

Proposed Amendment to Short Selling Regulations in Japan

On June 27, 2011, the Financial Services Agency of Japan (the “FSA”) announced a proposed Amendment to the Cabinet Order for the Financial Instruments and Exchange Act (Cabinet Order No. 321 of 1965, the “Cabinet Order”) and the Cabinet Office Ordinance for the regulation of securities transactions (Cabinet Office Ordinance No. 59 of 2007, the “Ordinance”) regarding new regulations on short selling (the “New Rules”). The New Rules will be implemented under the Financial Instruments and Exchange Act (the “FIEA”). This newsletter outlines the New Rules.

1. Background

In short selling in connection with a public offering of securities, there is a risk that someone who engages in short selling after the announcement of a public offering of securities, but before the offering price is determined and makes the offering price lower, will acquire such securities, and make settlement of the short sale using the securities acquired in the public offering. This transaction creates an imbalance in demand and supply and prevents fair pricing of securities. To address with this risk, the FSA decided to create additional regulation on short selling. The New Rules appear to be modeled on Rule 105 of Regulation M under the U.S. Securities Exchange Act of 1934.

2. New planned regulations

(A) Unlawful Activity

Under the New Rules, in connection with the public offering of securities, any person who undertakes a short sale, or asks a broker (including a broker’s broker) to intermediate a short sale of securities on the relevant securities exchange (i.e., the Financial Instruments Exchange Market) within a certain specified period (the “prohibited period”) is prohibited, subject to certain exceptions, from making settlement with the borrowed securities for such short selling (including securities purchased under repurchase transactions) using the securities acquired by such person through the public offering.

The “prohibited period” above means the period commencing on the day after the relevant Securities Registration Statement or Extraordinary Report, as the case may be, prepared in connection with the announcement of the public offering is filed and made available for public inspection and ending on the date on which an amendment to such Securities Registration Statement or Extraordinary Report is filed and made available for public inspection in connection with the pricing of the offered securities.

The New Rules also apply to short selling in any OTC securities market established by an authorized financial instruments traders association. However, currently there is no such OTC securities market.

(B) Exceptions

There are exceptions to the above prohibition, which are as follows:

1. Dealing in listed securities futures (e.g., Japanese Government Bond (“JGB”) futures listed on the Tokyo Stock Exchange)
2. Short selling of certain specified securities which include the following:

JGBs, municipal bonds, special corporate bonds issued by government affiliated corporations, corporate bonds (other than convertible bonds, bonds with warrants and exchangeable bonds), securities similar to those issued by foreign nations/municipal governments or foreign corporations, domestic and foreign Exchange Traded Funds (“ETFs”), bonds issued by domestic and foreign investment corporations, domestic and foreign ETFs in the form of trust certificates, beneficiary certificates of securities trusts, the entrusted assets of which are foreign ETFs, bonds issued by foreign investment corporations, or foreign bonds (government, municipal and corporate bonds) and trust-type foreign ETFs, or depositary receipts the underlying securities of which are foreign ETFs, bonds issued by foreign investment corporations, or foreign bonds (government, municipal and corporate bonds) and trust-type foreign ETFs.

3. Short selling through after-hours trading on a securities exchange (i.e., ToSTNeT, J-NET, N-NET).

(C) The duty of a securities company

A securities company in Japan registered pursuant to the FIEA is required, when it offers its clients any securities (which are listed securities and are subject to the New Rules) in connection with a public offering of such securities, to inform its clients, in advance, and in writing or by appropriate information-communication technology (i.e., e-mail, on the internet) to the effect that: (i) if the client has undertaken a short sale, or has asked a broker (including a broker’s broker) to intermediate a short sale of securities on a securities exchange during the “prohibited period”, such client is prohibited from making settlement with the borrowed securities for such short selling with the securities acquired by such person through the public offering; and (ii) if the client is acquiring the securities in the public offering for the purpose of settlement with the borrowed securities for a short sale (including securities purchased under repurchase transactions), the client cannot acquire such securities.

3. Schedule for Implementation

The New Rules are now under consideration (i.e., public comments are sought on the draft amendments to the relevant regulations by July 25, 2011), and it is expected that the FSA will publish the final version of the amendments to the Cabinet Order and the Ordinance in August and put them in force in fall 2011.

- End -

* * * * *

Contact Information:

Should you wish to receive further information or advice regarding the above-mentioned matters, please contact Kunihiko Morishita, Hirohito Akagami or Piyasena C. Perera.

Kunihiko Morishita
Partner
Email: kunihiko.morishita@amt-law.com
Telephone: +81-3-6888-1040

Hirohito Akagami
Partner
Email: hirohito.akagami@amt-law.com
Telephone: +81-3-6888-1044

Piyasena C. Perera
Senior Foreign Counsel
Email: piya.perera@amt-law.com
Telephone: +81-3-6888-1292

*This law bulletin is published as a general service to clients and friends of Anderson Mori & Tomotsune and does not constitute legal advice.

Copyrights reserved by Anderson Mori & Tomotsune.