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Introduction of Fair Disclosure Rule - Following the Submission of the Bill for Amendments of the Financial Instruments and Exchange Act -

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On March 3, 2017, a Bill for amendments to the Financial Instruments and Exchange Act was submitted to the Diet. Of the amendments of the said Bill, this newsletter outlines the amendments regarding the fair disclosure rules.

I. Background

There is no established fair disclosure rule in Japan that ensures that where an issuer discloses material non-public information to a third party, the issuer also makes public disclosure of such information.

However, the introduction of a fair disclosure rule in Japan is being considered following recent cases of administrative dispositions against securities companies that solicited clients for trades by providing them with inside information concerning certain issuers obtained by their sell-side analysts. The key issue in these cases was that the issuers had provided their non-public earnings information only to these securities analysts. Another consideration was that the introduction of a fair disclosure rule in Japan would align Japan with the United States as well as major jurisdictions in Europe and Asia where some form of fair disclosure rule has been adopted.

Based on the results of the discussion under the "Report by Task Force on Fair Disclosure Rule" dated December 7, 2016¹ ("Report"), reported by the "Working Group on Financial Markets" of the Financial System Council, a Bill for a Japanese fair disclosure rule ("FD Rule") was submitted to the Diet.

¹ A provisional English translation of the Report is available on the website of the JFSA [here](#).

II. Purpose of introducing the FD Rule

The Report asserts that the FD Rule should be adopted in order to ensure fair and timely disclosure of information to investors, including individual and overseas investors and so that all investors may trade with confidence. The Report also suggests that the adoption of the FD Rule would be significant toward positive aims in the nature of the following: (i) by putting into place and clarifying issuer-side disclosure rules, encourage prompt disclosure of information by issuers and eventually promote dialogue between issuers and investors, (ii) lay a foundation for more objective and accurate analyses and recommendations by analysts and (iii) by ensuring fairness in the timing for information disclosure by issuers, promote a change in the mindset of investors towards making investments from a mid- to long-term perspective, rather than from a short-term perspective based on information tip-offs².

III. Details of the FD Rule

The FD Rule aims to ensure that in cases where an information provider provides, in relation to its business, inside information before the information is made available to the public, to a certain third party (information recipients), such information is also provided (publicly disclosed) to other investors.

(1) Scope of information providers

The information providers covered by the FD Rule would include “Listed Companies, etc.” as defined in the Financial Instruments and Exchange Act (including, but not limited to, issuers of bonds, preferred equity securities, shares, securities with stock acquisition rights, investment units, securities with investment unit subscription rights, investment corporation bonds and foreign investment units that are listed on any stock exchange in Japan and certain other securities), asset management companies acting for certain Listed Companies, etc.³, and the officers of the foregoing entities as well as certain agents, employees or other personnel of the foregoing entities (collectively, “Personnel”). With respect to non-officer Personnel, these would be limited to those agents, employees or other personnel who, in the performance of their duties, communicate information to Transaction Related Parties as defined in Paragraph (3) below. Based on the above, a company’s investor relations personnel would generally fall within the definition of information providers.

As mentioned above, the FD Rule would be applicable only in cases where information providers communicate information in relation to their business.

² The specific term used in the Report is the popularly used Japanese expression “*hayamimi jyoho*” referring to information that is given to a specific person as a tip before the information becomes widely known by others. The term has been translated as “big-ears information” in the provisional English translation of the Report.

³ This item specifically refers to asset management companies retained to manage the assets of investment corporations formed under the Investment Trusts and Investment Corporations Act of Japan and whose shares are traded on any stock exchange in Japan.

(2) Scope of inside information subject to the FD Rule

The inside information subject to the FD Rule would include material information in relation to the operation, business or property of the Listed Companies, etc. that has not been made public and may have a material effect on investors in making their investment decisions (“Material Information”).

In discussions regarding the introduction of the FD Rule, certain viewpoints held that the scope of the Material Information should fundamentally correspond to the scope of information subject to Japan’s insider trading regulations. However, other viewpoints held that the scope of Material Information should also include other non-public information of a precise nature concerning an issuer or its financial products and which, if made public, would be likely to have a significant effect on the price of the relevant securities. Thus, the scope of Material Information is expected to be broader than the scope of information subject to Japanese insider trading regulations.

The Report also proposes that information that may have an effect on an investment decision combined with other information, but which would have no immediate effect on an investment decision, in of itself (referred to in Japanese as “*mosaic jyoho*” meaning, “information that is a piece of a mosaic”), should be exempt from the FD Rule. Such information could include information communicated by issuers to visitors at factory tours or attendees of business briefings. This is also described in the explanatory materials released by the Financial Services Agency dated March, 2017, which state that the financial information which has not been made available to the public, should fall under Material Information whereas dialogue regarding a company’s strategies and explanations of products during a factory tour, and the like should be excluded.

(3) Scope of information recipients

The scope of information recipients would include (i) financial instruments business operators, registered financial institutions, credit rating agencies, investment corporations or other persons to be specified by Cabinet Office Ordinance, or their Personnel, and (ii) any person so specified by Cabinet Office Ordinance as one who is highly likely to engage trades of an issuer’s securities based on Material Information received by such specified person in connection with the investor relations activities of such issuer (together with (i) and (ii), “Transaction Related Parties”).

It is expected that securities analysts would fall under category (i) above and the shareholders of the Listed Companies, etc. would fall under category (ii) above, while news media and the issuer’s customers/suppliers would be excluded from the scope of information recipients. In addition, category (i) excludes persons to be specified by Cabinet Office Ordinance as those who are not engaged in services relating to financial instruments business and who are employed by an entity that takes necessary measures for appropriate management of Material Information to be specified by Cabinet Office Ordinances. Based on the discussions in drafting the Task Force Report, exceptions are expected to be specified by Cabinet Office Ordinances in consideration of cases where an ethical wall is established within securities companies. For further details, we would need to wait for the provisions to be established by the Cabinet Office Ordinance.

(4) The entity to disclose information to the public

Under the FD Rule, Listed Companies, etc. would be obliged to disclose the subject information to the public.

(5) Methods to disclose information to the public

The public disclosure would be made through the use of the internet or any other manner to be specified by the Cabinet Office Ordinance.

Specifically, in addition to statutory disclosures made through EDINET and timely disclosures under the rules of Japan's stock exchanges made through TDnet, issuers would be expected to make public disclosure on their websites.

(6) Timing of public disclosure

Any issuer considered to be a Listed Companies, etc., would be required to make disclosure (i) "simultaneously" in the case of any intentional selective disclosure of Material Information to a certain information recipient; and (ii) "promptly" upon becoming aware that the selectively disclosed information was Material Information in the case of any unintentional selective disclosure (i.e., communication of Material Information to an information recipient without being aware that it was Material Information), or in other cases to be specified by Cabinet Office Ordinance where it is deemed to be difficult to make a public disclosure simultaneously with the selective disclosure.

(7) Cases where public disclosure is not required

A relevant issuer would not need to disclose information to the public when an information recipient, under laws and ordinances or contracts, bears confidentiality obligations and obligations under which he or she is prohibited from selling, purchasing or otherwise transacting in the relevant securities before the information is made available to the public. However, if an information recipient divulges such information received from other Transaction Related Parties or engages in sales, purchase, or other transactions of the relevant securities before the information is made available to the public in violation of his/her obligations under the relevant laws, regulations or contracts, and the relevant issuer becomes aware of such fact, as a general rule, such information would have to be promptly disclosed by the relevant issuer. However, this would not apply to the cases where the issuer is unable to disclose the Material Information due to unavoidable reasons or other circumstances to be stipulated by Cabinet Office Ordinance.

(8) Measures in case of violation of disclosure obligations (enforcement)

The Bill proposes the following administrative measures for violations of the FD Rule: (i) ordering the submission of reports or materials or inspecting of the books and documents or other articles and (ii) instructing and ordering the disclosure of the Material Information. The Bill also proposes that any person who (i) fails to submit a report or material, or submits a false report or material, (ii) refuses, impedes, or

challenges the inspections, or (iii) fails to follow the foregoing instructions and to comply with the subsequent orders, would be subject to imprisonment of 6 months or less or a fine of not more than JPY 500,000, or both.

IV. Conclusion

It is proposed that the Bill for the amendments should come into effect within 1 year of the day of promulgation. As substantial parts of the submitted Bill are left to be specified by Cabinet Office Ordinance, the practical consequences of the Bill would need to be considered in light of the details of the relevant Cabinet Office Ordinances once enacted. In addition, according to some media reports, the Financial Services Agency is also considering to develop guidelines regarding the FD Rule in order to avoid discouraging lawful disclosure. Further discussion is necessary regarding the scope of information subject to the FD Rule and disclosure so as not to cause a chilling effect on issuers and hamper prompt disclosure of information and dialogue with investors.

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