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Amendments to Japanese Insider Trading Regulations Which Broaden the Scope of Application to Tippers and Tender Offer Bids

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On June 12, 2013, a bill (the “Amendment Bill”) to amend the Financial Instruments and Exchange Act (FIEA) was passed at the Diet session and promulgated as of June 19, 2013. The Amendment Bill amends the insider trading regulations based on the Financial System Council’s report entitled, “The Review of Insider Trading Regulation Following Recent Violations and Other Developments” which was published on December 25, 2012.¹

The Amendment Bill is comprised of two main parts:

- new regulations on information disclosures and trade recommendations
- amended regulations based on recent financial and corporate practices.

The effective date of the Amendment Bill is to be specified in a cabinet order yet to be issued, but is intended to be a date within one year of the Amendment Bill’s promulgation (i.e., by June 19, 2014).

New Regulations on Insider Information Disclosures and Trade Recommendations

Current insider trading regulations in Japan prohibit insiders from trading on material, non-public information prior to the public announcement of such information. However, existing regulations do not specifically cover the discloser of such insider information (i.e., the tipper)². Government authorities have tried to prosecute tippers through an aiding-and-abetting theory, however because there are no clear regulations on tipper liability, such enforcement has been difficult. Further, in recent years, there has been an increase in the number of insider trading cases where inside information was leaked by the sales staff of lead underwriters in a number of public offerings for listed companies, some of which have led to major scandals for top Japanese securities firms.

Therefore, to deter individuals from disclosing insider information, the Amendment Bill prohibits a corporate insider³ from disclosing material, non-public information if the corporate insider disclosing

¹ http://www.fsa.go.jp/en/refer/councils/singie_kinyu/reports/20121225.html

² Basically, there are two types of insider trading prohibited under the FIEL: (1) trading by corporate insiders (*kaisha kankei sha*); and (2) trading by insiders with knowledge of a tender offer (*kokai kaitsukeshu tou kankeisha*). Corporate insiders are prohibited from trading when they are aware of material non-public information of the relevant company (such as a board’s decision to issue new shares), and insiders are prohibited from trading when they are aware of non-public information about a tender offer bid or a buyout of 5% or more of the relevant company’s shares. (See Article 166, Paragraph 2 and Article 167, Paragraph 2 of the FIEA for a detailed definition of “material non-public information”).

³ Sales staff of lead underwriters is included in the corporate insider if he/she becomes aware of non-public information in the course of negotiation, execution or implementation of agreements with listed companies.

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such information intends for the third party (i.e., the tippee) to profit or avoid losses by trading on the information⁴.

The Amendment Bill also prohibits a corporate insider from implying the existence of certain unpublished material facts or indicating that he/she is in a position to obtain such facts (e.g., by being an executive or having a similar high-level position within a company) and recommending that a tippee trade on such insider information with the intent to profit or avoid a loss⁵.

Further, for the Government of Japan to impose administrative fines and/or imprisonment, the tippee must have actually committed an insider trading (which is not exempted) based on the disclosure of insider information or trade recommendation by the tipper⁶.

Fines and Imprisonment

Under the Amendment Bill, if an individual has violated the regulations on insider information disclosures or trade recommendations, the offender could be subject to an administrative fine of up to one half of the profits gained by the tippee from the sale or purchase which constitutes insider trading⁷. In addition, the offender could face imprisonment of up to five years, a criminal fine of up to JPY5 million, or a combination of the two⁸. If the individual commits the violation during the course of a company's business, the company will also be subject to a criminal fine of up to JPY500 million⁹.

With respect to stockbrokers, given that they play an important role in ensuring the fairness and soundness of the securities market, and because they can substantially benefit from insider trading, the Amendment Bill calls for more severe sanctions to be imposed. For example, if a stockbroker engages in illegal insider information disclosures or trade recommendations, he/she could be liable for administrative fines equivalent to three times the monthly commissions for the months during which he/she committed a violation; and for public offerings, an additional one half of the underwriting commissions¹⁰.

Further, if an officer or employee of a brokerage firm commits a violation during the course of business, the names of the officers and employees will be published to alert any potential stock purchasers. The publication is considered to have a significant deterrent effect on the conduct of brokerage firm's officers and employees¹¹. Also, the Amendment Bill will allow the relevant government authority to publish the names of fund managers who have played a key role in insider trading – the new regulations recognize that hedge fund managers have great influence over brokerage firms through the use of brokerage rating reviews and often demand that such firms provide them with “useful information”¹².

The Amendment Bill has also increased the amount of administrative fines for asset managers where the fine would be equal to the product of commissions received for the months during which the

⁴ New Article 167-2, Paragraph 1 and 2 of the FIEA

⁵ New Article 167-2, Paragraph 1 and 2 of the FIEA

⁶ New Article 175-2 and Article 197-2, Paragraph 14 and 15 of the FIEA

⁷ New Article 175-2, Paragraph 1, Item 3 and Paragraph 2, Item 3 of the FIEA

⁸ New Article 197-2, Item 14 and 15 of the FIEA

⁹ New Article 207, Paragraph 1, Item 2 of the FIEA

¹⁰ New Article 175-2, Paragraph 1, Item 1 and 2, and Paragraph 2, Item 1 and 2 of the FIEA

¹¹ New Article 192-2 of the FIEA

¹² New Article 192-2 of the FIEA

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violation took place multiplied by three times the value of the relevant securities of the total assets under management¹³.

Amendment Bill's Application to Tender Offer Bids

Recent cases of insider trading relating to tender offer bids have shown an increase in the number of insider trading acts committed by officers and employees of the target company subject to a tender offer bid. However, since the existing rules do not clearly cover such officers and employees, the regulator and enforcement authority faces practical difficulties in recognizing them as offenders.

The Amendment Bill attempts to resolve this issue by adding officers or employees of a publicly listed target company to the list of offenders who will be subjected to administrative and/or criminal sanctions if they purchase shares of their company based on non-public tender offer information.

The Amendment Bill also revises the rules on competing acquirers of a target company. Under the existing rules, a potential acquirer which receives non-public tender offer information from another competing acquirer is prohibited from trading or submitting its own tender offer until and unless the competing acquirer publishes its tender offer.

To address this issue, the Amendment Bill allows the potential acquirer to either:

- clarify in its own tender offer announcement information such as the name of the competing acquirer who had informed him/her of its tender offer information, the timing as to when he/she was informed, and certain matters regarding the content of such facts (to be later specified in cabinet ordinances)¹⁴; or
- purchase shares (i.e., not through a tender offer) if six months have passed after the potential acquirer was informed of the non-public tender offer information¹⁵.

Expansion of Exemption from Insider Trading Regulation for Over-the-counter Trades Between Persons in Possession of Non-public Information

Under the current insider trading regulations, there is an exemption for over-the-counter (OTC) trades between a corporate insider and a tippee. However, this exemption does not apply to other OTC trades between the initial tippee and the tippee's purchaser/seller of the shares (who is not a corporate insider), nor does it apply to any subsequent trades between the tippee's purchaser/seller and other purchasers/sellers which do not fall under trades between a corporate insider and the initial tippee. Practitioners consider this exemption to be inflexible because it does not allow a large shareholder to make off-exchange block trades if he/she knows non-public information and neither the large shareholder nor its counterparty is a corporate insider or the initial tippee.

The Amendment Bill broadens this exemption to capture OTC trades between tippees and subsequent purchasers/sellers in possession of non-public information, which do not fall under trades between a corporate insider and the initial tippee from the corporate insider¹⁶. With this amendment, a large

¹³ For instance, new Article 175, Paragraph 1, Item 3 and Paragraph 2, Item 3 of the FIEA

¹⁴ Please however note that tender offer bid related insider trading regulations also apply to a recipient of information who intends to buy up 5% or more of the share without conducting tender offers, and this exemption does not cover such case.

¹⁵ New Article 167, Paragraph 5, Item 8 and 9 of the FIEA

¹⁶ New Article 166, Paragraph 6, Item 7 of the FIEA

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shareholder may make block trades with purchasers based on insider information that the large shareholder communicates to the purchasers¹⁷.

Conclusion

Among the number of revisions under the Amendment Bill, the increased scope of insider regulations to tipplers has particularly attracted much attention among legal practitioners because such tipper liability could significantly affect activities by listed companies, especially those related to investor relations, mergers and acquisitions, and business alliances.

Companies should ensure that it maintains appropriate documentary evidence to negate any allegations of insider trading, review and enhance internal trading rules and compliance manuals, and provides proper education and training to all officers and employees. As the detailed cabinet orders and enforcement ordinances will be drafted and promulgated, continuous monitoring of this Amendment Bill will be necessary.

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** Japanese legal concepts expressed in the English language may not be identical to the equivalent English terminologies.*

¹⁷ Note, however, that the Amendment Bill does not allow the purchaser to sell to a subsequent purchaser based on the non-public information.

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