

ClientAlert

Tokyo Financial Services Group

March 2013

Working Group Recommendations with respect to the Insider Trading Regulations of Japan

In response to recent high profile insider trading incidents conducted by tippees who received inside information from corporate insiders, especially in connection with public offerings made in Japan, on July 4, 2012, the Financial Services Agency of Japan (the "**Japan FSA**") appointed the "Working Group on Insider Trading Regulations" (the "**Working Group**") to evaluate and make recommendations regarding the future direction of the insider trading regulations in Japan.

On December 25, 2012, the Working Group publicly released its report to the Japan FSA setting forth its recommendations for amendments to the existing rules and regulations with respect to insider trading set forth in the Financial Instruments and Exchange Act of Japan (the "**FIEA**").

This Client Alert is a summary of the key recommendations made by the Working Group.

Regulation to prevent the improper disclosure of information and the encouragement of improper trading

Under the current FIEA, the administrative or criminal penalties with respect to insider trading are imposed only on the party that receives the inside information and makes the illicit trade based on the inside information received. However, these penalties are generally not imposed on the party (i.e., corporate insiders (including the marketing department of underwriting securities firms, "**Corporate Insiders**")) who improperly discloses such inside information to traders, without trading themselves, except where the actions of such Corporate Insiders are sufficient to make them an accomplices with the traders.

For the purpose of preventing recipients of traders inside information from the Corporate Insider from engaging in insider trading, the Working Group recommended that the following conduct of Corporate Insiders be regulated: (a) the disclosure of inside information; and (b) encouraging trades by (i) implying to the trader that the Corporate Insider has inside information, or (ii) indicating to the trader that the Corporate Insider holds a certain position in which he/she can access inside information.



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In order not to undermine listed companies' regular business or IR activities, the Working Group suggests that the following factors be considered with respect to the actions of the Corporate Insider that discloses the inside information: (1) whether the Corporate Insider had the intention to cause the tippee to trade based on the information disclosed; and (2) whether the tippee did in fact trade based on the information received.

Furthermore, with respect to a broker who discloses inside information, the Working Group recommended amending the calculation method of administrative sanctions applicable to such broker in a more efficient manner to cover the types of gains earned by such broker. In addition, the Working Group recommended that the name of the individual working for such broker and the tippee also be disclosed.

Amendment of the calculation of the amount of administrative sanctions

The second recommended change by the Working Group was in relation to the calculation of the administrative penalties with respect to those parties found culpable of engaging in insider trading.

Under the current regulations, with respect to a fund manager, the administrative penalty is calculated based on the management fees received by such fund manager that are directly attributable to the shares for which insider trades were made in connection with its asset management service. As the amount of the penalty under the foregoing calculation tended to be insignificant, the Working Group recommended that the calculation methodology be changed so that the administrative penalty applicable to the fund manager will be equal to the aggregate management fees received by such fund manager for a specified period of time (e.g. 3 months), without limiting the fees to the shares of a particular issuer.

Furthermore, in cases where it is either difficult or impossible for the regulator to make the foregoing calculation (e.g. cases where the fund manager that is engaged in insider trading is acting as the investment manager for multiple funds, etc), the Working Group recommended that any new regulations have a proper calculation method consistent with the calculation method described above.

Trading between persons who hold inside information

Under current law, trades outside of the financial markets that are made by and between the Corporate Insider and the direct recipient of the inside information from the Corporate Insider (the "**Primary Tippee**") are not subject to the prohibition on

insider trading. However, the foregoing exemption does not apply to recipients of inside information from the Primary Tippee (the "**Secondary Tippee**") and trades among Secondary Tippees, including trades between a Primary Tippee and a Secondary Tippee, are subject to the current prohibitions on insider trading.

The Working Group is of the view that off market trades between the Primary Tippee and the Secondary Tippee should also be excluded as the current prohibition is not appropriate in addressing certain types of trades, such as a block trade by a large shareholder (i.e. these trades should be permitted and outside of the application of the insider trading laws). Based on this, the Working Group recommended that the current exemption under the FIEA in relation to trades by Corporate Insiders and Primary Tippees should be expanded to include trades between Primary Tippees and Secondary Tippees.

Insider Trading and Tender Offer Bids

The Working Group also proposed specific changes to the current insider trading rules with respect to parties that are seeking to engage in a tender offer bid in Japan ("**Tender Offerors**").

1. Statute of Limitations on Tender Offerors

Under the existing rules, any person that receives information that a Tender Offeror has an intention to commence a tender offer for a company ("**TOB Related Information**") was essentially "tainted" and was not able to undertake its own trades with respect to the target company (e.g. making its own competing tender offer for such target company).

In consideration of the fact that a Tender Offeror could intentionally "taint" competitors through the disclosure of its intention to engage in a tender offer bid, the Working Group recommended that limitations be enacted on those parties that became aware of non-public information of a tender offer bid if such transaction would not impede fairness and undermine sound operation of the securities market.

In their report, the Working Group recommended a system under which the Tender Offeror's transaction could be exempt from the restriction against trading imposed as a result of becoming aware of TOB Related Information through:

- (1) making a disclosure in its own tender offer notification to the Local Finance Bureau regarding its receipt of the TOB Related Information (e.g. the original tender offer bid); or
- (2) where a reasonable specified period of time has elapsed (e.g. six months) and the original tender offer has not commenced its tender offer of the target company.

2. Expanded the scope of “TOB Offeror, etc. related Person”

Under the current language of Article 167 of the FIEA, the TOB Offeror and its related persons are subject to the insider trading regulations. However, the target company and its officers or employees are generally not subject to the insider trading regulations unless they have entered into, or negotiated to enter into, a legal agreement (e.g. a non-disclosure agreement) with the TOB Offeror. However, as most tender offer bids in Japan are amicable, and even in case of hostile tender offers, it is common for the target company to become aware of the TOB Related Information through the preparation of the TOB. Based on this, the Working Group recommended that the scope of the definition of “insider” under Article 167 be widened to include the target company (including the officers or employees of the target company), where such target company became aware of such TOB Related Information.

Timing of Enforcement

At this time it is uncertain what form any amendments to the existing laws and regulations on insider trading will take and the manner by which the recommendations of the Working Group will be implemented. An officer of the Japan FSA has stated that the Japan FSA will prepare a draft bill incorporating the proposed amendments to the FIEA and submit such bill to the Diet this year. We will continue to monitor the FSA's action and provide updated information as such information on this topic becomes available.

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