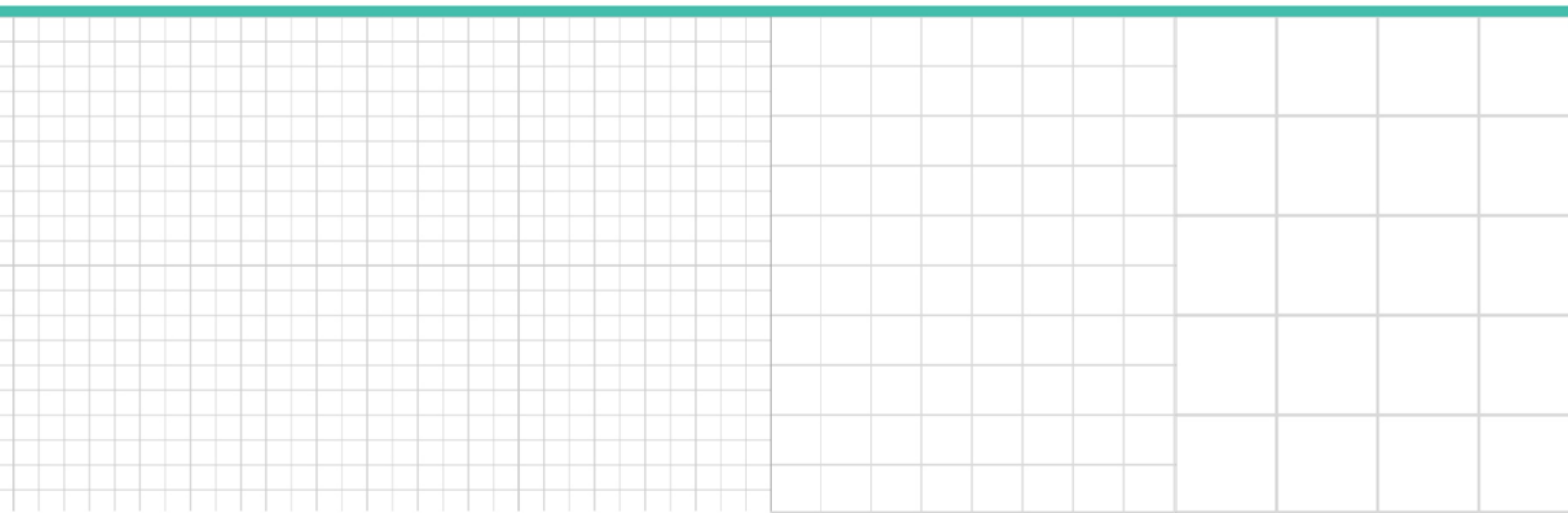


Professional Perspective

The *Cammer* Turnover Factor in Securities Class Actions

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The Cammer Turnover Factor in Securities Class Actions

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The 1989 case of [Cammer v. Bloom](#) established the five “Cammer factors” that are used as benchmarks for gauging market efficiency in securities class actions under [Section 10b-5](#) of the 1934 Exchange Act. The Cammer factors require a showing of a sufficiently high average weekly trading volume, sufficient number of analysts following, sufficient number of market makers, eligibility to file a form S-3, and the presence of a cause and effect relationship between unexpected material disclosures and changes in the security’s price.

This article examines the first Cammer factor: weekly turnover. While trading volume has increased over time, there is still a non-trivial fraction of exchange-traded companies that do not satisfy the minimal 1% Cammer turnover threshold for market efficiency. However, 98% of large exchange-traded companies exceed the 1% Cammer turnover threshold. The finding that a significant portion of stocks do not meet the Cammer turnover threshold contrasts with the claim that merely trading on a major U.S. exchange ensures efficiency.

There is also evidence that more companies targeted by 10b-5 actions meet the Cammer volume factor thresholds, suggesting that plaintiffs take into account the likelihood of satisfying the Cammer factors in filing a lawsuit.

Class Certification and Market Efficiency

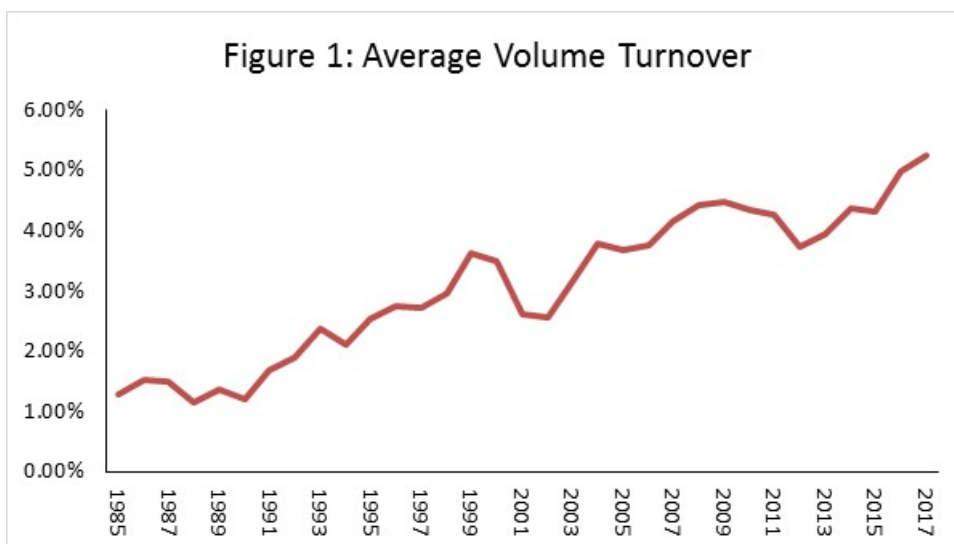
Class certification in Section 10b-5 matters requires a showing that questions common to the class predominate over questions affecting individual class members. In *Basic Inc. v. Levinson*, the U.S. Supreme Court created a rebuttable presumption of reliance that the entire class can be presumed to have relied on a single source—the information incorporated in the price of a stock—if the stock trades in an efficient market. This presumption is based on the efficient markets hypothesis. The efficient markets hypothesis contends that in efficiently operating markets, all relevant information is quickly incorporated into the stock price. Plaintiffs are allowed to claim reliance on the stock price alone as long as they can prove that the market for the stock is efficient.

The Share Turnover Factor

The Cammer court viewed a stock’s trading volume as an indication of investor interest in a stock: “The existence of an actively traded market, as evidenced by a large weekly volume of stock trades, suggests there is an efficient market is because it implies significant investor interest in the company.” Based on these criteria, the court set a threshold referred to as the share turnover factor, holding that “[t]urnover measured by average weekly trading of two percent or more of the outstanding shares would justify a strong presumption that the market for the stock is an efficient one; one percent would justify a substantial presumption.” This article refers to share turnover and trading volume interchangeably, unless a distinction is needed.

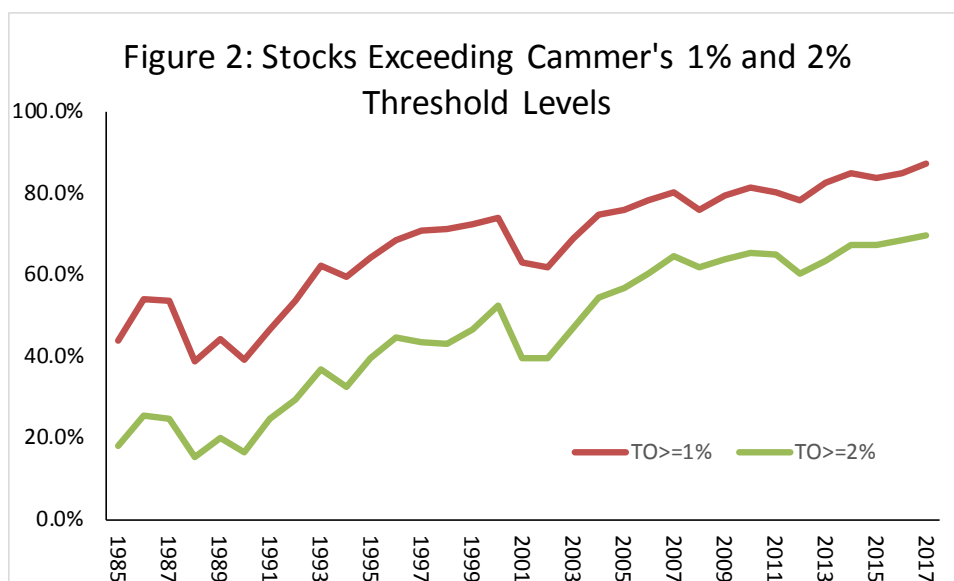
Significant Growth

When Cammer was decided 30 years ago, the average weekly share turnover across all publicly traded stocks was 1.4%. Today, that figure has more than tripled to 5.2% (Figure 1). This shows that share turnover has increased significantly since 1989 and that more companies pass the court’s turnover factor test for efficiency. The increase in share turnover in the last 30 years is not surprising. Reasons for the increase in stock trading volume include the increased participation in the stock market by domestic and foreign investors, the decline in trading costs, the rise of automated trading algorithms, the substitution away from the NYSE’s specialist system to trading mediated by broker-dealers, and other factors.



Source: CRSP, CRA analysis

In 1989, only 20% and 44% of stocks met the 2% and 1% thresholds set by the court, respectively. In 2017, those percentages were 70% and 87%, respectively (Figure 2). While the numbers point to a significant increase in the fraction of stocks satisfying the *Cammer* share turnover requirement, they also show that 13% of publicly traded common stocks fail to meet the less stringent of the two share turnover thresholds.



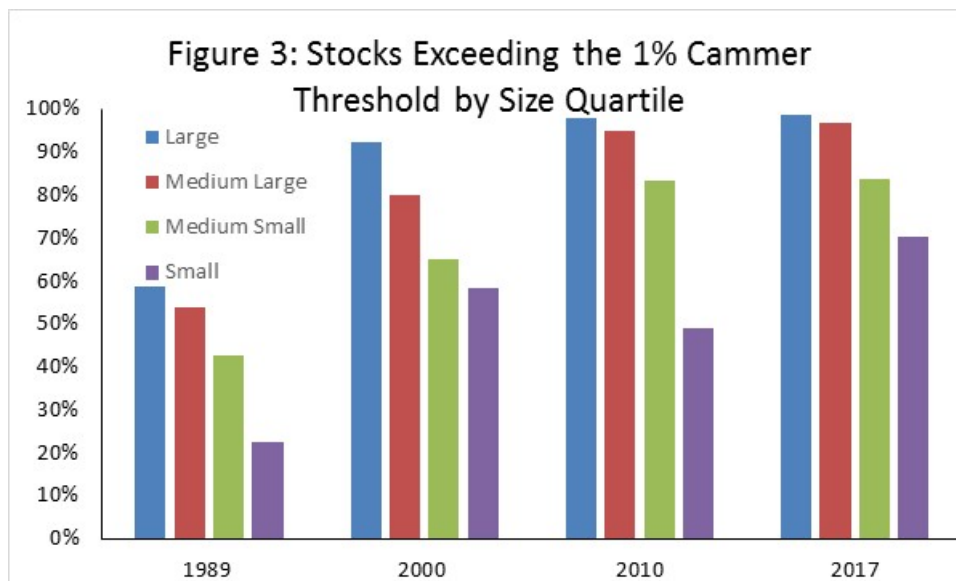
Source: CRSP, CRA analysis

Market Capitalization and Volume

Higher market capitalization has been increasingly correlated with share turnover. Figure 3 shows the correlation between a stock's market capitalization and share turnover above 1%. The chart places all stocks into one of four groups every year from 1989 to 2017, with each group representing one quarter of the common stocks traded in the U.S. We refer to the quartiles as 'large,' 'medium-large,' 'medium-small,' and 'small.' The chart further computes the fraction of companies that have share turnover in excess of the 1% *Cammer* threshold. For example, the last column shows that in 2017, 99% of large companies had turnover in excess of 1% of their shares outstanding.

As expected, large stocks tend to be more “efficient” (according to the *Cammer* turnover factor), as is shown by the fraction of them exceeding the 1% turnover threshold. More importantly, market capitalization has become a good proxy for the *Cammer* turnover factor in the last 30 years, especially for larger stocks. In 1989, 41% of large companies had turnover under 1%, so they did not satisfy the less stringent of the *Cammer* volume thresholds. In other words, the *Cammer* turnover factor ratio contained additional information, beyond the market capitalization of the firm, about whether the stock was “efficient” or not.

By 2017, however, the turnover ratio of large capitalization stocks has grown to a point at which almost all such stocks exceed the 1% *Cammer* turnover threshold. As Figure 3 shows, the turnover of 97%-99% of large and medium-large companies exceeded the lower of the *Cammer* turnover thresholds. Therefore, one can generally rely on a company being among the top 50% by market capitalization, instead of weekly trading turnover, in determining its efficiency via the *Cammer* turnover factor.



Source: CRSP, CRA analysis

Class Certification Denials

The finding that 13% of U.S. traded stocks did not meet the *Cammer* turnover threshold in 2017 contrasts with the claim that simply trading on a major U.S. exchange (NYSE, AMEX, NASDAQ) ensures efficiency. The data seems to suggest that such a claim is overly simplistic, at least as far as the *Cammer* turnover factor is concerned.

This finding is also notable when compared to the very few stocks that have been found inefficient in securities class actions. According to recent statistics, the fraction of stocks deemed inefficient in class certification proceedings is less than 2% of all stocks for which a class certification has been decided by the courts. While the *Cammer* turnover factor is only one of the five *Cammer* factors, it is rare to witness a class being certified with turnover below 1%.

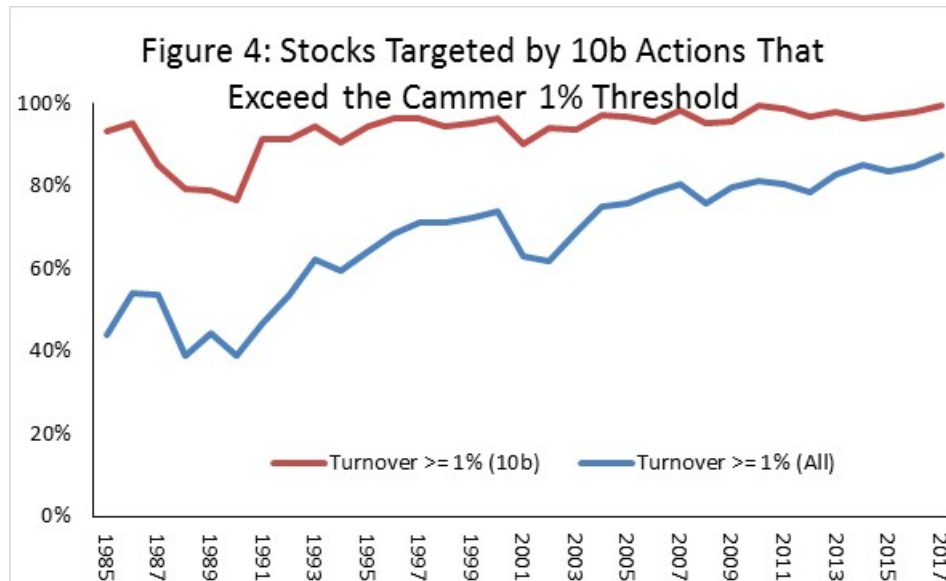
There are at least two explanations why so few stocks are deemed inefficient by the courts when so many publicly-traded stocks fail the *Cammer* turnover test for efficiency.

Size and ability to pay: Plaintiffs may be overly targeting larger firms, perhaps because of a perception that they have a greater ability to pay damages. As a result, the targets of 10b-5 actions would be mostly larger stocks. As shown in Figure 3, shares of larger firms are more likely to exceed the *Cammer* volume threshold and gain class certification.

Ability to certify a class: Plaintiffs may consider the likelihood of passing the *Cammer* thresholds when deciding whether to file a class action. As a result, the targets of 10b-5 actions would have higher volume turnover, exceeding the *Cammer* volume threshold and gaining class certification.

Stocks in 10b-5 Actions

This section focuses on companies that were subject of 10b-5 actions, as obtained from ISS's Securities Class Action Services. The results are limited to common stocks traded on NYSE/AMEX/NASDAQ.

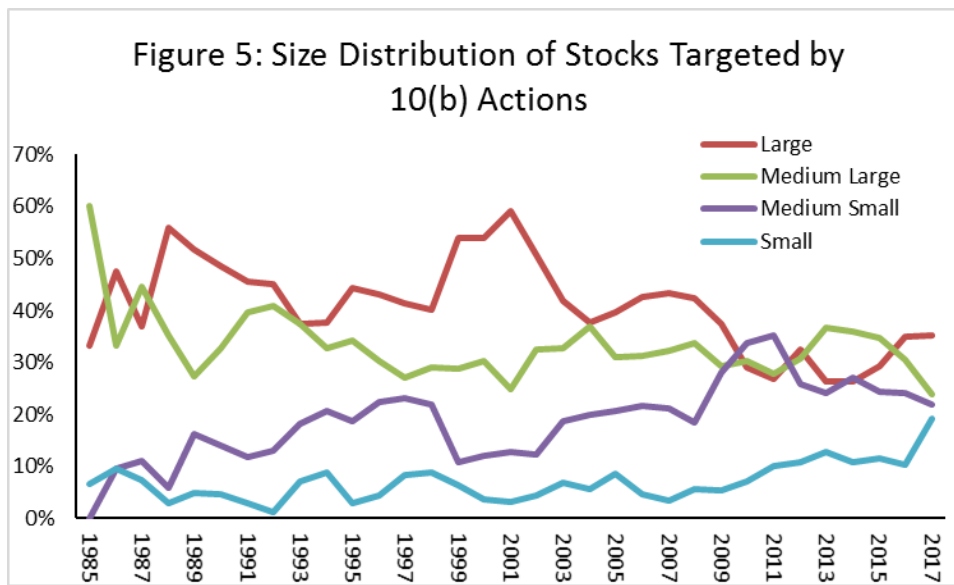


Source: ISS, CRSP, CRA analysis

Figure 4 shows the share turnover of stocks that were targets of class actions under Section 10b-5 of the 1934 Exchange Act. Its findings are consistent with the observed rate of class certification approvals; approximately 99% of the stocks in 10b-5 actions passed the 1% *Cammer* turnover threshold in 2017. In other words, while 13% of all publicly traded common stocks in 2017 had turnover below the 1% *Cammer* turnover threshold, only around 1% of the companies involved in 10b-5 actions had such low turnover. Stocks targeted in 10b-5 actions are not a random sample of the entire set of exchange-traded common stocks.

Likely Targets

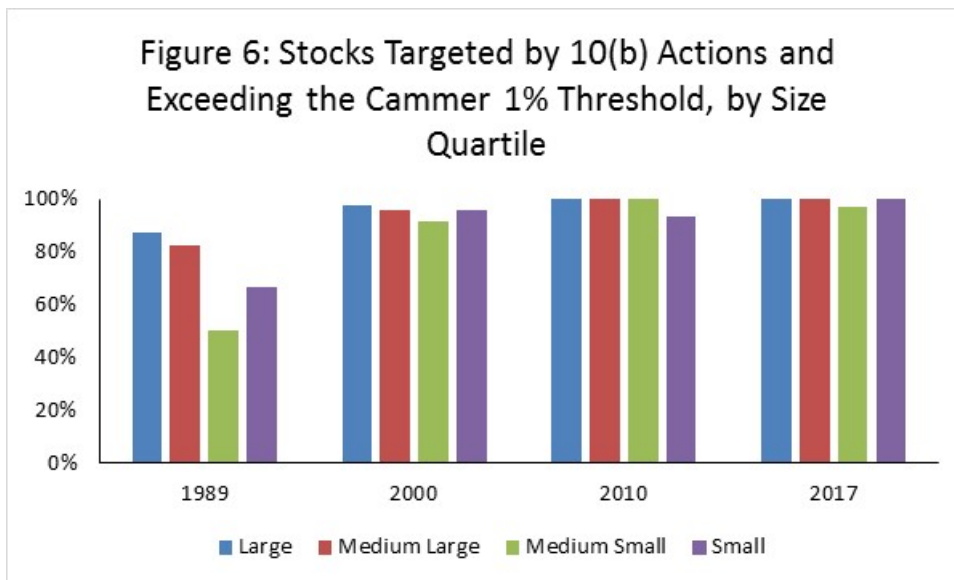
Figure 5 shows the size distribution of companies targeted by 10b-5 actions. It is immediately noticeable that few of the class actions were historically targeted at the smallest quartile of U.S. publicly traded stocks. The relative absence of small stocks from the 10b-5 actions explains, to some extent, the low rate of class certification denials. However, 10b-5 actions do not seem to target only the largest stocks. In fact, on average and despite some time variation, securities class actions in the last decade have targeted medium-small, medium-large, and large companies at roughly the same rate.



Source: ISS, CRSP, CRA analysis

Filing Considerations

To test whether plaintiffs consider the likelihood of winning the motion for class certification, when deciding whether to file a class action, it is useful to examine the “efficiency” (per *Cammer* turnover factor) of the firms targeted by securities class actions within each size group. Figure 6 shows the fraction of firms with average weekly turnover exceeding the 1% *Cammer* turnover threshold within each size group since the *Cammer* decision in 1989.



Source: ISS, CRSP, CRA analysis

Figure 6 shows a remarkable conclusion—by 2017, almost all firms targeted by securities class actions, regardless of their size, have average weekly share turnovers in excess of the 1% *Cammer* threshold. In other words, while only 70% of small firms can be considered “efficient” by the *Cammer* turnover factor in 2017 (see Figure 3), virtually 100% of small firms targeted by 10b-5 actions are “efficient.” Similar conclusions hold for nearly every size group over the period 2008-2017. Since there is no economic reason for “efficient” firms to commit more securities violations, this finding is a strong indicator that plaintiffs consider the likelihood of winning the class certification motion in filing a lawsuit.

Conclusion

While share turnover has increased over time, there is still a non-trivial fraction of companies that do not satisfy the 1% *Cammer* turnover threshold for market efficiency. However, virtually all large companies exceeded that threshold in 2017, while less than half of them exceeded it in 1989. Based on the proportion of companies across company sizes that are object of 10b-5 actions, those actions appear to have been filed with a clear notion that the *Cammer* turnover factor needs to be satisfied.