

By Online Submission

Securities and Futures Commission
54/F, One Island East
18 Westlands Road
Quarry Bay, Hong Kong

6 May 2021

Dear Commission,

Re: Consultation Paper on (i) the Proposed Code of Conduct on Bookbuilding and Placing Activities in Equity Capital Market and Debt Capital Market Transactions and (ii) the “Sponsor Coupling” Proposal (the “Consultation Paper”)

Thank you for the opportunity to respond to the Consultation Paper dated February 2021.

We view the Asian bond market as a vital and growing segment of financial markets in Asia, and that a robust and orderly debt capital market is essential for Hong Kong to consolidate its role in the market's development. With an increasing number of participants, codifying the best debt capital market practices expected by the Commission and in line with global markets is a laudable step in promoting transparency and accountability, and ultimately enhancing the integrity of the market on which issuers and investors depend. To this end, we offer our thoughts on the proposed paragraph 21 of the Code of Conduct based on our observations as well as those from clients gathered in the course of our CMI activities, with suggested amendments as shaded. Any misunderstanding is of course our own.

Commentary

1. *Investor Client Suitability – Debt Offerings*

Comment

CMI's should bear additional burden to ensure the suitability of their investor clients for the securities proffered particularly in a debt offering, given the off-exchange nature of trading in

most bonds and the risks that arise from the inherent lack of transparency and liquidity in many bonds traded bilaterally off-exchange.

Suggested Amendment

21.3.3 Assessment of investor clients

...

(c) In the case of a debt offering, a CMI should take all reasonable steps to identify whether its investor clients may have any associations with the issuer client, the CMI or a company in the same group of companies as the CMI ("group company") and provide sufficient information to an OC to enable it to assess whether orders placed by these investor clients may negatively impact the price discovery process. *In addition, the off-exchange nature of the trading in the majority of bonds lends a degree of opacity and illiquidity in bond markets that imposes an additional burden on the part of CMI's to ensure that their investor clients understand the risks and the suitability of the securities for their investor clients in the primary market.*

2. Inflating Order Book

Comment

Inflating or "padding" orders is a frequent practice in debt capital markets. It distorts the market and introduces additional risks and volatility which results in sub-optimal market pricing and allocation. It also undermines the integrity of the market by CMI's knowingly submitting false and misleading market information in the bookbuilding process.

Suggested Amendment

21.3.5 Order book

- a) A CMI should ~~take reasonable steps to~~ ensure that all orders (including indications of interest) placed in an order book represent bona fide demand of its investor clients, itself and its group companies. *CMI's should not knowingly "pad" or inflate orders for the purposes of securing more favourable allocation for itself or its clients. Evidence of padding or order inflation may amount to market misconduct.*
- b) A CMI should also make enquiries with its investor clients about orders which appear unusual, for example, an order which is not commensurate with the investor client's financial profile, before placing the order.

3. Order Book Transparency

Comment

Transparency in bookbuilding should be for the benefit of issuers as well as all participating CMI's (including non-syndicate CMI's), both during and after allocation. OC's should make available the final order book to the issuer and participating CMI's on request to minimize any potential for abuse.

Suggested Amendments

21.3.5 Order book

...

- c) A CMI should ensure transparency in the bookbuilding process. It should disclose (whether directly or indirectly) the identities of all investor clients in an order book *to the issuer client, OC and all participating CMI's upon request*, except for orders placed on an omnibus basis. For orders placed on an omnibus basis, a CMI should provide information about the underlying investor clients (whether directly or indirectly) to the OC and the issuer when placing the orders.

21.4.5 Bookbuilding

An OC should take all reasonable steps to ensure that the price discovery process is credible and transparent *to the issuer client and participating CMI's*, the order book has been properly managed and the allocation recommendations made to the issuer client as well as the final allocation have a proper basis *which reflects bona fide orders*. An OC should use its best endeavours, when advising the issuer client or when making pricing and allocation decisions as delegated by the issuer client, to strike a balance between the interests of the issuer client and investor clients and to act in the best interests of the integrity of the market.

(a) Order generation and consolidation of an order book

An OC should take reasonable steps to properly manage an order book and ensure the transparency of the order book *to the issuer client and participating CMI's*.

(i) In particular, an OC should:

- ensure that the identities of all investor clients are disclosed in the order book, except for orders placed on an omnibus basis;
- properly consolidate orders in the order book by taking reasonable steps to identify and eliminate duplicated orders, inconsistencies or errors *and ensure that order limits are observed*;
- segregate and clearly identify in the order book and book messages any proprietary orders of CMIs and their group companies; ~~and~~
- make enquiries with CMIs which have placed orders on behalf of their investor clients, themselves or their group companies which appear unusual or irregular, for example, orders which appear to be related to the issuer client-;
- *be responsible for originating any status report on the order book which should be communicated in writing to syndicate CMI's for dissemination to all participating CMI's; and*
- *be responsible for communicating any price sensitive information related to the order book, including but not limited to the participation or withdrawal of any cornerstone investor.*

4. Order Limits

Comment

Investor clients' order limits reflect true demand from the market, and should be clearly communicated to by CMI's and strictly observed by bookrunners. The absence of clarity and discipline in observing order limit conventions leads to uncertainty and miscommunication in the allocation process which ultimately results in investor clients inadvertently bearing more risk than they bargained for, and in their disposal of that risk which exacerbates any downward pressure in the after-market.

Suggested Amendment

21.3.6 Allocation

A CMI should establish and implement an allocation policy to ensure a fair allocation of shares or debt securities to its investor clients. This policy should:

- a) address or take into account the principles and requirements under paragraph 21.3.10 and the following factors:
 - (i) the marketing and investor targeting strategy;
 - (ii) the order size and circumstances of the investor client;
 - (iii) the price limits for the investor client's orders;
 - (iv) any minimum or maximum allocation amounts indicated by investor clients; and
 - (v) any applicable legal and regulatory requirements; ~~and~~
- b) prevent any practices which may result in the unfair treatment of investor clients or knowingly distort the demand for other share or debt offerings; *and*
- c) *require that bookrunning CMI's observe order limits, and that,*
 - i. *the last order limit expressed by a CMI is binding unless it is expressly revoked; and*
 - ii. *the onus is on the bookrunning CMI to clarify and confirm order limits at the time of final price guidance (for debt securities).*

5. Book Messages

Comment

Clear and accurate communication on the status of the order book is essential for OC's and investor clients to gauge the security's demand in a primary offering, which in turn determines the accuracy of the pricing in an efficient market. Reports on the status of the book should be in writing and should be reserved for the OC. Any significant developments, such as the withdrawal of a cornerstone investor, should be communicated only by the OC in writing. These measures would minimize the risk of false and misleading information being disseminated to the market by unethical syndicate members, and avoid market confusion.

Suggested Amendments

21.3.8 Disclosure of information to OC, non-syndicate CMIs and targeted investors

A CMI should disclose complete and accurate information *in writing* in a timely manner on the status of the order book and other relevant information it received to:

- (i) the OC (whether directly or indirectly) and non-syndicate CMIs it appoints for them to carry out their duties; and
- (ii) its targeted investors for them to make an informed decision.

The status of the order book and relevant information should only be communicated by the OC and in writing for dissemination to the issuer client and all participating CMI's. Relevant information includes price-sensitive information such as the participation or withdrawal of a cornerstone investor. Dissemination of false or misleading information knowingly by a CMI may constitute market misconduct.

6. "Price Talk"

Comment

"Price talk" or indicative pricing range is fundamental to the bookbuilding process based on the bookrunners' assessment of market conditions, issuer's credit quality, trading of comparable securities and investor demand, among other factors. Market integrity requires that price talk be based on transparent factors clearly communicated by syndicate leaders for the benefit of the issuer and investor clients.

Suggested Amendments

21.4.5 Bookbuilding

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(b) Pricing

An OC should:

- (i) *communicate the price-talk and its supporting basis in writing to issuer clients and to syndicate CMI's for the benefit of all participating CMI's and their investor clients.*
- (ii) ...

If the Commission has any questions in relation to our response to the Consultation Paper, please do not hesitate to let us know.

Yours sincerely,