

Application of fair disclosure rule to listed bonds

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Introduction

The newly introduced fair disclosure rule enacted under Japan's securities laws and regulation regime is most often considered to apply to issuers of listed shares. However, the rule is also applicable to issuers of bonds listed on the Tokyo Pro-Bond Market. This update explains the extent to which the fair disclosure rule applies to such listed bond issuers.

Fair disclosure rule

The fair disclosure rule has been in force since 1 April 2018 (for further details please see "[Fair disclosure rule under securities law](#)" and "[Finalisation of fair disclosure rule under securities law](#)"). The rule, which was enacted through an amendment to the Financial Instruments and Exchange Act, requires each issuer of listed securities (as well as certain individuals associated with the issuer, such as its directors and employees in charge of investor relations activities) which discloses certain 'material information' to a trade-related person (eg, a financial institution, investor or potential investor) to concurrently publicly disclose such material information. The aim of the fair disclosure rule is to secure fairness (among all investors and potential investors) with respect to material information disclosures.

As the fair disclosure rule is applicable to issuers whose securities are listed on a securities exchange, this rule is often discussed in the context of equity securities such as shares and share options. However, based on the clear wording of the rule, it is also applicable to issuers whose only listed securities are bonds. Although the majority of bonds issued in the Japanese market are unlisted, there is a market dedicated to listed bonds in Japan: the Tokyo Pro-Bond Market.

Tokyo Pro-Bond Market

The Tokyo Pro-Bond Market is a bond market administered by the Tokyo Stock Exchange. As this is a market for professional investors, only institutional investors, certain other sophisticated investors and non-Japanese investors can make investments in listed bonds through transactions in this market. Compared to conventional public offerings, bond offerings can be conducted much more simply and efficiently through transactions in this market. For example, in the case of a bond offering through the Tokyo Pro-Bond Market, certain requirements associated with public offerings (eg, the filing of a securities registration statement with a local financial bureau and a 15-day waiting period following the filing) can be avoided. In addition, disclosure documents can be prepared either in Japanese or English, and financial statements can be prepared in compliance with Japanese, US or international accounting standards. The making of disclosures in English is convenient for non-Japanese issuers and investors. In light of these benefits, there are various issuers (eg, Japanese and non-Japanese issuers and issuers in the private and public sectors) whose bonds are listed on the Tokyo Pro-Bond Market.

Japan's insider trading rule and debt securities

As explained above, it is clear that the fair disclosure rule is applicable to issuers whose only listed securities are bonds. Having said that, the Financial Services Agency (FSA) – which is responsible for enforcement of the rule – has indicated its position that the scope of what is considered material information under the fair disclosure rule will vary depending on the type of security at issue, as is the case with the application of Japan's insider trading rules (for further details please see "[Insider trading rule under Financial Instruments and Exchange Act](#)"). For this reason, it is useful to examine the application of Japan's insider trading rules in relation to bonds in order to gain a general understanding of what constitutes material information for listed bonds under the fair disclosure rule.

Under Japan's insider trading rules, certain insiders of an issuer who become aware of any material fact are essentially prohibited from trading listed securities of the issuer unless and until the material fact is publicly announced. The insider trading rules apply to listed bonds as well as listed equity securities. The insider trading rules stipulate a lengthy list of events that, in general, would be considered material facts – extending from information regarding contemplated stock offerings and M&A transactions to information regarding bankruptcy filings and loss arising from natural disasters. Any of the foregoing would be considered a material fact under the insider trading rules, preventing any insider of an issuer with knowledge of such a fact from trading listed equity securities of the issuer.

In contrast, in the case of listed bonds, insider trading rules are not applicable unless a certain credit event takes place (eg. the dissolution of the issuer or the filing of a bankruptcy petition in relation to the issuer) and an insider with advance knowledge of such credit event – which has not been publicly disclosed – engages in trading of the issuer's listed bonds.

Fair disclosure rule and debt securities

Under the fair disclosure rule, 'material information' is defined as "undisclosed material information which is related to the operation, business or assets of a listed issuer and which would have a material impact on investors' investment decisions". It is understood that 'material information' has a broader scope than 'material facts' under Japan's insider trading rules. Considering that the scope of 'material facts' is limited in respect of listed bonds, it is reasonable to conclude that the scope of material information should also be limited to some extent. However, the fair disclosure rule and its guidelines published by the FSA do not clearly define what information constitutes material information.

According to the FSA's guidelines, international enterprises which manage their investor relations activities based on standards which they have established (considering relevant rules applicable in foreign jurisdictions) to determine which information would have a material impact on the price of their securities can rely on such standards. Additionally, issuers which manage their investor relations activities in accordance with Japan's insider trading rules can, for the time being, treat as material information:

- information considered to be material facts under the insider trading rules; and
- their definitive financial information as of such issuers' fiscal year end or quarter end that would, if disclosed, have a material impact on the price of the issuers' securities in question.

According to the FSA's guidelines, the foregoing sets out the minimum standard for compliance by any issuer. Further, if an issuer cannot determine what financial information, if disclosed, would have a material impact on the price of such issuers' securities in question, the guidelines instruct it to treat as material information:

- information considered to be material facts under Japan's insider trading rules; and
- all undisclosed definitive financial information as material information.

In any event, the FSA expects each issuer to manage material information in an appropriate manner based on its particular situation and determine which information is to be considered material

information through active dialogue with its investors.

Comment

Care should be taken when considering whether information or a particular circumstance falls within the scope of material information based on a particular situation in light of the FSA's guidelines.

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