Revision of Insider Trading Regulations Corresponding to Grouping of Companies

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Working Group on Insider Trading Regulations

“Working Group on Insider Trading Regulations” Member List

As of December 15, 2011

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Introduction

Insider trading regulations were established by the 1988 revision of the Securities and Exchange Act, in light of society's growing concerns about insider trading and moves for tightening of regulations in the U.K. and U.S., etc.

After that, there has been a series of actions on insider trading regulations in accordance to the revised Antimonopoly Act lifting the prohibition on holding companies, Japan shifting to consolidated-basis disclosure, and the revised Commercial Code lifting the prohibition on treasury shares, etc.

However, recent years have brought a wave of corporate mergers and restructurings, and management of groups comprised of subsidiaries and affiliated companies has become widespread. Considering this situation, parts of existing insider trading regulations are not always sufficient and appropriate for companies to exercise smooth group management.

Based on this view of the issues, this Working Group on Insider Trading Regulations has held discussions five times since this July.

This report compiles the results of studies at this working group. We hope that related parties will consider the intentions of this report and proceed to make appropriate system developments.

I. Material Facts about Pure Holding Companies, etc.

1. Introduction

Insider trading regulations prohibit a certain corporate insider of a listed company, etc., who has come to know a material fact pertaining to business or other matters of the listed company, etc. in the course of his/her duty, etc., to make sales and purchase, etc. of share certificates, etc. pertaining to that listed company, etc. before that material fact is publicized. Generally, material facts regarding the operation, business or assets of listed companies, etc. that may have an influence on investors' investment decisions are treated as material facts.

(1) "Minor Criteria"

Article 166, Paragraph 2 of the Financial Instruments and Exchange Act (FIEA) lists the facts regarding decision making and events occurring in listed companies, etc. that may have an influence on investors' investment decisions. Even if they fall under such facts,

certain facts which fall under the criteria for facts which have minor influence on the investors' investment decisions (Minor Criteria) are excluded from facts subject to the regulations.

This is based on the thinking that, even if facts have qualities which should have an influence on investors' investment decisions, for facts which are deemed to have typically minor influences, even if corporate insiders who know such facts shall make sales or purchases, etc. of share certificates, etc., there is little loss of general investors' confidence in the fairness and soundness of the securities market, and so there is no need to prohibit such transactions.

In the existing Minor Criteria, for facts concerning listed companies, etc., facts which only have influences under a certain level compared to non-consolidated net sales and net asset value, etc. of the listed companies, etc. are specified as facts with typically minor influence on the investors' investment decisions.

(2) "Material Criteria"

Facts concerning changes of financial information are also treated as facts with qualities which should have an influence on investors' investment decisions. A difference between forecasts of net sales, etc., which falls under the criteria specified as a difference that may have a material influence on investors' investment decisions (Material Criteria), is a material fact.

The existing Material Criteria specify numerical criteria for non-consolidated net sales, current profits, net income and dividends of surplus of listed companies, etc., as well as net sales, current profits and net income of consolidated groups.

2. Minor Criteria, etc. for a Pure Holding Company, etc.

(1) Minor Criteria, etc. for a Pure Holding Company

A so-called pure holding company exclusively manages the business administration of operating companies and business incidental thereto through owning the shares of those operating companies. As the holding company does not operate its own business, it can be considered that its profits rely on profits from group companies, such as dividends and management consulting fee from subsidiaries.

Therefore, it is pointed out that, in general, investors of a pure holding company are mainly interested in consolidated statements, business development of each consolidated group company and the resulting forecasts, etc. for the entire group, and are not very interested in the status of non-consolidated statements of a pure holding company.

In addition, it is pointed out that insider trading regulations are not always neutral between companies, since net sales of a pure holding company are small compared to the size of the entire group, and the Minor Criteria, etc. is lower compared to the net sales of operating companies.

It could be considered that the facts concerning such pure holding companies typically have minor (not material) influence on investors' investment decisions when they only have influence under a certain level compared to consolidated-basis figures. In view of this, it can be considered appropriate to use consolidated basis figures for Minor Criteria, etc. of pure holding companies.

(Note) Among facts concerning changes of financial information, for facts concerning dividends of surplus, it can be considered appropriate to continue using non-consolidated figures of a pure holding company, as dividends are paid to group shareholders from the pure holding company.

(2) Minor Criteria, etc. for a Company Similar to a Pure Holding Company

Characteristics of a pure holding company (profits, size and the matters of investors' interest as described above) may also apply to a company which is not a pure holding company, but its own business is only a secondary one, and relies on profits from group companies (a company similar to a pure holding company).

Therefore, in addition to a pure holding company as described above, it can be considered appropriate to use consolidated basis figures for Minor Criteria, etc. of a company similar to a pure holding company.

(3) Scope of Companies Using Consolidated Basis Figures

It can be considered appropriate to distinguish the scope of companies with respect to which consolidated-basis figures are used

for Minor Criteria, etc., based on whether investors basically make investment decisions based on their consolidated-basis figures.

It can be considered appropriate to determine this based on the degree of dependence of a listed company, etc. on net sales (profits) from group companies. Specifically, listed companies, etc., which gain a certain percentage or more of non-consolidated sales of the listed company, etc. from profits (mainly dividends and management consulting fee, etc.) from group companies (affiliated companies) could be subject to such rule.

Regarding this point, it is pointed out that "Investors emphasize consolidated-basis information for investment decisions regarding most operating companies which prepare consolidated financial statements, so for all of these companies, consolidated basis figures should be used for Minor Criteria, etc." Although the scope may be reviewed in the future based on changes in investors' consciousness, etc., under the current circumstances where non-consolidated financial information is also subject to disclosure and usefulness of individual financial statements are also pointed out, it can be considered appropriate to make revisions within the scope mentioned above.

When calculating the "percentage" of "profits from group companies (affiliated companies)" divided by "non-consolidated sales of the listed company, etc.," considering that there are cases in which a listed company, etc. manufactures products and goods and its subsidiary is a sales company, it can be considered appropriate to exclude sales of products and goods to group companies from "profits from group companies (affiliated companies)."

(4) Level of Degree of Dependence on Profits

In the existing Minor Criteria, etc., a fact which influence only under 10% of sales is considered to have minor (not material) influence on investors' investment decisions.

On the other hand, for a company which relies the majority (80% or more) of its profits on profits from affiliated companies, sales from affiliated companies are dividends and business consulting fee, etc., while other sales often tend to be secondary ones compared with sales from affiliated companies, such as real estate rental revenues.

Also, for companies with a particularly high degree of dependence on profits from affiliated companies, although its profits do not change largely each fiscal year, temporary changes could occur due to special factors from time to time.

Considering these points, it can be considered appropriate to set the level of degree of dependence on profits from affiliated companies of listed companies, etc. at 80% or higher.

Regarding this point, while it is pointed out that "a lower standard is appropriate," for listed companies, etc. with under an 80% level of degree of dependence on profits, that listed company, etc. tends to conduct important business itself which is not necessarily a secondary one. For such a listed company, etc., it cannot always be said that investors' investment decisions are not affected by non-consolidated figures of that listed company, etc.

II. Application of Insider Trading Regulations on Company Reorganizations

1. Introduction

When a company reorganizes, the main means are business assignment, merger, company split, share exchange and share transfer. Existing insider trading regulations apply to "sales or purchase, other types of transfer for value or acceptance of such transfer for value, or Derivative Transactions (hereinafter referred to as "Sales and Purchase, etc.")" (FIEA, Article 166, Paragraph 1) concerning listed share certificates, etc. Therefore, it is pointed out that the following differences result depending on the means used in reorganization, and that there is not neutral application of insider trading regulations to means of reorganization selected by a company.

- A business assignment is an act of succession to individual rights and obligations (specified succession); therefore, it falls under "Sales and Purchase, etc.," and is subject to insider trading regulations. On the other hand, mergers and company splits are acts of succession to rights and obligations as a whole (universal succession); therefore, mergers and company splits do not fall under "Sales and Purchase, etc.," and are interpreted as not being subject to insider trading regulations.
- Upon allotting listed share certificates, etc. as the consideration for reorganization, when new shares are issued, there is no transfer of ownership rights; therefore, this is not "Sales and Purchase, etc.," and

is not subject to insider trading regulations. On the other hand, when treasury shares are delivered, this is a transfer of existing listed share certificates, etc.; therefore, it falls under "Sales and Purchase, etc.," and is interpreted as being subject to insider trading regulations.

2. Succession of Shareholding by Reorganization

(1) Revision of Matters Subject to Regulation

When there are listed share certificates, etc. in the company's assets succeeded by another company in reorganization, regardless of whether the means of that succession is a specified succession or universal succession, considering the point that listed share certificates, etc. are succeeded by another company, it can be considered that such succession has the character of a transaction of listed share certificates, etc.

Also, if a party of reorganization knows unpublicized material facts about an issuer of listed share certificates, etc. included in succession assets based on a transaction relationship, etc., those material facts are external information for both parties of the reorganization. Therefore, as long as one party who knows material facts does not actively communicate that information to another party, it is difficult for that other party to know.

If one party of the reorganization uses reorganization to succeed listed share certificates, etc. or have them succeeded while knowing material facts about an issuer of listed share certificates, etc., then general investors may lose confidence in the fairness and soundness of the securities market. Therefore, it may not be highly necessary to separate specified successions and universal successions.

Considering these points, similar to the case of a business assignment, it can be considered appropriate to also have insider trading regulations apply to successions of listed share certificates, etc. by mergers and company splits.

(2) Exemptions

Concerning succession of listed share certificates, etc. in reorganization, regardless of whether it is a specified succession or universal succession, in the following cases, the risk of being used for insider trading is expected to be typically low. Therefore, in view of the

characteristics of the reorganization, it can be considered appropriate to exempt these cases from application of insider trading regulations.

(1) When the Ratio of Listed Share Certificates, etc. to Succession Assets is low

Generally, when the ratio of listed share certificates, etc. to succession assets in mergers, company splits and business assignments are low, the character as a transaction of listed share certificates, etc. may not necessarily be strong. That is, even if there are unpublicized facts which have material effects on investment decisions regarding such listed share certificates, etc., their effects on the entire consideration for the succession are small, and the cost for reorganization is excessive for improper transaction using that information; therefore, it could be considered that the risk of insider trading using that information is low.

Considering the following points, it can be considered appropriate to set the criteria of the specific ratio of listed share certificates, etc. to succession assets at "under 20%."

- Under the Companies Act, as reorganization falls under a fundamental change in the company, a special resolution of a shareholders meeting is required in principle. On the other hand, if the succession assets by a company split or business assignment do not exceed 20% of total assets, then a resolution of a shareholders meeting is not required for the split company or assignor company (summary merger proceeding).

  It is interpreted that this is because there is little need to require a resolution of a shareholders meeting for a reorganization which cannot be considered a fundamental change to the reorganizing company. Elaborating on this way of thinking, it could be considered that, when the ratio of listed share certificates, etc. to succession assets by reorganization is less than 20%, it is of little importance to the succession assets as a whole.
- When most (80% or more) of the succession assets are assets other than listed share certificates, etc., even if there are material facts which could greatly affect the share price of the company issuing those listed share certificates, etc., their effects on the entire consideration for the succession are not necessarily great.

(2) When Material Facts Become Known after Final Board of Directors Resolution

Generally, the Board of Directors makes the final decision on entering into a merger agreement, company split agreement or business assignment agreement, which includes matters concerning consideration for succession. When a merger agreement, etc. is signed based on that decision, even if unpublicized material facts become known after that decision, the listed share certificates, etc. would be succeeded regardless of knowledge of such facts; therefore, it may be considered that there is little risk of losing general investors' confidence in the fairness and soundness of the securities market.

Also, reorganizations are agreed upon between the parties after repeated negotiations, due diligence, etc. over a long period of time. Considering this, if insider trading regulations are applied even after the final decision has been made by the Board of Directors to enter into a merger agreement, etc., which includes matters concerning consideration for succession, it may hinder smooth reorganizations.

There are cases where reorganizations are conducted without a Board of Directors resolution. However, when there is a Board of Directors resolution, meeting minutes are prepared and it is possible to verify later whether that resolution had been passed. On the other hand, when the final decision is made in form other than a Board of Directors resolution, it becomes difficult to determine the time when that decision was made, and it is not suitable for exemption from the application of insider trading regulations. Considering this, it can be considered appropriate to limit the scope of exemption from application of insider trading regulations to cases when a Board of Directors resolution has been passed.

(3) Succession by Incorporation-Type Company Split

Except for the case of a joint incorporation-type company split, an incorporation-type company split has the function of a company division, and basically does not have the characteristic of a transaction with third parties. Therefore, it can be considered that there is little need to apply insider trading regulations.

3. Delivery of Treasury Shares as Consideration of Reorganization

(1) Characteristics of a Consideration of Reorganization

Concerning the characteristics of reorganization, reorganization usually focuses on the succession of rights and obligations between companies, and allocation of new shares and treasury shares may be understood as consideration. Regarding this point, the nature of reorganization may differ from that of typical insider trading, where the focus is on selling or purchasing listed share certificates, etc. using unpublicized material facts to gain profit.

Also, if we limit our analysis to situations of reorganization, even if there were improprieties regarding the consideration, it would be an issue of damage compensation, etc. between the parties, and it may be considered that there is not a strong relation to market transactions which make sales or purchase, etc. of securities. Therefore, the need to apply insider trading regulations, which aim to ensure general investors' confidence in the fairness and soundness of the securities market, may not necessarily be high.

Also, in reorganization, it is considered to be usual that the value of the company's treasury shares are carefully scrutinized, for example by closely examining the company's business, assets and liabilities during the due diligence process between the parties. Moreover, considering that reorganization is in principle conducted after passing a check by the shareholders, it can be considered that the probability of unfair transactions which use unpublicized material facts occurring is typically low.

(2) Revision of Matters Subject to Regulation

Considering the characteristics of the consideration of a reorganization as mentioned above, in the cases of a merger, company split, share exchange or business assignment, it can be considered appropriate to not apply insider trading regulations to delivery of treasury shares as consideration and acquisition of the delivered treasury shares, similar to when new shares are issued.

The scope of analysis of this Working Group is limited to situations of reorganization, with a focus on their characteristics, etc. The question of how to generally understand the application of insider trading regulations to issuance of new shares and delivery of treasury

shares, including situations other than reorganizations, is an issue which requires further study, taking into consideration differences in their characteristics and actual usage situations, as well as consistency with other regulations, etc.

III. Publication Measure for Tender Offers by Parties Other than Issuers

1. Introduction

In existing regulations on insider trading by persons concerned with tender offeror, etc., three methods of publication measures for facts concerning tender offer, etc. are provided (Article 167, Paragraph 4 of FIEA, Article 30 of Order for Enforcement of FIEA):

(1) Public notice for commencing tender offer, or public inspection, etc. of tender offer notification.

(2) Passage of 12 hours after disclosure of the fact concerning tender offer, etc. to two or more journalistic organizations.

(3) The listed company has given notification, pursuant to the rules of each Financial Instruments Exchange, of the fact concerning tender offer, etc. to the relevant Financial Instruments Exchange, and the fact has been made available for public inspection at the relevant Financial Instruments Exchange.

Of these, the third method may only be used in the case of tender offer of listed share certificates, etc. by the issuer, and may not be used as publication methods for tender offer of listed share certificates, etc. by a party other than the issuer (hereinafter referred to as "Other Company Shares TOB) or buying up which is equivalent thereto. This could be because, in the case of Other Company Shares TOB, etc., a party which is not a listed company may be the tender offeror, etc.

2. Problems of Existing System

In an Other Company Shares TOB, when the listed company is the tender offeror or target company of the tender offer, in practice, based on timely disclosure rules of the Financial Instruments Exchange, it is usual for that listed company to announce the decision or statement of approval by TDnet (Timely Disclosure information transmission system) on or before the day immediately preceding the commencement date of the tender offer buyout (submission of tender offer notification).

However, as mentioned above, these announcements do not fall under the publication measures for insider trading regulations. Therefore, it is pointed out that such listed companies cannot give explanation to analysts, etc. (note) even after such announcements have been made, and this has the opposite effect of impeding the company's information disclosure.

It is also pointed out that in practice, when considering publication measure for insider trading regulations, it is important to ensure consistency with timely disclosure systems of Financial Instruments Exchanges.

(Note) If that listed company gives explanation to analysts, etc., then those analysts, etc. become subject to insider trading regulations as "Primary Information Receivers."

3. Other Company Shares TOB by Listed Company

When the tender offeror is a listed company, based on rules of the Financial Instruments Exchange, the tender offeror may notify that Financial Instruments Exchange of the fact concerning tender offer, etc. Therefore, it can be considered appropriate to approve this as a publication measure.

It is unavoidable that the scope of usable publication methods differs depending on whether the tender offeror is a listed company or a person other than a listed company, as each party may take publication measures for insider trading regulations using means and methods available to the relevant party.

4. Other Company Shares TOB by a Person Other than a Listed Company

When a person other than a listed company makes an Other Company Shares TOB, unlike the case for a listed company, that person itself cannot notify the Financial Instruments Exchange pursuant to the rules of that Financial Instruments Exchange.

However, under an agreement with the listed company which is the target company of tender offer, it may be able for a person other than that listed company to have that listed company provide a notice signed by both parties to the Financial Instruments Exchange.

In this case, as the Financial Instruments Exchange which receives the notice performs certain management via that listed company regarding

the content of that notice, it could be considered that the accuracy of the content of the announcement is basically ensured. (In the event the Financial Instruments Exchange receives a false notice which differs from the tender offeror's decision, as the content of that decision has not been announced, the insider trading regulations continue to apply. Depending on its characteristics, this could also fall under the prohibition of spreading rumors, etc.)

Considering these issues, even for an Other Company Shares TOB by a person other than a listed company, if a notice signed by both parties is given to the Financial Instruments Exchange via the listed company as described above and has been made available for public inspection, it can be considered appropriate to approve this as a publication measure for insider trading regulations.

Existing insider trading regulations also enable selection of announcement methods: making legal disclosure documents available for public inspection, disclosure to journalistic organizations, etc. Thus, the risk of inappropriate acts that take advantage of different announcement methods may not necessarily be particularly high in this case.

Regarding the revision of publication measures for an Other Company Shares TOB described above, it can be considered appropriate to also make a similar revision of publication measures for buying up which is equivalent to a tender offer.