



Consultation Conclusions on the Proposed Guidelines for Market Soundings

October 2024

Table of Contents

Executive summary	3
Summary of comments received and the SFC's responses	7
Section I – Proposed scope of application	7
Section II – Proposed core principles for both Disclosing Persons and Recipient Persons	11
Section III – Proposed specific requirements for Disclosing Persons	17
Section IV – Proposed specific requirements for Recipient Persons	21
Section V – Record keeping	22
Section VI – Implementation timeline	24
Conclusions and the way forward	25
Appendix A – List of respondents	26
Appendix B – Final form of the Guidelines for Market Soundings	27

Executive summary

1. On 11 October 2023, the Securities and Futures Commission (SFC) launched a two-month public consultation on the Guidelines for Market Soundings (Consultation Paper). The proposed requirements aim to provide guidance to assist intermediaries in their compliance with the general principle to conduct their business activities honestly, fairly, and in the best interests of their clients and the integrity of the market¹ during market soundings (the Guidelines).
2. The SFC received 27 written submissions from various industry and professional associations, intermediaries, law firms, professional bodies, individuals and other stakeholders. A list of respondents is set out in Appendix A.
3. After reviewing and analysing the written submissions, the SFC held further discussions with various industry stakeholders to better understand their views on key concerns raised and discuss the SFC's amendments to the Guidelines to address their concerns in 2024.
4. The key comments received and the SFC's responses are discussed in this conclusions paper.

Key comments

Scope of application

5. Most respondents, in principle, supported the objectives of the Guidelines in upholding market integrity during market soundings. However, the majority of respondents disagreed with the proposed application of the Guidelines to the communication of non-public information during market soundings. Many respondents were concerned that, given the subjectivity and complexity involved in applying the proposed carve-outs for exclusion from the Guidelines, its impact could be far-reaching and would inevitably capture voluminous information that the SFC did not intend to be in-scope, for example, routine conversations in relation to sales and trading activities.
6. These respondents were concerned that the aforementioned scoping of the Guidelines around non-public information could create a disproportionate compliance burden, affect market participants' ability to conduct normal capital formation activities, and disrupt the efficient functioning of the market and the price discovery process. Furthermore, while some of the information discussed during routine daily conversations between intermediaries and investors might be non-public in nature, much of it would not be confidential, and thus would not entail a duty to maintain confidentiality. However, when it comes to non-public information that are confidential, most respondents agreed that there is a duty to safeguard it.

¹ General Principle 1 of the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission.

7. We note the respondents' concerns over inadvertent uncertainty and complexity when applying the proposed carve-outs to a range of practical situations that intermediaries might encounter each day. In view of this and to better reflect our policy intent, we will refine the Guidelines to apply to confidential information that is entrusted by a client, an issuer or an existing shareholder selling or buying in the secondary market (Market Sounding Beneficiary) (Market Sounding Information). Following this refinement, related proposals around assessment of the level of certainty and the carve-outs will no longer be necessary.
8. Some respondents commented that the proposed scope covering market soundings for all securities² transactions would be unnecessarily wide as this would also include transactions in debt capital markets (DCM) and unlisted securities, where the risk of information abuse by bad actors might be relatively lower than, for instance, transactions in equity capital markets (ECM). These respondents also pointed out that the nature of transactions in DCM and ECM were different with there being more diverse range of transaction types and more frequent issuances for DCM transactions.
9. Having considered respondents' comments and the pattern of relevant cases we observed, we will no longer require coverage of all securities transactions. We will amend the Guidelines to apply to market soundings conducted in connection with a possible transaction in (a) shares that are listed on an exchange and (b) any other securities which is likely to materially affect the price of shares that are listed on an exchange. The SFC will continue its supervision of intermediaries' trading activities and will keep in view the need for the Guidelines to cover more transactions in the future.

Restrictions on trading or use of any non-public information passed or received during market soundings

10. The majority of respondents opposed the requirement that a Market Sounding Intermediary³ should not trade on or use any non-public information passed or received during market soundings. A number of respondents commented that applying trading restrictions to non-public information that was not inside information⁴ would have the effect of creating a new form of market misconduct or an indirect expansion of the existing insider dealing regime under the Securities and Futures Ordinance (SFO) without statutory backing. As for non-public information that is confidential, some respondents were of the view that existing safeguards are already in place to protect confidentiality.
11. Many respondents also commented that, where specific regulations on market soundings were established in other major jurisdictions, similar trading restrictions were only applied to inside information. This purported inconsistency between the Guidelines and international standards would create an uneven playing field for Market Sounding Intermediaries in Hong Kong.

² As defined in Part 1 of Schedule 1 of the Securities and Futures Ordinance (Cap. 571).

³ Licensed or registered persons who: (a) disclose Market Sounding Information during the course of a market sounding (Disclosing Person); or (b) receive Market Sounding Information during the course of a market sounding (Recipient Person) are collectively referred to as "Market Sounding Intermediaries".

⁴ As defined in sections 245 and 285 of the SFO.

12. The SFC clarifies that the Guidelines are aimed at addressing regulatory issues that are unrelated to the insider dealing laws under the SFO. The SFC maintains the view that substandard conduct by intermediaries can affect the fairness and orderliness of our markets and undermine investor confidence in them. If an intermediary abuses Market Sounding Information, irrespective of whether it is price sensitive or constitutes inside information, the intermediary may be in breach of the Code of Conduct for Persons Licensed by or Registered with the SFC (Code of Conduct).
13. With the refinements of the Guidelines to apply to Market Sounding Information and to better reflect our policy intent and align with the SFC's existing regulatory requirements associated with functional barriers and protection of confidential information, the key requirement in the Guidelines will be amended as follows:

A Market Sounding Intermediary is required to:
 - (a) protect Market Sounding Information and safeguard its confidentiality; and
 - (b) ensure there is an effective system of functional barriers to prevent inappropriate disclosure, misuse and leakage of Market Sounding Information.
14. Furthermore, we will expressly state that the Guidelines should be read in conjunction with, among other provisions, General Principles 1 (Honesty and fairness), 2 (Diligence) and 6 (Conflicts of interest), as well as paragraph 9.3 (Front-running) of the Code of Conduct and paragraph 1.3 (Functional barriers) of the Fund Manager Code of Conduct (FMCC).

Standardised script

15. The majority of respondents agreed with the use of a standardised script, and that specific information should not be provided to allow the recipients to identify the subject security before receiving relevant consent from the recipients to safeguard the Market Sounding Information. Some respondents suggested allowing flexibility for Market Sounding Intermediaries to design their own scripts.
16. The SFC welcomes the respondents' support. The policy intent of requiring the use of a standardised script is to prevent inappropriate disclosure or inadvertent leakage of Market Sounding Information. Disclosing Persons have the flexibility to design their own scripts as long as they contain the minimum required content set out in the Guidelines. Given the refinement of the Guidelines to apply to Market Sounding Information, we will also make corresponding modifications to the requirements around standardised script.

Cleansing

17. More than half of the respondents expressed concerns about the requirements for cleansing if the Guidelines were to apply to the communication of non-public information during market soundings, as cleansing of such information could only be done when they become public information. This creates practical challenges as much of the non-public information might never be made public (eg, where a proposed transaction is cancelled, suspended or postponed) if it is not inside information that is subject to public announcements or disclosure requirements. The lack of means to cleanse non-public information might result in Recipient Persons being restricted from trading for a prolonged period or indefinitely.

18. In light of the refinements of the Guidelines to apply to Market Sounding Information, the proposed requirements around cleansing are no longer applicable and will therefore be removed from the Guidelines.

Record keeping

19. For Disclosing Persons, respondents concurred that the proposed requirement to only use authorised and recorded communication channels was generally in line with existing market practices. However, many respondents have expressed concerns on practical challenges and extra costs if the same requirement was imposed on Recipient Persons, which were not typically subject to similar telephone recording requirements as Disclosing Persons. A few respondents also suggested that it was unnecessary for Recipient Persons to keep a duplicate of the same record that was already kept by Disclosing Persons. Separately, a number of respondents contended that the proposed record retention period of seven years was excessive and burdensome.
20. Taking into account practical challenges and potential cost concerns, as well as the fact that the same records would be kept by Disclosing Persons, we will amend the Guidelines such that the use of authorised communication channels and the record keeping requirements will apply to Disclosing Persons only. We will also shorten the required record retention period to two years.

Transitional period

21. Some respondents considered a transition period of six months to be sufficient, whereas some suggested extending it to 12 months or longer to give Market Sounding Intermediaries more time to revise their systems, policies and procedures.
22. Taking into account that intermediaries should already have existing policies, procedures and controls in place to safeguard confidential information, we conclude that the Guidelines shall become effective six months following the gazettal of the Guidelines. After the Guidelines come into effect, Market Sounding Intermediaries that have not completed the corresponding enhancements to their systems, policies and procedures should put in place interim measures to meet the objectives of the Guidelines.

Implementation timeline

23. The SFC has carefully considered the comments received and will amend the Guidelines where appropriate. The marked-up texts of the final form of the Guidelines are set out in Appendix B.
24. The Guidelines will become effective six months from the gazettal date.
25. The SFC would like to thank all respondents for their time and effort in reviewing the proposals and for their detailed and thoughtful comments.
26. The Consultation Paper, submissions received (other than those the respondents requested us to withhold from publication) and this paper are posted on the SFC's website.

Summary of comments received and the SFC's responses

Section I – Proposed scope of application

Questions:

1. Do you agree with the scope of application of the Guidelines? If not, please explain.
2. Do you consider the definition of “market soundings” to be clear and appropriate? If not, please explain.
3. Do you have any comments on the examples of factors to consider when determining the level of certainty of the corresponding potential transaction materialising in connection with a market sounding?
4. Do you agree that a Market Sounding Intermediary has a duty to maintain the strictures of confidentiality of non-public information passed or received during market soundings? If not, please explain.

Non-public information, level of certainty and carve-outs

Major comments

27. Most respondents, in principle, supported the SFC's underlying intentions to clarify regulatory expectations, deter substandard conduct, promote a level playing field among market players and assist intermediaries in upholding market integrity during market soundings. However, the majority of respondents disagreed with the proposed application of the Guidelines to the communication of non-public information during market soundings.
28. Many respondents were concerned that the impact of the Guidelines would be far-reaching and would inevitably capture voluminous information that the SFC might not have intended to be in-scope. For example, conversations between intermediaries and investors occur frequently throughout each day to match buyers and sellers for trades. These routine sales and trading activities are not generally considered as market soundings. However, they might fall within the proposed definition of communication of non-public information with investors.
29. These respondents were concerned that any additional regulation of such frequent conversations would create a disproportionate compliance burden and could affect market participants' ability to conduct normal capital formation activities and disrupt the market's efficient functioning and the price discovery process.
30. Furthermore, while some of the information discussed during routine daily conversations between intermediaries and investors might be non-public in nature, much of it would not be confidential, and thus would not entail a duty to maintain confidentiality. Two respondents further illustrated this by distinguishing three different types of non-public information as follows:

- (a) Non-public information that is not confidential;
 - (b) Non-public information that is confidential; and
 - (c) Material non-public information that is confidential and price-sensitive (ie, inside information).
31. When it comes to non-public information that is confidential, most respondents agreed that there is a duty to safeguard it.
 32. Regarding the concept of level of certainty and the proposed carve-outs⁵, many respondents expressed concerns about increased compliance burden and regulatory uncertainty as intermediaries would have to apply subjective assessments to determine whether they would apply to a wide range of permutations and scenarios handled by intermediaries on a daily basis.
 33. Some respondents commented that the concept of level of certainty and the proposed carve-outs will have areas open for interpretation, which would inevitably result in intermediaries arriving at different conclusions. Without further clarifications such as clear quantitative parameters and bright line tests, these would create practical uncertainty and complexity for Market Sounding Intermediaries' implementation of the Guidelines.
 34. Some respondents highlighted that the Guidelines would create undue hardship for Recipient Persons. Specifically, if the market sounding was performed by unlicensed persons or overseas brokers who are not subject to the same requirements, it would be practically difficult, if not impossible, for a Recipient Person in Hong Kong to assess the level of certainty of a transaction materialising.

The SFC's responses

35. Regarding the respondents' concerns that the drafting of the Guidelines' scope around non-public information might potentially impact much of daily conversations between intermediaries and investors, the SFC wishes to clarify that it is not our intention to regulate routine daily conversations between intermediaries and investors that are not associated with market soundings.
36. The proposals around the concept of level of certainty and the carve-outs were intended for such routine conversations to be scoped-out from the requirements of the Guidelines. The SFC notes the respondents' concerns over inadvertent uncertainty and complexity when applying these proposals to a range of practical scenarios that intermediaries might encounter each day.
37. Separately, the SFC also notes respondents' feedback that not all non-public information is confidential.

⁵ Eg, in paragraph 1.3 of the Appendix to the Consultation Paper, communications regarding the following were carved out and excluded from the Guidelines:

- speculative transactions or trade ideas put forward by a sell-side broker without consulting with the potential seller or without any level of certainty of such transactions materialising;
- transactions that are commensurate with ordinary day-to-day trade execution; and
- public offerings of securities.

38. In view of the aforementioned concerns and to better reflect our policy intent, we will refine the Guidelines to apply to the disclosure and receipt of Market Sounding Information (ie, confidential information that is entrusted by a Market Sounding Beneficiary during the course of a market sounding) by intermediaries. Following this refinement, the related proposals around assessment of the level of certainty and the carve-outs will no longer be necessary and will therefore be removed from the Guidelines.
39. The SFC has engaged in further discussions with various industry stakeholders regarding the aforementioned refinements to the Guidelines. Most participating respondents were in support of them. Some sought further clarifications on how to determine if they are in possession of Market Sounding Information, whilst a few of them sought to clarify if the removal of the carve-outs (eg, transactions that are commensurate with ordinary day-to-day trade execution) might result in routine conversations around order matching and execution being scoped in.
40. The SFC is of the view that Market Sounding Intermediaries should refer to their existing policies and procedures and well-established principles around confidentiality to determine if they are in possession of Market Sounding Information. Practically, the SFC understands one of the key factors considered by a Market Sounding Intermediary, as part of the industry norm to classify confidential information, would be establishing whether it has a duty of confidentiality, trust or care towards the handling and sharing of that information. The following are some examples of Market Sounding Information (where a duty of confidentiality is established):
- (a) name of the subject security (or specific information that would allow the name of the subject security to be deduced⁶);
 - (b) identity of the Market Sounding Beneficiary;
 - (c) the Market Sounding Beneficiary's intent to pursue a possible transaction; and
 - (d) the terms of or specifications related to the possible transaction such as its potential timing, size, pricing, structure and trading method.
41. As mentioned in paragraph 35 above, it is not our intention to regulate routine conversations between intermediaries and investors that are not associated with market soundings (eg, sharing of speculative trade ideas and market sentiments, and communications in relation to an intermediary's efforts in sourcing potential buyers or sellers to match and execute a trade after receiving an actual order instruction placed by a client with an intent for execution). The SFC will provide practical guidance in this regard by way of frequently asked questions (FAQs).

Coverage of all securities transactions

Major comments

42. Some respondents commented that the proposed scope covering market soundings for all securities transactions would be unnecessarily wide, as this would also include

⁶ See Note 2 of paragraph 3.3(b) of the Guidelines.

transactions in DCM and unlisted securities such as private equity, where the risk of information abuse by bad actors might be relatively lower than, for instance, transactions in ECM.

43. Some respondents noted the Guidelines did not distinguish between their application to ECM and DCM transactions. However, the nature of transactions in DCM and ECM were different, with there being more diverse range of transaction types and more frequent issuances for DCM transactions.
44. There are certain types of DCM transactions (eg, those involving frequent issuers and sovereigns, supranational and agencies issuers) where the issuers involved will typically engage with intermediaries as well as bank lenders on a highly regular basis to discuss the latest market conditions and transaction options to address their ordinary course of business funding needs. These DCM transactions are typically immaterial as compared to the issuer's total outstanding debt securities and commensurate with its ordinary course of issuance.
45. Similarly, investors would also generally expect these issuers to continue conducting DCM transactions to meet their ongoing funding needs and would request intermediaries to reach out to investors to explore potential financing options on an indicative basis. As such communications occur regularly without precise timing, plans or mandates, market sounding requirements are generally not applied.
46. Separately, one respondent suggested limiting the application of the Guidelines to market soundings associated with Hong Kong-listed issuers only.

The SFC's responses

47. We note respondents' concerns about the distinction between market soundings for ECM transactions and other types of transactions, such as DCM transactions and unlisted securities, where the level of susceptibility to information abuse may differ.
48. Having considered respondents' comments and the pattern of cases regarding trading activities ahead of placings and block trades observed by the SFC, we will no longer require coverage of all securities transactions. We will amend the Guidelines to apply to market soundings conducted in connection with a possible transaction in (a) shares that are listed on an exchange and (b) any other securities which is likely to materially affect the price of shares that are listed on an exchange.
49. When determining the applicability of the Guidelines, Market Sounding Intermediaries should apply the duty of confidentiality test for market soundings involving transactions in shares that are listed on an exchange, and the price-sensitivity test for market soundings involving transactions in any other securities (eg, DCM transactions).
50. We put forward these amendments for further discussions with some industry stakeholders, and all participating respondents were in support of them.
51. Regarding the suggestion to limit the Guidelines to market soundings associated with Hong Kong-listed issuers only, we are of the view that this would not be appropriate as the Guidelines set out the conduct standards for intermediaries in Hong Kong, irrespective of the listing venue of the securities in question.



52. The SFC will continue its supervision of trading activities ahead of placings and block trades, and will keep in view the need for the Guidelines to cover more transactions in the future.

Application

Major comments

53. A few respondents sought clarifications on whether the Guidelines would apply to a licensed or registered person who (i) is based outside Hong Kong, or (ii) delegates market sounding activities to be conducted by its group affiliates based outside of Hong Kong.

The SFC's responses

54. As the Guidelines are aimed at assisting intermediaries in their compliance with the Code of Conduct, the Guidelines will apply to licensed or registered persons who conduct market sounding activities in Hong Kong. In this regard, practical guidance will be provided to Market Sounding Intermediaries by way of FAQs.

Section II – Proposed core principles for both Disclosing Persons and Recipient Persons

Question:

5. Do you agree that, from the standpoint of the Code of Conduct, a Market Sounding Intermediary should not trade on or use any non-public information passed or received during market soundings for its own or others' benefits or financial advantages? If not, please explain.

Absence of regulatory needs

Major comments

55. The majority of respondents opposed the requirement that a Market Sounding Intermediary should not trade on or use any non-public information passed or received during market soundings.
56. A number of respondents commented that applying trading restrictions to non-public information that was not inside information would be incompatible with the existing insider dealing regulations under the SFO, which is a well-established regime with a wealth of case laws and regulatory guidance that market participants are familiar with. Some respondents expressed concerns that this would have the effect of creating a new form of market misconduct or an indirect expansion of the existing insider dealing regime under the SFO without statutory backing.
57. Some respondents found it conceptually difficult to understand how anyone could benefit from information that was not inside information. If any non-public information could be used for benefits or financial advantages, this would indicate that the information was inside information and should be dealt with in accordance with the existing insider dealing regime.

58. A few respondents offered their interpretations of the Securities and Futures Appeals Tribunal's (SFAT) determination⁷. One respondent contended that the SFAT's determination was made in the context of that case and its specific fact pattern (most notably the deceitful conduct of the relevant person), and the SFAT did not suggest that it was unnecessary to determine if information disclosed during market soundings was inside information when assessing an intermediary's conduct under the Code of Conduct.
59. Two respondents commented that the SFAT did not raise any regulatory issues that support the extension of regulation to apply to all non-public information that the SFC proposed. Another respondent took a different view that the SFAT determination affirmed wider regulatory concerns outside of the existing insider dealing regime, specifically whether the conduct is in breach of the Code of Conduct.
60. One respondent commented that the root cause of the relevant person's behaviour in the SFAT determination might not necessarily be the communication of non-public information, but rather the lack of robust information barriers and surveillance controls to prevent front-running.
61. As for non-public information that is confidential, some respondents were of the view that existing safeguards are already in place to protect confidentiality, including contractual arrangements (eg, non-disclosure agreements), regulations (eg, the SFC's Code of Conduct) and common law (eg, implied duty of confidentiality).
62. In particular, General Principle 1 of the Code of Conduct is sufficiently clear when viewed through the lens of market soundings. The SFAT's determination also showed that the SFC already has existing tools at its disposal to investigate and discipline intermediaries that fall below the standards expected of them. To go beyond this by applying the Guidelines to all information appeared disproportionate.

The SFC's responses

63. The SFC clarifies that the Guidelines are not intended to change, expand or replace the existing insider dealing regime. They are aimed at addressing regulatory issues that are unrelated with the insider dealing laws under the SFO.
64. Specifically, the SFC wishes to draw attention to an important distinction between the insider dealing laws under the SFO and the Guidelines:
 - (a) Insider dealing is a type of market misconduct, which is subject to parallel civil and criminal regimes under the SFO. Offenders of insider dealing may be subject to civil proceedings before the Market Misconduct Tribunal or criminal prosecution. Compliance with the Guidelines is no substitution or defence to one's obligation to comply with the relevant laws and regulations concerning insider dealing. A person involved in market soundings who is not an SFC-regulated intermediary remains subject to the relevant laws and regulations concerning insider dealing.

⁷ On 29 September 2022, the SFC announced its suspension of a hedge fund manager for two years after the SFAT upheld the SFC's disciplinary action against him for breaches of the SFC's Code of Conduct.

- (b) The Guidelines are only applicable to persons licensed by or registered with the SFC. They do not have the force of law and shall not be interpreted in a way which would override the provisions of any law. Failure by any person to comply with the Guidelines may cause the SFC to consider whether such failure adversely reflects on the person's fitness and propriety to remain licensed or registered.
65. The SFC also clarifies that the SFAT determination was not one of the main drivers behind the Guidelines as some respondents presumed. The SFAT determination was referenced to illustrate that it is not necessary to determine whether inside information is involved in considering whether the conduct of an intermediary during market soundings is in breach of the Code of Conduct⁸.
66. As for how anyone could benefit from information that was not inside information, the SFC maintains the view that irrespective of the materiality of the price impact, substandard conduct by intermediaries can affect the fairness and orderliness of our markets and undermine investor confidence in them. If an intermediary abuses Market Sounding Information, irrespective of whether it constitutes inside information, it may cause the SFC to consider if this was a breach of the Code of Conduct.
67. The SFC wishes to clarify that the Guidelines are not intended to restrict a Market Sounding Intermediary's legitimate trading activities. A Market Sounding Intermediary can still engage in these activities as long as effective information barrier controls are in place to prevent inappropriate disclosure, misuse and leakage of Market Sounding Information.
68. To better reflect our policy intent and align with literature used in the SFC's existing regulatory requirements associated with functional barriers and protection of confidential information⁹, we will amend the Guidelines by incorporating Core Principle 4 into Core Principle 1 to require a Market Sounding Intermediary to:
- (a) protect Market Sounding Information and safeguard its confidentiality; and
 - (b) ensure there is an effective system of functional barriers to prevent inappropriate disclosure, misuse and leakage of Market Sounding Information (eg, appropriate standards of conduct expected of its staff in handling Market Sounding Information, clear and robust information sharing principles and processes, and segregation of incompatible duties in compliance with the "need-to-know" principle).
69. These amendments were put forward for further discussions with various industry stakeholders, and most participating respondents were in support of them. Some participating respondents would welcome further clarity on behaviours or circumstances that may indicate misuse of Market Sounding Information. In this regard, we will also provide practice guidance to Market Sounding Intermediaries by way of FAQs.

⁸ Paragraphs 9 and 56(a) of the Consultation Paper.

⁹ Eg, paragraph 1.3 of the FMCC, paragraph 21.3.11 of the Code of Conduct, paragraphs 4.3 and 6.2 of the Corporate Finance Adviser Code of Conduct ("CFA Code"), and the FAQ issued to clarify the meaning of paragraph 4.3 of the CFA Code.

70. We wish to clarify our policy intent is to deter substandard conduct by providing clarity on regulatory expectations, ensure a level playing field for the industry and assist intermediaries in upholding market integrity in compliance with the Code of Conduct during market soundings¹⁰.
71. The upholding of intermediaries' conduct during market soundings will instil investor confidence in our markets, as it gives investors peace of mind that their Market Sounding Information will be safeguarded when engaging intermediaries to conduct market soundings in Hong Kong.

Uneven playing field

Major comments

72. Many respondents commented that, where specific regulations on market soundings were established in other major jurisdictions (eg, most notably the EU MAR¹¹), similar trading restrictions were only applied to inside information. The respondents considered that this purported inconsistency between the Guidelines and international standards would create an uneven playing field for Market Sounding Intermediaries in Hong Kong.
73. The uneven playing field would be most evident in an international transaction or where cross-border market soundings are conducted between intermediaries or investors located in different jurisdictions. In such cases, Recipient Persons in Hong Kong would be restricted from trading, whereas unlicensed or overseas market participants would not as they are not subject to the Guidelines. In some cases, Recipient Persons in Hong Kong might not even be informed that the communication constitutes a market sounding if Disclosing Persons were located overseas and were not required to follow the script of the Guidelines.
74. Overall, the above cases would put Market Sounding Intermediaries at a significant disadvantage and would weaken the competitiveness of Hong Kong compared with other global markets. The uneven playing field might also deter investors from participating in market soundings to avoid being subject to additional trading restrictions, which would impact Market Sounding Intermediaries' ability to effectively facilitate the price discovery process.
75. Some respondents were also concerned if the uneven playing field could result in regulatory arbitrage, where firms with a global presence might shift the market sounding process outside of Hong Kong to avoid having to comply with the proposed trading restriction.
76. Other respondents questioned whether the proposals would create an asymmetry if trading restrictions were applied only when non-public information was received through market soundings but not under other circumstances.

¹⁰ Paragraph 13 of the Consultation Paper.

¹¹ Regulation (EU) No 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse (Market Abuse Regulation) ("EU MAR").

77. A few respondents were concerned if the proposals around implementing an effective system of function barriers would put smaller firms, which are subject to size constraint, at a disadvantage.

The SFC's responses

78. We note the respondents' comments regarding the purported inconsistency with the regulations adopted by other major jurisdictions. In the Consultation Paper, we emphasised that direct comparisons between jurisdictions are bound to have inherent limitations¹².
79. Specifically, we note the EU MAR cited by some respondents was a piece of legislation adopted by the European Union to combat market abuse and insider dealing, among other things. The appropriate equivalent for meaningful comparison would be the SFO.
80. As mentioned in paragraphs 63-64 above, the Guidelines are aimed at assisting intermediaries to comply with existing requirements under the Code of Conduct, and are unrelated to the insider dealing laws under the SFO.
81. With the refinements of the Guidelines to apply to Market Sounding Information, the Guidelines should also align with general regulatory principles adopted by other major jurisdictions around protection of confidential information.
82. We do not agree with the premise that the Guidelines would put Market Sounding Intermediaries at a disadvantage compared to unlicensed persons. One of the main reasons to engage Market Sounding Intermediaries to manage the market sounding process is precisely because they are licensed by the SFC and subject to a higher conduct standard (eg, compliance with the Code of Conduct).
83. Furthermore, the regulatory principles of the Guidelines are not new. Most intermediaries should already have existing policies and procedures established around subject matters such as prevention of misuse or leakage of confidential information, staff personal dealing policies, proprietary trading rules, prevention of front-running, etc.
84. To emphasise this, we will expressly state that the Guidelines should be read in conjunction with, among other provisions, General Principles 1 (Honesty and fairness), 2 (Diligence) and 6 (Conflicts of interest), as well as paragraph 9.3 (Front-running) of the Code of Conduct and paragraph 1.3 (Functional barriers) of the FMCC. For avoidance of doubt, an intermediary's use and communication of confidential information will always be subject to these regulatory principles, in addition to any specific provisions of the Guidelines.
85. The SFC recognises that some aspects of the Guidelines may not be within an intermediary's control. We clarify that the Guidelines are principles-based, as such when assessing an intermediary's compliance with the Proposed Guidelines, the SFC will adopt a pragmatic approach, taking into account all relevant circumstances, including the size of the intermediary, and any compensatory measures implemented by its senior management.

¹² Paragraph 54 of the Consultation Paper.

Questions:

6. Do you have any comments on the Core Principles in the Guidelines as outlined above?
7. Are there any other areas which you think the Core Principles in the Guidelines should cover? If so, please provide examples.

Major comments¹³

86. Some respondents commented that the proposed requirement to designate a person sufficiently independent from the “front office” to monitor market soundings was too prescriptive and might result in uncertainty (eg, what constitutes “sufficiently independent”) and inefficiencies (eg, front-office staff might in fact be best placed to monitor market soundings given their expertise and access to communication exchanges). There might also be resource constraints and practical difficulties, particularly for smaller firms, to segregate a person independent from the front office to monitor soundings.
87. Given the far-reaching extent of non-public information:
 - (a) One respondent sought clarification as to how different types of information should be categorised and handled; and
 - (b) A few respondents commented that the proposed requirement to maintain a “Restricted List” and a list of internal and external individuals who possess non-public information as a result of market soundings was impractical, as significant resources would be required to maintain such lists owing to the volume and number of persons involved, particularly in cross-border deals. One respondent further expressed concerns that this might create confusion for firms with existing global frameworks established around the maintenance of watch lists and restricted lists.
88. Some other comments we received included the following:
 - (a) One respondent commented that the Core Principles should not apply to both Disclosing Persons and Recipient Persons equally, given the asymmetry of information they may possess; and
 - (b) Two respondents sought further clarifications on matters such as (i) what specific actions are required for management supervision of market soundings, (ii) whether management supervision can be discharged by periodic reviews by the compliance function, and (iii) whether independent functions are expected to be present as chaperons during market sounding conversations.

¹³ Note: Comments on paragraph 41 of the Consultation Paper regarding Core Principle 6 (authorised communication channels) are summarised in Section V below.

The SFC's responses

89. We acknowledge there might be circumstances when front-office staff would be best placed to monitor market soundings. Therefore, instead of requiring a person independent from front office to monitor market soundings, we will amend the Guidelines such that a Market Sounding Intermediary should designate a committee or person(s) with adequate knowledge of its internal policies and procedures governing market soundings to monitor market soundings in support of senior management's oversight.
90. In light of the refinements of the Guidelines to apply to Market Sounding Information, we will also make corresponding amendments to the Core Principles of the Guidelines. Specifically, the proposed requirements for a Market Sounding Intermediary to:
- (a) have policies and procedures to identify and handle different types of information gathered during market soundings will be amended to cover Market Sounding Information only; and
 - (b) maintain the list of internal and external individuals who possess non-public information as a result of market soundings will be amended to cover Market Sounding Information only, and will only be applicable to Disclosing Persons.
91. In relation to the other comments received:
- (a) Given that the policy intent is to uphold intermediaries' conduct and market integrity during market soundings, we maintain our view that the Core Principles should apply to both Disclosing Persons and Recipient Persons equally, as both parties may come into possession of Market Sounding Information; and
 - (b) For the clarifications sought, the Guidelines are principle-based and the SFC does not consider it necessary to provide such prescriptive requirements. This will allow flexibility for Market Sounding Intermediaries to decide how best to design their own policies, procedures and internal controls systems, having due regard to the nature, size and complexity of their business.

Section III – Proposed specific requirements for Disclosing Persons

Questions:

- 8. Do you agree with the proposal for Disclosing Persons to adopt the use of a standardised script? If not, please explain.
- 9. Do you have any comments on the minimum content and sequence of information set out in the standardised script?

Major comments

92. The majority of respondents agreed with the use of a standardised script. However, some respondents suggested allowing flexibility for Disclosing Persons to design their own scripts to accommodate diverse practices, different regulatory requirements

arising from cross-border market soundings, transactions for different asset classes and specific requests from Market Sounding Beneficiaries and investors.

93. A few respondents sought clarifications regarding the requirement for Disclosing Persons to confirm that the individual receiving the communication was the person designated to receive market soundings. Specifically, whether Disclosing Persons (i) are required to verify the identity of the designated person, and (ii) would be prevented from conducting market soundings if the Recipient Person is based overseas and not subject to the requirements of the Guidelines.
94. Aside from the standardised script, some respondents provided comments and suggestions around the pre-sounding procedures for Disclosing Persons:
- (a) A few commented that there might be situations where it may be impractical to conduct market soundings outside trading hours (eg, during cross-border market soundings and when market soundings involved securities listed in other jurisdictions or securities traded over-the-counter); and
 - (b) One suggested that market soundings should first include initial contact between the control or compliance functions from both Disclosing Persons and Recipient Persons to act as gatekeepers before any communication between their respective “front-offices”.

The SFC’s responses

95. The policy intent of requiring the use of a standardised script is to prevent inappropriate disclosure or inadvertent leakage of Market Sounding Information. We appreciate that respondents generally agreed with the use of a standardised script, which the SFC understands is an existing best practice adopted by most firms engaging in market soundings in Hong Kong.
96. We agree that Disclosing Persons should be given the flexibility to design their own scripts or decide whether to deploy one consistent script or different versions depending on the circumstances. In this regard, Disclosing Persons have flexibility to make such determinations as long as the scripts designed for use contain the minimum required content set out in the Guidelines.
97. We wish to clarify that Disclosing Persons are only required to obtain confirmation that the individual receiving the communication was the person authorised to receive market soundings. As such, verification of the person’s identity is not required. To address situations when there are no such authorised persons (eg, if the investor is an unlicensed person or is located overseas), we will amend the Guidelines such that Disclosing Persons are only required to obtain this confirmation if applicable.
98. In light of the refinements of the Guidelines to apply to Market Sounding Information, the standardised script as set out in paragraph 3.3 of the final form of the Guidelines will also be modified accordingly.

99. Regarding the comments on the pre-sounding procedures for Disclosing Persons:
- (a) We clarify that Disclosing Persons should self-determine an appropriate timing to conduct market soundings and that conducting market soundings outside trading hours is only an example listed for intermediaries' consideration based on their specific circumstances; and
 - (b) We recognise the benefits of having a gatekeeper control. However, we do not consider it necessary to prescribe this within the Guidelines given that it may not be practical or feasible for all firms to adopt such a mechanism.

Question:

10. Do you agree that Disclosing Persons should not provide specific information that may allow the Recipient Person or potential investor to identify the subject security before receiving relevant consent from the Recipient Person or potential investor? If not, please explain.

Major comments

100. Respondents generally agreed that Disclosing Persons should not provide specific information to allow the recipients to identify the subject security before receiving relevant consent from the recipients to, among other things, safeguard the Market Sounding Information. Some respondents agreed with this only to the extent when inside information is involved.
101. In our further discussions with the industry, some participating respondents sought clarifications on how much preliminary information could be shared by a Disclosing Person and whether the name of the subject security can be revealed before obtaining consent from Recipient Persons or other potential investors to receive Market Sounding Information.
102. Separately, one respondent suggested minimising the time interval between the initial market sounding communication and the request for consent from Recipient Persons or other potential investors to receive Market Sounding Information.

The SFC's responses

103. The policy intent is to ensure that Market Sounding Information is properly safeguarded as it is passed on from Disclosing Persons to other persons. Before Disclosing Persons disseminate Market Sounding Information to any recipients, they should seek consent from the recipients to safeguard its confidentiality. Where relevant consent is not obtained, Disclosing Persons should not proceed with sharing Market Sounding Information.
104. Care should be taken if any preliminary information is to be provided before receiving such consent to avoid tipping off the recipient. To better reflect our policy intent, we will amend the Guidelines with a note specifying that a Disclosing Person should ensure any preliminary information provided prior to receiving the said consent from Recipient Persons or other potential investors (eg, preliminary information to allow them to assess and determine if they wish to provide such a consent) is:

- (a) on a “no-name” basis so as not to reveal the name of the subject security; and
- (b) sufficiently broad, limited, vague and anonymised to ensure that a reasonable Recipient Person or other potential investor would not be able to deduce the name of the subject security.

105. As the script requires Disclosing Persons to only provide specific Market Sounding Information after receiving consent from Recipient Persons or other potential investors, we do not consider it necessary to further require Disclosing Persons to minimise the time interval between the initial market sounding communication and the request for consent.

Question:

11. Do you agree that Disclosing Persons have an obligation to determine if non-public information disclosed by them during market soundings has been cleansed? If not, please explain.

Major comments

106. More than half of the respondents expressed concerns about practical difficulties in cleansing if the Guidelines were to apply to the communication of non-public information during market soundings.
107. Respondents commented that the term “cleansing” is commonly understood by market participants to be associated with inside information, which is cleansed when it no longer constitutes inside information. Generally speaking, this occurs when inside information becomes public information (eg, by way of a public announcement or disclosure), or ceases to be materially price-sensitive.
108. If the scope of the Guidelines were to apply to non-public information irrespective of whether it is price-sensitive or not, cleansing would be possible only when such non-public information becomes public information. This would create practical challenges as many non-public information might never be made public (eg, where a proposed transaction is cancelled, suspended or postponed) if it is not inside information that is subject to any public announcement or disclosure requirements.
109. Many respondents were concerned that the lack of means to cleanse non-public information might result in Recipient Persons being restricted from trading indefinitely or for a prolonged period. A few respondents were concerned if this will be a burden to intermediaries if they have to assign resources to monitor the public domain for the purpose of cleansing non-public information.

The SFC’s responses

110. In light of the refinements of the Guidelines to apply to Market Sounding Information, the proposed requirements around cleansing of non-public information are no longer applicable and will be removed from the Guidelines.

111. The SFC had further discussions with various industry stakeholders regarding the refinements and most participating respondents were in support of them. Some participating respondents sought further clarifications on the timing at which a Market Sounding Intermediary would no longer be subject to the requirement to protect Market Sounding Information and safeguard its confidentiality in situations when Market Sounding Information did not become public information.
112. In determining whether a Market Sounding Intermediary is no longer subject to the requirement to protect Market Sounding Information, it should consider whether it continues to have a duty of confidentiality, trust or care towards the handling of that information based on its specific circumstances.
113. For situations when Market Sounding Information did not become public information, the SFC understands the current best practices adopted by Market Sounding Intermediaries to determine when Market Sounding Information ceases to be confidential include the following:
- (a) Disclosing Persons notify Recipient Persons when there is a change of status of the proposed transaction (eg, completed, suspended, postponed or cancelled);
 - (b) Disclosing Persons give advance notice that Recipient Persons could consider Market Sounding Information as “stale” if they do not receive any status update from them within a period of time (eg, a certain number of hours or days); and
 - (c) Disclosing Persons and Recipient Persons agree upfront among themselves on when the duty of confidentiality will end.
114. To provide flexibility, the SFC does not consider it necessary to prescribe requirements for the above within the Guidelines. We encourage Disclosing Persons and Recipient Persons to maintain transparent communication among themselves. Practical guidance will also be provided to Market Sounding Intermediaries by way of FAQs.

Section IV – Proposed specific requirements for Recipient Persons

Question:

13. Do you agree that a Recipient Person should designate a properly trained person(s) to receive market soundings? If not, please explain.

Major comments

115. Respondents were generally in support of the proposal. However, some respondents sought clarification regarding the expectations for such designated persons, such as specifying the types of training required and whether staff who are not necessarily independent from front-office can assume the role.

116. One respondent suggested introducing a licensing regime or training programme specifically for designated persons. Another respondent commented that it might not be necessary to prescribe formal designation and training requirements so long as personnel from Recipient Persons receiving market soundings are conversant with the firm's internal policies and requirements for market soundings.
117. Separately, some respondents expressed concerns about practical difficulties for Recipient Persons to determine if they have received Market Sounding Information. Specifically, they might arise in situations when Disclosing Persons did not properly state upfront that the communication was a market sounding or when the communication was initiated by unlicensed persons or overseas brokers who are not subject to the Guidelines.

The SFC's responses

118. We have considered respondents' comments and will amend the Guidelines accordingly such that a Recipient Person should authorise a person who has adequate knowledge of its internal policies on receiving and handling market soundings.
119. We also wish to clarify that the Guidelines do not require such an authorised person to be independent from front-office.
120. We have considered respondents' concerns about practical difficulties encountered by Recipient Persons to determine if they have received Market Sounding Information. To address this, we will amend the Guidelines such that, in circumstances when a Disclosing Person does not specify whether the communication is a market sounding, a Recipient Person should use its reasonable effort to verify whether it is in possession of Market Sounding Information.
121. In our further discussions with the industry, some participating respondents sought clarifications as to what would constitute reasonable effort. In this regard, practical guidance will be provided to Market Sounding Intermediaries by way of FAQs.

Section V – Record keeping

Questions:

12. Do you agree with the proposed periods of record keeping and details of the records to be kept by Disclosing Persons? If not, please explain.
14. Do you agree with the proposed periods of record keeping and details of the records to be kept by Recipient Persons? If not, please explain.

Major comments

122. For Core Principle 6 (Authorised communication channels), comments received were mixed.

123. For Disclosing Persons, respondents concurred that the proposed requirement to only use authorised and recorded communication channels was generally in line with existing market practices. However, some respondents suggested allowing flexibility for the use of unrecorded communication channels provided that notes of such meetings would be retained to align with relevant market sounding regulations of other jurisdictions (eg, EU MAR).
124. For Recipient Persons, many respondents have expressed concerns on practical challenges and resource constraints. For example, Recipient Persons were typically not subject to similar telephone recording requirements that only apply to the regulated activities conducted by Disclosing Persons, therefore many of them would have to incur extra cost to set up these systems. Recipient Persons might also be asked to respond to market soundings outside of office hours. A few respondents also suggested that it was unnecessary for Recipient Persons to keep a duplicate of the same record that was already kept by Disclosing Persons.
125. For the proposed records to be kept by Disclosing Persons, the majority of comments received were concerned with the voluminous communication records that would have to be retained if the Guidelines were to apply to non-public information.
126. For the proposed periods of record keeping, a number of respondents contended that the proposed record retention period of seven years was excessive and burdensome when compared to the current record retention periods for (i) order instructions received by telephone (ie, six months¹⁴) and (ii) written records associated with particulars of any orders and instructions (ie, two years¹⁵).
127. One respondent sought clarification on whether audio recordings would suffice for market soundings conducted via video calls.

The SFC's responses

128. Taking into account practical challenges and potential cost concerns for Recipient Persons, as well as the fact that Disclosing Persons would keep the same records, we will not proceed with the proposals to require Recipient Persons to use authorised recorded communication channels for market soundings.
129. We will amend the Guidelines such that the use of authorised communication channels will apply to Disclosing Persons only. Consequently, the proposed specific requirements for Recipient Persons on record keeping will also be removed from the Guidelines. In our further discussions with the industry, most participating respondents who are Recipient Persons welcomed the amendments, while some remarked that they would still choose to keep their own records voluntarily.
130. Regarding the suggestion to allow flexibility for Disclosing Persons to use unrecorded communication channels to conduct market soundings, while we agree that there might be benefits to have this option available to cater to unforeseen circumstances, we are of the view that they should only be used rarely. In this regard, we will amend the Guidelines to require a Disclosing Person to:

¹⁴ Paragraph 3.9(b) of the Code of Conduct.

¹⁵ Section 10(b) of the Securities and Futures (Keeping of Records) Rules (Cap. 571O).

- (a) only use authorised communication channels to conduct market soundings;
 - (b) use recorded telephone lines when market soundings are conducted by telephone or record the conversation through other means (eg, audio, video or text) when conducted through other recorded communication channels; and
 - (c) only use other formats (eg, written minutes) to record market soundings if the telephone recording system or other recorded communication channels cannot be accessed.
131. Having carefully considered the market feedback, we will amend the Guidelines and shorten the required record retention period to two years. We note respondents' comparison with the current record retention period for order instructions received by telephone (ie, six months). We wish to clarify that this requirement is associated with intermediaries receiving client order instructions by telephone, which occur very frequently each day and should not be compared to sporadic market soundings conducted by Disclosing Persons.
132. We would like to clarify that audio recordings will suffice for market soundings conducted via video calls.

Section VI – Implementation timeline

Questions:

15. Do you think a six-month transition period is appropriate? If not, what would be an appropriate transition period? Please set out your reasons.

Major comments

133. Some respondents considered a transition period of six months to be sufficient, whereas some suggested extending it to 12 months or longer so that Market Sounding Intermediaries have more time to revise their systems, policies and procedures.

The SFC's responses

134. Taking into account that intermediaries should already have existing policies, procedures and controls in place to safeguard confidential information, the Guidelines shall become effective six months following the gazettal of the Guidelines. After the Guidelines come into effect, Market Sounding Intermediaries that have not completed the corresponding enhancements to their systems, policies and procedures should put in place interim measures to meet the objectives of the Guidelines.



Conclusions and the way forward

135. The final version of the Guidelines is set out in Appendix B. The SFC will proceed with the gazettal of the Guidelines.
136. The SFC would like to thank all respondents for their time and efforts in reviewing the proposals and for their detailed and thoughtful comments.



Appendix A – List of respondents

(in alphabetical order)

1. Alternative Investment Management Association
2. ASIFMA
3. BlackRock
4. CFA Society Hong Kong
5. Clifford Chance
6. Davis Polk & Wardwell, Hong Kong
7. Debevoise & Plimpton
8. FIL Investment Management (Hong Kong) Limited
9. Hong Kong Investment Funds Association
10. Hong Kong Securities & Futures Professionals Association
11. International Capital Market Association
12. Macquarie Capital Limited
13. Mayer Brown
14. Optima Partners HK Limited
15. Private Wealth Management Association (PWMA)
16. Mr. Stanley Wong, Mr. IU Kwan Yuen
17. The Hong Kong Chartered Governance Institute
18. The Law Society of Hong Kong
19. Submissions of 5 respondents are published on a “no-name” basis upon request
20. Submissions of 4 respondents are withheld from publication upon request

Appendix B – Final form of the Guidelines for Market Soundings

The highlighted parts indicate revisions made to the Guidelines which differ from the proposed Guidelines set out in the Consultation Paper.

1. Introduction

- 1.1. These Guidelines are published by the Securities and Futures Commission (SFC) under section 399 of the Securities and Futures Ordinance (SFO) to set out the principles and regulatory expectations in relation to market soundings. These Guidelines provide guidance to licensed or registered persons in their compliance with the general principle to conduct their business activities honestly, fairly, and in the best interests of its clients and the integrity of the market¹ during requirements applicable to licensed or registered persons when they conduct market soundings¹.
- 1.2. These Guidelines should be read in conjunction with, among other provisions, General Principles 1, 2 and 6 and paragraph 9.3 of the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (Code of Conduct) and paragraph 1.3 of the Fund Manager Code of Conduct (FMCC).
- 1.23. These Guidelines apply to “Market sounding” in these Guidelines refers to the communication of non-public information, irrespective of whether this is price-sensitive inside information² or not, with potential investors, prior to the announcement (if any) of a securities³ transaction, to gauge their interest in a potential possible transaction or and assist in determining the terms and specifications related to a potential transaction⁴ it, such as its potential timing, size, pricing, structure and trading method². (referred to in these Guidelines as “market sounding(s)”), by a licensed or registered person acting in the following capacity:
- 1.4. These Guidelines apply to:
- (a) market soundings conducted in connection with a possible transaction in (i) shares that are listed on an exchange and (ii) any other securities³ which is likely to materially affect the price of shares that are listed on an exchange; and
 - (a)(b) a licensed or registered person who:
 - (i) as a person disclosing discloses confidential information that is entrusted to it by a client, an issuer or an existing shareholder selling or buying in the secondary market (Market Sounding Beneficiary) during the course of a market sounding (Market Sounding Information) (Disclosing Person) (eg, this is generally a sell-side broker acting on behalf of a client, an issuer or

¹ General Principle 1 of the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (Code of Conduct).

² Further practical guidance and examples are also provided by way of frequently asked questions.

³ As defined in sections 245 and 285 of the SFO.

⁴ As defined in Part 1 of Schedule 1 to the SFO.

⁴² Market soundings are typically conducted in connection with capital market transactions, such as private placements and large “block trades”.

³ As defined in Part 1 of Schedule 1 to the SFO.

an existing shareholder selling in the secondary market (Market Sounding Beneficiary) in a possible securities transaction); or

Note 1: A Disclosing Person is generally a sell-side broker that is sounding out potential investors, on behalf of a Market Sounding Beneficiary, about a possible transaction.

Note 2: For the avoidance of doubt, irrespective of whether a Disclosing Person has been formally appointed by, or has entered into a written agreement with, the Market Sounding Beneficiary, these Guidelines apply to a Disclosing Person that conducts market soundings on behalf of a Market Sounding Beneficiary.

Whether a Disclosing Person is conducting market soundings on behalf of a Market Sounding Beneficiary will depend on whether there is some “level of certainty” established of the corresponding potential transaction materialising, which requires a case-by-case consideration of the facts and circumstances. Examples of the factors to take into account include the extent to which the Market Sounding Beneficiary has orally or in writing:

- *expressed an interest with the Disclosing Person in proceeding with a possible transaction;*
- *shared any particulars with the Disclosing Person in relation to the possible transaction (eg, timing, size, pricing or structure); or*
- *mandated, requested or consented to the gauging of investor appetite by the Disclosing Person.*

Whether an information is being entrusted to a Disclosing Person would depend on whether the Disclosing Person has a duty of confidentiality to the Market Sounding Beneficiary. The following are some non-exhaustive examples of Market Sounding Information (where a duty of confidentiality is established): (i) the name of the subject security (or specific information that would allow the name of the subject security to be deduced⁴), (ii) the identity of the Market Sounding Beneficiary, (iii) the Market Sounding Beneficiary’s intent to pursue a possible transaction, (iv) the terms of or specifications related to the possible transaction such as its potential timing, size, pricing, structure and trading method.

(b)(ii) as a person receiving information receives Market Sounding Information during the course of a market sounding (Recipient Person), (eg, this is generally a buy-side firm that is sounded out by a Disclosing Person as a potential investor in a possible securities transaction)

Note: A Recipient Person is generally a buy-side firm that is sounded out by a Disclosing Person as a potential investor in a possible transaction.

⁴ See Note 2 of paragraph 3.3(b) below.

(collectively referred to as a “Market Sounding Intermediary”).

~~1.3. These Guidelines do not apply to communications regarding:~~

~~(a) speculative transactions or trade ideas put forward by a Disclosing Person without consulting with the potential Market Sounding Beneficiary or without any level of certainty of such transactions materialising;~~

~~*Note: Refer to the note under paragraph 1.2(a) for factors to consider in determining the level of certainty of a transaction materialising.*~~

~~(b) transactions, in such size (eg, in relation to average trading volume or market capitalisation), value, structure, or selling method, that are commensurate with ordinary day-to-day trade execution (eg, a broker sourcing potential buyers or sellers to execute a trade after receiving an actual order instruction placed by a client with a genuine intent for execution); and~~

~~(c) public offerings of securities.~~

1.45. Unless specified otherwise, :

~~(a) the provisions in these Guidelines apply to both Disclosing Persons and Recipient Persons; and~~

~~(b) terms used in these Guidelines bear the same meaning as defined in the SFO.~~

1.56. These Guidelines do not have the force of law and shall not be interpreted in a way which would override the provision of any law.

1.67. Failure by any person to comply with any applicable provision of these Guidelines:

(a) shall not by itself render it liable to any judicial or other proceedings, but in any proceedings under the SFO before any court, these Guidelines may be admissible in evidence, and if any provision set out in these Guidelines appears to the court to be relevant to any question arising in the proceedings, it may be taken into account in determining the question; and

(b) may cause the SFC to consider whether such failure adversely reflects on the person’s fitness and probeness⁵ to remain licensed or registered.

1.8. When considering a person’s failure to comply with these Guidelines, the SFC will adopt a pragmatic approach taking into account all relevant circumstances, including the size of the Market Sounding Intermediary and any compensatory measures implemented by its senior management.

1.9. Compliance with the Guidelines is no substitution or defence to one’s obligation to comply with the relevant laws and regulations concerning insider dealing. Any person

⁵ Under section 129 of the SFO, in considering whether a person is a fit and proper person, the SFC shall have regard to the person’s (i) ability to carry on the regulated activity competently, honestly, and fairly; and (ii) reputation, character, reliability and financial integrity, amongst others.

involved in market soundings remains subject to the relevant laws and regulations concerning insider dealing.

2. Core principles for both Disclosing Persons and Recipient Persons

CP1. Market integrity Handling of information

A Market Sounding Intermediary should maintain the strictures of protect Market Sounding Information and safeguard its confidentiality and not trade on or use any non-public information passed or received during market soundings for its own or others' benefit or financial advantage until the information ceases to be non-public. It should ensure there is an effective system of functional barriers to prevent inappropriate disclosure, misuse and leakage of Market Sounding Information. In this connection, a Market Sounding Intermediary should implement and maintain, among other things:

- (a) appropriate standards of conduct expected of its staff in handling Market Sounding Information, taking into account the requirements under the Code of Conduct and FMCC⁶;
- (b) clear and robust information sharing principles and processes to be adhered to by its staff (eg, Market Sounding Information should be restricted to authorised personnel on a "need-to-know" basis and disclosed only through authorised processes and communication channels); and
- (c) physical and functional segregation of incompatible duties (eg, between staff on the public and private sides) and associated system user access controls (eg, segregation of access rights) in compliance with the "need-to-know" principle.

CP2. Governance

A Market Sounding Intermediary should have robust governance and oversight arrangements in place to ensure effective management supervision over its market sounding activities. These include, but are not limited to:

- (a) senior management assuming overall responsibility for the oversight of market soundings and their related risks and outcomes;
- (b) establishing appropriate governance arrangements for market soundings, which are commensurate with the size and complexity of the Market Sounding Intermediary's business;
- (c) designating a committee or person(s), with roles, responsibilities and reporting lines clearly defined, to monitor market soundings in support of senior management's oversight. Such a committee or person(s) should be properly trained for this purpose and sufficiently independent from the "front-office" have adequate knowledge of its internal policies and procedures governing market soundings; and

⁶ Including General Principles 1 (Honesty and fairness), 2 (Diligence), 6 (Conflicts of interest) and paragraph 9.3 (Front-running) of the Code of Conduct and paragraph 1.3 of FMCC (Functional barriers).

- (d) developing and implementing appropriate managerial and supervisory processes, procedures and control measures to ensure that matters related to market soundings are promptly brought to the attention of senior management and designated committee or person(s) for review and follow-up actions to be taken, where necessary.

CP3. Policies and procedures

A Market Sounding Intermediary should establish and maintain effective policies and procedures specifying the manner and expectations in which its market soundings should be conducted. These should be documented in writing, reviewed periodically and updated where necessary to ensure they remain robust and effective, and address, among other things, the following:

- (a) market sounding policies, specifying circumstances when they become applicable as well as the timing and prescribed procedures of market soundings;
- (b) allocation of roles and responsibilities among staff involved in market soundings, including senior management, in the context of its “three lines of defence”, and ensuring they are properly trained for this purpose;
- (c) firm and staff personal dealing policies and procedures and restrictions to prevent the firm and its staff from trading on or misusing non-public information they become aware of in their professional capacity during market soundings inappropriate disclosure, misuse and leakage of Market Sounding Information for their own or other’s benefit or financial advantage;
- (d) circumstances and protocols for escalation of matters regarding market soundings to senior management or independent functions, such as Legal and Compliance;
- (e) consequence management framework, with appropriate sanctions or disciplinary measures imposed for non-compliance with market sounding requirements;
- (f) policies and procedures to define, categorise, identify and handle different types of information gathered during the course of market soundings (eg, non-public information) identification and handling of Market Sounding Information; and
- (g) record keeping requirements governing market soundings.

CP4. Information barrier controls

A Market Sounding Intermediary should implement adequate and effective physical and electronic information barrier controls to prevent the inappropriate disclosure, misuse and leakage of non-public information during the course of market soundings. These should be reviewed periodically to ensure they remain robust, effective, appropriate and up-to-date, and include, but are not limited to:

- (d) physical segregation between staff on the public and private sides;
- (e) system user access controls (eg, segregation of access rights between staff on the public and private sides in compliance with the “need-to-know” principle);

- (f) information sharing policies and procedures describing the information sharing principles to be followed by staff (eg, market sounding information should be restricted to authorised personnel on a “need-to-know” basis and disclosed only through authorised communication channels); and
- (g) developing and maintaining a list of internal and external individuals who possess non-public information as a result of market soundings as well as a “Restricted List” to prohibit the trading on non-public information received during market soundings. These lists should be updated promptly when changes occur.

CP54. Review and monitoring controls

A Market Sounding Intermediary should establish effective procedures and controls to monitor and detect suspicious behaviours, suspected misconduct, inappropriate or unauthorised disclosure, or misuse or leakage of information Market Sounding Information and non-compliance with internal guidelines related to market soundings. These include, but are not limited to, periodic reviews of:

- (a) firm and staff personal trading activities and other trade surveillance controls;
- (b) voice and electronic communications; and
- (c) unauthorised access to information Market Sounding Information.

CP6. Authorised communication channels

A Market Sounding Intermediary should only use recorded communication channels (audio, video or text) that were authorised by senior management or independent functions, such as Legal and Compliance, to conduct market soundings.

Note: This requirement applies to all stages of a market sounding until the information ceases to be non-public.

3. Specific requirements for Disclosing Persons

Note: These requirements shall apply to each disclosure of non-public information throughout the course of market sounding.

3.1. Pre-sounding procedures Procedures before conducting market soundings

Before initial contact with Recipient Persons or other potential investors to conduct market sounding, a Disclosing Person should:

- (a) conduct assessments, subject to appropriate review by senior management or independent functions such as Legal and Compliance, on information to be disclosed during different stages of market soundings and determine whether the information would constitute non-public information;
- (b)(a) obtain agreement or consent from the corresponding Market Sounding Beneficiary to engage in market soundings regarding their possible transaction; and

(e)(b) determine in advance, on a case-by-case basis:

- (i) a standard set of information to be disclosed to Recipient Persons or other potential investors in each market sounding and disclose the same standard set of information with all Recipient Persons or other potential investors throughout that market sounding;
- (ii) an appropriate timing to conduct market soundings (eg, as close as reasonably practicable to the time of launch of the proposed possible transaction, and where reasonably practicable, outside of the trading hours during which the securities associated with the market sounding may be traded); and
- (iii) a suitable number of Recipient Persons or other potential investors to contact, such that its market soundings are limited to as few Recipient Persons or other potential investors as it deems reasonably necessary for the purpose of gauging their interests and specifications on the proposed possible transaction.

3.2. Use of authorised communication channels

A Disclosing Person should only use communication channels that are authorised by senior management or independent functions, such as Legal and Compliance, to conduct market soundings.

Where market soundings are conducted by telephone, a Disclosing Person should use a telephone recording system to record the conversation and maintain the telephone recordings as part of its records⁷. Where market soundings are conducted through other recorded communication channels (eg, audio, video, or text), a Disclosing Person should record the conversation and maintain them as part of its records.

The use of other formats (eg, written minutes) to record market soundings conducted should only be allowed if a Disclosing Person's telephone recording system or other recorded communication channels cannot be accessed.

3.23. Standardised script

A Disclosing Person should adopt the use of a standardised script pre-approved and regularly reviewed by senior management or independent functions, such as Legal and Compliance, during initial and subsequent market sounding communications. Where the standardised script is modified to tailor for a specific transaction, an appropriate approval of the modifications should be obtained.

At a minimum, the script should include and follow the sequence of information set out below:

- (a) A an opening statement that the communication is for the purpose of a market sounding and that the Recipient Person or other potential investor is obliged to

⁷ See paragraph 3.4 below for the associated record keeping requirements.

~~keep confidential any non-public information disclosed and not to trade on or use the information received for its own or others' benefit or financial advantage until the information ceases to be non-public; a confirmation that the individual is the person authorised to receive market soundings (if applicable⁸); and~~

(b) ~~A statement that the conversation is being recorded and a request for consent from the Recipient Person's or other potential investor's consent* for recording the conversation; to:~~

a. ~~record the conversation if it is being recorded; and~~

b. ~~receive the Market Sounding Information, safeguard its confidentiality and prevent inappropriate disclosure, misuse or leakage of such information.~~

(c) ~~Confirmation that the individual is the person designated to receive market soundings;~~

(d) ~~A statement that the Recipient Person or potential investor will receive information which the Disclosing Person considers to be non-public and a request for their consent* to receive the non-public information; and~~

Note 1: A Disclosing Person should not proceed with the market sounding if relevant consent at any such point in time is not obtained.

Note 2: A Disclosing Person should ensure any preliminary information provided prior to receiving the said consent from the Recipient Person or other potential investor (eg, preliminary information to allow them to assess and determine if they wish to provide such a consent) is:

- ~~on a "no-name" basis so as not to reveal the name of the subject security; and~~
- ~~sufficiently broad, limited, vague and anonymised to minimise the chance for the ensure that a reasonable Recipient Person or other potential investor to guess or avoid revealing would not be able to deduce the name of the subject security to the Recipient Person or other potential investor.~~

Care should be taken in determining the amount of information to be provided where the subject security may be identified even with the provision of only limited information (eg, for narrow industry sectors).

In general, a Disclosing Person should only provide specific information Market Sounding Information regarding the subject security (eg, market capitalisation, market volumes, market prices) after receiving the said consent from the Recipient Person or other potential investor.

(e) ~~Where possible, an estimation of when the information will cease to be non-public.~~

⁸ Recipient Persons that are licensed persons in Hong Kong are expected to have authorised a person to receive market soundings in accordance with paragraph 4.1(a) below.

~~* A Disclosing Person should cease the market sounding if relevant consent from a Recipient Person or other potential investor at any such point in time is not obtained.~~

After obtaining all relevant consent, a Disclosing Person should provide a written confirmation to the Recipient Person or other potential investor as soon as possible, summarising the contents covered in its market sounding communications.

3.3. Cleansing

~~Where non-public information has been disclosed during market soundings, a Disclosing Person should:~~

- ~~(a) conduct assessments using its best endeavours, including but not limited to maintaining regular contact with the Market Sounding Beneficiary, subject to an appropriate review by senior management or independent functions such as Legal and Compliance, to determine if that information has ceased to be non-public (eg, following the announcement of the transaction or if the potential transaction was called off); and~~
- ~~(b) inform the Recipient Person(s) or other potential investor(s) as soon as possible in writing when that information has ceased to be non-public according to the assessment of the Disclosing Person.~~

3.4. Record keeping

A Disclosing Person should keep the following records in relation to its market soundings for a period of not less than ~~seven~~ **two** years in such manner as will enable them to be readily accessible:

- (a) ~~agreement or~~ consent obtained from the corresponding Market Sounding Beneficiary to engage in market soundings regarding the possible transaction;
- (b) a list of Recipient Persons or other potential investors who have informed the Disclosing Person that they do not wish to receive any market soundings;
- (c) audio, video or text ~~records~~ **recordings** of market soundings conducted ~~through~~ recorded communication channels;
- ~~(d) its assessment considerations, rationales, discussions with the Market Sounding Beneficiary (if any), and conclusions of whether:~~
 - ~~(i) the information to be disclosed by it during market soundings would constitute non-public information; and~~
 - ~~(ii) any non-public information disclosed during market soundings has ceased to be non-public;~~
- (d) written minutes of market soundings conducted through unrecorded communication channels; and

- (e) a list of all internal and external person(s) (including legal and natural persons) who possess non-public information as a result of market soundings by the Disclosing Person Market Sounding Information, including details on the date and time of sounding, name and contact details of persons sounded, information and materials disclosed and all relevant consents obtained. ; and
- (f) notifications to inform Recipient Persons or other potential investors when information ceases to be non-public.

4. Specific requirements for Recipient Persons

Note: These requirements shall apply to each receipt of non-public information throughout the course of the market sounding.

4.1. Handling of market sounding requests

A Recipient Person should:

- (a) designate authorise a specified person(s) who is properly trained for that purpose to receive has adequate knowledge of its internal policies on the receipt and handling of market soundings, and inform Disclosing Persons of such arrangement upon being contacted by Disclosing Persons for the purpose of market soundings; and
- (b) inform Disclosing Persons whether it wishes to, or not to, receive market soundings in relation to either all potential possible transactions or particular types of potential possible transactions from the Disclosing Persons; and
- (c) in circumstances when a Disclosing Person does not specify whether the communication is a market sounding, use its reasonable effort to verify whether it is in possession of Market Sounding Information.

4.2. Record keeping

A Recipient Person should keep the following records in relation to its market soundings for a period of not less than seven years in such manner as will enable them to be readily accessible:

- (a) Any notifications given to Disclosing Persons of its wish to or not to receive market soundings;
- (b) Audio, video or text recordings of market soundings received; and
- (c) A list of all internal and external person(s) (including legal and natural persons) who possess non-public information as a result of the market sounding, including details on the date and time of sounding, name and contact details of persons sounded, and information and materials received.