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Political Connections: Evidence from Insider Trading around TARP

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ABSTRACT

To test for private information leakages from government to top corporate executives, we exploit the 2008–2010 TARP bank bailouts after Lehman’s failure in conjunction with information on insider trading and political connections. Apart from an excellent platform for identification, the banking sector is interesting as the connections with politicians are huge and bank bailouts generate social outrage and potentially moral hazard. In politically connected banks, buying during the pre-TARP period is associated with increases in abnormal returns around bank-specific TARP announcement; whereas for unconnected banks, insider trading and returns are uncorrelated. Results hold when comparing connected to unconnected executives within the same bank and are driven by political connections to financial branches of government. Through a FOIA request we obtained the previously unknown TARP funds requested by each bank; the ratio of requested to received funds strongly correlates with abnormal returns and insider buying behavior in connected banks. Our results are consistent with insiders having, and exploiting, private information from political connections.

KEYWORDS Political Connections; Political Economy In Banking; Bank Bailouts

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