CHAPTER XV

Prohibited and Regulated Acts of Securities Trading

1. Outline

With a view to establishing a fair securities market and enhancing the market's credibility, the Financial Instruments and Exchange Act (FIEA) provides for various prohibited and regulated acts with respect to securities trading. In addition to prohibiting market manipulation (see Section 2) and regulating insider trading by persons associated with the companies concerned (see Section 3), it also imposes obligations on financial instruments business operators (securities companies) to maintain a trading surveillance system and a corporate information management system to prevent such unfair trading (see Section 4). In addition, the Financial Instruments and Exchange Act requires trade participants to disclose certain transaction-related information, such as the submission of reports of possession of large volume, to ensure the fairness of securities transactions (see section 5).

However, it is practically impossible to list in the Financial Instruments and Exchange Act all unfair trading in connection with securities transactions. In addition, as those securities transactions are complex and their structure changes rapidly, new methods that were unforeseeable at the time of legislation could emerge later. Faced with such issues, Article 157 of the Financial Instruments and Exchange Act bans unfair transactions in broad terms. More specifically, it prohibits the use of wrongful means, schemes, or techniques with regard to the sale, purchase, or other transaction of securities, etc. (Item (i) of the article); the acquisition of money or other property using a document or other indication which contains false indication on important matters or lacks indication about important matters necessary for avoiding misunderstanding with regard to the sale, purchase, or other transaction of securities, etc. (Item (ii)); and the use of false quotations in order to induce the sale, purchase, or other transaction of securities, etc. (Item (iii)) This article is considered to be a general provision that comprehensively prohibits wrongful acts, including new types of unfair trading yet to emerge.

In addition to the above, Article 158 of the FIEA prohibits the spreading of rumor, use of fraudulent means, assault, or intimidation for the purpose of

Table XV-1. Main Provisions Relating to the Ban on Unfair Trading

	Contents	Article of the Financial Instruments and Exchange Act (FIEA)
General provisions	· Prohibition of wrongful acts	Art. 157
Market manipulation	· Prohibition of fake transactions or prearranged transactions	Art. 159, Para. 1
	· Prohibition of transactions aimed at manipulating securities prices	Art. 159, Para. 2, Item (i)
	· Prohibition of making an indication with the aim of manipulating securities prices	Art. 159, Para. 2, Items (ii) and (iii)
	· Prohibition, in principle, of stabilization transactions	Art. 159, Para. 3, and Arts. 20-26 of the Order for Enforcement of the Act
	· Prohibition of purchase for own account during the stabilization period	Art. 117, Para. 1, Item (xxii) of the Cabinet Office Order on Financial Instruments Business, etc.
	· Prohibition of spreading of rumors or use of fraudulent means, assault, or intimidation	Art. 158
	· Prohibition of securities companies from getting involved in an artificial formation of stock prices	Art. 117, Para. 1, Item (xx) of the Cabinet Office Order on Financial Instruments Business, etc.
	· Prevention of use of corporate share repurchase for manipulating stock prices	Art. 162, Para. 2
Insider trading	· Prohibition of insider trading	Arts. 166 and 167
	· Duty of officers to report securities transactions and the duty to restitute profits made in short-term trading	Arts. 163 and 164
	· Prohibition of short selling by officers	Art. 165
	· Prohibition of disclosure of information and inducement of insider trading	Art. 167-2
	· Prohibition of accepting orders that are suspected to be in violation of insider trading regulations	Art. 117, Para. 1, Item (xiii) of the Cabinet Office Order on Financial Instruments Business, etc.
False indication	· Prohibition of public notice, etc., of false quotations	Art. 168
	· Restriction on the expression of opinion in newspapers, etc., for consideration	Art. 169
	· Prohibition of indication of advantageous purchase, etc.	Art. 170
	· Prohibition of indication of a fixed amount of dividends, etc.	Art. 171
Tender offers	· Regulations on tender offers	Art. 27-2 through 27-22-4
	· Filing of Report of Possession of Large Volume	Art. 27-23 through 27-30
Others	· Prohibition of compensation of loss	Art. 39
	· Restriction on Transactions conducted for their own account and excessive transactions	Art. 161
	· Regulations on short selling	Art. 162
	· Prohibition of massive promotional campaign of particular securities	Art. 117, Para. 1, Item (xvii) of the Cabinet Office Order on Financial Instruments Business, etc.
	· Restriction on front-running	Art. 117, Para. 1, Item (x) of the Cabinet Office Order on Financial Instruments Business, etc.
	· Ban on deliberate market manipulation by means of trading securities for own account	Art. 117, Para. 1, Item (xix) of the Cabinet Office Order on Financial Instruments Business, etc.

carrying out the sale, purchase, or other transaction of securities, etc., or causing a fluctuation of quotations on securities, etc. Article 168 prohibits the publishing of false quotations on market prices of securities, etc. Restrictions on expression of opinions in newspapers, etc., in exchange for consideration are stipulated in Article 169, while Articles 170 and 171 prohibit indication of advantageous purchase, etc., and that of a fixed amount of dividends, etc., respectively.

2. Regulation of Market Manipulation

Market manipulation is an act of artificially influencing securities prices that would otherwise be determined by the securities market through natural supply and demand. With a view, therefore, to ensuring fair price formation in securities markets and protection of investors, the Financial Instruments and Exchange Act prohibits market manipulation and imposes heavy penalties for the violation thereof.

Acts of market manipulation are largely divided into the following five types: (1) fake transactions, (2) prearranged transactions, (3) price manipulation, (4) indication made for the purpose of market manipulation, and (5) stabilization transactions (Article 159).

A fake transaction is a securities transaction in which the same person places purchase and sale orders during the same time frame with no actual change in ownership occurring. With prearranged trades, similar transactions are carried out in collusion with different persons. In both cases, the intention is to mislead other investors into thinking trading in the security is very active; the requisite for being deemed a wash transaction is the existence of someone whose purpose is to mislead other investors regarding trading status. Price manipulation refers to an act of engaging in transactions that could possibly cause a fluctuation in securities prices for the purpose of misleading (inducing) other persons into believing that, despite intentional price manipulation, the prices are determined by natural supply and demand, and thus inducing them to purchase or sell the securities. (Supreme Court ruling on the Kyodo Shiryo case, July 20, 1994)

Stabilization transactions are transactions done for the purpose of pegging, fixing, or stabilizing the prices of specific securities. However, when primary offerings and secondary distributions are made, there is a concern that flooding the market with the securities could result in a large decline in the security price, making it difficult to float the issue. For that reason, stabilization transactions are only permitted with a primary offering or secondary distribution of securities pursuant to the provisions of a cabinet order.

The offense of market manipulation carries a punishment of imprisonment

Table XV-2. Provisions of the Financial Instruments and Exchange Act Relating to Market Manipulation

Fake transactions	No person shall, for the purpose of misleading other persons about the state of securities transactions, conduct fake sale and purchase of securities without the purpose of transferring a right (Art. 159, Para. 1, Items (i) through (iii)).
Prearranged transactions	No person shall, for the purpose of misleading other persons about the state of securities transactions, conduct sale and purchase of securities at the same time and price, etc., based on collusion with another party (Art. 159, Para. 1, Items (iv) through (viii)).
Price manipulation	No person shall, for the purpose of inducing the sale and purchase of securities in securities markets, conduct sales and purchases of securities that would cause fluctuations in the prices of the securities (Art. 159, Para. 2, latter part of Item (i)).
Market manipulation by indication	No person shall, for the purpose of inducing the sale and purchase of securities in securities markets (1) spread a rumor to the effect that the prices of the securities would fluctuate by his/her own or other party's market manipulation (Art. 159, Para. 2, Item (ii)) or (2) intentionally make a false indication or an indication that would mislead other parties with regard to important matters when making a sale and purchase of securities (Art. 159, Para. 2, Item (iii)).
Stabilization transactions	No person shall conduct sales and purchases of securities in violation of a cabinet order for the purpose of pegging, fixing, or stabilizing the prices of the securities (Art. 159, Para. 3).

with work for not more than 10 years or a fine of not more than ¥10 million. In some cases, both penalties can be inflicted and the property gained through market manipulation confiscated and, if it cannot be confiscated, the value thereof shall be collected from the offender. If market manipulation is conducted by trading securities for the purpose of gaining property benefits (indirect financial benefits), the offense is subject to a punishment of imprisonment with work for not more than 10 years or a fine of not more than ¥30 million. The offense is also subject to an Administrative Surcharge Payment Order. Moreover, there are provisions on liability for compensation for damages claims for investors in violation of market manipulation regulations (Article 160 of the FIEA).

In the Cabinet Office Order on Financial Instruments Business, etc., securities companies are prohibited from accepting the entrustment of orders from customers with the knowledge or expectation that acceptance of the entrustment may lead to artificial market manipulation and are required to have in place trading surveillance systems for the prevention of such violations.

3. Prohibited and Regulated Acts of Corporate Insiders

Regulations concerning the acts of corporate insiders are largely classified into two categories: those prohibiting insider trading per se and those designed for its prevention.

Prohibition of Insider Trading

"Insider trading" refers to acts of effecting the sale, purchase, or other type of transaction of securities pertaining to any unpublished corporate information that may significantly influence the decision-making of investors by an insider of a listed company who has come to know the information through the performance of his/her duties or due to his/her position before such information is publicized (Article 166). If such transactions were to take place, the investing public would be put at a significant disadvantage and the credibility of the securities markets would be seriously undermined.

Japan's insider trading regulations were introduced with the amendment of the law in April 1989 in line with the modernization of the securities market. The framework has since been revised, with legislative changes put in place. In 2013, further amendments (1) expanded the scope of criminal charges and Administrative Surcharge Payment Orders to include disclosure of information and inducement of insider trading by a corporate insider and (2) expanded the scope of regulation to include REIT transactions.

On the other hand, in 2016, the Cabinet Office Ordinance on Restrictions on Securities Transactions, etc. was amended to expand the scope of exemptions from insider trading regulations pertaining to so-called prior knowledge contracts and plans.

Insider trading is punishable by imprisonment with work for not more than five years or a fine of not more than ¥5 million. In some cases, both penalties can be inflicted. For the case of a legal entity, the fine shall be not more than ¥500 million. Any property gained through insider trading shall be confiscated and any deficient amount collected from the offender. In addition, when receiving an Administrative Surcharge Payment Order, the offender must pay an amount equivalent to the profit made (half the profit in the case of disclosure of information and inducement of insider trading by a corporate insider) to the government treasury.

Preventing Insider Trading

Along with the prohibition of insider trading, the officers and principal shareholders of listed companies, etc., are required to officially report any transactions in the shares of the company concerned. They are required to return to the company any short-term trading profit they have made in the shares of

Table XV-3. An Outline of the Targetted People of Regulations, Material Facts, Methods of Announcement Relating to the Regulation of Insider Trading

Item	Outline
1. Targetted People of regulation	
(1) Persons associated with the company	(i) Directors of the listed company (directors, officers, agents, key employees) → information not announced to the public that came to their knowledge (ii) Persons who have the right to inspect the books and accounting records of the company (for example, those who hold 3% or more of the outstanding shares of the company) → Information not announced to the public that came to their knowledge in the course of the exercise of the right to inspect the books and accounting records of such company (iii) Persons who have the power vested in them by laws and regulations to inspect the books and accounting records of listed companies (for example, officials of the regulatory agencies) → Information not announced to the public that came to their knowledge in the course of the exercise of such power (iv) Persons who have concluded a contract with the listed company (for example, banks, securities companies, certified public accountants, lawyers, etc.) → Information not announced to the public that came to their knowledge in the course of negotiating, signing, and performing a contract. (v) In case any person referred to in (ii) or (iv) above is a corporation or director, etc., of such corporation → Information not announced to the public that came to such person's knowledge in the course of performing his/her official duty
(2) Recipients of information	(i) Persons who have received information concerning a material fact from persons associated with the company (ii) Directors of a corporation to which the person who has received information concerning a material fact from a person associated with the company belongs and who have learned of information not announced to the public in the course of the performance of their duty
2. Material facts	
(1) Matters decided	A decision made by a decision-making body of the listed company to carry out or not to carry out the matters set forth below: The issuance of new shares, a decrease in capital, the acquisition or disposal of its own shares, a stock split, a change in the amount of dividend, a merger with another company, transfer of business, dissolution of the company, commercial production of a newly developed product or commercial application of a new technology, an assignment or acquisition of fixed assets, etc.
(2) New facts	When any of the facts set forth below has occurred to the listed company: A loss caused by a disaster; a change in major shareholders; a development that could cause a delisting of its shares; lawsuits relating to a claim against the property right of the company; an administrative disciplinary action ordering the suspension of business, etc.; a change in the parent company; a petition for bankruptcy of the company; a failure by the company to honor its notes or bills falling due; suspension of business with its bank; or the discovery of natural resources, etc.
(3) Information on settlement of accounts	When newly announced results, projected or actual, are significantly at variance with those announced earlier: Sales (10% or more up or down); current profit (30% or more up or down, and its ratio to the total net assets is 5% or more up or down); net profit (30% or more up or down, and its ratio to the total net assets is 2.5% or more up or down)
(4) Others	Material facts, other than those listed in (1)－(3) above, relating to the management, business, or property of a listed company that have a profound influence on the investment decisions the investors make
(5) Material facts related to subsidiaries	(1) to (4) above apply
3. Methods of announcing information	When a company notifies the stock exchange on which its stock is listed of material facts and the material facts are placed on the website of the stock exchange that received the information for public inspection. When twelve hours must elapse after the company that has issued the stock in question has disclosed its material facts to two or more news media. When a company has notified the stock exchange on which its stock is listed, and the stock exchange has placed the securities report, etc. containing the information notified on its web site for public inspection.

Note: Any person who had been associated with any listed company and had learned of a material fact of such company as set forth above and who is no longer associated with such listed company is subject to these regulations for one year after that person dissolves association with the company.

the company held for a period of six months or less, and they are prohibited from selling the securities, etc., of the company in excess of the share certificates, etc., of the company that they hold.

Checks by securities companies on orders they receive and internal frameworks of listed companies (to manage and control corporate information and regulate employee trading of company shares) and posting information on J-IRISS play a critical role in preventing insider trading. J-IRSS stands for Japan-Insider Registration & Identification Support System, a searchable database where securities companies regularly register information on their customers and listed companies post information on their directors.

4. Regulations on the Conduct of Financial Instruments Business Operators (Securities Companies)

There are various regulations in place for securities companies (see figure on the right). This section focuses on regulations for ensuring the fairness of transactions.

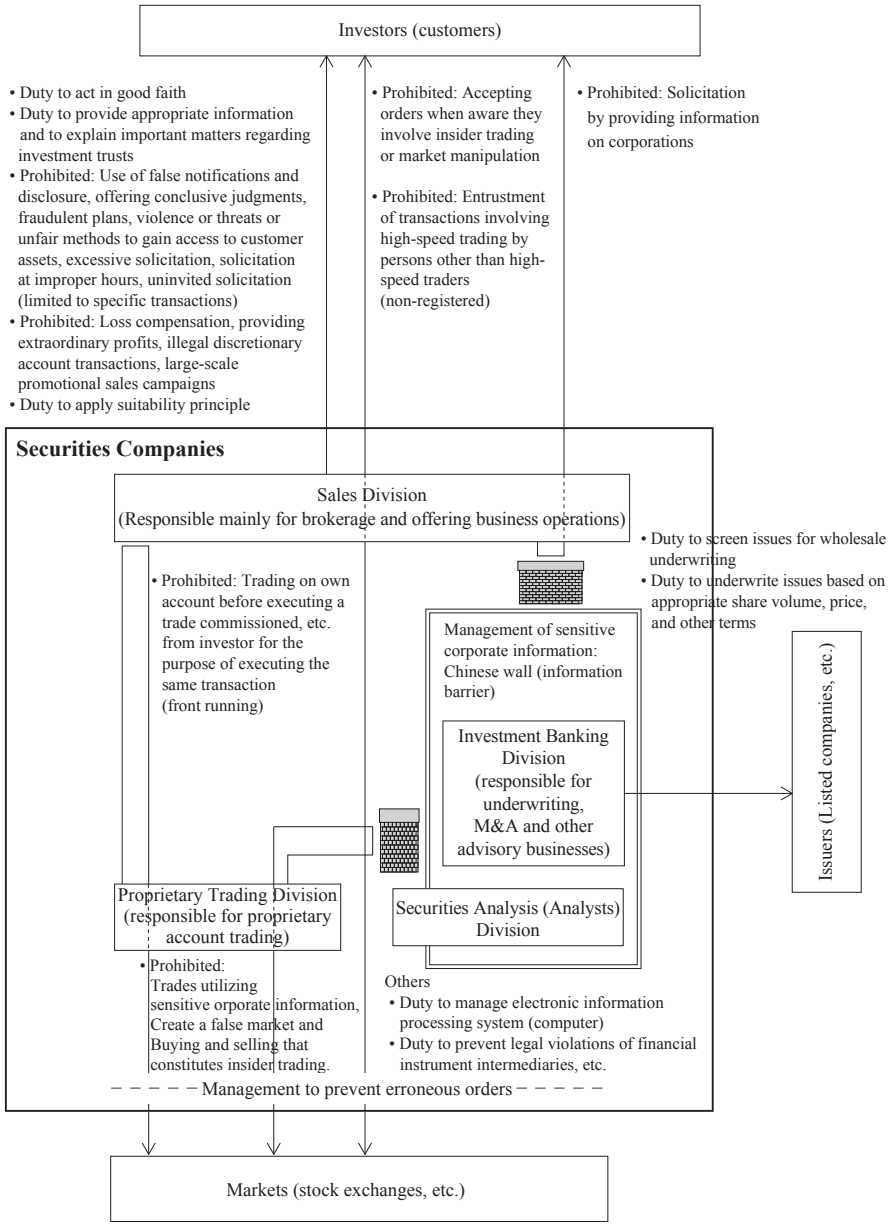
Trading surveillance system

Securities companies are prohibited from buying or selling securities or accepting orders if they know there is a risk that such orders could create a false market that does not reflect the actual market conditions or could be insider trading. Securities companies are required to carry out appropriate checks for investors to prevent this occurring. Specifically, they are required to monitor the motives behind investor transactions in a timely and accurate manner to identify and examine any possible unfair transactions (including proprietary trades) based on established standards. In the event that any issues are identified, securities companies must take appropriate measures (inquiries, alerts, suspension of transactions, etc.) and develop a system to ensure the effectiveness of these standards and measures.

Corporate information management system

Through their underwriting and M&A-related advisory and other businesses, securities companies have access to undisclosed information that could influence investors' investment decisions (sensitive corporate information). To prevent unfair trading based on such information, including proprietary trading, securities companies are required to establish appropriate systems. Specifically, securities companies should set up an information barrier between departments with access to such information and other operating divisions. In addition, personnel are forbidden to use sensitive corporate information to solicit investors customers or to engage in trading.

Chart XV-1. Major Prohibited and Regulated Acts of Securities Companies (Duties and Prohibited Acts)



Management system to prevent erroneous orders
Securities companies are required to establish appropriate order management systems, such as a system for setting order limits, to prevent erroneous orders (such as errors with the name of an issue, volume, price, etc.).

Management system for high frequency trading
Securities companies are prohibited from accepting orders for transactions related to high frequency trading from counterparties who are not registered with the Prime Minister. In addition, regulations are in place for high-speed traders, including systems to prevent abnormal orders as well as appropriate adequate monitoring systems.

Besides the previously mentioned areas, Article 117, Paragraph 1 and Article 123, Paragraph 1 of the Cabinet Office Order on Financial Instruments Business, etc. and the self-regulation rules of the Japan Securities Dealers Association and each Financial Instruments Exchange, etc., set out various strongly advised or required management systems for securities companies.

5. Other Regulated Acts—Information Disclosure to Ensure Fairness of Transactions

A tender offer or takeover bid (TOB) is a type of corporate action in which an acquiring company publicly announces its offer to buy a certain number of share certificates, etc. of a target company at a certain price in a certain period of time in an aim primarily to gain control of the target company. Since such an offer involves purchasing share certificates, etc. from an unspecified number of investors off the exchange, the bidder is expected to disclose information by which investors can judge whether or not to sell the respective shares and deal with shareholders in a fair and rightful manner. Additionally, as it is likely that control over the target company may be transferred as a result of the takeover bid, disclosure of information on the buyer is also required. Given such factors, takeover bidders are required to: (1) publish the purpose of TOB, purchase price, number of shares to be purchased, purchase period, etc.; (2) submit the Tender Offer Notification; (3) issue the Tender Offer Statement, a document explaining the TOB, to applying shareholders; and (4) report the results of the TOB after the completion of the purchase period. In order to prevent the use of TOB for market manipulation or abuse, cancellation of TOB is prohibited as a general rule, and certain restrictions apply for making changes to the terms of purchase. Meanwhile, information on the views of the target company regarding the TOB is extremely important for shareholders in judging whether or not to accept the tender offer. For this reason, the target company of a TOB must immediately

Table XV-4. Flow of Tender Offer

(1) Begin offer
- Publicly announce the start of tender offer (TOB) (publish the purpose of TOB, purchase price, number of shares to be purchased, purchase period, etc. in a daily newspaper).
- On the date of the public notification, file the Tender Offer Notification addressed to the Prime Minister and send copies thereof to the target company of TOB, stock exchanges, and parties that have submitted the Tender Offer Notification regarding the company.

(2) Purchase period (as a general rule, a period of 20 days or more and up to 60 days)
- Issue the Tender Offer Statement to parties intending to sell or offer stock certificates, etc.
- Terms of TOB purchase price are consistent; decrease of purchase price and reduction of purchase period are not allowed as a general rule.
- Withdrawal of application for purchase and cancellation of contract are not allowed as a general rule. Obligation to purchase all shares if the allotment ratio of stock certificates, etc. after the TOB exceeds two-thirds
- The party intending to sell or offer may cancel the contract at any time
- The target company submits its Position Statement addressed to the Prime Minister and sends copies thereof to the takeover bidder and the stock exchange.
- The party intending to execute a TOB is prohibited, as a general rule, from purchasing the respective shares, etc. through a method other than TOB

(3) Completion of purchase
- Issue a public notice or disclosure regarding the number of stock certificates, etc. associated with the TOB and submit the Tender Offer Report to the Prime Minister.
- Send the notice containing the number of stock certificates, etc. for TOB to applying shareholders.
- Settle purchases without delay.

Table XV-5. Flow of Disclosure of Possession of Large Volume of Shares

(1) Obligation to submit the Report of Possession of Large Volume arises
- A shareholder or joint shareholder submits, if its holding ratio of share certificates, etc. exceeds 5% of the total number of issued shares, the Report of Possession of Large Volume (containing shareholder or joint shareholder's name and address, business description, matters concerning the holding ratio of share certificates, purpose of holding, matters concerning purchase funds, etc.) to the Prime Minister within five business days from the occurrence of the obligation, and sends copies of the Report to the stock exchange and the issuing company.
- In the case of an institutional investor, etc., if its holding ratio of share certificates does not exceed 10% of the total number of issued shares, the Report of Possession of Large Volume may be submitted within five business days from the record date on which the obligation arises (twice or more a month) (Special Reporting System).

(2) Subsequent reporting obligation
- After a Large Volume Holder submits the Report of Possession of Large Volume, if its holding ratio of share certificates, etc. increases or decreases by 1% or more, it submits the Change Report addressed to the Prime Minister within five days, as a general rule, from the date of the aforesaid increase or decrease, and sends copies of the Change Report to the stock exchange and the issuing company.
- The party that has submitted the Report of Possession of Large Volume or the Change Report of Possession of Large Volume submits the Correction Report to the Prime Minister if any deficiency was found with the content of the report initially submitted.

(3) Public inspection of reports
- The Prime Minister and stock exchanges disclose the reports for public inspection for a period of five years.

Note: Effective from April 2007, the reports are required to be submitted via EDINET.

submit its Position Statement addressed to the Prime Minister.

While the act of purchasing a large amount of share certificates, etc. in itself does not immediately cause a problem, it can, in many cases, cause fluctuations in stock prices or influence the controlling interests of the company concerned and may lead to inflicting damage on general investors. In consideration of such possibilities, any person or entity, if it becomes a holder of more than 5% of the shares or other equity securities of a listed company, etc., is required to file a Report of Possession of Large Volume to the Prime Minister. In addition, such a person or entity, after having become a Substantial Shareholder, is required to file a Change Report Pertaining to Report of Possession of Large Volume addressed to the Prime Minister if its shareholding ratio in the entity covered by the aforesaid Report increases or decreases by 1% or more or there is a material change to any other entry in the Report. The Reports of Possession of Large Volume and Change Reports are publicly disclosed. This system was put in place with the aim of further protecting investors by encouraging timely and accurate disclosure of information on large-scale purchases and on holding and secondary offering of shares, etc. to investors and promoting high fairness and transparency in the securities market.