

2012

# lakkyara

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**vol.134** (12.March.2012)

**Olympus's stock remains listed**

In response to the revelation that Olympus had concealed losses for many years, the TSE designated its stock a "security on alert," allowing Olympus to retain its listing. Although the TSE's decision itself is not unjustified, its disciplinary system should be improved in certain respects.

### Olympus stock designated a security on alert

On January 20, 2012, the Tokyo Stock Exchange (TSE) designated Olympus's stock a "security on alert" in response to the revelation that the company had concealed large losses on financial assets. The TSE's regulations stipulate that if a company's Securities Report or other disclosure filing contains any misrepresentations deemed to be material by the TSE, the company's stock shall be delisted. In Olympus's case, however, the TSE decided that this provision had not been violated, thereby permitting Olympus to retain its listing.

The security-on-alert designation was first adopted in November 2007. It is applied to companies that committed violations deemed to possibly be grounds for delisting but ultimately determined not to be. Security-on-alert

designees are deemed to urgently need to improve their internal controls. They are granted three years to do so, during which time they must annually submit affirmations regarding the state of their internal controls to the TSE. Designees that fail to adequately improve their internal controls within three years are delisted.

Excluding Olympus, there have been ten security-on-alert designees to date (see table). Of the ten, three succeeded in having the designation rescinded by improving their internal controls. Five others were ultimately delisted due to bankruptcy, merger, or other reason. The designation can be thus characterized as a means of inducing companies that have made "gray area" misrepresentations not material enough to warrant immediate delisting to improve their internal controls.

Exhibit. TSE security-on-alert designees to date

Designation Date	Company	Outcome
February 9, 2008	IHI	Designation rescinded on May 12, 2009
March 26, 2008	Magara Construction	Delisted on August 6, 2008
March 20, 2009	Futaba Industrial	Designation rescinded on June 25, 2010
August 26, 2009	Japan Digital Contents	Delisted on November 1, 2009
November 25, 2009	Aredepro	Designation still in effect
April 22, 2010	I'rom Holdings	Designation rescinded on June 22, 2011
May 19, 2010	Link One	Delisted on April 25, 2011
September 25, 2010	Mercian	Delisted on November 26, 2010
December 22, 2010	DesignEXchange	Delisted on May 1, 2011
January 18, 2012	Keiozu Holdings	Designation still in effect
January 21, 2012	Olympus	Designation still in effect

Source: TSE

## TSE's decision is not unreasonable

Olympus's concealment of its losses attracted much public attention in Japan, partly because Olympus is renowned as a top global manufacturer of endoscopes and other optical medical devices. Another factor behind the public interest is that Olympus had appointed a Briton, Michael Woodford, as its president, making it a rarity among listed Japanese companies. The scandal came to light when Mr. Woodford was abruptly fired six months into his tenure for attempting to investigate the concealed losses.

Some have criticized the TSE's security-on-alert designation decision on the grounds that Olympus rightfully should have been delisted given the facts in the case.

A number of companies have previously been delisted for making material misrepresentations, including Seibu Railway, Kanebo, and livedoor. Other companies, including IHI and Nikko Cordial Group, have remained listed despite making misrepresentations involving large sums of money.

Among these previous cases, Seibu Railway and Kanebo's circumstances were such that even if they had not made misrepresentations, they most likely would have been delisted anyway. Additionally, livedoor had split its stock several times, including a 100-to-1 split, in addition to falsely reporting operating losses as profits. The news of livedoor's accounting fraud triggered a huge spike in trading volume that could have crashed the TSE's trading system.

In contrast to these other cases, Olympus's loss concealment was arguably not a material misrepresentation given that there was no long-term deception regarding Olympus's profit level or earnings trend, although it was egregious in certain respects, including its long duration and top management's heavy involvement. From such a standpoint, the TSE's decision is by no means unreasonable.

## Issues that should be addressed

However, the TSE's use of materiality of misrepresentation as a delisting criterion has been persistently criticized as an opaque standard. Although the TSE has clarified its decision-making criteria to a considerable extent through its many decisions in disciplinary cases, it may need to take further steps to enhance its decisions' perceived fairness, such as establishing an appeal process for delisting decisions.

Strengthening the security-on-alert designation's punitive aspects is also worth considering. In the case of TSE First Section-listed stocks, one idea is to disqualify security-on-alert designees from inclusion in the TOPIX index. Olympus was fined ¥10 million for violating its listing agreement. Instead of a flat ¥10 million fine, the TSE should consider imposing fines that vary in size based on the severity of the violation.

Incidentally, in the Olympus case, some non-Japanese institutional investors argued against delisting on the grounds that delisting due to misrepresentation is contrary to global standards. While delisting is undeniably disadvantageous to existing shareholders, delisting of problem companies is intended to protect prospective investors. Overseas stock exchanges' delisting criteria grant the exchanges broad discretion, including even the power to delist on the grounds of misrepresentation.



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