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Inside Track
Collars Give Insiders Way To Cut Risk

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Insider-sales reports aren't always a sure-fire guide for investors to learn how corporate officers and directors feel about their company stock holdings.

Thanks to Wall Street's financial engineers, insiders now have a variety of derivative instruments to reduce or eliminate the risk of their holdings, without actually selling the stock. Though still used relatively infrequently, such instruments are becoming more popular.

For example, Ted Turner, vice chairman and the largest single shareholder of **Time Warner** Inc., sold 500,000 shares on May 12 at $45 each. But at the same time Mr. Turner put a "collar" on another two million shares, according to CDA/Investnet, a Fort Lauderdale, Fla., insider-transaction-tracking service. The collar essentially protected him against any drop in the stock for the next three years below $39.63 while requiring him to forfeit any profit above $60.90.

A spokesman says Mr. Turner wanted to eliminate some downside risk to the stock, while participating in any appreciation to what he considered a more reasonably valued level. The spokesman noted that Mr. Turner had hedged less than 5% of his total holdings with the device, which is still in place.

Such transactions are legal, although the insider must disclose them on the appropriate Securities and Exchange Commission forms, as Mr. Turner did. Still, they may escape notice by an investor looking only at insider purchases and sales because they don't involve an actual sale of stock.

Robert Gabele, president of CDA/Investnet, says while such instruments have been around for years, as have the disclosure requirements, it's only in the last few years that they started popping up regularly on insider filings. The SEC first issued explicit instructions on how to report these transactions in 1994, clarifying them in 1996.

"I think the typical investor or observer of insider trades tends to be rather naive [and] looks at just buys and sells as the whole picture. Increasingly, it is only part of the picture," says Mr. Gabele. He believes the level of insider disclosure of such derivative transactions is far below the actual level of insider activity.

One derivative available to insiders interested in hedging their stock is the equity swap, in which an insider typically agrees to pay the securities dealer the total return on his stock, in exchange for the return on another asset, such as Treasury bills or a stock index. Swaps are still relatively new; only last year did the SEC assign them a specific code for insider filings and Mr. Gabele says very few have yet appeared in the reports. Recent tax law changes appear to have hurt their popularity.

The most popular derivative remains the collar, which appears to have survived the latest tax bill. An insider acquiring a collar typically buys a put option giving him the right but not the obligation to sell his stock at a predetermined "strike" price, thereby protecting against drops below that price for a certain period of time.

At the same time, the insider sells a call option obligating him to sell his stock at a predetermined price, costing him the profit if the stock rises above that price. Usually, the cost of the put is offset by the income received from the collar, reducing or eliminating the collar's cost.

John Braddock, managing director of Oppenheimer & Co.'s structured products group, says interest in collars has risen with stock prices and valuations, prompting many corporate insiders to seek ways to diversify their holdings. The collar does that without drawing the attention of an outright sale and also avoids triggering capital gains taxes, he says.

Chief executive officers, Mr. Braddock says, worry that if they sell stock, "their analysts and shareholders will pick up the phone and give them a piece of their mind. When you put a collar on, you haven't sold stock, you still collect the dividend, you vote it, you're still bullish because you kept some of the upside. All you've done is purchased insurance."

But Mr. Gabele says a derivative hedge is commonly motivated by concern with where the stock price may go, and thus is as revealing to investors, if not more so, than an outright sale, which can be driven by a number of other considerations.

Joseph Tallman hasn't sold any stock in Access Health Inc. since becoming a director of the supplier of health-care diagnostic services in late 1996, according to CDA/Investnet. But on Feb. 26, he did acquire a collar that protected about 500,000 shares, the majority of his and his spouse's holdings, from drops below about $20, while giving up gains in the stock above prices between $24.856 and $27.882, according to CDA/Investnet.

The move came just before a company warning March 11 that fiscal 1997 results would fall short of expectations, which sent the stock down to $15.375 from $22.50 in one day. Though still a shareholder, Mr. Tallman's collar appeared to insulate him from much of the turmoil, says Mr. Gabele. Soon after Mr. Tallman became president the stock began to recover, and on May 23 he took off the collar, his filings indicate. He has since become chief executive officer.

Tim Connor, chief financial officer at Access Health, says Mr. Tallman put on the collar in February because his future at Access Health was unclear. "He had all his assets tied up in the company, and given that uncertainty, he elected to sort of hedge his risk on the stock." He removed the collar upon becoming president to "have full exposure to the stock-price movement."

The proximity of the initial collar to the earnings warning was coincidental, Mr. Connor says. "He was involved in running the operations. He wasn't involved with the numbers or [Wall] Street expectations." He added that Mr. Tallman made no profit or loss when he unwound the collar.

Another recent collar transaction was that of Tadd Seitz, a director and former chairman of Scotts Co., which makes lawncare products. On May 23, he put on a collar hedging his exposure on 120,000 shares of his Scotts stock. A company spokesman said Mr. Seitz is retiring from the board.

Todd Gutschow, vice president of technology development at HNC Software Inc., used a collar in February to hedge 75,000 of his shares against a drop below $27 while giving up appreciation above $38. But he also sold a put that exposed him to price declines below $20.25. "It was just a pure hedge based on concerns about where the whole market is," says Raymond Thomas, HNC's chief financial officer.

The growing popularity of insider hedging transactions has prompted the SEC to consider whether rules requiring immediate reporting of certain insider sales should also apply to these derivative transactions.

Journal Link: Additional statistics on insider transactions are available in The Wall Street Journal Interactive Edition at http://wsj.com

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