

## Japan moves to facilitate rights offerings

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### Speedread

The Financial Services Agency of Japan (the FSA) published a report by its study group regarding how to improve rules for rights offerings. This article looks at the FSA's proposed improvements to current rules for rights offerings.

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On 19 January 2011, the Financial Services Agency of Japan (the FSA) published a report by its study group regarding how to improve rules for rights offerings.

In Japan, it has been quite usual for companies in need of new equity to offer new shares in the market or to allocate the new shares to persons other than existing shareholders, but without providing existing shareholders with pre-emptive rights. Such share issuance can be made pursuant to a board resolution and without a shareholders' resolution, unless the company is a closed company or the issue price of new shares is particularly favourable to subscribers. Such share issue practice has recently been questioned (though not prohibited) from the viewpoint of dilution of existing shareholders' rights; this dilution issue may be one of the factors that has led to a decline in investment in Japanese stock markets. Rights offerings are expected to overcome this problem (pursuant to which, share options are allocated to existing shareholders without consideration for the options themselves and such share options are listed so that the existing shareholders may either exercise the options by subscribing for new shares, or sell the options in the market).

The FSA report addresses issues under current rules for rights offering and proposes certain improvements (though a timetable for the rule amendments is yet to be determined) as follows:

**Change of method in providing prospectus to existing shareholders.** As a general rule, under the Financial Instruments and Exchange Act of Japan (the FIEA), listed companies may allocate share options without consideration only by means of public offering which would require a prospectus to be directly provided to each investor. This process might be quite onerous for rights offerings where there are numerous existing shareholders (while the existing shareholders, who will automatically be allocated with share options, need information in the prospectus only in relation to making a decision as to whether to exercise or sell the options); the FSA report proposes to change the rule so that publishing the prospectus on EDINET will constitute sufficient disclosure.

**Appropriate regulations for "undertaking" type rights offerings.** When an issuing company needs a securities firm to provide an assurance that a certain amount of equity funding will be obtained by the rights offering (effectively an "underwriting"), the most likely structure would be:

to provide in the terms of the share option that the issuing company will buy back the options from existing shareholders who do not exercise the options prior to the exercise date;

for the securities firm to provide an undertaking to purchase from the issuing company the bought-back options (then the securities firm will exercise the options and sell the new shares it obtains).

Under the current FIEA, the provision of the abovementioned undertaking by a securities firm would not constitute an "underwriting of securities" for the purposes of that Act and would therefore not be subject to the various regulations thereunder applicable to underwriting by Financial Instruments Business Operators. However, the FSA report proposes to expand the scope of "underwriting of securities" to cover the same. Also, securities firms which provide such undertakings may be inclined to encourage existing shareholders to exercise the options in order to mitigate the risk they have undertaken as underwriters. Such activities would not constitute an "offering" of securities under the FIEA, but the FSA report suggests to add appropriate regulations to cover such activities (such as prohibition of false statements, etc.).

**Dealing with foreign countries' securities regulations.** In the case of a shareholder who resides in a foreign country, such shareholder's exercise of share options may trigger an obligation on the issuing company to make onerous registration or disclosure under such foreign country's securities regulations. The FSA report states that further discussion is required on whether it would be permissible to exclude existing shareholders in foreign countries from the rights offering process.

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