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Recent Amendments of Financial Instruments and Exchange Act (FIEA) Concerning Insider Trading Regulations

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In recent years, Financial Instruments and Exchange Act (FIEA) has been amended very often and it has become an onerous task for market players and listed companies to follow each amendment. The purpose of this News Letter is to outline recent important amendments of FIEA with regard to insider trading, including the ones which are expected to become effective from April 2014.

I Amendments Which Became Effective On 6 September 2013

Some of the FIEA amendments promulgated in 2012 came into force as of 6 September 2013. Those are mainly of technical nature, but because they are technical, one needs to pay attention, especially to the ones tightening previous regulations.

1. Inclusion of transfer of Specified Securities as a result of merger and company split (*Kaisha Bunkatsu*) into the scope of regulation

Before this amendment, what was prohibited as insider trading was sale, purchase, other transfer for value or derivative transaction with regard to the Specified Securities[1] of a Listed Company, etc[2]. while in possession of a Material Fact[3] concerning the Listed Company, etc. before the Material Fact is made public. While the transfer of Specified Securities as a result of a business transfer (*Jigyo Joto*) was considered as transfer for value, the succession by the acquiring company to Specified Securities as a result of mergers or company splits used to be outside the scope of the insider trading restriction. Paragraph 1 of Article 166 of FIEA has been amended to include succession by acquiring company to Specified Securities by way of merger or company split within the scope of the insider trading restriction.

[1] Specified Securities are defined in Paragraph 1 of Article 163 of FIEA as stocks, stock warrants, corporate bonds, investment securities, etc.
[2] Listed Company, etc. are defined under Paragraph 1 of Article 163 of FIEA. They are the issuers of listed stocks, stock warrants, corporate bonds, etc.
[3] Defined under each Item of Paragraph 2 of Article 166 of FIEA as material facts concerning the business operation, etc. of a listed company, etc. or its subsidiary company.

At the same time, some exemptions were introduced, including a) where the book value of the Specified Securities succeeded to by the acquiring company is not more than 20% of the book value of the assets succeeded to by the acquiring company, b) where Specified Securities are succeeded to by a company newly created as a result of a company split, c) where the Specified Securities are issued by the Listed Company, etc. which is a party to the merger or company split are transferred, etc[4].

2. Amendment of *de minimus* standards with regard to certain holding companies

Before this amendment, whether a fact qualifies as a *de minimus* standard (i.e. deemed insignificant to investment decisions of investors) or not was judged based on financial figures pertaining to the listed company itself. For example, when a listed company becomes the 100% parent of another company through a stock-for-stock exchange, the *de minimus* standard applies if the turnover of the 100% subsidiary is not more than 10% of the turnover of the listed (parent) company. There are some listed companies the business of which is primarily to hold other companies in the group. The turnover of such holding companies is basically dividends received from other group companies. In such a case, acquisition of a relatively small company through a stock-for-stock exchange may exceed the *de minimus* standard. An amendment has been made to the relevant Cabinet Office Ordinance[5] so that if 80% or more of the turnover (excluding the sale of goods and services) of a listed company is with group companies, the *de minimus* standard should be calculated based on a consolidated basis. A listed company meeting this turnover criterion is called a "Specified Listed Company" and the fact that a company is a Specified Listed Company must be disclosed in its Securities Report[6].

3. Addition to the methods of disclosure with regard to Tender Offer Related Facts[7]

FIEA used to provide that only with regard to a Tender Offer by a listed company of its own stocks can notice to and disclosure by the relevant Financial Instruments Exchange qualify as measures for making information available to a large number of people with regard to the fact concerning the Tender Offer, etc[8]. However, with regard to a Tender Offer for shares of a listed company other than by the Tender Offeror, etc. itself, a Tender Offer Related Fact was deemed to be made available to a large number of people only when such fact had been disclosed for 12 hours or more to two or more widely distributed press or major broadcasting companies or was disclosed to the public in a statutory Tender Offer Public Notice or Tender Offer Statement[9].

As a result of the recent amendment in Article 30 of Cabinet Order Enforcing FIEA, when a Tender Offeror, etc. (a non-listed company) requests its parent listed company or the target

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[4] *cf.* Items 8 through 11, Paragraph 6, Article 166 of FIEA
[5] Items 5 through 14 of Paragraph 1 of Article 49 of Cabinet Office Ordinance Concerning the Regulations of Securities Transactions as well as Paragraph 2 of the same Article.
[6] As defined under Article 24 of FIEA
[7] Facts concerning the commencement or cancellation of Tender Offer, etc. as defined under Paragraph 3 of Article 167 of FIEA
[8] Tender Offer and similar accumulated purchases as defined under Paragraph 1 of Article 167 of FIEA
[9] Required under Paragraph 1 of Article 27-3 and Paragraph 2 of Article 27-22-2 of FIEA

company to give notice of a Tender Offer Related Fact to the relevant Financial Instruments Exchange and as a result, such Financial Instruments Exchange discloses the fact, then the information is deemed to have become available to a large number of people.

II Forthcoming Amendments That Are Expected To Become Effective As Of 1 April 2014

Further amendments of FIEA were promulgated on 19 June 2013. The proposed amendments of the related articles of the Cabinet Order are being made open for public comment as of the day of writing of this News Letter. The amendments are expected to become effective as of 1 April 2014[10].

1. Prohibition on Conveying to a third party Material Facts or Tender Offer Related Facts, etc. or on making a trade recommendation knowing Material Facts or Tender Offer Related Facts, etc.

（1） This amendment was triggered by a widely publicized scandal on "New Share Issue Insider Trading Incidents", where some major securities companies conveyed to some of their institutional investor clients the fact that some of their investment banking clients were about to issue new shares via public offering. Those institutional investors that were engaged in insider trading based on the information were ordered to pay administrative fines (*Kachokin*) but the securities companies or their employees were not fined[11]. Under the current FIEA, conveying Material Facts or Tender Offer Related Facts to a third party is not prohibited by itself, although such act may be punished if it constitutes aiding, abetting or incitement of insider trading[12].

（2） FIEA was amended to add a new article (Article 167-2), which, in essence, prohibits a Company Insider (*Kaisha Kankeisha*)[13] or a Person Concerned with Tender Offer (herein called "Tender Offer Insider (*Koukai Kaitsukesha-tou Kankeisha*)[14]") from conveying Material Facts or Tender Offer Related Facts to a third party person or from recommending a third party person to trade in Specified Securities or Stocks, etc. before such facts are made public, if the Company Insider or the Tender Offer Insider came to know of the Material Facts or the Tender Offer Related Facts of a listed company in a number of specified ways of acquiring the information and as long as such transfer of information or recommendation is done for the purpose of making the third party person

[10] Amendments of related Cabinet Office Ordinances were made open for public comment on 21 November 2013.
[11] While the securities companies involved were not criminally or administratively fined, they lost some important underwriting businesses and orders from institutional investors following the scandal. Therefore, they suffered significant loss of revenue and their reputation was severely damaged.
[12] Financial Instruments Business Operators are prohibited from soliciting business by providing Corporate Information of the issuer, etc. (Item 14 of Paragraph 1 of Article 117 of Cabinet Office Ordinance Concerning Financial Instruments Business Operators, etc.) Further, Financial Instruments Business Operators must avoid the situation concerning the management of Corporate Information and of transactions by customers where measures that are both necessary and appropriate to prevent unfair transaction with regard to Corporate Information are not taken (Item 5 of Paragraph 1 of Article 123 of the aforementioned Cabinet Office Ordinance). A Financial Instruments Business Operator violating those provisions may receive administrative sanctions including a business improvement order from Financial Services Agency of Japan (JFSA).
[13] As defined under Paragraph 1 of Article 166 of FIEA
[14] As defined under Paragraph 1 of Article 167 of FIEA

gain a profit or avoid a loss by trading in the Specified Securities or the Stocks, etc. of the Listed Company, etc. Please note that making a recommendation is prohibited even if it is done without conveying Material Facts or Tender Offer Related Facts. This new set of restrictions is imposed only on Company Insiders and Tender Offer Insiders as defined in Paragraph 1 of Articles 166 and 167 respectively and those who received information from them ("primary information recipient", *i.e.* those defined under Paragraph 3 of Article 166 or 167 respectively) are outside the scope of the restrictions.

(3) At the same time, Article 175-2 (Administrative Fine) was added and Article 197-2 (Penal Provision) was amended. Those who commit an act prohibited under Article 167-2 will be liable to pay an administrative fine and/or be subject to a criminal charge if the person who received information or a recommendation in contravention of Article 167-2 is actually engaged in the trading of the Specified Securities or the Stocks, etc. As the purpose of Article 167-2 is to prevent insider trading, if the sale or purchase made by the information recipient is exempt from the insider trading prohibition under Paragraph 6 of Article 166 or Paragraph 5 of Article 167 respectively, the information provider or the person who has made recommendation is not subject to an administrative fine or criminal penalty. However, one should note that in case of a recommendation without conveying Material Facts or Tender Offer Related Facts, while the person who makes the recommendation may be punished, the person who buys or sells the Specified Securities or the Stocks, etc. based on the recommendation cannot be punished, if he/she is not in possession of insider information at the time of trading.

(4) The amount of administrative fine imposed for violation of this new rule (Article 167-2) is differentiated according to the circumstances such provision of information or recommendation is made.

a) If it is done in relation to brokerage or PTS[15] business, the amount of the fine would be three times the amount of fees the business operator received during the month when the violation was committed.

b) In the case where a business operator commits the violation in relation with underwriting business, the amount of fine is the amount calculated in a) above plus one half of the underwriting fee with regard to the Specified Securities or the Stocks, etc..

c) In all other cases, the amount of the fine is set at one half of the amount of the profit deemed to have been gained[16] by the information recipient through the trading of the Specified Securities or the Stocks, etc.

2. Amendment to increase the amount of administrative fine in the case where the insider trading committed involves other people's assets under the management of an asset manager.

[15] Proprietary Trading System as defined under Item 10 of Paragraph 8 of Article 2 of FIEA
[16] The deemed profit amount is calculated according to Paragraph 3 of Article 175-2 of FIEA and does not necessarily represent the amount of profit (or avoided loss) that has actually been realized.

Many people criticized that administrative fines imposed on institutional investors in recent cases were too low to effectively deter insider trading. In response to this criticism, Article 175 of FIEA was amended to increase the amount of administrative fine in the case where the insider trading committed involves assets under the management of an asset manager. The amount of the fine will be three times the amount of the remuneration for the total assets under management such asset manager received in the month when the insider trading was committed and not just the remuneration received from the client for whose account the insider trading was done.

3. Disclosure of the names of offenders, etc.

Article 192-2 which was newly added to FIEA authorizes the Prime Minister (JFSA) to make public the name of any person who has violated any provision of FIEA or any administrative order based on FIEA or such other information which needs to be disclosed in order to prevent or contain harm and to maintain the fairness of transactions, if the Prime Minister deems it necessary and appropriate to do so for the public benefit or protection of investors. This applies not only to insider trading violations but to violations of other provisions of the FIEA. According to comments by JFSA officials involved in the drafting of this article, the disclosure of the names, etc. is not an administrative disposition and can be done even without the authorizing provision. The disclosure is expected to be done in serious cases especially those committed by the officers of Financial Instruments Business Operators[17] who have violated FIEA provisions before.

4. Introduction of Insider Trading restriction to listed Investment Securities

(1) Investment Securities[18] (*Toshi Shoken*) issued by Investment Corporations[19] (*Toshi Hojin*) were hitherto not covered under insider trading restrictions. However, there are certain facts that can affect the investment decision of investors in Investment Securities. Typically, for example, the change of asset management company, acquisition of a major asset, etc. can affect the price of a REIT. Further, Tender Offers may be commenced with regard to Investment Securities, which might affect the price of Investment Securities.

(2) Paragraph 1 of Article 163 of FIEA has been amended so that Investment Securities are now included in the definition of "Specified Securities" and issuer of listed Investment Securities are now included in the definition of "Listed Company, etc." The definition of Company Insider (Paragraph 1 of Article 166 of FIEA) now includes the directors, agents, employees, etc. of an Investment Corporation as well as of the asset management company, its parent company and sponsor company (defined as the Specified Related Company under Paragraph 5 of Article 166 of FIEA and Article 29-3 of the amended Cabinet Order). Material Facts with regard to Investment Securities are listed in Items 9 through 14 of Paragraph 2 of Article 166. Among them, Item 12 is

[17] As defined under Article 28 of FIEA
[18] As defined under Item 15 of Article 2 of the Act on Investment Trusts and Investment Corporations
[19] As defined under Item 12 of Article 2 of the Act on Investment Trusts and Investment Corporations

related to the decisions made by the asset management company on matters such as the acquisition, transfer or lease of specified assets. Item 13 is related to the factual matrix with respect to the asset management company itself. With regard to Material Facts related to the asset management company, disclosing measures can be taken by the asset management company which would release it from the trading restriction.

Tender Offer Insiders are prohibited from buying or selling, as the case may be, the Stocks, etc. before the fact concerning the commencement or cancellation of a tender offer is made public. The definition of Stocks, etc. is left to the Cabinet Order and Investment Securities was hitherto not included in the definition in Article 33 of the Cabinet Order. Article 33 of the Cabinet Order has now been amended to include Investment Securities.

5. Creation of new exemptions with regard to Tender Offer related insider trading restriction

Before the recent amendment, the rule was such that if a would-be tender offeror makes a potentially competing purchaser of the same listed company (the target company) aware of his intention to launch a Tender Offer, the recipient of the information may not purchase the shares, etc. of the target company until the offeror makes his intention public. In order to alleviate this situation, two exemptions have been added to Paragraph 5 of Article 167.

（1） When the information recipient makes purchases in observance of Tender Offer regulations and the salient facts such as the name of person who conveyed the intention to launch a tender offer, the timing of such information transfer, etc are disclosed to the public in a Tender Offer Public Notice or Tender Offer Statement filed by the information recipient, the restriction is lifted.

（2） When six months have elapsed since the information was conveyed by the would-be tender offeror, then the restriction is lifted and the information recipient may purchase the Stocks, etc. of the target company. In line with this amendment, the length of time during which a person who used to be a Tender Offer Insider is restricted from buying or selling the related Stocks, etc. has been shortened from one year to six months.

6. Expansion of the definition of Tender Offer Insiders

Tender Offer Insiders were hitherto limited to the directors, etc of the offeror (including its parent company), the shareholder that has the power to peruse the books of the offeror, a person who has statutory power over the offeror, a person who has or is going to have a contractual relationship with the offeror and did not include anybody related to the target listed company[20]. Now under the amended rule (Item 5 of Paragraph 1 of Article 167), the issuer of the target listed stocks and its directors, etc. are also considered as Tender Offer Insiders if they have come to know the Tender Offer Related Facts from a Tender Offer Insider.

[20] Even under the current rule, if the target company enters into an agreement such as confidentiality agreement with the offeror, then the target company and its directors, etc. may became Tender Offer Insiders.

Please note that the above description is not intended as an exhaustive commentary of current or expected regulations concerning Insider Trading but a brief outline of only such part of the existing regulations and the expected amendments thereof that the author considers significant in his personal opinion. The opinion expressed here is purely that of the author and does not represent the views of Atsumi & Sakai. Neither Atsumi & Sakai nor the author warranties the factual accuracy of this News Letter, although the author has made reasonable efforts to avoid obvious mistakes. Neither Atsumi & Sakai nor the author assumes any responsibility for the consequences the reader might face by relying on the contents of this News Letter. If you consider entering into any transaction, do not rely on this News Letter but consult the author or any lawyer admitted in Japan at Atsumi & Sakai.

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