Do Hedge Funds Exploit Material Nonpublic Information from Corporate Bankruptcies?


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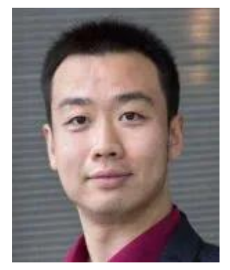
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Motivation:

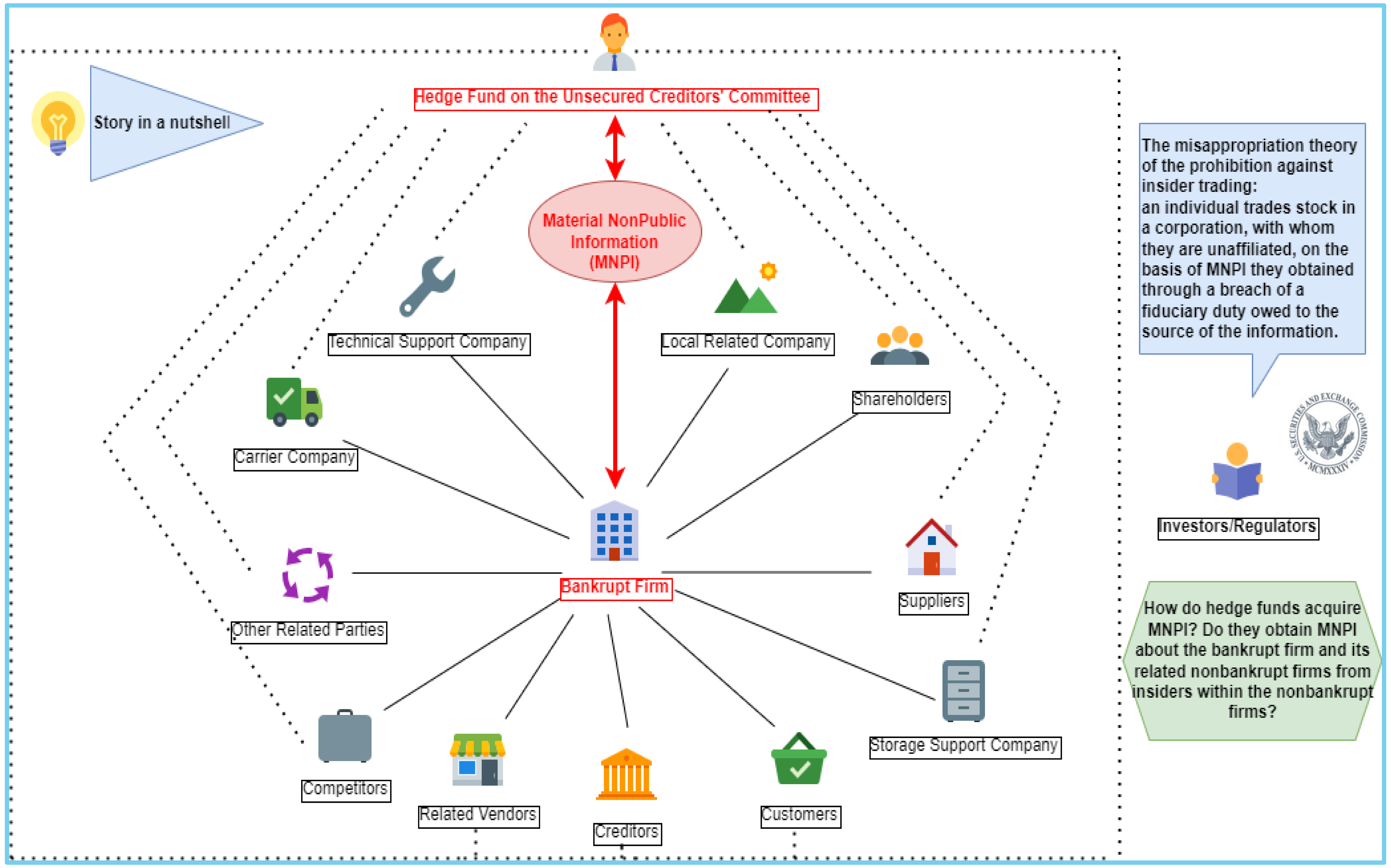
- Hedge funds actively involved in many large U.S. bankruptcy cases.
- Hedge funds specialized in investing distressed securities outperform other hedge funds.
- Hedge funds on **the Unsecured Creditors' Committee (UCC)** of a bankrupt firm:
  - Holders of the seven largest unsecured debt claims.
  - Fiduciary duty to all unsecured creditors.
  - **Access to material nonpublic information.**
  - Restrictions on trading securities of the bankrupt firm.
- **A bankrupt firm does not operate in a vacuum.**

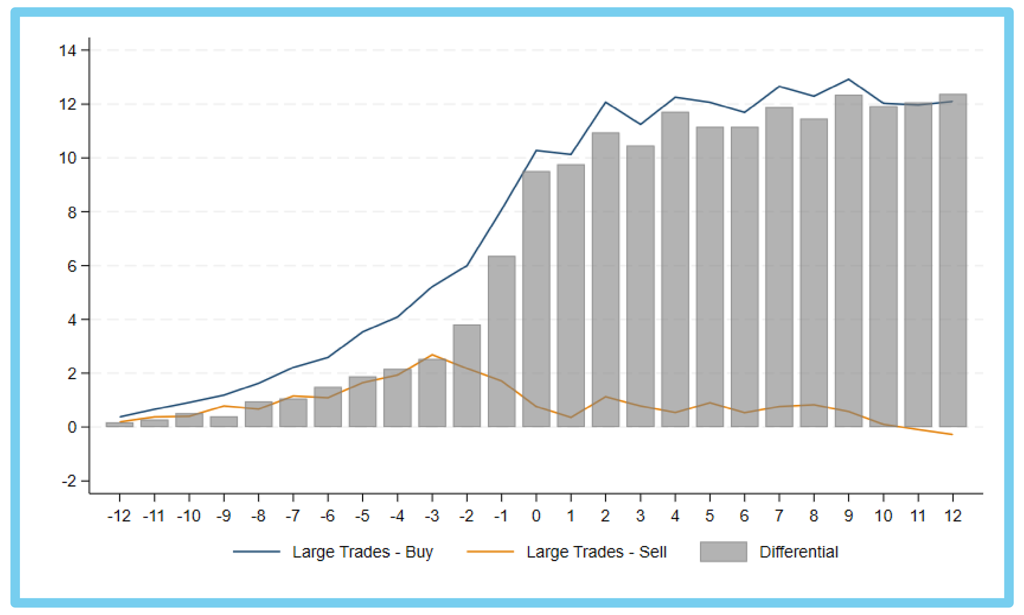
Research Question:

- Do hedge funds specializing in distressed debt markets trade stocks upon accessing MNPI after joining an UCC?
- What kind of firms do they intensely trade?
- Do those trades generate large returns?

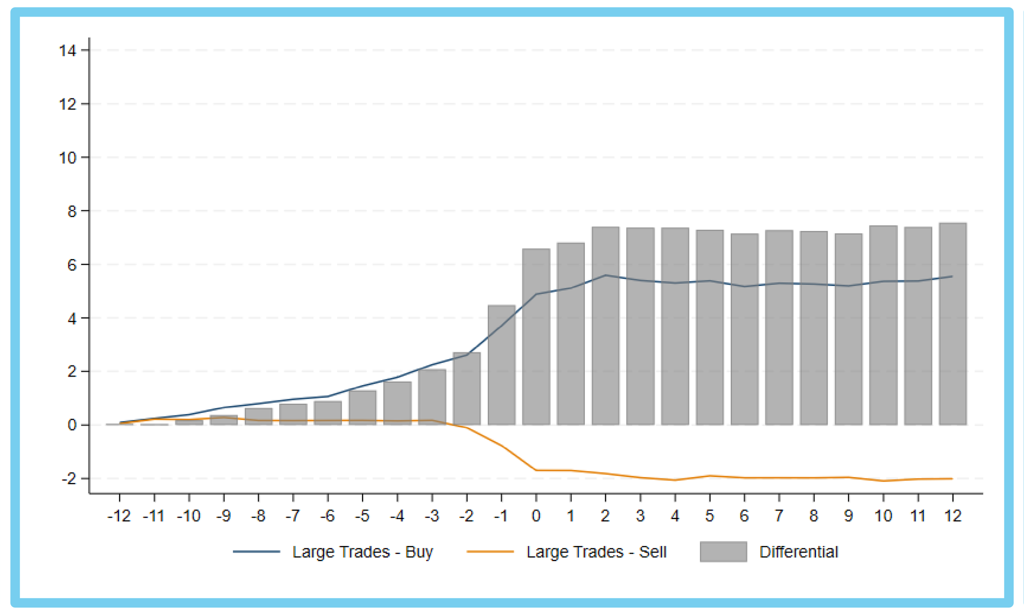
Data:

- Bankruptcy: BRD, PACER,NGR.
- Hedge funds: 13F, TASS.
- SEC filings, Compustat, Capital IQ, industry publications.

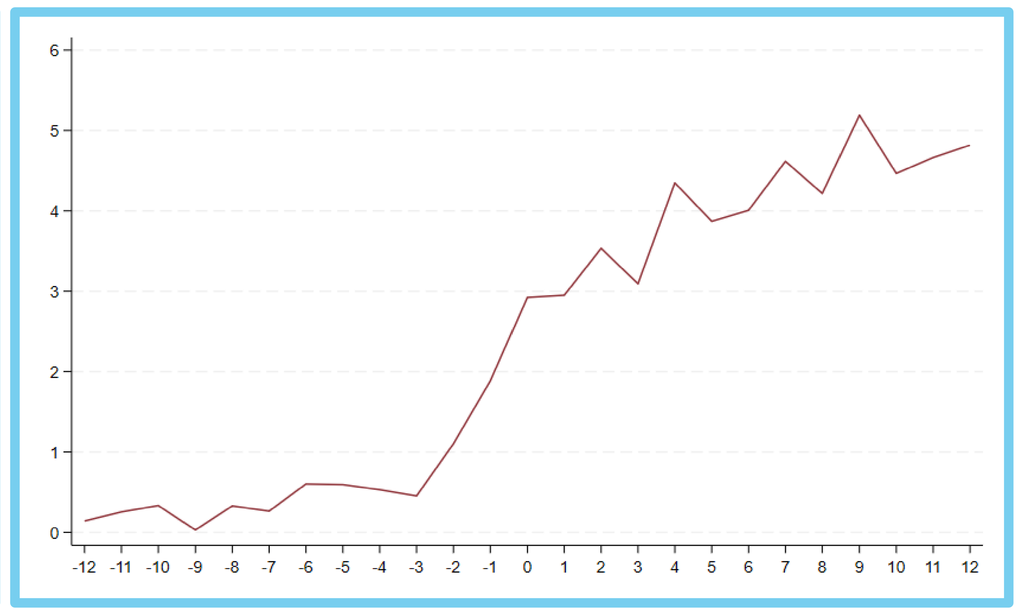




Cumulative DGTW-adjusted returns of large transactions of HFs on UCC (gray bars-A)



Cumulative DGTW-adjusted returns of large transactions of HFs NOT on UCC (gray bars-B)



Return Differentials (A-B)

Main Findings:

- Trading intensity with UCC information access:
  - High Turnover ↑ 29%
  - Large Trade ↑ 19%
- Stronger abnormal trading:
  - Dual equity-and-debt strategies
  - Low analyst coverage
- No abnormal trading:
  - Bankruptcies without UCC appointment
  - UCC without hedge funds members
- Abnormal stock trading activities concentrate in competitors, customers, or suppliers of the bankrupt firm.
- Positive returns to large trades.

Contribution:

- Informed equity trading by hedge funds.
- Nonbank institutional investors' presence on the debt market and its influence on the equity market.
- Raise concerns on ``insider trading in a gray zone".
- Hedge funds' strategic trading in bankruptcies may enhance market efficiency but undermine the integrity of the financial market.

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