event of material information and its announcement day and decided on the event period (30 days before and after the announcement day) to observe the price movement and CAR of each security in each event. Finally, by calculating the pre-announcement degree of run-up based on CAR, we estimated corporate information leaks in China—in detected and confirmed criminal cases—in aggregate.

3. Sample

The sample originally contained 66 corporate information events (material public disclosure or announcement) for the 58 insider trading criminal cases from 1997 to 2019 (in several cases, defendants identified by the court profited from multiple informational events).⁵⁶ However, this sample size decreased for a few reasons.

First, we excluded four events for which stock price information was not complete in the market database.⁵⁷ Second, a distinct phenomenon in the Chinese securities market—the trade halt system when a major corporate event is pending—disrupted the continuity of price movement and made some observations troublingly fragmented. For this reason, we excluded 24 events where the trade halt was substantially long or occurred before announcement day.⁵⁸ Third, we excluded events where stock returns (in the form of CAR) moved in the opposite direction both before the announcement and afterward. That is, the stock price dropped when good news was announced, or rose when bad news was announced. These events (10 in total) cannot be explained by modern finance theory or the

55. See, e.g., Arthur J. Keown & John M. Pinkerton, *Merger Announcements and Insider Trading Activity: An Empirical Investigation*, 36 J. FINANCE 855, 866 (1981) (discussing market influences prior to the announcement day); Meulbroek, *supra* note 51, at 1675, 1696 (defining and discussing the run-up period); Zhenyang Tang & Xiaowei Xu, *What Causes the Target Stock Price Run-Up Prior to M&A Announcements?*, 16 J. FINANCE 106, 109 (2016) (providing data on the run-up period).

56. See *supra* Part III.B.1.

57. We used the Taiwan Economic Journal, a financial database focusing on Asian financial markets including Taiwan, China, Hong Kong, Singapore, Korea, the Philippines, Thailand, Malaysia, and Japan. It is widely used in similar quantitative research. For more detail, see TAIWAN ECON. J., <https://www.finasia.biz/> [<https://perma.cc/KB49-RMGY>]. The lack of historical price is mainly due to the removal of a company's information when they were delisted or no longer existed.

58. If a trade halt lasted longer than one week before the announcement day, we disqualified it from the observation. Twenty-four events were eliminated due to trade halts. See Appendix D.

literature, so we excluded them to prevent an offsetting effect for the remainder of our sample.⁵⁹ Lastly, three additional events were excluded to avoid double counting.⁶⁰

Our final sample includes 25 events (described in Tables 3 and 4). For more details regarding the disposition of each criminal transaction and information regarding the observed events, see Appendixes B and C.

Table 3. The Final Sample and Excluded Events

All events: 66			
Excluded events: 41		Final sample: 25	
Data N/A	4	Clean	6
Excluded due to long trade halts (Appendix D)	24	Events with insubstantial trade halts (Appendix C)	19
Reverse price movement	10		
Duplicate calculation	3		

Table 4. Final Sample (by Market)

Market	Number
SSE (Shanghai Stock Exchange)	5
SZSE-Main (Shenzhen Main Board)	11
SZSE-SME (Shenzhen Small and Medium Enterprise Board)	9
Total	25

59. We limited our sample to insider trading cases where the price movement went in the expected direction. This is an important design decision when running an event study because, if we had observed the mixed effect of both good and bad news across all the cases (including situations where the stock price fell after good news or surged after bad), the news with a negative effect on stock prices would have offset the news with a positive effect. As a result, the degree of pre-announcement run-up could not have been accurately estimated. See Lin & Wu, *supra* note 52, at 27–28.

To point out the problem of an offsetting effect, we tested our comparison M&A group. See *infra* Part III.D, App. E. When we observed the aggregate effect for the M&A sample without excluding news with a negative effect in a sample of 321 events, the average CAR on day 0, the announcement date, was 2.04%. This number is consistent with Zhang and Zhu's 2003 paper, in which the average CAR on day 0 for the 1172 events (from 1993 to 2002) was 2.5%. However, this number conflicts with our normal understanding of the effect of M&A because the returns are economically insignificant. In contrast, if we remove the cases with a negative effect on stock prices from the comparison group, the average CAR rises to 8.84% on day 0. This approach lets us observe the events without the offsetting effect. See App. E for a comparison of the two approaches. For more discussion on this point, see, for example, Meulbroek, *supra* note 51, at 1676.

60. The possible duplicate calculation arises from situations where (1) the same impending material information gives rise to multiple criminal cases: Security code 002238 (announcement date: 20120611, leading to case No. 23 on 20120207, 17, 27–28, and case No. 26 on 20120119); Security code 600562 (announcement date of the pending information: 20090420, leading to case No. 7 on 20090401, 07, 13–15, and case No. 10 on 20090402), and (2) two announcements surrounding the same corporate action within a short period: Security code 002617 (announcement dates: 20130422 and 20130425). We removed all three duplicate events to prevent double counting.

C. Result: Cumulative Abnormal Returns and Pre-Announcement Run-ups

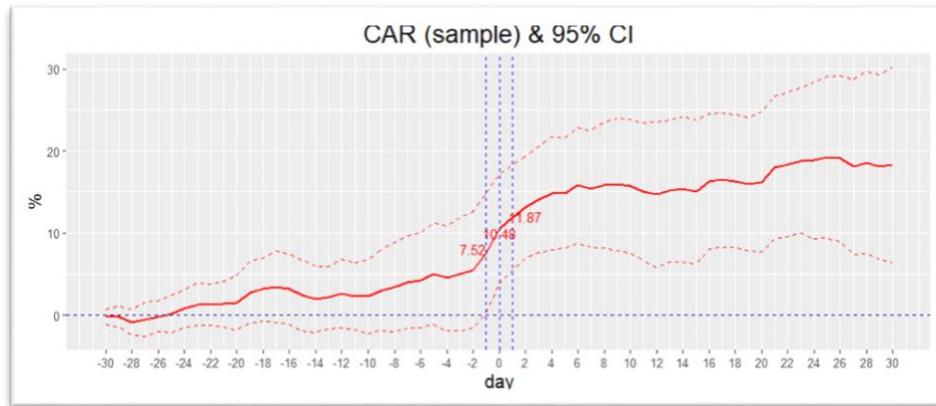
Table 5. CAR Observation

Day	CAR	p-value	t-value	Significance (Student t- test)	Adjusted significance (SQ test)
-30	-0.223	0.687	-0.493		
---	---	---	---	---	---
-10	2.225	0.156	1.034		
-9	2.989	0.110	1.258		*
-8	3.418	0.103	1.302		*
-7	4.015	0.076	1.478	*	*
-6	4.249	0.073	1.504	*	*
-5	5.040	0.051	1.703	*	**
-4	4.480	0.081	1.441	*	*
-3	4.948	0.076	1.478	*	**
-2	5.451	0.062	1.592	*	**
-1	7.519	0.023	2.113	**	**
0	10.481	0.002	3.241	***	***
1	11.874	0.000	3.789	***	***
2	13.112	0.000	4.336	***	***
3	14.042	0.000	4.469	***	***
4	14.769	0.000	4.418	***	***
5	14.873	0.000	4.594	***	***
---	---	---	---	---	***
30	18.276	0.002	3.154	***	***

NOTE: The 25 events in our final sample all involve trading on positive news. Accordingly, we conducted a one-sided t-test. In addition, we are aware of the non-normality problem given our small sample size. Therefore, we also tested the statistical significance of our result by the SQ test developed by Gelbach, Helland, and Klick.⁶¹ The adjusted critical value at the 90%, 95%, and 99% quantiles according to the SQ test is, respectively, 2.92%, 4.53%, and 8.56%. And *** denotes significance at the 99% confidence level; ** denotes significance at the 95% confidence level; and * denotes significance at the 90% confidence level.

⁶¹ See Gelbach et al., *infra* note 62.

Figure 2. Average CAR and Confidence Interval of the Sample



In Figure 2, the sign of pre-announcement price run-up, where the average CAR increases stably before announcement day, from day -25 to day -1 (from around 0% to 7.52%), is clear. Given the sample size limitation, the CARs are not statistically significant until day -7, according to the Student t-test. To address this issue, we again adopted the SQ test developed by Gelbach, Helland, and Klick⁶² and matched the critical values produced by the SQ test to our sample. As shown in Table 5, the CARs after the adjustment become statistically significant starting on day -9.

The average CAR goes up to around 11.87% one day after announcement day. This shows that, without considering the effect of the remaining insubstantial trade halts, there is a 65.8% $\left(\frac{7.52\% - (-0.85\%)}{11.87\% - (-0.85\%)}\right)$ pre-announcement run-up in stock prices (i.e., the degree of run-up) before announcement day. Considering the effect of trade halts (see Appendix C for details), we also expanded the observation window to day +5, where CAR rises to around 14.87% and stays steadily around that level for a substantial period. This day +5 approach gives rise to a 53.2% $\left(\frac{7.52\% - (-0.85\%)}{14.87\% - (-0.85\%)}\right)$ adjusted degree of pre-announcement run-up.

These numbers show that, on average, more than half of the value of information is incorporated into stock prices before announcement day (or slightly more than 50% when the window at day +5 is counted to allow the market to absorb the information more fully).

D. Comparison Group: M&A Events in China from 2007 to 2017 and the Puzzle the Results Create

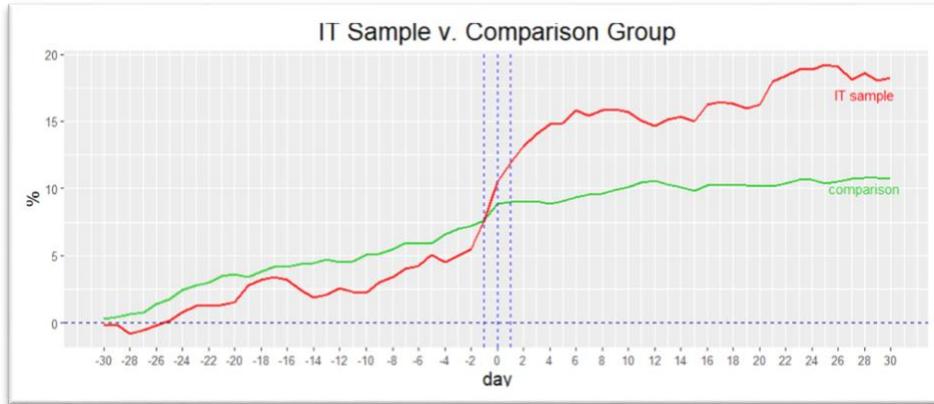
To put pre-announcement abnormal return and law enforcement in context, as well as to address the problem of potential selection bias,⁶³ we established another sample for the purpose of comparison. We hypothesize that law enforcement is driven by the degree of abnormal return, which means that an investigation is triggered when abnormal return is

62. See generally Jonah B. Gelbach, Eric Helland & Jonathan Klick, *Valid Inference in Single-Firm, Single-Event Studies*, 15 AM. L. & ECON. REV. 495 (2013).

63. Uptal Bhattacharya & Hazem Daouk, *The World Price of Insider Trading*, 57 J. FINANCE 75, 76-77 (2002).

comparatively high and spotted. We thus compiled a comparison group of randomly chosen stocks (initially 330 and finally 176, after applying the same selection criteria we applied to the first sample) that experienced major M&A events between 2007 and 2017 in China.⁶⁴ We chose M&A as the target of observation because it is the typical event that triggers substantial price movement and is a common cause of insider trading.⁶⁵

Figure 3. Average CAR of Insider Trading Cases v. Comparison Group



NOTE: The numbers in detail can be found in Appendix F.

As displayed in Appendix F and the green line of Figure 3, the degree of run-ups for the comparison group is surprisingly 83.9% $\left(\frac{7.58\% - (-0.26\%)}{8.98\% - (-0.26\%)}\right)$ before announcement day. When we expand the observation window to day +5, allowing more time for the information to be acted on, the adjusted degree of run-ups becomes 83.1% $\left(\frac{7.58\% - (-0.26\%)}{9.06\% - (-0.26\%)}\right)$.

Table 6. Pre-announcement Run-ups: Insider Trading Group v. Comparison Group

	Min [CAR ₋₃₀ , CAR ₋₁]	CAR ₋₁	CAR ₁	CAR ₅	Degree of run-ups	
					Day +1	Day +5
Insider trading group	-0.85%	7.52%	11.87%	14.87%	65.8%	53.2%

64. The comparison group included stocks being traded on the Shanghai Stock Exchange, Shenzhen Main Board, and Shenzhen Small and Medium Enterprise Board. We observed the pre-announcement stock price movement of the targets in the M&A events where the deal price exceeded RMB 100 million yuan. We excluded transactions between affiliated companies under the umbrella of the same enterprise group. After applying our screening conditions, we had a sample of 1,182 events. We then randomly selected 30 events for each year (330 in total for the time span from 2007 to 2017) to make up the sample. After we adopted the same research method described in Part III.B, the final sample size of the comparison group was 176.

65. For similar application, *see, e.g.*, Keown & Pinkerton, *supra* note 55 (analyzing merger events); Bradford Cornell & Erik R. Sirri, *The Reaction of Investors and Stock Prices to Insider Trading*, 47 J. FIN. 1031 (1992) (discussing the circumstances surrounding an acquisition); Meulbroek, *supra* note 51 (examining M&A events and other events).

Comparison group	0.26%	7.58%	8.98%	9.06%	83.9%	83.1%
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Table 6 compares the degree of run-ups between the insider trading group and the comparison group. We can see that at first, given the much larger size of the comparison group, the average CAR does not vary much between day +1 and day +5. Second, an interesting and more important observation is a puzzle that emerges. The degree of run-ups (i.e., informational leakage to the market, a proxy of insider trading), contrary to what we had expected, is surprisingly lower in the insider trading group. According to this result, we assume there might be reasons—other than the extent of pre-announcement information leakage—that affect insider trading law enforcement in China. This misalignment between enforcement and informational leakage, at minimum, indicates a systemic insufficiency in securities law enforcement in China.

Third, we noticed that the after-announcement CAR of the insider trading group is higher than that of the comparison group in absolute terms (11.87% vs. 8.98%). To determine whether there is a systemic difference in the two samples, and given that the sample size is small and any outlier may cause large variance in the sample mean, we rechecked our insider trading sample after excluding the highest outlier from the sample.⁶⁶ That exclusion gave rise to the alternative results in Table 7.

Table 7. Run-ups: Insider Trading Cases Excluding the Highest Outlier v. Comparison Group

	Min [CAR ₋₃₀ , CAR ₋₁]	CAR ₋₁	CAR ₁	CAR ₅	Degree of run-ups	
					Day +1	Day +5
Insider trading cases (w/o the highest outlier)	-0.85%	5.18%	8.28%	12.85%	66.0%	44.0%
Comparison group	0.26%	7.58%	8.98%	9.06%	83.9%	83.1%

When the highest outlier was excluded, CAR in the insider trading sample decreased and came closer to the comparison group on day +1 after the announcement. But even after excluding the outlier, the degree of pre-announcement run-up is still substantially lower in the insider trading sample. This suggests there are reasons other than the degree of informational asymmetry/leakage leading to an indictment for violating insider trading law in China. However, we have no clear explanation to offer for this securities law enforcement anomaly.

IV. CASE STUDY AND REFLECTIONS

66. *Infra* App. A, Case No. 6 (Security code 600193).

To complement our quantitative analysis, we selected notable insider trading criminal cases—ones that are well documented and that attracted widespread public notice—to provide a qualitative characterization of insider trading in China.

A. *Qualitative Analysis of Notable Cases*

Three main types of defendants went to court for insider trading criminal charges in China: government officials, corporate insiders (directors and senior managers), and broker-dealers. We profile illustrative cases for each type.

1. *Nantong People's Procuratorate of Jiangsu Province v. Liu Baochun*⁶⁷

Liu Baochun was the former chairman of an economic commission in China's principal municipality, Nanjing. In February 2009, Guorui Group, a subsidiary of China Electronics Technology Group Corporation (CETGC, an enterprise owned by China's central government), initiated a "backdoor" listing (an equivalent to a reverse merger) to go public. A company listed on the Shanghai Stock Exchange, Gaochun Ceramic Co. (located in Nanjing), was selected by CETGC as a shell company. Given that the Gaochun County government (under the Nanjing government) was the biggest shareholder of the Gaochun Ceramic Co., Liu was appointed a governmental coordinator for the acquirer and the target. In the next two months, Liu arranged a deal where the Gaochun County government would transfer all its shares in Gaochun Ceramic Co. to Guorui Group. During that time, Liu learned when the share transfer would take place and then conspired with his wife to profit from this information.

Working for Nanjing Securities Co. Ltd., Liu's wife took this inside information from her husband and used multiple accounts to buy 614,022 shares of Gaochun Ceramic Co. before trading was suspended on April 21 of the same year. The court later learned that Liu and his wife had illegally gained RMB 7,499,479 yuan from insider trading. Liu was sentenced to five years of imprisonment and a penalty of RMB 7,500,000 yuan.

2. *Chengde People's Procuratorate of Hebei Province v. Liu Zhiqiang*⁶⁸

Liu Zhiqiang was the former general manager of the investment department of Northeast Securities Co. Ltd., a securities firm mainly operating in Jilin Province, China. In 2006, Northeast Securities planned a reverse merger with Jinzhou Liulu Co., a company listed on the Shanghai Stock Exchange. Liu was in the interim reorganization group for Northeast Securities and learned details of the merger, including the compensation terms between the non-tradable and the transferable shareholders of Jinzhou Liulu Co. Between October 18 and 28, 2006, Liu took advantage of this non-public information to buy

67. Jiangsu Sheng Nantong Shi Renmin Jianchayuan Su Liu Baochun (江苏省南通市人民检察院诉刘宝春) [Nantong People's Procuratorate of Jiangsu Province v. Liu Baochun] (Jiangsu Province Nantong Intermediate People's Ct., Dec. 20, 2010).

68. Hebei Sheng Chengde Shi Renmin Jianchayuan Su Liu Zhiqiang (河北省承德市人民检察院诉刘志强) [Chengde People's Procuratorate of Hebei Province v. Liu Zhiqiang] (Hebei Province Chengde Intermediate People's Ct., July 18, 2016).

7,449,045 shares of Jilin Yatai (Group) Co. Ltd., the controlling shareholder of Northeast Securities.

The Chengde intermediate court affirmed the district court's opinion and found that the unlawful gain of Liu's insider trading amounted to RMB 61,702,911 yuan. The court sentenced Liu to five years in prison and issued a fine of RMB 20,000,000 yuan. Because multiple defendants were tried in this case, Liu's cooperation and testimony against the other defendants led to a more lenient sentence.

3. *Taiyuan People's Procuratorate of Shanxi Province v. Zhou Haijun*⁶⁹

The third type of defendant, a frequent one in insider trading cases in China, is brokers and dealers who engage in what is sometimes called "rat trading." Before being arrested, Zhou Haijun was an investment manager of Shanghai Yingpu Investment. Qin Xuan (not indicted in the criminal proceedings) worked for Northeast Securities as the vice general manager of the Shenzhen Market Department in Beijing. Qin, on Northeast Securities' behalf, provided investment bank services to PKU International Healthcare Group Southwest Synthetic Pharmaceutical Co. Ltd. (Southwest Synthetic Pharmaceuticals), an indirect subsidiary of Peking University. Zhou and Qin had been work friends since 2007 and remained in contact.

In 2010, Qin learned of Southwest Synthetic Pharmaceuticals' plan to acquire all shares of Beijing Beiyi Medicine with a merger to follow. Meanwhile, Zhou noticed that Qin took several business trips to Chongqing, the headquarters of Southwest Synthetic Pharmaceuticals. Based on his professional intuition, Zhou started looking into whether Qin was working on a project related to Southwest Synthetic Pharmaceuticals. To confirm his hunch, Zhou sent a publicly available research report to Qin and asked for her comment.⁷⁰ Qin eventually confirmed the accuracy of the report one day before Southwest Synthetic Pharmaceuticals' stock was prohibited from trading. With that information, Zhou used the accounts he managed on behalf of his clients to buy 5,969,179 shares of Southwest Synthetic Pharmaceuticals and later sold all of the shares on the first day that trading resumed. The Taiyuan Court ruled that Zhou Haijun had committed the crime of insider trading, and the illegal gains of Shanghai Yangpu Investment Co. were RMB 8,172,061 yuan. Zhou received a three-year prison sentence with a suspension for three years, and the court confiscated the illicit gain.

69. Shanxi Sheng Taiyuan Shi Renmin Jianchayuan Su Zhou Haijun (山西省太原市人民检察院诉周海军) [Taiyuan People's Procuratorate of Shanxi Province v. Zhou Haijun] (Shanxi Province Taiyuan Intermediate People's Ct., Aug. 2, 2017).

70. The research report was published by Essence Securities Co. Ltd., which suggested Beijing Beiyi Medicine would be one of the potential target companies for the reorganization of Southwest Synthetic Pharmaceuticals. See Hong Lu, *Xinan Hecheng: Qidai Yiyuan Gaige Guangkuo Qianjing, Dazao Yiyao Zichan Zhenghe Pingtai* [Southwest Synthetic Pharmaceuticals: Looking Forward to the Prospect of Hospital Reform, Establishing the Integration Platform for Medical Capital], XINLANG CAIJING [SINA FINANCE], (Mar. 18, 2010), http://stock.finance.sina.com.cn/stock/go.php/vReport_Show/kind/search/rptid/322211410000/index.phtml.

4. *The Second Branch of Beijing People's Procuratorate v. Huang Guangyu*⁷¹

The case of Huang Guangyu is probably the most cited case brought to trial since the inception of insider trading law in China. As a controller of a company listed on the Shenzhen Stock Exchange and a household name in China, Huang's serial financial criminal activities—including insider trading, bribery, and money laundering—netted him RMB 396.2 million yuan in total.⁷²

Huang Guangyu was the chairman and controlling shareholder of Gome Electrical Appliances Holding (Gome), China's most successful electrical appliance retailer at the time. His decision to list Gome on the Hong Kong Stock Exchange through a reverse merger and make his company public in 2004 paved the way for his business success. When he became the richest man in China, Huang decided to do the same trick again for his real estate investment in 2006—leading to his eventual downfall.

Huang's plan was simple: find a suitable public company as the shell company, acquire shares in a shell company for cheap, and start a reverse merger to become a public company. As shown in Figure 4, to publicly list his real estate company, Huang chose Beijing Centergate Technologies Co., a Shenzhen-listed company (hereinafter Beijing Centergate), as the target shell company. In July 2006, Huang used his investment arm, Beijing Pengtai Investment Co. (hereinafter Pengtai Investment), to acquire 27.51% of the shares of Beijing Centergate from its prior controlling shareholder, Beijing Zhuzong Group Co. Along with shares he previously had, this made Pengtai Investment a 29.58% shareholder of Beijing Centergate and a de facto controller.⁷³ On May 4, 2008, Beijing Centergate announced a plan to merge with Huang Guangyu's Beijing Pengrun Property Development Holding Co. Ltd.⁷⁴ Noticeably, every acquisition and announcement occasioned substantial market price movement for all related companies, including Gome and other companies in the group or target companies. Therefore, observers started to scrutinize these transactions and criticize the suspicious timing of the acquisitions and announcements. At the same time, Huang's controversial style—marked by aggressive business maneuvers, the bribing of government officials, and a gambling binge in Macau—caught the public's attention and later led to a government inquiry. Owing to rising public pressure and criticism, Beijing Centergate aborted its reverse merger three months after announcing it. Huang was subsequently accused of insider trading and stock manipulation in his transactions.⁷⁵

71. Beijing Shi Renmin Jianchayuan Su Huang Guangyu (北京市人民检察院第二分院诉黄光裕) [The Second Branch of Beijing People's Procuratorate v. Huang Guangyu] (Beijing Second Intermediate People's Ct., May 18, 2010).

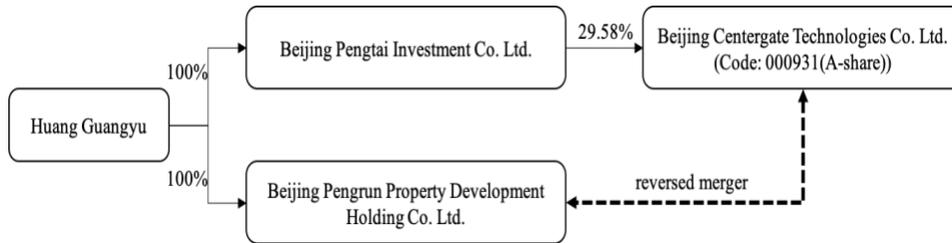
72. The other financial crimes that Huang Guangyu was charged with include market manipulation, tunneling company assets, and "the crime of illegal business dealing (Article 225 of China's Criminal Code)." *See id.*

73. *144 Million Yiyuan Konggu Zhongguancun Huang Guangyu's 48 Hour Break Out to Earn 1 Billion Yuan*, SINA FIN. (July 28, 2006, 4:55 PM), **Error! Hyperlink reference not valid.**<http://finance.sina.com.cn/stock/s/20060728/04552771284> [https://perma.cc/2KRV-M446].

74. Greg Tzu Jan Yang, *Insider Trading in China: Compared with Cases in the United States*, 209 MD. CONTEMP. ASIAN STUD. 1, 1, 10 (2012), <https://digitalcommons.law.umaryland.edu/mscas/vol2012/iss2/1> [https://perma.cc/W9U8-PN6G].

75. *Id.*

Figure 4. Huang Guangyu's Investment Structure in Pengtai Investment



The court identified two insider trading incidents. First, as the controller and director of Beijing Centergate, Huang had arranged an asset swap between Beijing Centergate and Beijing Eagle. With this information pending, Huang purchased over 9.76 million shares of Beijing Centergate for a total of more than RMB 93.1 million yuan from April 27, 2007, through June 27, 2007. When the relevant news became public on June 28, 2007, Huang's accounts stood at more than RMB 3.48 million yuan in profit.⁷⁶

The second incident of insider dealing happened from July or August 2007 to May 7, 2008. For a contemplated 100% equity acquisition by Beijing Centergate of Beijing Pengrun and related restructuring, Huang used accounts opened in the names of Cao Chujian, Lin Jiafeng, and another 77 individuals to buy over 104 million Beijing Centergate shares for a total price of more than RMB 1.322 billion yuan. When the relevant public announcement was made on May 7, 2008, the book earnings of the 79 securities accounts stood at more than RMB 306 million yuan.⁷⁷

On May 18, 2010, the Beijing Second Intermediate Court sentenced Huang to nine years in prison for insider trading and ordered that he pay a fine of RMB 600 million yuan.⁷⁸ The Beijing High People's Court affirmed the ruling upon Huang Guangyu's appeal.⁷⁹

5. *Wuxi People's Procuratorate of Jiangsu Province v. Du Lanku*

The case of Du Lanku involved a high-ranking official of a state-owned enterprise. The case received much attention because the defendant was a member of the Chinese Communist Party, and its timing coincided with a much-publicized CSRC campaign against party corruption.⁸⁰

76. See Beijing Shi Renmin Jianchayuan Su Huang Guangyu (北京市人民检察院第二分院诉黄光裕) [The Second Branch of Beijing People's Procuratorate v. Huang Guangyu] (Beijing Second Intermediate People's Ct. May 18, 2010) (establishing the value of Huang's accounts).

77. See *id.* (detailing the securities accounts).

78. Because he was convicted of other offenses, including bribery and money laundering, Huang received a consolidated jail term of 14 years with fines of RMB 600 million yuan and the confiscation of personal property valued at RMB 200 million yuan. *Id.*

79. *Huang Guangyu Final Trial Upheld the Original Verdict*, SINA (Aug. 31, 2010, 3:52 PM), https://news-sina-com-cn.translate.google.com/2010-08-31/035218042759s.shtml?_x_tr_sl=zh-CN&_x_tr_tl=en&_x_tr_hl=en&_x_tr_pto=sc [https://perma.cc/J52T-T6G7].

80. 1 HU BIN, CHINA'S FINANCIAL SUPERVISION AND REGULATION: A REPORT 77 (2012). On December 27, 2011, the Ministry of Supervision, the Ministry of Public Security, and the CSRC held a news conference to announce four typical cases of insider trading, in which four government officials were under investigation: Xiao

The China Electronics Technology Group Corporation (CETC) is a state-owned enterprise controlled by the State-owned Assets Supervision and Administration Commission of the State Council (SASAC). Du Lanku was the former chief accountant of CETC. To finance its subsidiary business entity—the 14th Institute of CETC (14th Institute)—CETC began its search in January 2009 for a potential shell company to gain quick access to a public capital market. Jiangsu Gaochun Ceramics Co. Ltd. (Gaochun Ceramic), a state-owned enterprise controlled by the Gaochun County government of the city of Nanjing and listed on the Shanghai Stock Exchange, was chosen as the shell company.⁸¹

On April 19, 2009, coordinated by the Nanjing government and CETC, the 14th Institute secretly signed an agreement with Gaochun Ceramic in which the 14th Institute would purchase 27.33% of the shares in Gaochun Ceramic from the Gaochun County government with cash.⁸² After the purchase, the 14th Institute would be the de facto controller of Gaochun Ceramic. On May 22, 2009, Gaochun Ceramic announced its reverse merger plan, stating that “after the reorganization, Gaochun Ceramic will [be renamed] Glarun Technology Co., Ltd., and transform[ed] into a high-tech company.”⁸³

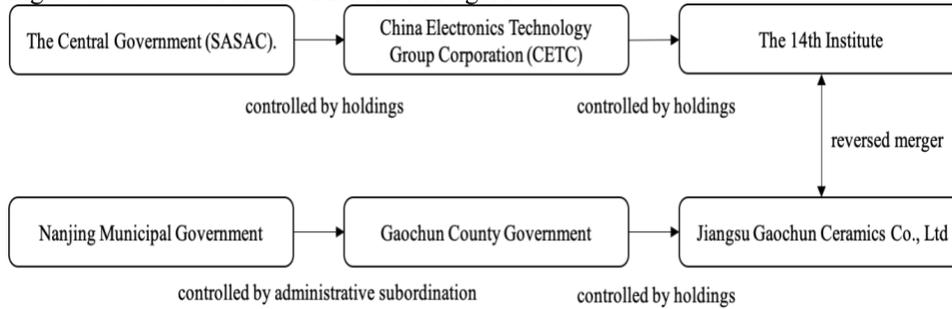
Shiqing, Li Qihong, Du Lanku, and Liu Baochun. Xiao Shiqing was the former secretary of the party committee and director-general of China Galaxy Securities, who had obtained illegal gains of RMB 104 million yuan through insider trading; Li Qihong was the former mayor of Zhongshan City, Guangdong Province, who had obtained illegal gains of RMB 4.21 million yuan and helped her relatives obtain illegal gains of RMB 12.02 million yuan. Liu Baochun was the former director of the Economic Commission of the Nanjing government who obtained illegal gains of RMB 7.5 million yuan through insider trading.

81. Before China’s Securities Law was amended on December 27, 2019, most initial public offerings in China were tightly controlled by regulators who determined which companies could list. These determinations were time-consuming and unpredictable, even for state-owned enterprises. Another option is a backdoor listing, also known as a reverse merger, reverse acquisition, or, in Chinese, *jieke shangshi*, which literally means a company borrows a “shell” to go public. Instead of going through an initial public offering, a company just buys a public company that’s already done all the hard work. It can then merge with this shell company, give it a new name, and raise capital on the stock market. See Tang Ziyi & Ke Baili, *Caixin Explains: Why the Back Door to China’s Stock Markets Is So Attractive*, CAIXIN FIN. (Jan. 17, 2019, 7:44 PM), <https://www.caixinglobal.com/2019-01-17/caixin-explains-why-the-back-door-to-chinas-stock-markets-is-so-attractive-101371176.html> [<https://perma.cc/Y8WJ-THDQ>] (explaining the “back door” option to go public).

82. See Jiangsu Sheng Wuxi Shi Renmin Jianchayuan Su Du Lanku (江苏省无锡市人民检察院诉杜兰库) [*Wuxi People’s Procuratorate of Jiangsu Province v. Du Lanku*] (Wuxi Interim. People’s Ct., Jiangsu Province, Dec. 19, 2011). See Dou Zhendong, *Identification of Inside Information, Persons Who Knows Insides Information, and Persons Illegally Obtaining Inside Information, and Recognition of Relevant Legal Issues*, (Oct. 3, 2019), https://www.drxf.com.translate.google.com/xf/anli.asp?bh=1873&_x_tr_sch=http&_x_tr_sl=zh-CN&_x_tr_tl=en&_x_tr_hl=en&_x_tr_pto=sc [<https://perma.cc/E5ZZ-AGFK>].

83. See Su Jiang, *Shisuo Jieke Gaochun Taoci: Zhongguo Diankexi Ziben Bantu Zai Kuozhang* (14所借壳高淳陶瓷: 中国电科系资本版图再扩张) [*The 14th Institute Borrowing Shell from Gaochun Ceramic: the Territory of China’s Electric Science Series Enlarges Again*], SINA FIN. (May 23, 2009), <http://finance.sina.com.cn/stock/s/20090523/02056263405.shtml> [<https://perma.cc/9SAR-PX9Q>] (stating after reorganization, the major business scope of Gaochun Ceramic would be switched from ceramic manufacture to information technology).

Figure 5. Gaochun Ceramic's Reverse Merger Plan



As the decision of the Wuxi Intermediate People's Court revealed, on March 23, 2009, Du Lanku accompanied the supervisors of CETC (appointed by the State Council) to a meeting of the 14th Institute. That night, Luo Qun and Bao Weiping (chief director and vice general economist of the 14th Institute, respectively) briefed Du on some details of the transaction, including the target company's conditions of capital and ownership structure and the local government's willingness to support the merger, but they did not reveal the name of the target company.⁸⁴

On March 29, 2009, after Du Lanku was back in Beijing, he used the information he learned from Luo and Bao to identify the one and only available target company through online research. Two days later, when attending a ceremony at the 14th Institute, Du confirmed that the target company was located in the Nanjing area. On the next day, Du divulged this information to his wife, Liu Naihua. From April 2 to April 20, Du Lanku purchased 223,000 shares of Gaochun Ceramic with his personal account. In addition, Du and Liu Naihua, his wife, jointly purchased 137,100 shares of Gaochun Ceramic with his wife's account. When the relevant public announcement was disclosed on April 20, 2009, the book earnings of their securities accounts stood at more than 4.21 million yuan.⁸⁵

In May 2010, the Wuxi Intermediate Court sentenced Du Lanku to a term of six years and ordered a fine of Renminbi 4.25 million yuan. His wife, Liu Naihua, was sentenced to a term of three years and fined the same amount.

6. Questions Remained

The cases discussed above are typical of our surveyed cases. Overall, insider trading cases in China are similar to those in many other countries. They involve largely opportunistic misuse of corporate information by managers, controlling shareholders, or government officials. However, the number of cases detected and the size of illicit gains are somewhat smaller than we expected to find. Presumably, as comparative law teaches us, similarity in the nature and pattern of violation does not equate to a similarity in law enforcement. This is especially true in light of the size of the Chinese securities market and

84. Jiangsu Sheng Wuxi Shi Renmin Jianchayuan Su Du Lanku (江苏省无锡市人民检察院诉杜兰库) [*Wuxi People's Procuratorate of Jiangsu Province v. Du Lanku*] (Intermediate People's Ct. of Wuxi Mun., Jiangsu Province, Dec. 19, 2011), <http://gongbao.court.gov.cn/Details/f285c2d07d098b89a3afe4ee9936ce.html> [<https://perma.cc/N8WH-6GJE>].

85. *Id.*

other institutional/cultural idiosyncrasies. The low level of criminal enforcement, if that assessment is right, may have multiple reasons behind it.

B. Reflections: Empirical Research and Its Limitations, Methodology of Comparison, and Implications of the Contradicting Data

1. Limitations of Traditional Approach and Quantitative Approach

Researchers in comparative law inevitably face questions that challenge the validity of their method. Comparison of rules, events, or results may be accused of ignoring deeper historical or structural complexity. The choice of an observation target or point also faces questions of selection criteria or interpretation error. To counter some of these criticisms, it is necessary to delve into the quantitative data. The basic idea is that by offering a quantitative observation, to mitigate or even overcome the idiosyncrasies in law and cases, which might be, to various extents, based on varying facts or subject to doubtful enforcement consideration.

However, the quantitative method—designed to utilize the law of large numbers to average out misleading trivial differences and amplify the common features in a larger picture—faces severe challenges due to the nature of the data in this research. First, all observers assume that there is a certain number of insider trading across the market, but we can only observe those instances that were being indicted and recorded in court documents. The limited number of criminal cases, however, entails problems for its explanatory power as only 58 criminal insider trading cases were available from 1997 to 2019. Second, the pervasiveness of trade halts in the Chinese securities market undermines the continuity of market prices and complicates the analysis of the price movement for both pre-announcement and post-announcement periods. The trade halt was originally designed to avoid information leakage as well as minimize price fluctuation. However, its use in the Chinese market is subject to uncertain criteria and often overused.⁸⁶ As a result, our data is disturbed by numerous halts.⁸⁷ Similarly, we are unable to conclude whether those trade halts help achieve their designed goals.⁸⁸

86. See Xie Yu, *MSCI Warns Against Prolonged Trading Suspensions of Mainland Chinese A-shares*, S. CHINA MORNING POST (July 31, 2017, 1:12 PM), <https://www.scmp.com/business/banking-finance/article/2104726/msci-warns-against-prolonged-trading-suspensions-mainland> [https://perma.cc/L2QN-GG4P] (indicating the trade halts creates problems for large investors in China based on the announcement by Morgan Stanley Capital International's decision of removing from its widely tracked Emerging Market Index (EMI) any mainland Chinese A-shares that are suspended from trading for more than 50 days).

87. See *infra* App. D.

88. On Nov. 6, 2018, the CSRC issued another "Guidance" to prohibit Chinese companies from suspending too long, following detailed trading rules specified by the Shanghai and Shenzhen Stock Exchanges. In the light of the new rules announced by the Shanghai and Shenzhen Stock Exchange, the suspension period for a major asset restructuring was shortened from six months to 10 days, and the shares of the companies whose major asset restructuring does not involve the issuance of new shares cannot be suspended. See Zhang Yu & Timmy Shen, *China Stock Markets Tighten Rules on When Share Trading Can Be Suspended*, CAIXIN GLOB. (Dec. 29, 2018, 5:09 PM), <https://www.caixinglobal.com/2018-12-29/china-stock-markets-tighten-rules-on-when-share-trading-can-be-suspended-101364970.html> [https://perma.cc/SQ33-W2F7].

2. *Methodology Enhanced: Multi-Layer Comparison*

Having these difficulties in mind, we conceive several additional comparisons to reinforce our traditional observation as well as quantitative analysis. First, to counter the potential negative impact of a small sample set, we created a comparison group comprising 330 M&A events randomly, which is intended to represent the whole Chinese market and to see if enforcement bias exists in our main sample.

Second, we believe Chinese enforcement data—insider trading criminal cases—can make more sense when compared with U.S. data. By this comparison, the difference in market structure, enforcement capacity, or the sincerity of the will or need to enforce rules can be inferred, given the similar substantive law between the two countries. Third, we also compared criminal enforcement data with administrative enforcement data that two of the authors collected in another article. The purpose is to estimate whether the low criminal enforcement data, if true, can possibly be attributed to a heavier reliance on the administrative proceeding.⁸⁹

With this multi-layer comparison approach and analysis, we hope to approximate the real causes, or at least provide a more plausible reading, of the phenomenon of insider trading in China.

3. *Summary of Observations and Takeaways*

Based on the quantitative and qualitative data analyzed, the following observations can be made about Chinese insider trading in the 21st century:

(a) In absolute numbers, there are between two and three Chinese criminal insider trading cases annually (on average, from 1997 to 2019). This is low but not extremely low when compared with the U.S. (averaging about 15.6 cases per year from 2009 to 2013), especially considering the differences in market size and enforcement sophistication.⁹⁰ Additionally, the behaviors of defendants in China's cases are similar to what has been reported in other countries. But when the strength of supplementary mechanisms such as investor maturity, market discipline, and reputation are added into calculation, we conclude that Chinese enforcement of insider trading law, by means of criminal sanction, is neither strong nor adequate. This holds institutionally as well as in the retail sphere.

(b) However, a more comforting view comes from including administrative enforcement of insider trading violations. In another study conducted by two of the authors,

89. Several substantive differences in proceedings may explain the dynamics and choice in-between, including the different evidential standards, the speed and capacity of the administration of proceedings, the severity of the penalty, and thus enforcement cost. Especially, the “beyond the reasonable doubt” standard in criminal processing can create an insurmountable bar for insider trading cases. By definition, profitable information, when its use is prohibited by law, is transmitted in secrecy and cannot be obtained without highly intrusive detection techniques like long-term wiretapping or extensive reliance on testimony from co-defendants, even confession. These all make criminal prosecution against insider trading inherently difficult. However, the choice between two proceedings can be a result of a political choice too. We expect another empirical study to settle this question in the future.

90. Chien-Chung Lin & Eric Hung, *U.S. Insider Trading Law Enforcement: Issues and Survey of SEC Actions from 2009 to 2013*, 11 NAT'L TAIWAN U. L. REV. 37, 62 tbl.12 (2016).

the number of administrative proceedings for insider trading law violations from 2011 to 2019 were tracked, showing 62.6 cases a year, on average, with a high of 86 cases and a low of 48 cases.⁹¹ These results show that enforcement is functioning in administrative proceedings. Comparatively, there is a similar ratio between criminal and administrative proceeding in the United States.⁹²

(c) We observed substantial leakage of material corporate information before its formal announcement in China. China's environment of concentrated corporate ownership seems to show a higher degree of pre-announcement run-up when compared to countries with dispersed stock ownership. This phenomenon is particularly clear in the comparison group.⁹³ Steady upward price movement after an announcement in China also implies the following: the disclosure mechanism does not prompt a timely comprehension of the disclosed information by a majority of market participants, indicating perhaps a substantial distrust between the market and the announcing companies. Of course, the overall effects of trade halts on corporate information flow are subject to further examination.

(d) The relatively low overall CAR (or control premium) is another notable point to consider. This point can be divided into two sub-points. First, the low CAR is particularly clear if compared to data of major corporate transactions in other major countries.⁹⁴ However, this is puzzling because controllers in a weak enforcement environment, like China's, should have a wide avenue of methods for maximizing controllers' private benefit. The fact that the high control premium does not reflect in a major corporate event suggests that controllers may already take part of the control premium in other forms without having it reflected in the stock price or sharing it with the general investing public. Second, the low CAR may also affect the high degree of pre-announcement run-up; where the ceiling of price run-up is comparatively lower, the reflection of the value of information on stock prices might be relatively higher or faster.

(e) The high percentage of pre-announcement run-up (substantial information expropriation) and low overall CAR (control premium diversion) jointly point to a

91. Chien-Chung Lin (林建中) & Yang Li (李扬), *Zhong Guo Da Lu Nei Mu Jiao Yi Fa Jie Shao Yu Xing Shi Chu Fa Shi Zheng Yan Jiu: 1997–2019* (中國大陸內幕交易法介紹與刑事處罰實證研究: 1997–2019) [*Insider Trading Law in China and Its Criminal Enforcement: 1997–2019*], 22 *ZHONG ZHENG CAI JING FA XUE* (中正財經法學) [CHUNG CHENG FIN. & ECON. L. REV.] 103, 185 fig.1 (2021).

92. There is a tendency to rely on civil proceedings in China, similar to what has been generally observed in the United States. One study notes that in the United States, the ratio of insider trading enforcement instances involving parallel criminal investigation ranged from 21.6% to 38.6% between 2009 to 2013. Lin & Hung, *supra* note 90, at 62. To corroborate the persistency of this ratio, we confirmed with SEC annual reports from 2019 and 2020. In 2019, 18.8% of enforcement actions involved parallel criminal proceedings. In 2020, the percentage rose to 27.3%. SECS. & EXCH. COMM'N, DIV. OF ENF'T, ANNUAL REPORT (2019), <https://www.sec.gov/files/enforcement-annual-report-2019.pdf> [<https://perma.cc/H6HF-3Y6T>]; U.S. SECS. & EXCH. COMM'N, DIV. OF ENF'T, ANNUAL REPORT (2020), <https://www.sec.gov/files/enforcement-annual-report-2020.pdf> [<https://perma.cc/JTY8-NBXM>].

93. U.S. figure: 33%. Tang & Xu, *supra* note 55, at 109. Taiwan figure: 58.9%. Lin & Wu, *supra* note 52, at 26–27.

94. For example, a 2016 study of 10,202 U.S. M&A activities from 1981 to 2011 showed a 15%–20% overall CAR after the announcement of information. Tang & Xu, *supra* note 55, at 109–10, 112. Meanwhile, our sample gives only an 8%–12% premium. *Supra* Part III tbl.7.

corporate environment that is tilted toward controllers and is unsupportive to ordinary investors. The irregular enforcement pattern, either due to its unspoken case-selection criteria (whether or not they be biased) or to its total low enforcement numbers, seems not able to close the gap effectively. In all, we think our data refutes the assumption that the existence of corporate controllers promotes effective information flow to the general public in China. In other words, we are unable to verify that the existence of corporate controllers is superior in terms of suppressing managerial agency cost by incurring controller agency cost in aggregate terms.

V. CONCLUSION

In this Article, we expanded on the research method from the authors' previous research. We used CAR and the degree of pre-announcement run-up as a proxy for information leakage to measure the effectiveness of insider trading law enforcement in China. We also combined data we collected from previous work and work from other researchers in a multilayer comparison, with which we sought to paint a complete picture of insider trading law, its enforcement, the quality of enforcement, and traders' motivations and behaviors in China.

We originally intended to use insider trading as a lens to observe the behavioral patterns of corporate controllers and the way they use private corporate information. From observing data, enforcement, and comparison group of M&A data combined, it can be ascertained that weak enforcement leads to many instances of pre-announcement information leakage. But whether those information leaks come from controllers or managers and if controllers use it as a form of compensation, as suggested by Manne, cannot be proven with the information at hand.

We have the following closing observation to make. From a normative perspective, our findings suggest that a greater enforcement endeavor is needed to reduce the information asymmetry or expropriation between corporate insiders and the general public, which will, in turn, foster investor confidence. However, enhanced enforcement does not guarantee improvement if the case-selection criteria remain unclear, random, or based on political considerations.

Appendix A. Case Number of the Companies Involved

Coding No.	Security Code	Case No.	Coding No.	Security Code	Case No.
1	000029	(2003) SHENLUOFA XING CHU NO.115	16	000049	(2013) YUEGAOFA XING ER ZHONG NO.274
2	600259	(2006) HAINAN XING CHU NO.38	17	000611	(2014) ZHESHAO XING CHU NO.12
3	000776	(2008) TIANFA XING CHU NO. 689	18	002112	(2014) ZHETAI XING ER CHU NO.4
4	600817	(2009) PU XING CHU NO.1895	19	000760	(2014) ERZHONG XING CHU NO.315
5	000931	(2010) ERZHONG XING CHU NO.689	20	300057	(2014) XIXINGER CHU ZI NO.00008
6	600193	(2010) MINXINGZHONG NO.398	21	000976	(2014) JIANGKAIFA XING CHU NO.546
7	600562	(2010) TONGZHONG XING CHU NO.0005	22	002617	(2015) ZHETAI XING ER CHU NO.1
8	000813	(2011) WUZHONG XING CHU NO.2	23	002238	(2015) YUEGAOFA XING ER ZHONG NO.134
9	000908	(2011) LU XING CHU NO.122	24	002035	(2015) ZHONGERFA XING ER CHU NO.243
10	600562	(2011) XI XING CHU NO.0002	25	002479	(2015) ZHEHANG XING CHU NO.78
11	600576	(2011) PU XING CHU NO.2738	26	002238	(2015) YUEGAOFA XING ER ZHONG NO.151
12	600634	(2012) ZHAN XING ZAI NO.2	27	000504	(2015) XIANGGAOFA XING ER ZHONG NO.6
13	002289	(2013) HUIZHONGFA XING CHU NO.108	28	600212	(2016) CHUAN01 XING CHU NO.00008
14	002562	(2013) ZHEJIA XING CHU NO.49	29	002088	(2016) LU03 XING CHU NO.12
15	300135	(2013) XI XING CHU NO.0010	30	300029	(2015) HUGAO XING ZHONG NO.140

Coding No.	Security Code	Case No.	Coding No.	Security Code	Case No.
31	600403	(2018) YU XING ZHONG NO.547	46	600103	(2016) MIN05 XING CHU NO.92
32	000623	(2016) JI08 XING CHU NO.12	47	002211	(2017) HU01 XING CHU NO.86
33	002476	(2016) LU05 XING CHU NO.14	48	002454	(2017) HU01 XING CHU NO.121
34	300114	(2016) JING02 XING CHU NO.82	49	002442	(2017) JI01 XING CHU NO.102
35	000659	(2016) YUE XING ZHONG NO.1505	50	600862	(2018) E XING ZHONG NO.139
36	002178	(2016) HU02 XING CHU NO.115	51	300292	(2016) YU01 XING CHU NO.131
37	600766	(2016) LU03 XING CHU NO.11	52	002416	(2018) YUE XING ZHONG NO.1244
38	300309	(2017) LU05 XING CHU NO.3	53	002098	(2019) MIN0203 XING CHU NO.283
39	300050	(2016) HU XING ZHONG NO.141	54	600259	(2019) YUE XING ZHONG NO.195
40	000526	(2017) MIN XING ZHONG NO.43	55	000032	(2019) JING XING ZHONG NO.139
41	000066	(2017) YUE03 XING CHU NO.214	56	002440	(2019) YUE XING ZHONG NO.1221
42	300118	(2017) ZHE01 XING CHU NO.28	57	000548	(2019) XIANG01 XING CHU NO.13
43	600674	(2016) CHUAN17 XING CHU NO.14	58	002663	(2019) YUE03 XING CHU NO.473

44	000788	(2017) JIN01 XING CHU NO.21			
45	600674	(2016) CHUAN17 XING ZHONG NO.193			

Appendix B. Case Disposition of the Final Sample

Case No.	Event No.	Security Code	Undisclosed Material Info.	Actors/Sources ⁹⁵	Deal Size (USD)	Personal Gain (USD)
1	1	000029	Share Transfer	Financial Professional (Director of Financial Advisor of the Deal)	29,031,257.93	189,901.07
27	2	000504	Reverse Merger into Public Listing	Corporate Insider (Director; Secretary of the Board)	211,392,581.67	121,198.46
57	3	000548	Winning a bid for a license of state-owned lands through shell company	Corporate Insider (Chairman of the Board, who was also appointed as an official of the Bureau of Finance of Changsha municipal government)	159,225,869.97	722,823.91
57	4	000548	Shell company completes the transfer of land use		159,225,869.97	
57	5	000548	Merge with shell company and initiate corporate reorganization		97,611,764.56	
17	6	000611	Share Acquisition	Corporate Insider (General Manager)	339,586,594.04	22,846,700.00
35	7	000659	Share Acquisition	Corporate Insider (General Manager)	98,086,191.83	738,295.89
44	8	000788	Asset Reorganization	Corporate Insider (Low-Level Worker)	101,327,545.87	16,291.33
9	9	000908	Asset Reorganization	Corporate Insider (Friend of the Target's Director)	29,876,828.55	290,439.41
5	10	000931	Asset Reorganization in the Level of Parent Companies	Corporate Insider (Vice General Manager)	179,965,613.46	4,509.71
21	11	000976	Capital Increase and Share Expansion	Corporate Insider (Secretary to the Chairman of the Board)	N/A	265,974.24
24	12	002035	Takeover Bid	Corporate Insider (Chairman of the Board)	222,666,929.73	2,097,015.14

⁹⁵ Friends or relatives of the tipper are classified according to the identity of their tipper.

53	13	002098	Takeover Bid	Financial Professional (Middleman of the Deal)	384,710,082.48	11,542.36
36	14	002178	Private Placement	Corporate Insider (Chairman of the Board)	6,352,842.53	227,965.84
13	15	002289	Winning A Bid	Corporate Insider (Vice General Manager)	88,080,272.84	108,514.90
56	16	002440	Asset Reorganization	Corporate Insider (Relative of the Chairman of the Board)	N/A	178,643.97
25	17	002479	Dividend Distribution	Financial Professional (Manager in the Investment Bank)	55,792,158.74	40,319.63
22	18	002617	Dividend Distribution	Misappropriator (Misappropriating from Target's Major Shareholder)	77,510,640.10	215,817.81
30	19	300029	Agreement for Debt Payment	Financial Professional (Vice General Manager of the Investment Bank)	77,510,640.10	28,848.05
15	20	300135	Dividend Distribution	Corporate Insider (Shareholder/Chairman of the Board)	N/A	713,985.74
6	21	600193	Assets Injection Restructuring	Financial Professional (Fund Manager)	42,278,530.96	96,902.39
7	22	600562	Reverse Merger into Public Listing	Third-Party Financial Professional (Middleman of the Deal)	225,767,355.34	281,856.87
11	23	600576	Reverse Merger into Public Listing	Corporate Insider (Brother of the Chairman of the Board)	7,046,421.83	0.00
45	24	600674	Share Acquisition	Corporate Insider (Director; General Manager)	1,470,110.00	2,588,855.38
37	25	600766	Share Acquisition	Corporate Insider (Manager)	113,703,542.94	57,992.05

Appendix C. Details of the Final Sample

Case No.	Event No.	Security Code	Undisclosed Material Info.	Announcement Date	Market	Trade Halt	Insider Trading Transaction Period
1	1	000029	Share Transfer	20011101	SZSE-MAIN		20010115
27	2	000504	Reverse Merger into Public Listing	20100317	SZSE-MAIN	+1, +13, +25	20100125-0317
57	3	000548	Winning a bid for a license of state-	20061013	SZSE-MAIN		20060404-1012

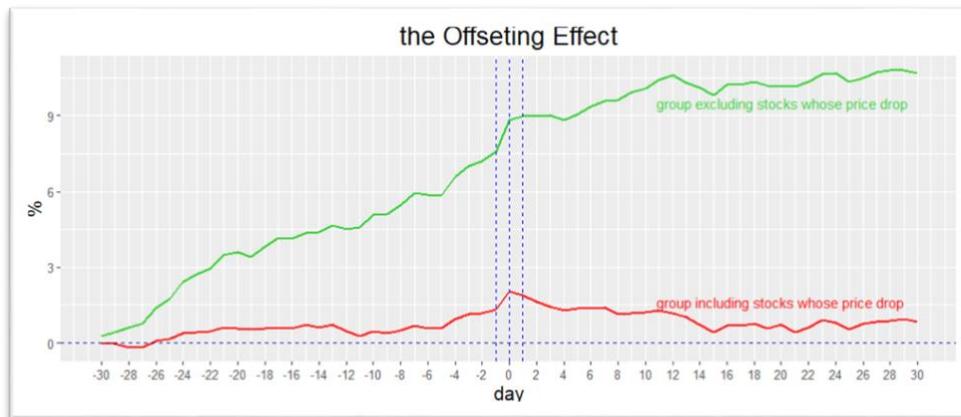
			owned lands through shell company				
57	4	000548	Shell company completes the transfer of land use	20070417	SZSE-MAIN		20061107–20070417
57	5	000548	Merge with shell company and initiate a corporate reorganization	20060703	SZSE-MAIN	0 to +7, +14 to +33	20060404–0702
17	6	000611	Asset Reorganization	20120410	SZSE-MAIN	0 to +17	20120409
35	7	000659	Share Acquisition	20140321	SZSE-MAIN	+1 to +4, +27	20140319
44	8	000788	Asset Reorganization	20100927	SZSE-MAIN	0 to +15	20100914–21
9	9	000908	Asset Reorganization	20070123	SZSE-MAIN	–3 to –1, +25 to +40	20061206
5	10	000931	Asset Reorganization in the Level of Parent Companies	20070628	SZSE-MAIN		20070427–0627
21	11	000976	Capital Increase and Share Expansion	20120810	SZSE-MAIN	–3 to –1, +2, +7 to +10	20120802–03
24	12	002035	Takeover Bid	20120717	SZSE-SME	0 to +15	20120523–0711
53	13	002098	Takeover Bid	20161031	SZSE-SME	0 to +9, +15 to +35	20161027
36	14	002178	Private Placement	20151020	SZSE-SME	0 to +4	20150824
13	15	002289	Winning a Bid	20120204	SZSE-SME	–1, +6 to +10	20120202
56	16	002440	Asset Reorganization	20161021	SZSE-SME	+1 to +57	20161017–19
25	17	002479	Dividend Distribution	20130226	SZSE-SME		20130208
22	18	002617	Dividend Distribution	20130422	SZSE-SME	–2 to +2	20130301
30	19	300029	Agreement for Debt Payment	20131102	SZSE-SME	0	20130911–13
15	20	300135	Dividend Distribution	20120217	SZSE-SME		20120215–16
6	21	600193	Assets Injection Restructuring	20070509	SSE	0 to +10	20070423
7	22	600562	Reverse Merger into Public Listing	20090420	SSE	+1 to +22	20090401, 07–07, 13–15
11	23	600576	Reverse Merger into Public Listing	20090519	SSE	0 to +20	20090518
45	24	600674	Share Acquisition	20070517	SSE	–1	20070218
37	25	600766	Share Acquisition	20120803	SSE	–1	20120524–25

Appendix D. Details of Non-observed Events Excluded Because of Trade Halt

Case No.	Security Code	Announcement date	Market	Trade Halt	Trading Date
16	000049	20120220	SZSE-MAIN	–6 to +24	20111108–20120209

41	000066	20140922	SZSE-MAIN	-24 to -1	20140414-0815
40	000526	20130325	SZSE-MAIN	0 to +90 over	20130218-0325
19	000760	20121105	SZSE-MAIN	-81 to -1, +4 to +11	20120702
3	000776	20060605	SZSE-MAIN	0 to +86	20060510-0605
8	000813	20090722	SZSE-MAIN	0 to +90 over	20090721-22
29	002088	20140408	SZSE-SME	-57 to -1	20131119-1213
18	002112	20120425	SZSE-SME	-45 to -1	20111024-20120217
26	002238	20120611	SZSE-SME	-45 to -1	20120119
52	002416	20130924	SZSE-SME	-4 to -1	20130411-0625, 20130830
49	002442	20150508	SZSE-SME	-90 over to -1	20140912, 1117-20
48	002454	20160606	SZSE-SME	-10 to 0	20160422
33	002476	20140121	SZSE-SME	-30 to -1	20131016-1121
14	002562	20120321	SZSE-SME	-10 to -1	20120305-06
39	300050	20140729	SZSE-SME	-41 to 0	20140529
34	300114	20130304	SZSE-SME	0 to +64	20130206, 18, 28
42	300118	20130805	SZSE-SME	0 to +43	20130719-0802
51	300292	20131014	SZSE-SME	+1 to +67	20131010, 14
38	300309	20150819	SZSE-SME	-31 to -27, 0 to +30	20150720-21, 24, 0804-05
46	600103	20150129	SSE	-76 to +9	20140909-1009
46	600103	20150212	SSE	-76 to +9	20140909-1009
28	600212	20140912	SSE	-65 to -1	20140418, 0507-13
54	600259	20071214	SSE	-90 over to +21	20070214-0420
12	600634	20100706	SSE	-25 to -17, -5, +13	20100701

Appendix E. Comparison Group Excluding (Including) Stocks Whose Price Dropped after Public Announcement



Appendix F. Pre-announcement Run-ups: The Comparison Group

day	CAR (comp.)	p	t	Significance	CAR (sample)
-30	0.258	0.090	1.346	*	-0.369
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-10	5.068	0.000	5.379	***	0.723
-9	5.117	0.000	5.402	***	1.527
-8	5.457	0.000	5.860	***	1.900
-7	5.959	0.000	6.245	***	2.725
-6	5.861	0.000	6.075	***	3.139
-5	5.852	0.000	6.163	***	3.917
-4	6.594	0.000	6.786	***	3.120
-3	7.000	0.000	7.149	***	3.717
-2	7.208	0.000	7.376	***	4.424
-1	7.577	0.000	7.593	***	6.821
0	8.844	0.000	8.809	***	9.879
1	8.980	0.000	9.238	***	11.468
2	8.978	0.000	9.076	***	12.865
3	9.030	0.000	9.321	***	13.917
4	8.832	0.000	9.095	***	14.739
5	9.064	0.000	9.155	***	14.849
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30	10.701	0.000	7.865	***	16.286