CAPITAL MARKETS - JAPAN

Finalisation of fair disclosure rule under securities law

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Introduction

In June 2017 the Financial Instruments and Exchange Act was amended to introduce the fair disclosure rule in Japan (for further details please see "Fair disclosure rule under securities law"). Subsequently, in October 2017 the Financial Services Agency (FSA) published draft legislation (comprising an implementing order and an ordinance) and guidelines for public comment, followed by final versions of the legislation and its opinions on the public comments in December 2017. In February 2018 the FSA published new guidelines and further opinions on the comments. This update examines the latest versions of the legislation and guidelines and the current circumstances regarding the fair disclosure rule.

Scope of application

Issuers and material information

Under the amended Financial Instruments and Exchange Act, a 'listed issuer' (ie, an issuer whose debt securities, shares, options or investment securities are listed on a Japanese stock exchange) must simultaneously publish any material information that is disclosed to a trade-related person by:

- the listed issuer;
- a director, corporate auditor or executive officer of the listed issuer; or
- an agent or employee of the listed issuer who is in charge of the listed issuer's investor relations.

Foreign issuers whose debt securities, shares, options or investment securities are listed on any foreign securities exchange specified by the FSA (including the New York Stock Exchange, the Nasdaq Stock Market, the London Stock Exchange and the Luxemburg Stock Exchange) are exempt from the application of the fair disclosure rule. However, foreign issuers are still subject to the Japanese fair disclosure rule if they issue debt securities that are listed only on a Japanese stock exchange (eg, the TOKYO PRO-BOND Market). In this regard, the FSA's opinions have clarified that the scope of information that will be regarded as material information will vary depending on the type of security in question, which is in line with Japan's insider trading rules. Under these rules, the scope of information that will be regarded as insider information in respect of debt securities (excluding convertible debt or other equity-related debt securities) is limited to certain information relating to the issuer's creditworthiness, such as information concerning its insolvency or dissolution. Therefore, the FSA's opinions suggest that the scope of information that will be regarded as material information in respect of debt securities in the context of the fair disclosure rule should be limited to such credit-related information, but the precise scope of the material information must be carefully considered.

Material information

According to the amended Financial Instruments and Exchange Act, 'material information' means undisclosed material information that:

- concerns the listed issuer's operations, business or assets; and
- would have a material effect on an investor's investment decision.

Based on this definition, the scope of material information is considered to be broader than that of the insider information to which the insider trading rules apply. However, even after the release of the FSA's final guidelines and its opinions regarding the public comments that it received, the precise scope of what constitutes material information remains unclear.

The final guidelines suggest that insider information, as well as undisclosed and settled financial information, would constitute material information. The FSA has suggested that monthly gross revenue would not be regarded as constituting settled financial information, but forecasts of increases or decreases in settled financial results may be regarded as such and hence constitute material information.

Under the act, the definition of 'insider information' is uniquely structured and contains an objective threshold that is used to exclude certain information from the scope of insider information. For example, in the case of a merger, if the surviving entity's total assets are expected to increase by less than 30% and its gross revenue is expected to increase by less than 10%, information relating to such a merger is excluded from the scope of insider information. However, there is no such objective threshold in the definition of 'material information' under the fair disclosure rule. In this respect, the FSA's guidelines suggest that information relating to the aforesaid merger should be treated in the same way as it is in the case of insider information and be excluded from the scope of material information. However, the above interpretation is not definitive. The FSA has also stated that the scope of material information should be established by the practice developed through communications between listed issuers and investors.

The FSA's guidelines also touch on forward-looking information concerning a listed issuer, such as mid to long-term strategies and plans. More specifically, the FSA has stated that any information communicated to investors in respect of a listed issuer's strategy or plan will not generally constitute material information. However, if such strategy or plan contains information relating to target operating or net profits that would have a material effect on investment decisions, that information may be regarded as material information.

Recipients

Under the amended Financial Instruments and Exchange Act, the disclosure of material information by a listed issuer will trigger the requirement to publish such material information if the disclosure is made to 'trade-related persons', the definition of which includes the following parties:

- financial instrument business operators, registered financial institutions, investment corporations and investment advisers; and
- owners of listed securities of the said listed issuer and qualified institutional investors if they receive the material information in connection with the listed issuer's investor relations.

The FSA's opinions have clarified that the persons described in the first category above do not include M&A advisory firms or consulting firms which are not financial instrument business operators. With respect to organisations which fall under the first category, if they establish a so-called 'Chinese wall', the directors and employees of such organisations who are engaged in the organisation's non-financial instruments business and received material information in the course of such business will not be regarded as trade-related persons.

Exemptions

The amended Financial Instruments and Exchange Act also provides that if a person who receives material information is subject to a statutory or contractual obligation that prevents them from disclosing such material information and trading the listed issuer's securities, the listed issuer will not be required to publish that information simultaneously. However, if the listed issuer becomes aware that such a person subsequently violates that obligation, the listed issuer will be required to

publish such material information promptly unless the exceptions prescribed in the legislation apply.

This requirement to make simultaneous publications will not arise where the material information concerns certain prescribed corporate actions and the publication of such information may result in such corporate actions becoming materially adversely affected. The final version of the legislation expanded the scope of such corporate actions, which now include:

- mergers;
- corporate splits;
- share exchanges and transfers;
- sales or purchases of all or part of a business;
- tender offers;
- disposals and acquisitions of a subsidiary;
- petitions for bankruptcy, civil rehabilitation or a corporate reorganisation;
- capital or business alliances or the termination of such alliances;
- any of the foregoing actions that are carried out by a parent company or a subsidiary of the listed issuer; and
- public offerings and secondary distributions of shares, options and investment securities of the listed issuer and any action that is similar to such offering or distribution.

Further, the FSA has clarified that a block trade of shares of a listed issuer may be regarded as an action that is similar to the public offering or secondary distribution described above.

Publication method

The legislation lists the posting of material information on the listed issuer's website as one of the methods available for publishing material information, provided that investors can readily access it free of charge for at least one year. The FSA has clarified that this one-year requirement would be satisfied if, at the time that the information is posted on the website, the listed issuer implements measures to make such information accessible to investors for at least one year, even if it turns out that such information subsequently becomes inaccessible after less than one year due to unexpected reasons. According to the FSA's opinions, this publication requirement can also be satisfied by publishing visual and audio information, such as a webcast of an investors' meeting.

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