Insider Trading (Japan)

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A Practice Note providing an overview of insider trading laws in Japan. This Note discusses the legislation setting out insider trading offences, the behaviors and activities amounting to prohibited insider trading, the types of securities and persons subject to insider trading restrictions, defenses against insider trading claims or prosecutions, and potential consequences of violation. This Note also outlines what companies and relevant persons should do to ensure compliance with these insider trading laws.

In Japan, insider trading is an offense with potentially severe consequences. Companies, their insiders, and other persons with access to inside information should understand the elements of insider trading to help prevent its occurrence.

This Note provides an overview of insider trading offenses in Japan, including:

- What constitutes unlawful insider trading behavior.
- The types of securities and persons subject to insider trading prohibitions.
- The defenses against insider trading claims or prosecutions.
- How insider trading laws are enforced and what the potential penalties are.

This Note also discusses the compliance processes and procedures that should be considered to help companies and individuals properly handle inside information and avoid insider trading.

Elements of Insider Trading

In Japan, insider trading is prohibited under:

- The Financial Instruments and Exchange Act (Act No. 25 of 13 April 1948) (FIEA).
- The Order for Enforcement of the Financial Instruments and Exchange Act (Cabinet Order No. 321 of 30 September 1965) (Enforcement Order).
- The Cabinet Office Ordinance on Restrictions on Securities Transactions (Cabinet Office Ordinance No. 59 of 8 August 2007) (Transaction Ordinance).

Article 166 of the FIEA is a general provision dealing with insider trading in Japan. Certain specified company insiders who have learned a material fact regarding the business or other matters of a "listed company" in the manner specified by Article 166, and recipients of inside information, must not trade specified securities of the listed company until the material fact has been publicized, except in certain limited situations.

A listed company, in this context, means an issuer of certain stipulated securities (including, among other things, bonds of a company, stock and stock warrants of a corporation, and securities issued by an investment corporation) that satisfy any of the following conditions:

- The securities are listed on any securities exchange in Japan.
- The securities are traded on the over-the-counter market established by the Japanese Securities Dealers Association (a self-regulatory organization of which all registered securities companies are members).
- Solicitations of purchase, sale, or other transactions involving the securities are allowed by the rules of the Japanese Securities Dealers Association.

(Article 163(1), FIEA; Article 27-2, Enforcement Order.)

Except in certain limited situations, tender offer insiders (see Tender Offer Insider) and inside information recipients who know that a tender offeror has decided to launch a tender offer are prohibited from purchasing shares and equivalent securities of the issuer until after this fact has been publicized. Share and equivalent securities include:

- Stocks, stock warrants, and bonds with stock acquisition rights of a corporation.
- Shares, share options and bonds with share acquisition rights of an investment corporation.

In addition, tender offer insiders and inside information recipients who know that a tender offeror has decided to suspend the tender offer are prohibited from selling shares and equivalent securities of the issuer until after this fact has been publicized, except in certain limited situations (Article 167, FIEA).

Article 167-2 of the FIEA prohibits insiders from disclosing inside information or recommending trades to third persons in certain prescribed circumstances.

Definition of Material Facts

Inside information that can lead to an insider trading offence by a company insider (see Company Insider) is called a material fact. Material facts are described in detail in the FIEA, the Enforcement Order, and the Transaction Ordinance.

Material facts of listed companies, other than listed investment corporations, are divided into four categories:

- Information relating to decisions.
- Information relating to occurrence of facts.
- Information relating to changes in business performance.
- Information relating to subsidiary companies.

The Transaction Ordinance sets out criteria for these four categories to exclude inside information from being a material fact, where it would have only a minor influence on an investor's investment decisions (Articles 49 to 53, and 55, Transaction Ordinance). Unless inside information meets these criteria, it is deemed to be a material fact, regardless of whether it is material, or has a potential impact on the price of the securities.

In addition, the regulations contain a "basket clause" (catch-all clause) for material facts concerning operations, business or property of the listed company that could have a significant influence on investors' investment decisions (see Basket Clause).

The material facts of listed investment corporations are defined differently.

Information Relating to Decisions

It is deemed a material fact that a decision-making body of a listed company (other than a listed investment corporation) decides:

- To carry out certain specified actions.
- Not to carry out any of these specified actions after they have already been publicized.

Some typical examples of these specified actions include:

- Solicitation of subscriptions for shares or share options.
- Reduction in the amount of stated capital or capital reserves.
- Acquisition of its own shares by the issuer.
- Share split.
- Distribution of surplus.
- Merger.
- Transfer or acquisition of business in whole or in part.
- Dissolution.
- Commercialization of new products or new technology.
- Business collaboration or cancellation of business collaboration.
- Transfer or acquisition of shares or equities that results in changing a subsidiary relationship.
- Petition for commencement of proceedings for rehabilitation or reorganization.
- Commencement of new business.

(Article 166(2)(i), FIEA; Article 28, Enforcement Order.)

However, in certain circumstances, a decision is deemed to be "minor," and therefore does not constitute a material fact. For example, an issue of shares for subscription for which the total amount to be paid is expected to be less than JPY100 million is deemed to be minor. (Article 49(1)(i), Transaction Ordinance.)

The decisions must be made by a "decision-making body." Decision-making bodies are not limited to bodies of the company that have the legal authority to make these decisions. A body that in reality makes decisions is deemed to be a decision-making body. Court precedents have deemed presidents, chairpersons, board members, boards of directors, management meetings, boards of managing directors, and officer meetings to be decision-making bodies.

In addition, a decision by a decision-making body of a listed company's subsidiary to carry out (or not) certain prescribed acts is also deemed to be a material fact (Article 166(2)(v), FIEA; Article 29, Enforcement Order).

Information Relating to Occurrence of Material Events

The occurrence of any of the following events with respect to a listed company is deemed to be a material fact:

- Damage arising from a disaster or in the course of performing operations.
- Change of major shareholders.
- Facts which are a cause for de-listing of specified securities.
- Institution of or judgment in a suit concerning claims on property rights.
- Petition for injunction against a business.
- Rescission of license or other similar administrative punishment.
- Suspension of transactions with major business partners.
- Discharge of debts by creditors or assumption or performance of debts by a third party.

(Article 166(2)(ii), FIEA; Article 28-2, Enforcement Order.)

Criteria have also been set to exclude the above situations from constituting material facts. For example, damage arising from a disaster or in the course of performing operations, with a total value of less than 3% of the net assets at the end of the most recent fiscal year, are deemed minor. (Article 50(i), Transaction Ordinance.)

In addition, certain prescribed events with respect to a listed company's subsidiary are also deemed to be material facts (Article 166(2)(vi), FIEA; Article 29-2, Enforcement Order).

Information Relating to Financial Results or Projections

A difference in the newly calculated forecast of a listed company's business result or in the actual results for the current fiscal year, compared to the most recently announced forecast (or, if no such forecast is available, the actual results for the previous fiscal year) can constitute a material fact (Article 166(2)(iii), FIEA), subject to certain exceptions (Article 51, Transaction Ordinance).

If a subsidiary is itself a listed company, changes in the business performance of that subsidiary can also constitute a material fact for its parent company (Article 166(2)(vii), FIEA; Article 55, Transaction Ordinance).

Basket Clause

Any material information concerning the operation, business or property of the listed company or its subsidiaries that could have a significant influence on investors' investment decisions is deemed a material fact, even if this information does not fall into one of the four categories discussed above (Articles 166(2)(iv) and (viii), FIEA).

Definition of Inside Information Related to a Tender Offer

The following facts are deemed to be inside information for the purposes of the prohibitions on insider trading by tender offer insiders:

- A tender offeror has decided to launch a tender offer.
- A tender offeror has decided to suspend a tender offer.

(Article 167(2), FIEA.)

A tender offer, for these purposes, means a tender offer regulated by the FIEA, and purchases of shares that result in the purchaser becoming a holder of 5% or more of the voting rights of all shareholders (Article 167(1), FIEA; Article 31, Enforcement Order).

A tender offeror means a person who conducts a tender offer (Article 167(1), FIEA).

Certain criteria have been established that exclude these facts from being inside information because they are deemed to be minor. For example, the purchase during one year of less than 2.5% of the voting rights of all shareholders is deemed minor, and therefore not inside information (Article 62(i), Transaction Ordinance).

The decisions by the tender offeror must be made by its decision-making body. This includes any decision on matters leading to the launch or suspension of a tender offer with the intention to achieve a tender offer.

Publicizing Inside Information

As discussed above, insiders must not trade specified securities of a listed company until the relevant inside information has been publicized, except in certain limited situations. Inside information is deemed to be publicized only in the specific circumstances listed in the FIEA, the Enforcement Order, and the Transaction Ordinance. Examples of these circumstances include the following:

- The inside information has been disclosed in an annual securities report, a semi-annual report, or an extraordinary report that has been filed by the listed company or its subsidiary, as the case may be, pursuant to the provisions of the FIEA (Article 166(4), FIEA).
- 12 hours have elapsed after the listed company or its subsidiary made the inside information available to two or more specified public media organizations (Articles 30(1)(i), and 30(2), Enforcement Order).
- The listed company has disclosed the inside information through TDnet (the Tokyo Stock Exchange's online timely disclosure network) or another system provided by a stock exchange on which the securities of the listed company are listed (Article 30(1)(ii), Enforcement Order; Article 56, Transaction Ordinance).

Inside information is also deemed to have been publicized when it has been disclosed in a tender offer notification filed by a tender offeror under the FIEA (Article 167(4), FIEA).

Prohibited Behaviors and Activities

Trading by Company Insiders

Article 166 of the FIEA prohibits company insiders from "trading" the securities. Trading in this context includes:

- Purchase, sale, transfer or acquisition for value.
- Transfer as a result of a merger.

- Equity related derivative transactions.

(Article 166(1), FIEA.)

Trading is generally understood to include transactions concluded by the insider on behalf of a third party.

However, certain transactions are excluded, such as:

- Acquisition of shares by exercising share warrants.
- Acquisition of shares as demanded by law.
- Acquisition of treasury shares by a listed company under certain circumstances.

(Article 166(6), FIEA.)

There is no prohibition on cancelling unexecuted trade orders based on inside information.

Purchase and Sale by Tender Offer Insiders

Article 167 of the FIEA prohibits tender offer insiders from purchasing or selling the shares and equivalent securities of the issuer. Purchasing and selling include transactions that have substantially the same effect, such as succession by merger, and derivative transactions (Article 167(1), FIEA; Articles 33-3 and 33-4, Enforcement Order).

If the tender offer is to be implemented, only purchases are prohibited; if the tender offer is to be suspended, only sales are prohibited.

There is no prohibition on cancelling unexecuted trade orders based on inside information.

Tipping Off and Trade Recommendation Based on Inside Information

Article 167-2(1) of the FIEA prohibits company insiders from disclosing material facts to another person, or recommending trading of the specified securities to another person, with the intent to encourage that person to make a profit or avoid losses by trading before the material facts have been publicized. Article 167-2(2) of the FIEA provides an equivalent prohibition for tender offer insiders.

Persons Liable for Insider Trading

Company Insider

A company insider is any person who has a particular relationship or connection with a listed company, and has learned non-public inside information about that company in a certain non-public manner (Article 166(1), FIEA).

Company insiders include:

- Officers, agents, and employees of the listed company or its related companies, who acquire any material facts in performing their duties and functions.
- Shareholders that hold 3% or more of the voting rights of a listed company or its related companies, who learn any material facts upon exercising their shareholders' right to inspect the accounting books in accordance with the

Companies Act. If a corporate shareholder is an insider, its officers, agents, and employees are also deemed to be insiders. If an individual shareholder is an insider, its representatives, agents, and employees are also deemed to be insiders. (Act No. 86 of 26 July 2005.)

- Persons who, in accordance with laws or regulations, have power or authority over the listed company or its related companies, and who acquire any material facts upon exercising the power or authority.
- Persons, other than the officers, agents and employees of a listed company or its related companies, who have executed or have participated in negotiations with regard to a contract to which a listed company or any of its related companies is a party, and who acquire any material facts in the execution, negotiation or performance of the contract.
- Officers, agents and employees who belong to the same corporation as an officer who is a company insider in the second and fourth categories above, who acquire any material facts upon performing their duties and functions.

Persons who cease to occupy a company insider role continue to be subject to the insider trading regulations for one year after ceasing the role.

There is no difference between individuals who have regular access to inside information and individuals who have occasional access to inside information. The violation of a fiduciary duty or duty of trust is not a necessary condition for insider dealing.

The listed company itself is not a company insider.

Tender Offer Insider

A tender offer insider is any person who has a particular relationship or connection with a tender offeror, and has learned non-public inside information about the tender offer in a certain non-public manner (Article 167(1), FIEA). Tender offer insiders include the same five categories as company insiders, replacing the listed company with the tender offeror, and material fact with "decisions concerning a launch or suspension of a tender offer." In addition, tender offer insiders include the issuing company of the shares and equivalent securities subject to the tender offer, and its officers, agents and employees who have received inside information from the tender offeror (in performing their duties and functions, in the case of officers, agents and employees).

Persons who cease to occupy a tender offer insider role continue to be subject to the insider trading regulations for six months after ceasing that role.

Inside Information Recipient

An inside information recipient is either:

- Any person (primary information recipient) who learns non-public inside information directly from:
    - a company insider;
    - a person who ceased to occupy a company insider role within the past year;
    - a tender offer insider; or
    - a person who ceased to occupy a tender offer insider role within the past six months.
- An officer, agent or employee of the company to which the primary information recipient belongs, who receives inside information in the course of their duty.

(Articles 166(3) and 167(3), FIEA.)

In principle, inside information recipients are limited to primary information recipients and their colleagues. Other persons who receive inside information from information recipients are not subject to the insider trading prohibition.

Defenses Against Insider Trading Claims

Off-Market Trading Between Insiders

There is an exemption for off-market trading between insiders (Article 166(6)(vii), FIEA). If both the seller and the buyer have inside information, the insider trading prohibition does not apply to the trade unless one party knows that the other party will subsequently conduct a trade violating the insider trading prohibition.

Article 167(5)(vii) of the FIEA provides an equivalent exemption for tender offer insiders.

Trades Based on a Contract or Plan Before the Acquisition of Knowledge

Trades based on a contract or plan before the acquisition of knowledge are exempted from the insider trading prohibition (Articles 166(6)(xii) and 167(5)(xiv), FIEA; Articles 59(1)(xiv) and 63(1)(xiv), Transaction Ordinance). This exemption is available in situations including those that meet all the following requirements:

- The transaction is conducted under:
    - a written contract that was entered into before knowledge of a material fact; or
    - a written plan that was determined before knowledge of a material fact.
- Any of the following measures was taken before knowledge of a material fact:
    - the contract or plan, or a copy of it, was submitted to a Type I Financial Instruments Business Operator (limited to those conducting securities related business), and the date of submission was confirmed by the operator (limited to cases where the operator is not a party to the contract, or has not jointly determined the relevant plan);
    - the contract or plan has a certified date (limited to cases where a Type I Financial Instruments Business Operator is a party to the relevant contract, or has jointly determined the relevant plan); or
    - the contract or plan was made available for public inspection in accordance with the prescribed publicity measures.
- The contract or plan specifies the type of transaction, issue and due date, and total amount or number of transactions on the due date (or equivalent matters in the case of derivative transactions), or these are to be specified in accordance with a contract or plan that does not provide for any room for discretionary decisions.

Enforcement and Penalties

Administrative Monetary Penalties for Insider Trading

A company insider, tender offer insider, or inside information recipient who violates the insider trading prohibitions is subject to administrative monetary penalties (Article 175(1) and (2), FIEA). In addition, if an officer, agent, or employee of an issuing company who is deemed a company insider conducts insider trading on behalf of the issuing company or its related company, the issuing company is subject to administrative monetary penalties (Article 175(7), FIEA).

For offenders who trade on their own behalf, the amount of administrative monetary penalty is calculated as follows:

- If they sold securities or conducted equivalent transactions, the difference between the lowest price within two weeks after publication of the relevant information and the actual transaction price.
- If they purchased securities or conducted equivalent transactions, the difference between the highest price within two weeks after publication of the relevant information and the actual transaction price.

(Article 175(1)(i)(ii) and (2)(i)(ii), FIEA.)

For offenders who traded on behalf of another person, the administrative monetary penalty is calculated based on their fees, in accordance with the Cabinet Office Ordinance on Administrative Monetary Penalty under the Provisions of Chapter VI-2 of the Financial Instruments and Exchange Act (Cabinet Office Ordinance No. 17 of March 4, 2005) (Administrative Monetary Penalty Ordinance). (Article 175(1)(iii) and (2)(iii), FIEA; Article 1-21, Administrative Monetary Penalty Ordinance.)

Administrative Monetary Penalties for Tipping Off and Trade Recommendation

For tipping off and trade recommendation based on inside information, the offender is subject to administrative monetary penalties if the person who received the inside information or was recommended the transaction actually conducted a transaction before the public disclosure of inside information.

The administrative monetary penalty is:

- Equivalent to half of the profit acquired by the third person who conducted the transaction if the tipping off or trade recommendation does not occur in the course of the offender's securities related business.
- Calculated based on the fees of the offender if the tipping off or trade recommendation occurs in the course of their securities related business.

(Article 175-2, FIEA; Article 1-25, Administrative Monetary Penalty Ordinance.)

Criminal Penalties

Individuals who conduct transactions violating the insider trading prohibitions can be subject to one or both of the following:

- Imprisonment for up to five years.
- A maximum fine of JPY5 million.

(Article 197-2(13), FIEA.)

The profits gained from the transaction are confiscated or collected from the offender (Article 198-2(1), FIEA).

Individuals who conduct tipping off or trade recommendation violating the insider trading prohibitions can be subject to one or both of the following if the person who received the inside information, or was recommended the transaction, actually conducted the transaction before the public disclosure of inside information:

- Imprisonment for up to five years.
- A maximum fine of JPY5 million.

(Article 197-2(14) and (15), FIEA.)

If an officer of a corporation violates the insider trading prohibition in connection with the business or property of the corporation, the corporation can also be held liable and subject to a maximum fine of JPY500 million (Article 207(1)(ii), FIEA).

The FIEA has no specific provisions regarding civil liability for violations of insider trading prohibitions. While a person who has suffered damage from insider trading can claim tort liability against an offender, it is difficult to prove a causal relationship between the trading acts of the offender and their own losses.

Compliance Considerations

Insider Lists

Under the insider trading prohibition rules in Japan, there is no requirement for a company to keep a list of insiders, or to advise insiders of their obligations when they are in possession of inside information. However, most companies in Japan have practices related to inside information and insiders (see Insider Trading Policies).

Insider Reporting Requirements

If a listed company's director, statutory auditor, or major shareholder (meaning a shareholder that owns at least 10% of the voting rights of the listed company) purchases or sells specified securities of that listed company, or conducts another transaction that has substantially the same effect, they must file a report on the transaction to the Director General of a Local Finance Bureau (LFB) or Local Finance Branch Bureau (LFBB) by the 15th day of the following month, unless an exemption applies (Article 163(1), FIEA; Article 30, Transaction Ordinance). If a director, statutory auditor or major shareholder of a listed company gains a profit from an initial sale and a subsequent purchase (or an initial purchase and a subsequent sale) of specified securities of the listed company when the two transactions are done within six months of each other (short-term trading profit), the regulator makes the information regarding these transactions publicly available unless the director, statutory auditor, or major shareholder has provided the listed company with that profit (Article 164(7), FIEA).

Similarly, if a partnership owns 10% or more of the voting rights of all shareholders of a listed company, and a partner of the partnership purchases or sells specified securities of the listed company, or conducts another transaction that has substantially the same effect, on behalf of the partnership, the partner must report the transaction to the Director General of an LFB or LFBB by the 15th day of the following month (Article 165-2(1), FIEA).

Insider Trading Policies

Under the insider trading prohibition rules in Japan, there is no requirement for a company to have insider trading policies. However, most companies in Japan have individual rules, guidance or policies, with certain common features, such as provisions regarding inside information management, and restrictions on transactions by its officers or employees.

Inside Information Officer or Department

Many companies in Japan appoint an officer or a department responsible for inside information management according to their rules or policies. Responsibilities of this officer or department typically include:

- Deciding whether the information disclosed to the company constitutes a material fact.
- Managing the material facts of the company.
- Deciding whether it is necessary to disclose any material fact.
- Approving or disapproving trading of the company's specified securities if requested by a company insider.

Management of Inside Information

In many companies, an officer or employee who acquires information that could constitute a material fact must report this immediately to the inside information officer or department. They must not disclose the information to any other officer or employee, or any other third party, without the permission of the inside information officer or department.

Restriction on Officer or Employee Transactions

Many companies in Japan require their officers and employees to obtain prior approval by the company's inside information officer or department to transact securities issued by the company. Some companies permit their officers and employees to transact securities issued by the company during certain periods, such as a few weeks after announcement of the quarterly or annual financial statement.

Trading Plans

Transactions based on a trading plan can be exempted from the insider trading prohibition (see Trades Based on a Contract or Plan Before the Acquisition of Knowledge).

Return of Short-Term Trading Profit

A company can demand that a director, statutory auditor, or major shareholder of a listed company, provide the company with any short-term trading profit (see Insider Reporting Requirements) (Article 164, FIEA).

Similarly, a company can demand that a partner of a partnership that owns 10% or more of the voting rights of a listed company provide the company with any short-term trading profit made on behalf of the partnership (Article 165-2(3), FIEA).

Prohibition on Short-Selling by Officers of Listed Companies

A director, statutory auditor, or major shareholder of a listed company is prohibited from short-selling shares of the listed company that exceed the scope of hedging of the securities issued by the company (Article 165, FIEA).

There is an equivalent prohibition for a partner of a partnership that owns 10% or more of the voting rights of a listed company (Article 165-2(15), FIEA).

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