

MEMO# 3695

April 14, 1992

DISCLOSURE REQUIREMENTS IMPOSED BY JAPANESE LAW ON LARGE SHAREHOLDERS

April 14, 1992 TO: INVESTMENT ADVISER MEMBERS NO. 16-92 RE: DISCLOSURE
REQUIREMENTS IMPOSED BY JAPANESE LAW ON LARGE SHAREHOLDERS

Counsel retained by the Institute in Japan has provided information about Japan's "5 percent Rule", which imposes disclosure obligations on shareholders holding positions in securities listed on a Japanese securities exchange or traded in the Japanese over-the-counter market. The new disclosure requirements, which were part of an amendment to the Securities Exchange Law of Japan promulgated on June 22, 1990, became effective December 1, 1990. Many of the details regarding implementation of the Rule are set forth in Orders issued by Japan's Ministry of Finance, English translations of which are as yet unavailable. Generally, the 5 percent Rule provides that a person or entity that owns more than 5 percent of an issuer's securities must disclose information related to the holdings to the Ministry of Finance, the issuing corporation, and either the relevant stock exchange or the Japanese Securities Dealers Association. Disclosure must be made within five working days after the 5 percent threshold is first exceeded, and also following certain changes in holdings. The rule is modified in the case of investment companies and certain other entities. The following discussion highlights some of the Rule's main features. Members doing business in Japan might wish to consult their own counsel to determine the application of the Rule in specific circumstances.

A. Shareholders Obligated to File The Rule places the disclosure obligation on any person who a) owns, b) has the voting rights to, or c) has the authority to dispose of more than 5 percent of the outstanding shares of a company. All beneficial owners of securities are subject to the Rule, regardless of whether the shares are held in the name of a third party or nominee. Voting rights include the power to instruct some other person, such as a trustee, how to vote the shares. Where different persons have the power to vote and dispose of securities, each will be considered an owner for purposes of the Rule. Persons who are committed to purchase shares in the future are considered shareholders under the Rule. If there are "group owners" of shares and the total amount held by them exceeds 5 percent, all must file, either jointly or separately. Group owners include shareholders who agree to purchase, transfer or exercise the voting rights with respect to shares jointly, and also includes related persons or entities such as husband and wife and a parent company and its subsidiaries. It is important to note that an investment adviser is deemed to own, and must aggregate, securities owned by its clients that are subject to the Rule if the adviser has the right to dispose of the securities.

B. Securities Subject to the 5 Percent Rule The reporting requirements apply to securities of corporations listed on a stock exchange in Japan and companies the shares of which are traded in the over-the-

counter market and registered with the Japanese securities Dealers Association. Equity-related securities must be counted in determining a disclosure obligation. Thus, the securities to be reported under the Rule include a) shares (excluding non-voting preferred shares), b) convertible bonds, c) bonds with warrants to subscribe for shares, d) certificates representing the right to subscribe for shares, e) warrants to subscribe for shares, and f) securities or certificates issued by foreign companies which are of the same nature as instruments described in a) to e). It is important to note that we are informed that the owner of American Depositary Receipts or similar instruments is deemed to own the securities underlying the ADRs for purposes of the Rule.

C. Calculations In determining whether the 5 percent threshold has been exceeded, the total number of shares held is divided by the total number of outstanding shares. In cases where stock holdings include or consist entirely of equity-related securities, the equity related securities must be translated into shares in accordance with a formula established by the Ministry of Finance. In such a case, the number of shares translated from equity-related securities would be added to the number of shares outstanding in determining the percentage of shares owned.

D. When to File For shareholders owning more than 5 percent of an issuer's outstanding securities prior to the effective date of the Rule, the Report was required to be filed within 5 days, excluding holidays, following the effective date. Other shareholders are required to file within 5 business days after first becoming a holder of more than 5 percent. Amendments to filed Reports must be made within 5 days following a change of more than 1 percent in the holdings, or whenever there has been a material change affecting the Report as filed, such as a change in the filer's name, address or purpose for holding the shares. Filing obligations continue until an Amendment is filed that states that the shareholder's holdings have fallen to no more than 5 percent.

E. Information Required The Report to be filed under the 5 percent Rule calls for fairly detailed information, including:

- information concerning the shareholder and the subject company;
- number of shares held, with information as to the types of shares held;
- purpose of ownership;
- source of funding for the purchase of the shares;
- information concerning any agreements or arrangements with respect to the shares;
- information concerning recent trading activities.

F. Exceptions to the 5 Percent Rule There are special reporting requirements for securities companies, insurance companies, investment fund trusts, local governments, etc. In general, these entities are subject to modified reporting requirements except when they hold shares for the purpose of controlling the issuer or when they hold more than a certain percentage of an issuer's shares (which may be set at 10 percent). We understand that the modified reporting requirements are:

- filing obligations are determined as of the end of each quarter. If ownership exceeds 5 percent at the end of a quarter, the Report must be filed within 15 days after the end of the quarter. It appears that there is no obligation to file if holdings exceed 5 percent at times during a quarter, so long as they do not exceed 5 percent at the end of the quarter.
- If a report has already been filed with respect to a quarter, and its holdings increase or decrease by more than 1 percent as of the end of any subsequent quarter, an amendment must be filed within 15 days of the end of the quarter.

G. Penalties Failure to file a Report or an Amendment or a fraudulent filing can result in imprisonment for up to one year or a fine of up to one million yen. Members wishing further information about this Rule should contact the undersigned at (202) 955-8419 for copies of memoranda prepared by the Japanese Securities Dealers Association and two Japanese law firms that describe the Rule. We will keep you informed of further developments. Angela C. Goelzer
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should not be considered a substitute for, legal advice.