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Dear Sirs

Consultation Paper on Proposed Guidelines for Market Soundings

Introduction

We refer to the Consultation Paper on the Proposed Guidelines for Market Soundings (the "**Consultation Paper**") issued by the Securities and Futures Commission (the "**SFC**") on 11 October 2023. Unless otherwise defined, terms used in this letter shall have the meaning ascribed to them in the Consultation Paper.

We welcome the opportunity to comment on the Consultation Paper.

In principle, we welcome SFC's stated vision to introduce a set of specific guidelines applicable to market soundings to provide clarity on regulatory expectations and deter substandard conduct, so to ensure a level playing field in the industry and assist intermediaries in upholding market integrity during market soundings. The Proposed Guidelines will provide a set of working / conduct standards for intermediaries to follow and this will certainly help uphold market integrity in respect of capital market transactions such as block trades and placings. We would, however, respectfully request additional clarity and guidance from the SFC on a few requirements in the Proposed Guidelines.

Scope of Application

We note that the Proposed Guidelines expand existing practices that are already adopted by many intermediaries in the market regarding the communication of inside information during market soundings to cover the communication of any non-public information, irrespective of whether the information is price-sensitive or would otherwise fall under the definition of "inside information" under the SFO. The net effect of this proposal would mean the Proposed Guidelines impose a (much) broader regulation on market soundings than the existing laws and regulations that apply to insider dealing and disclosure of inside information.

In Paragraphs 20 and 21 of the Proposed Guidelines, the SFC states that if the market soundings regime was limited to inside information, there would be a risk of potential misconduct because the determination of what constitutes inside information is a difficult exercise that involves complex judgment and interpretation. The statutory regime under the SFO is well-established and already requires in-scope parties to make a determination as to what constitutes inside information, therefore we would invite the SFC to consider whether there is a benefit to splitting the regulatory regimes and making a distinction between what is considered to be "inside information" under the SFO and "non-public information" under the Proposed Guidelines. We recommend that the regulation on market sounding to be aligned with "inside information" under the SFO. This will reduce an additional requirement to identify or determine what is non-public information versus inside information. If the information is indeed not inside information, any trading with such information (even though may be non-public) would not fall foul of the inside dealing regime. The SFC may also consider issuing further guidance to supplement the existing Guidelines on Disclosure of Inside Information (June 2012) to assist intermediaries in making the assessment.

In light of Hong Kong's role as international financial centre where financial transactions often involve cross-border elements and non-Hong Kong intermediaries, it is important that when ensuring a level playing field in the industry (for both buy-side and sell-side), this is benchmarked at an international level and avoids possible regulatory arbitrage and confusion. This is particularly relevant where international practices and processes are generally referenced to a material non-public information standard rather than non-public information standard. For example, where a Hong Kong intermediary (as disclosing party or recipient) is dealing with a non-Hong Kong intermediary, the non-Hong Kong intermediary may not be restricted from trading even if they receive non-public information or may inadvertently taint the Hong Kong intermediary by disclosing non-public information (if the market sounding regulations in its home jurisdiction would not be triggered by having mere non-public information).

Additional Clarification

There are a few areas where we would like to invite the SFC to consider providing more clarity to the market so to promote proper compliance with the proposed regime whilst preserving business efficacy and efficiency in the management of capital market transactions.

Whilst we appreciate that this robust level of regulation reflects SFAT's decision in recent cases, we invite the SFC to consider providing more clarity on the types of transactions to

which the Proposed Guideline will **not** apply, with a view to striking a sensible balance between regulation and market efficiency.

Paragraph 25 of the Proposed Guidelines sets out three types of exempted transactions, as follows:

"The Proposed Guidelines do not apply to communications regarding:

- (a) speculative transactions or trade ideas put forward by a Disclosing Person without consulting the potential Market Sounding Beneficiary or without any level of certainty of such transactions materialising;
- (b) transactions in such size (e.g., in relation to average trading volume or market capitalisation), value, structure or selling method that are commensurate with ordinary day-to-day trade execution (e.g., 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."

We invite the SFC to provide more specific examples for the types of exempted transactions under (a), (b) and (c). With regards to the exemption in sub-paragraph (a), what constitutes a "speculative transaction[s] or trade idea" not associated with a market sounding can be a difficult and subjective determination, so we would welcome more guidance from the SFC on what this would capture. The factors to consider when determining the "level of certainty" of such a transaction or idea materialising also introduces an additional element of discretion. We would ask the SFC to consider whether such a determination is necessary, given that Disclosing Persons are more likely to approach Market Sounding Beneficiaries with transactions or ideas that would have some possibility of success.

We would also kindly request that the SFC provide more clarity on what constitutes a "public offering[s] of securities" exempt from the regime under sub-paragraph (c). The definition of a prospectus under the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap 32) (CWUMPO) Prospectus Regime includes an "offering of any shares or in debentures of a company ... to the public for subscription or purchase" but excludes offerings to professional investors. Without additional guidance, there may be a risk of interpretation that a public offering subject to the prospectus registration requirements is exempt from the market sounding regime but offers to professional investors are not. However, if "public offerings of securities" is intended to capture professional investors, most transactions could fall outside the scope of the Proposed Guidelines. We would welcome additional guidance from the SFC on this point.

We would also kindly request that the SFC provide more guidance on the factors to consider when assessing the information disclosed during market soundings has ceased to be non-public or has been "cleansed". In particular, in the case where a potential transaction which was communicated by a Disclosing Person to a Recipient Person did not result in an actual transaction. There is often lack of clarity as to when information was sufficiently material that needs to be cleansed, and when cleansing has occurred. We would welcome additional guidance from the SFC on this point.

Noting that capital market transactions may be conducted under extremely tight timetables, we also invite the SFC to consider the extent to which the 7-year record keeping obligation under paragraph 4.2 of the Proposed Guidelines shall apply to the daily practice of the intermediaries. We would specifically request that SFC to clarify if it is SFC's intention that the recording requirements would apply to all communications between the relevant parties.

"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."

Last but not least, we would also welcome additional guidance from the SFC on what constitutes "sufficiently independent" under Core Principle 2.

"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:

- [...](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** [our emphasis] from the "front-office"..."

Use of Standardised Scripts

Paragraph 3.2 of the Proposed Guidelines provides that:

"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 should be obtained."

We do agree in principle that Disclosing Persons adopt the use of a standardised script. The SFC may also wish to consider including a requirement that scripts used by Disclosing Persons be consistent across a syndicate for a transaction.

**C L I F F O R D
C H A N C E**

CLIFFORD CHANCE
高偉紳律師行

Should the SFC wish to discuss any of our comments please do not hesitate to contact our

Yours faithfully