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 so-called 'fair disclosure' rule in Japan. The amendments, which are scheduled to take effect no later than June 2018, address:

- recent cases of selective disclosure of material information by issuers to sell-side analysts; and
- investors' requests to introduce similar fair disclosure rules to those of other jurisdictions.

In October 2017 the Financial Services Agency (FSA) published a draft implementing order, ordinance and guidelines for public comment. This update examines the amendments to the Financial Instruments and Exchange Act and the draft order, ordinance and guidelines with respect to the fair disclosure rule's introduction in Japan.

Scope of application: issuers and material information

Under the amended Financial Instruments and Exchange Act and the draft order, if undisclosed material information concerning the operation, business or assets of an issuer whose debt securities, shares, options or investment securities are listed on a Japanese stock exchange (ie, a listed issuer) is disclosed to a trade-related person (as defined below) – and such material information would have a material effect on an investor's investment decision – the listed issuer must publish the material information at the same time as its disclosure of the information to the trade-related person in cases where the disclosure was made by one of the following parties in connection with its business:

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

Pursuant to the draft order, issuers of investment securities – other than investment corporations that invest more than half of their assets into real properties – are excluded from the application of the fair disclosure rule in Japan. Further, foreign issuers whose debt securities, shares, options or investment securities are listed on a foreign securities exchange specified by the FSA (eg, the New York Stock Exchange, Nasdaq, the London Stock Exchange, the Luxemburg Stock Exchange, the Singapore Exchange or the Hong Kong Stock Exchange) are excluded from the scope of the fair disclosure rule.

While the scope of material information is considered to be broader than the scope of the material facts to which the insider trading rules under the Financial Instruments and Exchange Act apply, the scope of what constitutes 'material information' is unclear. In this respect, the FSA's draft guidelines suggest that listed issuers should manage not only material facts, but also undisclosed and settled

financial information. However, the draft guidelines do not provide an exhaustive list of what information constitutes 'material information' for the purposes of the act. As such, listed issuers, investors and regulators should establish best practices concerning the scope of material information so that communications between listed issuers and investors are not negatively impacted as a result of such ambiguity.

Scope of application: recipients

Under the amended Financial Instruments and Exchange Act, a disclosure by a listed issuer of material information to the following categories of persons (ie, so-called 'trade-related persons') will trigger a requirement to publish such material information:

- financial instruments business operators and other persons prescribed in the ordinance, as well as, for example, their directors; and
- the parties prescribed in the ordinance as being likely to trade securities of the listed issuer based on investment decisions derived from the material information received in connection with the listed issuer's investor relations business.

The persons categorised in the first bullet point above and prescribed in the draft ordinance include:

- financial instruments business operators;
- registered financial institutions;
- credit rating agencies;
- investment corporations;
- investment advisers; and
- high-frequency traders.

These categories apply equally to non-Japanese entities that are engaged in business which corresponds to any of the above categories in foreign jurisdictions.

Further, with respect to the persons categorised in the first bullet point above, if measures to manage material information appropriately, as prescribed in the ordinance, have been established, directors (among other parties) of that person who are not engaged in the financial instruments business and prescribed in the ordinance will not constitute trade-related persons. Further, the draft ordinance provides that if a person categorised in the first bullet point above has established measures to ensure that material information disclosed by a listed issuer in the course of that person's non-financial instruments business will not be used in its business before the publication of such information (namely, the so-called 'Chinese Wall'), the directors (among other parties) of such person who are engaged in the non-financial instruments business of that person and who received such material information in the course of that person's non-financial instruments business will not constitute trade-related persons.

The persons categorised in the second bullet above and prescribed in the draft ordinance include:

- owners of a listed issuer's listed securities;
- qualified institutional investors;
- legal entities and other groups (including those established outside Japan) whose primary purpose is to invest in securities; and
- participants in a meeting to provide information regarding a listed issuer to specified investors.

The FSA's draft guidelines provide that a parent company of a listed issuer that receives material information in connection with the management of its group companies will not be considered a trade-related person, as it would not have received such information in connection with the listed issuer's investor relations business.

Exemptions from fair disclosure rule

The amended Financial Instruments and Exchange Act provides that if a listed issuer, or its directors (among other parties), is unaware that disclosed information constitutes material information, it will

not need to publish such information simultaneously. However, it will be required to do so promptly on becoming aware that such information constitutes material information. The draft ordinance also prescribes a similar exemption where a listed issuer, or its directors, discloses material information unintentionally or without knowledge of the recipient being a trade-related person. In such cases, the listed issuer must promptly publish such information on becoming aware that it was disclosed or that the recipient is a trade-related person.

The amended act also provides that if the person who receives material information is subject to a statutory or contractual obligation to refrain from disclosing such material information and trading securities of the listed issuer, the listed issuer will not be required to publish the information simultaneously. The draft guidelines explain that investment banking sections of securities companies and registered credit rating agencies are subject to such statutory obligations under the act. Therefore, the disclosure of material information to such persons would not require simultaneous publication under the fair disclosure rule. However, under the amended act, if the listed issuer becomes aware that a person who received material information and is bound by a statutory or contractual obligation subsequently violates this obligation, the listed issuer must promptly publish such material information, with certain exceptions, as prescribed in the ordinance. Under the draft ordinance, this simultaneous publication requirement will not arise where the material information concerns one of the following corporate actions and publication of the information may result in such action being materially adversely affected:

- a merger;
- a corporate split;
- a share exchange or other corporate reorganisation; or
- an issuance of shares, options or investment securities of the listed issuer.

Publication method

The amended Financial Instruments and Exchange Act requires material information to be published online or as set out in an ordinance. The draft ordinance provides the manner in which material information may be published, including as follows:

- Securities registration statements, securities reports, semi-annual reports, extraordinary reports and other disclosure documents required under the act must be filed with the relevant regulatory authorities.
- Press releases must be published pursuant to the rules of the relevant Japanese stock exchanges.
- Material information must be posted on the listed issuer's website and be readily accessible by investors free of charge for at least one year.

Enforcement

If the FSA determines that material information required to be published under the fair disclosure rule has not been published, it can instruct the subject person to publish the information or take other measures that it deems necessary. Further, if that person fails to take the measures requested by the FSA without any justifiable reason, the FSA can order that person to take such measures. Violation of such order may be subject to criminal penalties, which are stipulated as up to six months' imprisonment, a fine of up to Y500,000 or both.

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