



ESG INVESTING

The Role of Financial Economics in Securities Fraud Cases

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Modern financial economics is becoming increasingly influential in securities fraud law. The efficient markets hypothesis has provided a framework for the analysis of certain questions and a basis for generating empirical evidence on the value of information in individual cases.

Of particular importance is an empirical technique derived from the efficient markets hypothesis — the event study. Event studies are useful to establish, among other things, materiality, as well as to calculate damages in securities fraud litigation.

At the time this article was published, event study analysis already had been used in five SEC enforcement actions. Event study analysis is useful at all stages of litigation to both defendants and plaintiffs. The analysis is applicable, not just in SEC insider trading cases, but in all types of securities fraud actions, including private suits.

The article describes event study as an empirical technique developed by academic financial economists and shows how it is relevant in securities fraud law. It also shows its application in SEC enforcement actions to establish materiality and calculate disgorgement. In particular, they show how regulators and the courts used an event study to calculate how much in ill-gotten gains an executive recruiter should be required to disgorge after he was shown to have traded on nonpublic information about a CEO change at a telecommunications company.

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