Expansion and clarification of exemptions from the insider trading regulation

The Financial Services Agency of Japan ("JFSA") published an amendment to the Cabinet Office Ordinance concerning Regulation of Securities Transactions, etc. ("Cabinet Office Ordinance") on September 2, 2015. As a result, *execution of trade based on* plans which were made before a party became aware of material information or contracts which were entered into before a party became aware of material information ("Eligible Plans or Contracts") will be added to the list of transaction categories exempt from the insider dealing regulation. This amendment will come into force on September 16, 2015.

The JFSA also clarified the interpretation of an existing category of the exemption for transactions entered into by a friendly bidder (e.g. white knight) pursuant to the target company's request for competing bids in the context of a tender offer.

1. Exemption for transactions based on contracts or plans before becoming aware of material information

The Financial Instruments and Exchange Act ("FIEA") prohibits a person[1] who knows non-disclosed[2] material information[3] concerning a listed company from entering into transactions in securities of that listed company[4].

The FIEA and the Cabinet Office Ordinance currently provide a list of exempt transactions including those based on the specifically-defined scope of Eligible Plans or Contracts (e.g. an exemption for employee stock purchase plans) entered into before the person recognizes material information ("point of recognition"). This list, however, has been "piecemeal" rather than comprehensive.

In light of the necessity of a comprehensive exemption, the JFSA introduced a new category of exemption for transactions based on Eligible Plans or Contracts. On and after September 16, 2015, a transaction in securities of a listed company meeting all of the following three criteria will be exempt regardless of whether such transaction is effected inside or outside the exchange:

(1) The transaction is executed (a) as performance of a written contract which was concluded before the point of recognition or (b) as implementation of a written plan which was established before the point of recognition;

[1] Persons who fall under the definition of Affiliated Persons (*kaisha kankeisha*) in Article 166, Paragraph 1 of the FIEA and persons who have received non-disclosed material information from Affiliated Persons are subject to the insider trading regulation.
[2] Until material information is disclosed in a way using disclosure methods specified under Article 166, Paragraph 4, the information is deemed as non-disclosed.
[3] Material information (*juyo jijitsu*) which triggers the prohibition of insider trading is defined in Article 166, Paragraph 2 of the FIEA.
[4] Transactions covered by the insider dealing regulation include, among others, sales and purchases of the securities and derivatives which refer to the securities.

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(2) Any one of the following measures was taken before the point of recognition;

(i) A copy of the contract or plan was submitted with a securities company[5] and the date of submission was confirmed by the securities company;
(ii) A certified date (*kakutei hizuke*) was given to the contract or plan[6]; or
(iii) The contract or plan was disclosed to the public in a way similar to the statutory disclosure method for material information[7]; and

(3) The following terms and conditions of the transaction are specified, or can be automatically determined without any discretion, in the contract or plan:

(i) Position to be taken by the person (e.g. buy or sell);
(ii) Issue of the securities;
(iii) Date of the transaction; and
(iv) Amount or number of the securities traded on the date of the transaction.

In addition, according to the JFSA's Q&A on the insider trading regulation, a contract or plan which was concluded or established with knowledge of material information would be still eligible for the purpose of the aforementioned exemption, if such material information has been disclosed before the transaction is effected, regardless of other material information which may arise after the contract or plan being concluded or established.

The JFSA also clarified, in its answer to the public comments, that a withdrawal of an Eligible Plan or Contract itself will not constitute a breach of the insider trading regulation, but the existence of multiple Eligible Plans or Contracts, that allow a person to choose which contracts or plans to follow, would make those contracts or plans ineligible for the exemption.

Separately from the insider trading regulation for material information, the FIEA provides an article[8] for the insider trading regulation in respect of information related to a tender offer and other significant purchase of the shares of a listed company[9]. An exemption for Eligible Plans or Contracts (similar to the exemption as summarized above) has also been added to the list of exempt transactions for the purpose of such information related to tender offer, etc.

[5] Such securities company must be a Financial Instrument Business Operator (*kin-yu shohin torihiki gyosha*) which conducts Category One Financial Instruments Business (*dai-isshu kin-yu shohin torihiki gyo*) including securities-related business (*yuka shoken kanren gyo*) and must not be the counterparty to or co-decision maker of the transaction.
[6] This measure can be used only where a securities company is the party to or co-decision maker of the transaction.
[7] Please refer to footnote 2.
[8] Article 167 of the FIEA.
[9] This category of the insider trading regulation is triggered by acquisition of shares representing 5% or more of the total voting rights of the listed company as well as a tender offer (*koukai kaitsuke*).

2. Clarification of an existing exemption for transactions based on a target company's request for competing bids in the context of a tender offer

In the context of a tender offer by a bidder (typically, a hostile bidder), transactions entered into by a friendly bidder (e.g. white knight) acting pursuant to the issuer's request[10] for competing bids are currently exempt from the insider trading regulation[11]. It has been, however, uncertain under what circumstances a friendly bidder can rely on this exemption.

The JFSA clarified the interpretation on this exemption by amending its Guidelines on the FIEA. According to the amended Guidelines, a friendly bidder may rely on the exemption if the request for competing bids has been made by the issuer's decision-making body based on reasonable grounds to believe that a tender offer exists and made for the purpose of resisting such tender offer.

According to the JFSA's Q&A, examples of such reasonable grounds include a third party's concrete proposal to the listed company for a contemplated tender offer and a concrete press release which confirms the existence of a contemplated tender offer.

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The amendment to the Cabinet Office Ordinance, Guidelines and Q&A expanded the scope of transactions exempted from the insider trading regulation and also removed legal uncertainty concerning such exemptions. These measures will support the smooth operation of the financial market.

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[10] Such request must be made by resolution of the board of directors or other equivalent decision-making bodies of the listed company.

[11] Article 166, Paragraph 6, Item 4 of the FIEA.

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