DEVELOPMENTS IN INSIDER TRADING IN JAPAN

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1. Introduction

There has been no new legislation nor any court decision with respect to insider trading in Japan during the past ten years. The administrative agency and the self-regulatory bodies, however, have made every effort to educate businessmen about insider trading and to deter them from taking advantage of inside information in securities transactions.

Japanese Securities Exchange Law has a section 16(b) type of provision requiring the disgorgement of short-swing profit obtained by corporate insiders; but that provision is not working as effectively as originally intended — partly because of the lack of section 16(a) type of provision, which was repealed in 1953 just after the end of the Occupation by the Allied Forces. The Securities Exchange Law also has a rule 10b-5 type of general anti-fraud provision, but it does not function like its U.S. counterpart with respect to insider trading. Some argue that the provision is too general to apply to insider trading in particular.

The Securities Exchange Law and the rules of the self-regulatory body contain specific rules that prohibit members of the securities industry from trading securities on non-public material information. The Securities Exchange Law and the rules of the Ministry of Finance prohibit officers or employees of a securities company from trading securities for their own accounts on special information — such as the state of purchase or sale orders from customers — obtained by virtue of their position. The self-regulatory rule of the Securities Investment Trust Association prohibits officers or employees of a mutual fund managing company from trading securities for their own accounts on special information obtained by virtue of their position — such as the management of a mutual fund portfolio. Under this legal framework, there has been no court decision nor any disciplinary action with respect to insider trading.

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2. Orders from corporate insiders checked by the securities companies

To prevent illegal trading by corporate insiders, securities companies are now asked, under administrative and self-regulatory guidance, to check purchase or sale orders from corporate insiders before executing them. The Securities Bureau of the Ministry of Finance, in its 1971 release to the Securities Dealers Association, asked that when a purchase or sale order in a company's shares is received from corporate insiders — such as directors, key employees, or major shareholders of an issuing company — all securities companies should inquire whether the order involves insider trading. If they find any suspicion of insider trading, they should refuse to accept the order and must communicate that fact to the stock exchange of which they are a member. In 1972 each stock exchange, in its release to listed companies, called the attention of corporate insiders to the insider trading prohibitions and, in its release to member companies, reminded these companies of their duty to check each order from corporate insiders.

Compliance by a securities company with this guidance is appraised through an examiner's visit to the securities company office. Examiners of the Ministry of Finance or stock exchanges visit the office of each securities company on a regular basis: usually once a year and occasionally an extra visit on a particular problem. If the examiner finds execution of insider trading by a securities company, or suspicion thereof, the Minister of Finance or stock exchange gives warning to the securities company.

3. Surveillance of insider trading

Insider trading is monitored through the investigation of unusual market action by the market surveillance department of each stock exchange. When unusual market action in a particular stock — price movement, trading activities, or both — is followed by the announcement of material information that might account for such activity, the market surveillance department of the stock exchange begins an investigation to determine whether insider trading is involved. The department asks the securities companies that executed transactions in the stock during the unusual market action to report the ultimate traders involved. If corporate insiders are included in the list of ultimate traders, the staff of the stock exchange inquires whether the insiders had access to the material information.

The market surveillance department of the Tokyo Stock Exchange, which has 27 staff members in July 1982, conducted such investigations of insider trading in twenty-seven cases in 1978, ten cases in 1979, fifteen cases in 1980, and fifteen cases in 1981. Based on these investigations, the Tokyo Stock Exchange gave warnings about insider trading to member companies and listed
companies in twenty-six cases during the past ten years; and in 1978 it gave a warning in writing to a member company that had executed suspicious purchase and sale orders in a company's shares for the president of that company. All member companies of the exchange were informed of this written warning because the exchange thought this execution of orders seriously violated the business ethic of the securities industry.

4. Suspension of trading

To prevent insider trading, stock exchanges use the technique of temporarily suspending trading in a particular issue of securities. The rules of stock exchanges provide that when the stock exchange becomes aware of a rumor or report containing information that might influence investors' investment decisions and that should be clarified or publicly disseminated, or when unusual market action—in price movement, trading activities, or both—occurs without any publicly available information that would account for the action, the stock exchange may suspend the trading of that particular issue of securities temporarily.

Ten years ago, such a temporary suspension of trading was very rarely imposed, but these days, stock exchanges frequently use this technique for the prevention of insider trading. For instance, the Tokyo Stock Exchange suspended trading in particular issues of securities sixty-four times in 1978, twenty-four times in 1979, fourteen times in 1980, and sixteen times in 1981.

5. Conclusion

In conclusion, I will make some observations on insider trading in Japan. First, the regulation of insider trading has been carried out through administrative or self-regulative guidance and warnings rather than court decisions or formal disciplinary action. Indeed, there has been no civil or criminal case brought to trial nor any disciplinary action with respect to insider trading.

Secondly, none of the parliamentary committees, the Securities Bureau of the Ministry of Finance (which has the responsibility of enforcing the Securities Exchange Law), or the Advisory Committee on Securities Regulation has shown any intention of recommending or proposing the enactment of specific legislation on insider trading. The Advisory Committee on Securities Regulation said in its 1976 report to the Minister of Finance that the most practical way of dealing with the insider trading problem was to educate businessmen that such a practice was against public morals, without recommending any specific legislation in this respect.

But thirdly, the regulatory bodies, such as the Securities Bureau of the
Ministry of Finance and the stock exchanges, are increasing their pressure against insider trading. Through repeated warnings against insider trading and the revelation of such warnings by news journals, the business circle is now beginning to consider insider trading as seriously against the business ethic. In this way, educational efforts are bringing about the desired effect. Therefore, it is likely that in the not remote future, the enactment of more effective specific regulations on insider trading will be discussed in business as well as academic circles.