Piggy's Trading & Investing Tips

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Focus on insider trading

ONE of Piggy's favourite drama series is *"Billions"*. It is an American television drama series premiered on Showtime and has produced five complete seasons to date. The series is set in large financial centres, most notably New York and Connecticut. It tells the story of how Hedge Fund Manager Axelrod's aggressive tactics to secure high returns frequently cross over into the illegal — acts that United States Attorney Chuck Rhoades (Paul Giamatti) attempts to prosecute.

Piggy believes that Billions is a "must watch" and investors can learn several finance concepts from the series. Billions exposes viewers to the genius and dirty tricks of hedge fund managers who weave portfolio trading strategies around financial regulators, insider trading and corporate actions. In this article, Piggy focuses on one important theme in the series; Insider Trading.

What is Insider trading?

Insider trading refers to the practice of purchasing or selling a publicly-traded company's securities while in possession of material information that is not yet public information. Material information may result in a substantial impact on the decision of an investor regarding whether to buy or sell the security. Non-public information is that which is not legally out in the public domain and that only a handful of people directly related to the information possess. An example of an insider may be a corporate executive or someone in government who has access to an economic report before it is publicly released. A high-level employee who overhears some conversation about a merger and understands its market impact and consequently buys the shares of the company in his father's account. Another example of insider trading would be when the CEO of a listed company divulges important information about the acquisition of his company to a friend who owns a substantial shareholding in the company. The friend then acts upon the information and sells all his shares before the information is made public.

Who is an Insider?

As outlined in the Investment 101 Handbook, anyone can be on the inside of information. A person has information as an insider if he is aware that it is inside information and knows that he has it from an inside source. A person will have information from an inside source if he or she obtains it through (i) being a director, employee or shareholder, (ii) having access to the information by virtue of his employment, office or profession and (iii) the direct or indirect source of the information, being one of the persons listed above albeit merely from tips or overhearing conversations. Insider information is non-public information that, if acted upon, could be financially advantageous to the investor or trader. People who work in a company or have close links to employees of a company may be privy to insider information, which by itself is not illegal, until the information is used to buy or sell stock for profit.

Insider trading vs information

Insider information is knowledge of material related to a publicly-traded company that provides an unfair advantage to the trader or investor. For example, say the Head of a technology company's engineering department overhears a meeting between the CEO and the CFO where they discuss that the company failed to meet its sales expectations. The Head of the engineering department knows their friend owns shares of the company and warns the friend to sell their shares right away and look to open a short position. This is an example of insider information because earnings have not been released to the public. Suppose the friend then sells their shares before the earnings are released. This then becomes illegal insider trading. However, if they trade the security after the earnings are released, it is not considered illegal because they do not have a direct advantage over other traders or investors.

Rules against Insider trading

Piggy notes that rules regarding insider trading are complicated and generally, vary from country to country. The definition of an "insider" can also differ significantly under different jurisdictions. Some may follow a narrow definition and only consider people within the company with direct access to the information as an "insider." On the other hand, some may also consider people related to company officials as "insiders". On Zimbabwe capital markets, there are clear guidelines on when key company executives can trade their company shares. There are also disclosure requirements that compel directors the declare their shareholding in the company.

In conclusion, there are severe penalties for insider trading. If someone is caught in the act of insider trading, he or she can either be sent to prison, charged a fine, or both. According to the SEC in the US, a conviction for insider trading may lead to a maximum fine of USD5.0 million and up to 20 years of imprisonment.

Chapter 4 of the *Investor 101 Handbook on Regulation & Taxation* covers all aspects of Insider Trading. Download a copy of the *Investor 101 Handbook* from *www.piggybankadvisor.com*

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A promotional poster of the Billions drama series.