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

11 December 2023

Re: Consultation Paper on the Proposed Guidelines for Market Soundings

Dear Sir/Madam,

The Asia Securities and Financial Markets Association ("**ASIFMA**")[1] appreciates the opportunity to respond to the Securities and Futures Commission's ("**SFC**") Consultation Paper on the Proposed Guidelines for Market Soundings (the "**Consultation Paper**"). Feedback set out in this response has been collected from ASIFMA's members.

ASIFMA wishes to thank the SFC for the opportunity to share this feedback on the Consultation Paper. We value the opportunity to respond to the proposals and appreciate that they have been made with a view to ensuring that Hong Kong's financial markets continue to remain agile and competitive within a sound and well-respected regulatory framework. In particular, we would like to work with the SFC to ensure that the policy objectives are met in a manner that strikes the right balance in order to ensure that the regime is aligned with the Hong Kong Government's current promotion of Hong Kong as an international financial centre. Members' responses to the Consultation Paper have been made with the promotion of market liquidity and attraction of financial activities (such as market sounding) to Hong Kong in mind. The issues currently identified risk causing such activities to be re-located outside Hong Kong – we hope to engage in further discussions with the SFC to ensure that solutions to such issues are implemented, and that the industry is fully consulted and is comfortable with the application of the Proposed Guidelines.

Unless otherwise defined, capitalised terms used in this response have the same meaning as those used in the Consultation Paper. By way of general observations:

[1] ASIFMA is an independent, regional trade association with over 160 member firms comprising a diverse range of leading financial institutions from both the buy and sell side, including banks, asset managers, law firms and market infrastructure service providers. Together, we harness the shared interests of the financial industry to promote the development of liquid, deep and broad capital markets in Asia. ASIFMA advocates stable, innovative, and competitive Asian capital markets that are necessary to support the region's economic growth. We drive consensus, advocate solutions and effect change around key issues through the collective strength and clarity of one industry voice. Our many initiatives include consultations with regulators and exchanges, development of uniform industry standards, advocacy for enhanced markets through policy papers, and lowering the cost of doing business in the region. Through the GFMA alliance with SIFMA in the United States and AFME in Europe, ASIFMA also provides insights on global best practices and standards to benefit the region.

ASIA SECURITIES INDUSTRY & FINANCIAL MARKETS ASSOCIATION | Unit 3603, Tower 2 Lippo Centre | 89 Queensway Admiralty, Hong Kong | Tel: +852 2531 6500 www.asifma.org

- The members' key concern with the current proposal is the communication of 'non-public information' as the trigger for following the Proposed Guidelines. Members note that the requirements in the Proposed Guidelines, such as trading restrictions and cleansing, usually apply to the disclosure of inside information as defined in the Securities and Futures Ordinance ("**SFO**") ("**Inside Information**"). Non-public information on the other hand, is a much broader concept that includes confidential information, which in turn includes Inside Information. Inside Information is a narrow and clearly defined sub-set of non-public information, and because it is confidential and price-sensitive, it is justifiably subject to restrictions. Members are concerned that using the wide-reaching net of non-public information as a standard would inevitably capture information that the SFC may not have intended to be in-scope. The impracticalities that may arise as a result would drastically change existing market practices and negatively impact Hong Kong's competitiveness as compared to other financial markets. The members therefore suggest that, if the SFC is to introduce guidelines for market sounding activities, they should reflect different sets of treatment for each of Inside Information and non-public information (which would also be in line with international standards such as MAR).

- In the Proposed Guidelines, the SFC makes references to the complexity in differentiating between Inside Information and non-public information. Members do not agree with this point – Inside Information is a well understood concept that fits inside firms' global architecture and serves as a trigger for many control systems (e.g., the process by which banks wall-cross information or share Inside Information). Non-public information, on the other hand, is much broader. Given the uncertainties that may arise in light of its broad scope, this concept also does not fundamentally fit into the global architecture. To substitute the trigger of Inside Information for existing systems with non-public information and then circumscribe it with new guidance on market sounding will therefore cause Hong Kong to be an anomaly and would be incredibly confusing for the market.

We have set out the members' key concerns in response to the questions, and have also provided an Appendix setting out typical examples of transactions and situations to highlight the difficulties of complying with the Proposed Guidelines as currently drafted.

Given the significance and ramifications for the industry, we believe it is critical for the SFC to provide the industry with opportunities for further discussions. We understand from prior discussions that the SFC is open to such further engagements, and ASIFMA looks forward to continued discussions with the SFC on this matter.

Sincerely,

Patrick Pang
Head of Compliance and Tax
ASIFMA
(+852 2531 6520; ppang@asifma.org)

ASIFMA – Industry Consultation Response on the Consultation Paper on the Proposed Guidelines for Market Soundings

Question 1: Do you agree with the scope of application of the Proposed Guidelines? If not, please explain.

ASIFMA: No, the members do not agree with the scope of application. The members' key concern with the current proposal is the use of 'non-public information' as the 'trigger' for following the Proposed Guidelines. Overall, the current scope of application is extremely broad when considering that the types of conduct the Proposed Guidelines are aiming to regulate are relatively narrow and contained. Using the potentially very wide meaning of non-public information as a trigger to apply the Proposed Guidelines may address some of the concerns identified in the Consultation Paper, but the impact would be more far-reaching than just achieving the intended result, and may even have a net negative impact on market integrity.

The current proposed scope of application could affect market participants' ability to conduct normal capital formation activities and disrupt market efficiency. This may also discourage market participants from conducting or participating in market soundings in Hong Kong, which would negatively impact the capital formation process and inadvertently discourage market activity and squeeze liquidity. Moreover, buy-side and sell-side participants in Asia and globally could be incentivised to operate elsewhere; while a more straightforward and flexible approach with clarity and certainty around expectations would conversely drive activity to Hong Kong by ensuring a level playing field, which would be critical to maintain the competitiveness of Hong Kong as an international financial hub.

If the SFC intends to proceed with a set of guidelines for market sounding activities, the members strongly recommend that a distinction needs to be made between the treatment of Inside Information and mere non-public information. Our members would therefore recommend a dual track approach to market soundings, which will depend on whether Inside Information is shared in the market sounding along similar lines to the approach taken under MAR.

For instance, where Inside Information forms part of a market sounding, this should be made clear at the outset of the market sounding. Consequentially, a cleansing stipulation should apply and trading restrictions will necessarily follow. If a market sounding did not result in a disclosure of Inside Information, then members suggest that the cleansing stipulation be removed. The members also suggest that there should not be an automatic prohibition on trading (i.e., there should be a distinction between non-public information and Inside Information, and restrictions on trading should only apply when in possession of Inside Information). Receiving Persons should be required to assess whether the non-public information they have received results in them having Inside Information based on other information that they hold. Where the Receiving Person assesses that it does not hold Inside Information, it should be permitted to make its own decision as to whether it can trade. Parts XIII and XIV of the SFO would of course still apply where there is misconduct.

Further information on the meaning of non-public information is set out in our response to Question 2. However, members have raised the following further points on the scope of application:

1.1 **Scope of application dependent on clear definitions:** Members note that certain terms in the definition of "market soundings" should be defined in order to limit the scope of application of the Proposed Guidelines – see our response to Question 2 below.

1.2 **Definition of "public offerings" carve-out**: Members believe the carve out for "public offerings" of securities should be clearly defined in the Proposed Guidelines to avoid confusion and remove any ambiguity, and definitively specify the scope of application of the Proposed Guidelines. In the absence of a clear definition or guidance, it is likely that firms will take different interpretations as to what constitutes a public offering, which will lead to different practices in the market. In particular, it is unclear whether "public offering" should be interpreted through the lens of the nature of the offer, or, rather, whether it is simply a function of the deal being in the public domain.

The members would support guidance in the form of a non-exhaustive list of examples to confirm that "public offering" covers all IPOs (in Hong Kong this would cover offerings subject to the prospectus regime under the Companies (Winding up and Miscellaneous Provisions) Ordinance (Cap. 32)), as well as transactions launched through a widely disseminated channel or news service such as Bloomberg, for example with a public Bloomberg term sheet.

The members also note that as the Proposed Guidelines may contemplate transactions outside Hong Kong (please see our responses in paragraphs 1.3, 1.6 and 1.7 related to this), there may be different definitions of what constitutes a public offering, therefore guidance from the SFC would be vital. The use of the term 'public offerings' also raises difficulties for debt capital markets ("**DCM**") transactions; however we refer the SFC to the International Capital Market Association's response to the Consultation Paper for the specific issues identified in this area.

1.3 **Application to certain companies and securities**: The Proposed Guidelines are intended to apply to "securities" as defined in the SFO and therefore should not include the securities of a private / unlisted company (noting this defined term does not extend to shares/debentures in private Hong Kong companies). The members support this approach given there is a very limited avenue for trading securities in a private company and hence the mischief does not exist. We therefore note that (i) transactions in relation to private / unlisted companies (including market soundings for unlisted companies for a private equity/debt placement, cornerstone outreach or for feedback ahead of an IPO, or structured product transactions where the issuers are unlisted) will not be in scope. We understand that this is the case for private / unlisted companies which are incorporated outside of Hong Kong as well.

Members also wish to clarify whether the Proposed Guidelines would need to be followed by SFC licensed persons when conducting market soundings in relation to the following;

1.3.1 companies with only listed debt securities (whether listed only in local currencies or not). Members' strong preference is that these companies should not be in-scope (see paragraph 2.3.3);

1.3.2 companies with shares listed in markets other than Hong Kong. Members' strong preference is that these companies should not be included (see our further responses to Questions 1, 2 and 5 for discussions around cross-border issues); and

1.3.3 new issuances of asset backed securities which are issued via special purpose vehicles. As each such issuance is from separate and discrete asset pools, members consider that information about a potential new issuance should not be material or price sensitive to existing asset backed issuances.

1.4 **"Ordinary day-to-day trade execution" carve-out:** From an equity perspective, members would like to make a proposal in relation to secondary equities sales and trading transactions. It is common to have sizable 'block' transactions that could be relatively large compared to a "usual" trade order size, but these will typically not be sufficiently material to attract any market sounding requirements (as compared with transactions handled by the capital markets space) (please refer to paragraph 6 (*Block trades and series of transactions*) of the Appendix for an example). Members propose that the public-side equities trading business should not fall in-scope of the Proposed Guidelines, and should instead continue to follow existing requirements to protect the flow of information (e.g., sharing only on a need-to-know basis and wall crossing for any Inside Information involved). However, if the SFC believes that the Proposed Guidelines should apply to some of these transactions, the members would support clarifying that all transactions of a size below 5% of a company's issued share capital, unless the seller is a connected person under the SFO, should be considered "ordinary day-to-day trade execution". This would be consistent with the level for Hong Kong disclosure of interests regulatory reporting. If the level is set too low, this may be cumbersome and could have significant adverse impact on the public-side equities trading business and may have a negative impact on liquidity.

1.5 **Scope of application for secondary fixed income sales and trading transactions:** While the ASIFMA response focuses mainly on equity, the members would like to make a proposal in relation to fixed income products. In the secondary fixed income sales and trading business, it is not uncommon to receive sizable client orders that could be relatively large compared to a "usual" trade order size, but these will typically not be sufficiently material to attract any market sounding requirements (as compared with transactions handled by the primary markets space). Fixed income instruments are traded over the counter and there is no "public announcement" concept in the secondary bond trading market (further information on this is in paragraphs 11.2 (*Scope of "non-public information"*) and 11.5 (*Clarification on "announcement"*) below). Members therefore propose that the secondary fixed income sales and trading business should not fall in-scope of the Proposed Guidelines and should

instead continue to follow existing requirements to protect the flow of information (e.g., sharing only on a need-to-know basis and wall crossing for any Inside Information involved).

1.6 **Applicability to overseas persons:** Members request guidance on the applicability of the Proposed Guidelines to: (i) SFC-licensed persons located in Hong Kong who conduct market sounding activities with non-Hong Kong based investors and/or for non-Hong Kong listed securities, (ii) SFC-licensed persons located outside of Hong Kong, including itinerant professionals, (for example, SFC-licensed persons based in Singapore engaging in market soundings with Hong Kong based investors) and (iii) persons not licensed by the SFC located outside of Hong Kong who conduct market sounding activities with Hong Kong-based investors (for example, where syndicate personnel in the US speak to non-US investors on a particular security). This is an important point of application – if the jurisdictional reach of the Proposed Guidelines is unclear or too wide, firms may elect not to make or take market sounding calls in Hong Kong, or may move the process offshore, which may dilute Hong Kong's competitiveness as an international financial market.

In addition, where overseas persons contact SFC licensed buy-side firms in Hong Kong for market soundings (assuming the overseas persons are unlikely to be subject to the Proposed Guidelines), the buy-side may remain a Receiving Person and subject to the Proposed Guidelines. These buy-side firms may also be contacted by employees from listed corporates to discuss potential transactions. Does the SFC expect the Receiving Person to follow the Proposed Guidelines in this scenario, and if so how, as the person located overseas may not follow the requirements in the Proposed Guidelines (for example, they may not have a script with the same requirements and may have different approaches to the sharing of information and cleansing).

The members also note that some buy-side firms may have centralised gatekeeper functions located outside of Hong Kong, which receive market soundings regionally. The centralised function then liaises on the market sounding with relevant investment desks across the group globally, including the desk in the Hong Kong licensed corporation. The members assume that in this scenario, the Proposed Guidelines would not apply to the 'gatekeeper' and would in turn not apply to the sharing of information between the gatekeeper and the Hong Kong licensed corporation.

1.7 **Competing regulatory regimes:** Members have also noted that they envision situations of cross-border activity where two different market sounding regimes or relevant insider regimes may apply to the same market sounding exercise (e.g., in the case of companies with dual listings in Hong Kong and the European Economic Area they would need to comply with both the EU Market Abuse Regulation ("**MAR**") and the proposed SFC market soundings regime). This is of concern to members in both the DCM and the equity capital markets ("**ECM**") space. As the two regimes have some key differences (the current Proposed Guidelines seem to differ from the market sounding regimes in other jurisdictions in terms of key scope and obligations, for example the requirement to cleanse even when no Inside Information is communicated), this may pose compliance risks for intermediaries. If alignment with the MAR market soundings regime is to be considered, the

forthcoming changes to MAR, which are still being negotiated (e.g., whether the market soundings regime is mandatory or an optional safeharbour) should also be considered to ensure that Hong Kong's regime does not retain the inefficiencies sought to be addressed by the proposed changes to MAR.

By way of example, for global or regional transactions, teams in Hong Kong may work together with teams located in other jurisdictions and perform market soundings together depending on the location of the investors. There is no single approach to carrying out market soundings in these cases, but it is possible that this may further complicate broader syndicate operations outside of Hong Kong as well as lead to uneven playing fields regionally (please also refer to paragraph 2.1.5 below).

Question 2: Do you consider the definition of "market soundings" to be clear and appropriate? If not, please explain.

ASIFMA: No, the definition of market soundings is not clear and the members have expressed concerns around the appropriateness of the "market sounding" definition. Members wish to raise specific issues regarding (i) the threshold point of application in respect of the information involved, (ii) the meaning of "non-public information", (iii) the nature of communications with investors, (iv) the scope of "securities transactions" and (v) block trades that fall in scope.

2.1 **Threshold point of application:** Market Sounding Intermediaries play a crucial role in gathering and disseminating information about potential market transactions. They often engage in discussions with various stakeholders and gather non-public information to gauge market interest and potential investment opportunities. As a primary position, members are of the view that the higher threshold of Inside Information should instead be the trigger for the Proposed Guidelines to apply by reason of the following:

2.1.1 The Proposed Guidelines and the Consultation Paper contain very little indication of how firms should approach the question of what type of information will be non-public information or why using non-public information as a threshold will be more consistently applied to benefit market integrity. Currently, firms have procedures in place to assess whether information is "Inside Information" and it is a well-understood concept. Our members feel that imposing the additional category of non-public information will cast a broader, but vague net. Adopting the clearer set of criteria for Inside Information would allow for a much smoother transition process, as firms would be able to simply apply existing procedures for the purpose of compliance with the Proposed Guidelines.

Currently, because the point at which information becomes Inside Information is inevitably susceptible to being a grey area, there is a natural bias in the market to err on the cautious side when determining the categorisation of information given the uncertainty (and the consequences of trading if they reach the wrong conclusion). If the Proposed Guidelines were to introduce a different test for assessing the nature of market information, this would be likely to create extra complexity in this area as well as strain resources that are often responsible

for considering the rules of multiple jurisdictions that may be relevant on international transactions (see 2.1.5 below).

2.1.2 The wide scope of "non-public information" may lead to over-regulation as it will affect not just private side capital markets teams, but will also affect other private side divisions covering private equity investments, private wealth management as well as public side trading desks (on the sell-side). Some buy-side firms currently do not accept any wall-crossed conversations at all, so if the public side trading desks are to be brought into this proposed regime, this will create a material change to their business and may have a detrimental effect on liquidity.

2.1.3 Currently, listed companies are subject to requirements around the disclosure of Inside Information under the SFO and the Listing Rules, which means that it is clear when this information becomes public. However, there are no such disclosure requirements for "non-public information" so there is a mis-match in relation to the treatment of the information. This means that under the Proposed Guidelines, it will be the Disclosing Person who will be entirely responsible for assessing whether the non-public information continues to fall within the concept of non-public information. As there will be some particularly difficult situations around the assessment of whether non-public information remains non-public (we cover further in our response to Question 11 below), it is very likely that some information will remain categorised as 'non-public' for an extended, or even indefinite, period as the liability for mischaracterising the information will lie with the Disclosing Person. In addition, as mentioned in 1.6 above, where Receiving Persons are market sounded by brokers from outside Hong Kong who are not subject to the Proposed Guidelines, it will be difficult to see how the Receiving Person would be able to make the determination as to whether the information remains non-public. This could result in Receiving Persons who have agreed to participate in market soundings being subject to prolonged periods of trading restrictions, which could further discourage the buy-side from engaging in market soundings.

2.1.4 Given the important role that Market Sounding Intermediaries play in the market, restricting them from using any non-public information could hinder their ability to effectively assess market conditions and provide valuable insights to their clients. We are of the view that any prohibition or control should only limit the use of Inside Information for its own or other's benefit or financial advantage. It should not apply to all non-public information received during market sounding.

2.1.5 It is also worth noting that the proposed use of non-public information as the threshold for obligations under the Proposed Guidelines (e.g., prohibition on trading and requirement to cleanse) is inconsistent with international market sounding regimes. For instance, MAR only prohibits trading on inside information received during market soundings (see also our response to Question 5) and only requires cleansing where inside information has been disclosed in the market sounding (see also our response to Question 11). By contrast, the Proposed

Guidelines require Market Sounding Intermediaries to not trade on or use *any* non-public information passed or received during market soundings, and cleansing will always be required as long as such information is non-public information (the cleansing of non-public information will be particularly problematic given often the information will not be information that is made known publicly – please see the response to Question 11 below). Expanding Hong Kong's scope to cover all non-public information, regardless of materiality or price sensitivity, deviates from other established regimes and may place Hong Kong in a less competitive position compared with other global markets given the large administrative burden placed on market participants and potential inefficiencies that may arise as a result.

2.1.6 Taking note of the above, and the possibility of having a variety of different standards possibly applying on an international transaction, adopting a threshold that is critically incongruous with international norms may result in imbalanced feedback, at best, or feedback that effectively precludes meaningful participation by Hong Kong based market participants at worst (see paragraphs 1.6 and 1.7 above).

2.2 **Meaning of "non-public information"**: Notwithstanding the reasons set out in paragraph 2.1 above, if the SFC wishes to adopt "non-public information" as the threshold of application, members strongly suggest the introduction of a clear definition and guidance on what constitutes "non-public information" that would fall within the scope of application of the Proposed Guidelines. Specific guidance is required to avoid uncertainty and confusion (especially with the insider dealing regime), which may discourage market participants from conducting or participating in market soundings.

2.2.1 Members are of the view that it would be detrimental to the market to treat all non-public information with the same level of sensitivity as Inside Information. In reality, the introduction of a different interpretive approach for non-public information would be more difficult for firms, and may even cast doubt on firm's interpretation of, and existing approach to compliance with, parts XIII and XIV of the SFO. If the concern is around variability in how different market practitioners evaluate whether information is "price sensitive", then the prudent approach would be to set clear, standardized criteria in the Proposed Guidelines for the specific purpose of market sounding and the criteria for determination of "price sensitive" information, rather than casting a wider yet equally vague net. Members are concerned that the broad scope will paralyse the legal and compliance ecosystem by imposing more obligations than necessary that are out of sync with global practices. This would inevitably hinder the normal capital formation process, discourage market activity, and inadvertently squeeze liquidity, all while creating an uneven playing field for Hong Kong-based market participants.

2.2.2 Non-public information encompasses a broad range of data that has not been made available to the general public. However, not all non-public information is inherently price-sensitive or capable of significantly impacting market prices. Market

sounding intermediaries often come across non-public information that may not have a direct correlation to price movements or is of low materiality. Prohibiting the use of all non-public information would be overly restrictive and could impede the efficient functioning of the market.

2.2.3 Determining what constitutes non-public information can be a complex task. In many cases, information that may initially be deemed non-public can quickly become public due to various factors such as leaks, rumors, or changes in market conditions. Imposing a strict prohibition on the use of non-public information could create ambiguity and potential legal challenges for Market Sounding Intermediaries in determining the status of the information they possess.

2.2.4 If the Proposed Guidelines restrict trading on the lower threshold of "non-public information" passed or received during sounding, this would effectively indicate that the information is classified as Inside Information and is likely price sensitive. Such a proposal would appear to be an indirect expansion of the SFO's insider dealing regime, but it would only be applicable to SFC licensed persons who are participating in market soundings. This raises the possibility that Recipient Persons may decide not to engage in any soundings procedures as the consequences are akin to being tainted with Inside Information. Members propose that the SFC should continue to follow the existing insider dealing regime under the SFO to only restrict trading activity based on Inside Information.

2.2.5 The members also believe that the Proposed Guidelines risk creating an uneven playing field as they will create restrictions around trading while in possession of non-public information which do not apply evenly throughout the market. Where the purpose of sharing non-public information is to gauge market feedback on a particular security there will be restrictions on trading, however the communication of the same non-public information for different purposes will not necessarily result in a trading restriction. For example, in the case of a firm selling a small block of shares (not involving information amounting to Inside Information), any Recipient Persons who received the market sounding will be restricted, however a non-SFC licensed person connected to the seller who has the same information obtained through their employment or from a social context would not be restricted from trading. This creates an illogical result and uneven playing field for the market.

2.2.6 Further details on our thoughts regarding this proposal are provided in some of the responses below.

2.3 Scope of "securities transactions":

2.3.1 The term "securities transactions" should be clearly defined to ensure that typical mergers and acquisitions ("**M&A**") activity is out of scope of the Proposed Guidelines. Members have flagged that many M&A deals, including privatisations, may involve the sale or purchase of listed securities, which may therefore be seen as a "securities transaction" under the Proposed Guidelines. However, we

submit that the nature, as well as the mode of execution, of these deals are so different from capital markets transactions that the mischief does not exist and therefore warrants a different approach to be taken. A clear distinction is required between capital markets and M&A transactions, as the latter typically requires lengthy prior discussions between investors, investment banks and shareholders that should not be caught in scope of the Proposed Guidelines. For example, in an M&A context, the sharing of any confidential information is typically protected and governed by the terms of a non-disclosure agreement ("**NDA**") between the M&A client and the relevant third party. The terms of the NDA (which would be subject to advice from the M&A client's external legal advisers to protect the M&A client's interests) would itself govern the permitted/restrictions on disclosure/use of the information shared and where relevant, impose relevant trading restrictions should the information provided potentially constitute Inside Information.

It would therefore be helpful to clarify that it is not the SFC's expectations that the Proposed Guidelines would apply to the sharing of confidential information by the M&A client (which may or may not be done via its financial adviser) about its business or otherwise to a counterparty in the context of a potential transaction (where the M&A client is advised by its legal advisers on the legal and regulatory issues to be considered in the sharing of such information).

2.3.2 Members have also requested that exchange traded funds ("**ETFs**") be excluded from the scope of "securities transactions". ETFs may consist of a number of constituent securities or track an index which may alter in its constitution. The effect of a block sale of ETFs on the individual constituent shares based on non-public information (whether it meets the threshold of Inside Information or not) is unlikely to be material and in addition is very hard to establish, particularly where an ETF is tracking an index. Restricting activities on such ETF securities would therefore seem unlikely to meet SFC's intentions as set out in the Consultation Paper.

2.3.3 Members have also queried whether immaterial debt securities market placements or offerings, especially those made by frequent issuers or sovereigns can be carved out or exempted. Generally, an offering or placement will be considered immaterial if the anticipated size of the proposed transaction is considered immaterial to the issuer and/or any affiliated companies, including but not limited to any parent company, subsidiary and/or other listed affiliates. Certain large issuers raise debt and refinance on a regular and continuous basis, and in certain cases very small amounts. Governments, quasi-sovereigns, supranational entities, large investment grade companies, etc. are examples. Debt issuances by these repeat issuers are generally understood and expected by the market, although specific issuances may not be 'public'. If Recipient Persons are barred from trading as a result of having received a market sounding, but the rest of the market is not restricted, market participants would not want to be a subject of any market sounding and hence this

could have a negative effect on liquidity and pricing, ultimately negatively affecting issuers.

2.3.4 Members have also requested that financings similar to a private loan, which are bilateral or "club" style in nature but may be issued as a "note", be considered to be carved-out from the scope of the Proposed Guidelines. Such financings more closely resemble a typical bilateral loan transaction than a public securities transaction as the debt instruments are not listed and are typically subject to transfer restrictions.

2.4 **Block trades**: the Consultation Paper also refers to large "block trades" as an example where market soundings are typically conducted. As mentioned in paragraph 1.4 above, the members support a quantitative definition for large block trades as 5% of the issued share capital.

2.5 **Nature of communications with investors:** Members understand that the following communications are out of scope for the Proposed Guidelines:

2.5.1 Communications with investors (even where non-public information is involved) which are purely for the purposes of obtaining general investor feedback on an issuer, and not for the purposes of gauging interest in any potential transaction.

2.5.2 Communications with investors (even where non-public information is involved) in connection with "non-deal roadshows" whose purposes are to provide business updates and not to gauge interest in any potential transaction.

2.5.3 Internal communications among different divisions/business units within a sell-side broker firm when leveraging another division/business for the purposes of conducting market soundings (for example, when ECM teams pass on Inside Information or non-public information to the Private Wealth Management division to allow them to conduct market soundings with their Private Wealth Management clients).

2.6 **Clarification on Paragraph 1.3 of the Proposed Guidelines (communications which the Guidelines do not apply to):**

2.6.1 In paragraph 1.3 of the Proposed Guidelines, the SFC stated that "*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*" is out of scope of the Guidelines.

2.6.2 Members would like to highlight to the SFC that sell-side firms may, based on their ordinary course of business communications with potential Market Sounding Beneficiaries, discuss speculative transactions or trade ideas with other parties.

2.6.3 Investors may also proactively contact sell-side firms, on a reverse inquiry basis, to discuss their own trade ideas, indicate their interest in participating in potential transactions, or request to see a bid / offer / risk price. Such reverse inquiries could

be (a) triggered by information in the public domain or (b) based on the investors' own views of specific stocks or the market generally.

2.6.4 Of note, during these discussions, brokers could be mandated by, or have otherwise consulted, the Market Sounding Beneficiary; alternatively, brokers may be engaged in pitching for a role in a potential transaction. However, there is no exchange of non-public information during discussions with investors when seeking their feedback. As such, we believe these communications with investors should be out-of-scope of the Proposed Guidelines.

2.6.5 Examples of information in the public domain which could be used as a basis for such communications include:

(i) For equities, lock-up expiries (which is publicly available information), which may indicate a shareholder's intention to sell their holdings; in such circumstances potential vendors may request to see a bid /offer / risk price in respect to public side equity transactions, without materiality, where the marketability or certainty of execution is unclear at the time of the request.

(ii) For debt / equities, information (either confirmed or unconfirmed) about a company published in a news agency and/or Exchange announcements, e.g., changes in C-suite personnel, financial position, corporate strategy or plans for fund raising, etc., or trading activity known to market (e.g., the fact that a substantial shareholder of a company has been selling down their stake over a period of time).

(iii) For debt / equities, Private Equity investors' publicly disclosed holding in listed companies.

(iv) For debt / equities, bonds and CB refinancing timing (based on Bond/CB maturity dates and/or analysis of stock price versus Bond price or CB conversion price). Again, since information on the maturities of debt instruments is publicly available information and would be discussed by investors and sell-side firms ahead of time, we would not consider refinancing timing to be non-public information.

(v) For debt, Medium Term Note ("**MTN**") Programs which are listed and for which the market would expect the issuer to issue under the program.

(vi) For debt, Securitized Products and Sovereign, Supranational and Agency transactions: these are frequent issuers for which the market expects them to issue given their supranational status.

Question 3: Do you have any comments on the examples of factors to consider when determining the level of certainty of the corresponding potential transaction materializing in connection with a market sounding?

ASIFMA: The factors listed in the Consultation Paper are already used by members for determining whether information amounts to Inside Information. It would create a tension to be using the same assessments to determine the level of certainty as to whether there will be a transaction which triggers the use of the Proposed Guidelines. Members have raised the following observations on the examples given under paragraph 26 of the Consultation Paper:

3.1 **Paragraph 26(a)**: members' key concern is that the term "expressed an interest" is too broad and not sufficiently clear so as to be precisely understood by Market Participants. "Interest" can span a wide spectrum, ranging from passively allowing the Disclosing Person to continue with their market sounding exercise to proactively expressing interest in the transaction. Examples include (i) clients expressing interest in executing potential transactions during the normal course of business communications with brokers, or (ii) in the case of ECM syndicates, clients may ask these teams to provide indicative terms based on current market conditions. In each case, there is an "expression of interest", but these factors do not necessarily point towards any level of certainty of a transaction materializing, as this is often dependent on additional factors such as changing client interest, the interest may span over an extended period of time, the state of the market, or whether what a client has in mind would be marketable. For the avoidance of doubt, general marketing or pitching of possible transactions should not be regarded as "expressing an interest" for the purpose of the Proposed Guidelines.

3.2 **Paragraph 26(b):** members consider this insufficient for the purpose of determining the level of certainty of a transaction materializing. For example, if a key corporate shareholder expresses interest in selling a certain percentage of their holdings over a one-year timeframe, it remains difficult for brokers to assess whether the transaction would materialize until the client signs a mandate letter and agrees to specific launch timing. In practice, clients often share ideas of potential transaction sizes or price ranges with brokers during preliminary discussions, with such discussions taking place over an extended period of time before the transaction reaches a point of potential materialisation. It would therefore not be prudent to render communications with investors based on preliminary terms as being subject to the Proposed Guidelines, especially in respect of trading restrictions and cleansing obligations, as investors may become restricted for an unknown duration without a clear method or time by which they could be cleansed. Taking into account all of the above, members suggest the removal of this example.

3.3 **Paragraph 26(c):** members agree that the receipt of a client mandate for a specific transaction or an actual order (with confirmed size and clear price targets) is the clearest indication of a transaction materializing.

Overall, 'level of certainty' is very transaction specific; for equity block trades, the receipt of a mandate may be a good barometer, but for other deals which are less quick to market, a mandate may mean that banks work with the issuer but without any visibility as to the terms or structure of an actual transaction. Although the Proposed Guidelines assert that there would be a 'level of certainty', in many cases there remains a level of ambiguity particularly where the information is non-public rather than Inside

Information. The Proposed Guidelines should therefore make clear that more emphasis should be given to paragraph 26(c) of the Consultation Paper in assessing whether there is a 'level of certainty'.

Question 4: Do you agree that a Market Sounding Intermediary has a duty to maintain the structures of confidentiality of non-public information passed or received during market soundings? If not, please explain.

ASIFMA: Members generally agree, noting that confidential information received by Market Sounding Intermediaries must be safeguarded from improper disclosure, regardless of whether that information was passed or received during market soundings. However, not all non-public information will be confidential information; non-public information is a very broad category and only some will fall within the subset of confidential information.

Most responding members already believe that they have appropriate safeguards in place for this purpose, as the members have procedures for assessments of the facts and circumstances around information that is received and/or is to be shared. Depending on the result of the assessment of the information, there are various measures to protect confidentiality, including contractual arrangements (for example non-disclosure agreements), regulations (such as the SFC's Code of Conduct) and common law (for example the implied duty of confidentiality). In light of this, the members do not believe that additional safeguards for confidentiality on pure non-public information are required.

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' benefit or financial advantage? If not, please explain.

ASIFMA: No**,** members do not believe that there should be an automatic restriction on trading or using non-public information passed or received during market soundings without an assessment as to whether it amounts to Inside Information.

5.1 Market participants often have access to information which is confidential in nature but which falls far short of the 'Inside Information' threshold (for example contemplated transactions which are not material or which are announced in broad terms, loan-related activity or other debt transactions). Non-public information which is capable of conferring a benefit or financial advantage when trading would effectively indicate that the information is classified as Inside Information and is likely price sensitive, i.e., "trading on" information raises the question of that information's materiality, which effectively bypasses the current definition and evaluation of Inside Information under the SFO. It would therefore appear that there is a mismatch in the trading restriction in the Proposed Guidelines as it conflates non-public information with the consequences of being in possession of Inside Information, which is of a much higher threshold.

5.2 As mentioned in paragraph 2.2.5 above, the ultimate result would appear to be an indirect expansion of the insider dealing regime (rather than a clarification for a specific use case), however this extension is only applicable to SFC licensed persons. This raises the very likely

possibility that Recipient Persons may decide not to engage in any soundings procedures as the consequences are akin to being tainted with Inside Information. Alternatively, if the scope covers all market sounding activities conducted in Hong Kong including for non-Hong Kong listed securities, this may result in Recipient Persons being put at a competitive disadvantage compared to other market participants (i.e., from other locations such as Singapore, Korea, Japan) who have access to such information. Buy-side firms outside of Hong Kong may have an information advantage over those in Hong Kong as they will not be subject to the Proposed Guidelines. Recipient Persons / buy-side firms may choose to deal out of a jurisdiction where the insider dealing or market soundings regime is narrower, leading to an uneven playing field in the Asia Pacific region where certain market participants have an informational advantage over others, potentially impacting market efficiency. Members propose that the SFC should continue to follow the existing insider dealing regime under the SFO by only restricting trading activity that is based on Inside Information and not to all non-public information received during a market sounding.

5.3 Potential Impacts

5.3.1 If the Proposed Guidelines encompass all market sounding activities conducted in Hong Kong, including for non-Hong Kong securities, both sell-side and buy-side could potentially transfer their market sounding process to an overseas affiliate for non-Hong Kong securities. Moreover, if the scope also covers all market soundings communicated to Recipient Persons in Hong Kong, some overseas sell-side firms might opt not to engage with Hong Kong recipient persons for non-Hong Kong securities to avoid the additional burden.

5.3.2 As highlighted in paragraph 2.1.3, if the trading restriction is based on information being non-public, it is possible that non-public information may remain undisclosed or otherwise non-public for a prolonged or potentially indefinite period of time, because under the SFO and Listing Rules, there is only the requirement for disclosure of Inside Information. This would mean that Recipient Persons who have agreed to Market Soundings are entirely reliant on Disclosing Persons to assess the information and cleanse, which could lead to extended trading restrictions due to receipt of immaterial non-public information.

5.3.3 The members are also concerned generally that the Disclosing Persons / sell-side firms may also be hesitant to take on mandates for the execution of blocks of securities which are carried out over an extended period, as they would be subject to restrictions on trading in those securities for the extended period.

5.3.4 In view of the above, the members are concerned that the proposed changes may reduce the number of firms willing to participate in market soundings based on non-public information. While transactions will still go ahead, it is very likely that the lack of communication around the transactions will result in issues such as suboptimal timing, size, or pricing levels which are unattractive to the investing community.

5.4 SFAT Decision

5.4.1 We understand that the SFAT decision on Aarons is one of the main drivers behind the proposed requirement to restrict all trading activities based on information provided during Market Soundings. Two points the members would like to raise in relation to the SFAT decision are: 1) it is unclear whether the hedge fund manager or his firm had access to any other source of information, in conjunction with what he was told during that one specific market sounding call, which informed his decision to trade ahead of the transaction; 2) the hedge fund manager was unlikely to be the only one who received a market sounding call as sell-side firms would typically use the same script (with the same information) to sound multiple investors, and yet there were no other investors who were identified as having engaged in similar trading behaviour ahead of the transaction.

5.4.2 While the SFAT decision was not based on whether Aarons used Inside Information to trade, it does consider whether his behaviour was substandard for an SFC licensed individual and breached the Code of Conduct.

5.4.3 As such, the root cause of the problematic behaviour identified in the case above may not necessarily be the communication of "non-public information" passed during the market sounding call, but rather the lack of robust information barrier and surveillance controls, or a failure to follow them:

(i) For example, if the market sounding call cited in the SFAT case was made by the sell-side firm to a designated gatekeeper without trading authority, rather than to a portfolio manager or a trader, the gatekeeper could have first potentially assessed whether the information provided in the initial market sounding call constituted information that would enable a reasonable person to make educated guesses at what the stock is, in conjunction with other information available to their firm;

(ii) Separately, Recipient Persons that implement post-trade surveillance to check whether there is trading of the placement stock or derivatives referencing the stock ahead of the hedge fund participating in a placement may also discourage frontrunning.

5.4.4 Ensuring firms have specific controls to control information flow and prevent frontrunning, rather than to have a blanket ban on trading on all non-public information, would be more effective in addressing the conduct issues which the SFC is concerned with.

5.4.5 In conclusion, it is essential to strike a balance between protecting market integrity and allowing market sounding intermediaries to access non-public information that does not have a direct impact on market prices. By focusing regulatory efforts on Inside Information and implementing appropriate safeguards, it would be possible

to maintain market efficiency while mitigating the risks associated with insider trading.

5.5 **Block Trades:** Members have also raised a related query regarding the restriction of trade. There are scenarios where a Market Sounding Beneficiary may request a block of securities to be sold, but this may occur over a series of transactions over a period of time. In these situations, the members suggest the trading restriction should be based on whether the Market Sounding Intermediary has any Inside Information after assessing the totality of facts at the point of each sell-down.

Question 6: Do you have any comments on the Core Principles in the Proposed Guidelines?

ASIFMA: Yes – members generally note that the Core Principles are sensible and are largely covered by existing internal procedures. However, compliance with the Core Principles will be challenging if the Proposed Guidelines drastically increase the scope of coverage by applying the same level of rigour to the broad scope of "non-public information" instead of Inside Information, which will add more strain to existing resources and diminish the quality and volume of feedback. Please see below for specific comments on the Core Principles:

6.1 **Core Principle 1 – Market integrity**: Core Principle 1 requires Market Sounding Intermediaries to "not trade on or use any non-public information… for its own or others' benefit or financial advantage until the information ceases to be non-public" (emphasis added). This is problematic for two reasons:

6.1.1 **Use of non-public information that provides a "financial advantage" would be Inside Information:** any non-public information that could have an effect on price (so as to provide a financial advantage) would be Inside Information. Members reiterate their view that Inside Information should be the standard of information used for the purpose of the obligations imposed on Market Sounding Intermediaries under the Proposed Guidelines (see responses to Questions 1 and 2).

6.1.2 **Information may not always become public:** Members note that non-public information may not always become public (see practical examples in paragraphs 1 (*ECM scenario*), 2 (*DCM scenario*), and 6 (*Block trades and series of transactions*) in the Appendix). In many cases, information simply becomes stale with the passage of time (e.g., the deal does not proceed), and the use of such information would not bring any benefit to its user. Members suggest that the wording of the Core Principle be revised to take this into account, as it would be imprudent to place a trading restriction for the use of mere non-public information for an indefinite period of time.

6.2 **Core Principle 3 – Policies and procedures**:

6.2.1 **Categorisation and handling of different types of information:** Core Principle 3(f) requires Market Sounding Intermediaries to establish and maintain policies and procedures to define, categorise, identify and handle different types of information gathered during the course of market soundings. It would be appreciated if the SFC

could clarify how it expects different types of information to be categorised and handled, given that most of the information disclosed or received during a market sounding would be non-public information, and all non-public information is equally subject to the Proposed Guidelines.

6.3 Core Principle 4 – Information Barrier Controls:

6.3.1 **Clarification on the use of a "Restricted List":** For Core Principle 4(d), it would be appreciated if the SFC could clarify the intended purpose of a "Restricted List" – whether this is to restrict individuals from trading (for which firms have watchlists, wall-crossing processes or personal trading policies), or to impose firm-wide restrictions on trading (members note that this could be deemed to be tipping off the public side, as banks typically add securities to the Restricted List when deals launch to restrict post-launch trading). Some members note that the SFC's use of the term "Restricted List" in this Core Principle does not appear to align with the general practice of most sell-side firms. Are firms required to develop and maintain a list of all internal and external individuals who possess non-public information as a result of market soundings (see paragraph 3.4(e) of the Proposed Guidelines), as well as a "Restricted List"? Assuming that this is the case, members express concern over the impracticality of this arrangement, as this would require a significant amount of resources to maintain. In many cases, the full list of personnel who have been wall crossed could include hundreds of associates (e.g., compliance and control personnel, legal, ECM, trading teams, investment groups, etc.). Members suggest that the scope of this list should be limited in order to reduce the consequential burden on market sounding participants.

6.3.2 **Existing control processes:** For sell side firms, control processes normally comprise the following (to be clear, these processes have been implemented in relation to Inside Information as opposed to non-public information):

(i) **Watchlist:** deal teams would inform a "control room" if a deal has progressed to a point where they believe the firm is or may be in possession of Inside Information, at which point the control room would add the name to the watch list. This would subsequently trigger personal account dealing trading restrictions.

(ii) **Restricted list:** securities are only added to the restricted list upon deal launch (i.e. when the deal has launched or when the deal is announced) to avoid firm activities that may present a potential conflict of interest, i.e. restricting trading or marketing activities related to a name for which the firm is acting as a bookrunner.

Members also flagged that concepts of a watchlist and restricted list are already required under paragraph 8.2 (*Prohibition of dealings*) of the SFC's Corporate Finance Adviser Code of Conduct. It would be appreciated if the SFC could clarify whether there is a particular reason for only requiring the use of a restricted

list for the purpose of this core principle, and whether a watchlist would still be required.

6.3.3 **Inconsistency with global processes**: Members note that control rooms of many global sell-side firms typically apply processes consistently across regions in order to control information flows and manage conflicts of interest. Wall-crossing procedures are also typically based on the concept of Inside Information, rather than non-public information. The introduction of a new regime with non-public information as the standard would require significant overhauls to existing processes.

6.3.4 **Significant changes to existing frameworks**: Members note that some firms have set up frameworks and put in place controls to handle Inside Information and non-public information. For many member firms, if it is Inside Information, the private side desks will need to wall-cross the public side if Inside Information is shared, and the names of the relevant personnel involved in the public side would need to be included in the insider register. This would trigger several established (and often globally aligned) procedures and control frameworks, e.g., trade surveillance, dealing restrictions, personal account dealing, etc. If market soundings that only involve non-public information are also subject to trading restrictions, such established frameworks will need to be changed. Manual additions of people who have simply received non-public information to the insider register would create confusion.

6.4 **Core Principle 5 – Review and monitoring controls**: Members note that under Core Principle 5, Market Sounding Intermediaries are expected to establish "effective procedures and controls to monitor and detect suspicious or inappropriate behaviours or unauthorised disclosure or misuse of information related to market soundings". Based on the language used, members assume that the SFC is referring to measures to actively monitor such market sounding activity and to conduct reviews where issues arise (i.e., retrospective measures rather than preventative measures).

6.5 **Core Principle 6 – Authorised communication channels:** For face-to-face meetings (e.g., informal gatherings) where non-public information is disclosed, members recommend that the SFC allow Disclosing Persons to take notes of the meeting in order to record the contents of the discussion. The Disclosing Person may then circulate the meeting notes to the Receiving Person for confirmation within a designated period of time (e.g., 5 business days). Such an approach would be in line with international standards (e.g., MAR), and will provide market participants with sufficient clarity as to expectations of conduct in such situations – please also see our response in paragraph 12.1 on this point.

Question 7: Are there any other areas which you think the Core Principles in the Proposed Guidelines should cover? If so, please provide examples.

ASIFMA: No – members are generally of the view that the main areas have been covered by the Core Principles and generally welcome the standardization of the market sounding process across intermediaries.

Question 8: Do you agree with the proposal for Disclosing Persons to adopt the use of a standardized script? If not, please explain.

ASIFMA: Yes, members generally agree. As an additional point, members note that some investors require some scripts to be aligned with their internal requirements by the Disclosing Person. As such, it would be preferable to retain a degree of flexibility in terms of the content set out in the standardized script, such that Disclosing Persons can add information as required without seeking approval.

Question 9: Do you have any comments on the minimum content and sequence of information set out in the standardized script?

ASIFMA: Yes, members generally agree with the minimum content and sequence of information set out in the standardized script, but raise the following additional points:

9.1 Members query whether there is a need for Disclosing Persons to obtain confirmation that the individual is the person designated to receive market soundings. As a related point, it would be appreciated if the SFC could clarify whether the mis-designation of the individual designated to receive market soundings could potentially render consents invalid?

9.2 One member has also suggested that paragraph 3.2(a) of the Proposed Guidelines should also specify that the information disclosed as part of the communication is not to be disclosed to anyone other than compliance and legal teams (if any) or other internal personnel involved in evaluating or executing the deal, and such persons should be made aware that they are subject to the same restrictions.

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.

ASIFMA: Yes, members generally agree.

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.

ASIFMA: No, as mentioned above, where “non-public information" is the standard to be adopted, cleansing under the Proposed Guidelines is one of the key areas of concern among members. Members have raised the following points of potential concern:

11.1 **Cleansing of non-public information not always feasible**: Members note that, given the broad scope of non-public information, there may be situations where cleansing may simply not be feasible. For instance, transactions that do not materialise, or transactions that

simply do not require any form of public disclosure – see paragraphs 1 (*ECM scenario*), 2 (*DCM scenario*) and 6 (*Block trades and series of transactions*) of the Appendix.

11.2 **Scope of "non-public information":** As noted in our response to Question 2, requiring cleansing for "non-public information" is inconsistent with international market sounding regimes. Should cleansing for non-public information nonetheless be required, clear guidance is required in relation to the definition of "non-public information" in order for members to properly assess whether information will need to be cleansed, and if so, how. For example, with price-sensitive Inside Information, it is generally a more straightforward process to assess if information will be published and cleansed – there will be no Inside Information once the seller no longer wishes to proceed with the trade, as specific terms such as timing and pricing remain unknown. It will be much harder to assess if the obligation to cleanse also expands to "non-public information" that is not price-sensitive without specific additional guidance on what this entails. This will be especially problematic in situations such as:

11.2.1 private placement transactions involving private companies or "club" deals, where information will almost always remain non-public, irrespective of whether such transactions are launched or fall through – e.g., certain non-public financial information of a company may be provided to potential investors to gauge interests and such information will not usually be announced or made publicly available – see paragraph 1(a) (*ECM scenario*) of the Appendix;

11.2.2 market soundings for transactions that do not proceed, such that no public announcements are made and firms may be unnecessarily restricted from trading for extended periods of time – see paragraph 1(b) (*ECM scenario*) of the Appendix; and

11.2.3 large equity block trades executed via an equities sales or trading desk, as such trades would not normally be disclosed to the market unless certain conditions are met. Sell-side brokers are also expected to keep information about the trade non-public post-execution due to client confidentiality obligations – see paragraph 7 (*Block trades and cleansing of information*) of the Appendix.

There should therefore be a distinction between non-public information and Inside Information, and the obligation to cleanse should only apply when Recipient Persons are in possession of Inside Information.

11.3 **Burden on Disclosing Persons:** Under the Proposed Guidelines, the Disclosing Person must conduct assessments as to whether the information has ceased to be non-public, and it must also inform the Recipient Person as soon as possible in writing that the information has ceased to be non-public. As "non-public information" is broad in scope, this may have the effect of requiring Disclosing Persons to be engaged in frequent assessments of a very wide range of information which have been required to be the subject of a market sounding. Members note that there may be complex situations where the decision that a transaction will not go ahead might give rise to potential non-public

information, further adding to the onerous burden on Disclosing Persons when making their assessment. As such, similar to the above responses to other questions, this may be a factor that discourages firms from participating in a sounding and may have a negative impact on market activity. If non-public information is to be the standard under the Proposed Guidelines, members would appreciate if the SFC could provide guidance as to the information that should be in-scope, in order to minimise this potential burden.

11.4 **Obligation on Recipient Persons:** Members suggest that the Proposed Guidelines should specify that Recipient Persons shall also make their own assessment as to when cleansing has occurred. Some sell-side members have commented that it is not fair for the obligation to solely rest with the Disclosing Person, as their assessment may be different from that of the Recipient Person due to the asymmetry in knowledge. The introduction of this obligation on the Disclosing Person may place additional burden on existing resources and add to legal and compliance costs. While Disclosing Persons should conduct their own assessment of when information discussed during market soundings are expected to become public, Recipient Persons, based on the sum of information they have received about a potential transaction from various sources including but not limited to market soundings, should also make their own determination of whether they are still in possession of any information which would restrict their firm from trading in the relevant securities (for the avoidance of doubt, this is a separate obligation and does not absolve the Disclosing Persons' obligation to conduct their assessment as to whether the information has been cleansed and communicate such cleansing information to the Recipient Persons).

11.5 **Clarification on "announcement":** Members also seek clarification on what constitutes an announcement. Given the potentially broad scope of in-scope transactions, there may be scenarios where announcements are made to select market participants only through "public" means (e.g., public disclosure of interest filings, "books open" announcements, Bloomberg messages, standard term sheet launches or press releases), instead of a formal public announcement (e.g., formal stock exchange announcement). Some members from the fixed income, currency and commodities trading space have also queried what would constitute an announcement in the secondary debt markets. Clarification from the SFC is needed as there will otherwise be difficulty in assessing a cleansing event, which may inadvertently cause the restrictions on trading to persist for an extended period.

11.6 **Transactions with no announcements:** Members note that this is a practical challenge with debt securities offerings or secondary equities sales and trading transactions which are deemed as confidential information and not Inside Information. These are not announced to the market so formal cleansing events do not occur, other than the completion of the offering and signing of documents. To remedy this issue, members suggest that (i) such transactions should be excluded to avoid issues such as those set out in paragraphs 6 (*Block trades and series of transactions*) and 7 (*Block trades and cleansing of information*) of the Appendix from arising, or (ii) Disclosing Persons should be able to rely on other information that would enable them to reasonably determine that the information has been cleansed (e.g., representations of an issuer to that effect).

Question 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.

ASIFMA: No – see comments from members as follows:

12.1 **Market sounding channels**: The Consultation Paper notes that records in relation to market soundings would include audio, video or text recordings of market soundings conducted. Members assume that this would include market soundings conducted orally over telephone (via a recorded line) and over email. As a further recommendation, members also suggest that the SFC should expressly permit record keeping by way of note taking by the Disclosing Person (e.g., for conversations that take place during meetings or unrecorded telephone conversations), with such notes being written and signed by both the Disclosing Person and Recipient Person as an accurate record of the conversation.

12.2 **Proposed periods of record keeping:** Sell-side members are generally fine with the proposed 7-year record keeping period, noting that this is in line with existing order placement record keeping retention periods for capital market intermediaries under the bookbuilding requirements. In respect of telephone recordings, some members have queried whether these can be retained for a shorter period of six months, noting that this is the duration for which telephone-recorded order instructions are to be kept (see paragraph 3.9(b) of the SFC Code of Conduct). Members wish to emphasise that the requirement for record keeping should only be applicable to Disclosing Persons, as many Recipient Persons from the buy-side typically do not have existing record keeping systems – see our response in paragraph 14.1 below for further details.

12.3 **Details of the records:**

12.3.1 **In-scope persons:** Market Sounding Beneficiaries and other professional parties, including external counsel, involved in an in-scope transaction would typically be in possession of non-public information or Inside Information even prior to market soundings taking place. Members suggest that this list should only be limited to Disclosing Persons, Recipient Persons and other persons who are directly involved in the market soundings, and that control functions within a firm (e.g., Legal and Compliance) should not be in scope given the large number of personnel who may be involved.

12.3.2 **Requirements on the list of internal persons:** For the list of internal persons, members assume that the SFC requires a separate list of specific personnel involved for each market sounding mandate. Members do not think that this should be the case, as members note that such persons are generally the same across different mandates, so if details of specific personnel are required for each mandate, such a requirement would increase the administrative burden for firms.

12.4 **Records of notification:** Paragraph 3.4(f) of the Proposed Guidelines require that Disclosing Persons keep records of notifications to inform Recipient Persons or other potential investors when information ceases to be non-public. Members note that the current

practice is, where deals are publicly launched, Recipient Persons are deemed to be cleansed when a copy of the deal launch announcement is circulated to all targeted investors (including Recipient Persons). There may not be cleansing notifications separately circulated to Recipient Persons in such situations.

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

ASIFMA: Yes, members generally agree, noting that this proposal is a feasible approach that is in line with similar practices in other jurisdictions. However, for the purpose of implementation, members have highlighted the following issues:

13.1 **Ability to proceed with market sounding where trained Recipient Person is unavailable:** Members have requested clarification as to whether this means that the Disclosing Person must ensure that the Recipient Person is a designated trained person to receive market soundings. If this is the case, if the designated trained person(s) are not available, or where dealing with offshore Receiving Persons that are not subject to a similar requirement (e.g., there is no designated trained Recipient Person at all), does that mean that the Disclosing Person would not be able to proceed with the market sounding?

13.2 **Feasibility for family offices:** Members note that the proposed requirement may seem feasible from an institutional perspective, but some private wealth management clients may not have designated persons to receive soundings (e.g., small family offices with few personnel). It would be appreciated if the SFC could provide additional guidance in this regard.

13.3 **Designated person does not need to be licensed:** Members assume that the designated person will not need to be a licensed representative of a firm, noting that in most cases, the gatekeeper functions are conducted by internal control personnel (e.g., Legal and Compliance), who would not be licensed representatives of a firm. Further not all Recipient Persons will be licensed corporations that are subject to the SFC's regulatory requirements – investors may be the treasury of a large corporate, or a multinational corporate.

13.4 **Requirements for training:** Members note that some market participants generally already require that Disclosing Persons must contact their legal or compliance departments for clearance before reaching out to the specific individuals to obtain feedback. As the Proposed Guidelines suggest that the relevant person should be trained, members assume that such training is to be provided by the legal or compliance teams for the purpose of ensuring that persons designated to receive market soundings are familiar with their obligations and the requirements set out in the guidelines.

13.5 **No obligation on Disclosing Person**: Members assume that this requirement also imposes a requirement on the Disclosing Person to ensure that the Recipient Person is the designated person to receive market soundings. Members' preference is for this to not be the case in order to provide more flexibility to the Disclosing Person (especially in cases

where market soundings are to be conducted with investors in other jurisdictions where such similar requirements do not exist).

Question 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.

ASIFMA: Members generally agree and have made a comment that these requirements should be aligned with the record keeping periods for Disclosing Persons. save for the following points:

14.1 **Recording for buy-side firms**: Members note that buy-side firms are typically not required to implement telephone recordings for interactions with sell-side firms (current tape-recording requirements are only applicable to licensed corporations that accept and execute orders). As many buy-side firms do not currently have such systems in place, members suggest that the telephone recording requirement for market sounding purposes shall only apply to Disclosing Persons (which are typically sell-side firms), not Recipient Persons. The requirement for a written confirmation to be provided by the Disclosing Person to the Recipient Person under paragraph 3.2 of the Proposed Guidelines should be sufficient to set out the content covered during the market sounding process, and such written confirmation can serve the same purpose without adding administrative burden to buy-side firms.

14.2 **Record-keeping periods to align with Disclosing Persons:** Members have made a general comment that the record keeping periods for Recipient Persons should be aligned with that for Disclosing Persons.

14.3 **Exclusion for buy-side firms***:* Buy-side members have suggested that the record-keeping requirement under paragraph 4.2(c) of the Proposed Guidelines should be excluded for buy-side firms that have implemented firm-wide restrictions, i.e., buy-side firms should not be required to maintain a list of all internal persons who possess the market sounding information if a firm-wide restriction is in place. This is because buy-side firms that have implemented firm-wide restrictions have already restricted trading globally for all of their managed investment funds, portfolios and staff. This is already a conservative approach, such that a restricted list may not be necessary for these firms.

Question 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.

Members strongly suggest an extension of the implementation period to 12 months to account for the anticipated material changes to internal documentation, systems and training requirements for compliance with the Proposed Guidelines.

15.1 **Time required for gap analysis and consequent changes to internal systems:** It was noted in the Consultation Paper that many market participants have market sounding procedures in place. While this is true, the practices and controls vary between firms. In order to ensure that firms meet the final requirements on market soundings, all firms will have to undertake a gap analysis exercise and subsequently are likely to need to make changes to documentation, procedures and internal systems such as recording lines, policy changes

and record-keeping. These changes will also need to be implemented and then subject to a period of testing before the go-live date.

15.2 **Additional burden for certain members (especially buy-side firms):** For some firms, the changes required could be an extensive exercise that covers new desks and may require entirely new documentation (for example the introduction of standardised scripts for Disclosing Persons). This is particularly true for some buy-side members, who have noted that the Proposed Guidelines contain obligations that go beyond the practices that are typically in place for buy-side firms (e.g., addition of a written policy for the market sounding process (or significant updates to be made where such policies are already in place), clear records of the process). Given the additional measures that will need to be implemented, members would appreciate if a longer transition period is provided.

15.3 **Changes to governance structures:** Changes will also need to be made to governance structures to create the roles and committees as envisioned in Core Principle 2.

15.4 **Training period required**: Once the additional measures are implemented, there will necessarily need to be a training period to ensure compliance with the additional measures from the start date, and as mentioned above this could include employees who have not previously been involved in market soundings.

16 Miscellaneous Comments

16.1 **Pre-sounding procedures for market soundings conducted outside trading hours of securities listed in offshore jurisdictions:** Members note that Disclosing Persons are required under paragraph 3.1(c)(ii) of the Proposed Guidelines to determine in advance, on a case-by-case basis before initial contact with Recipient Persons or other potential investors, an appropriate timing to conduct market soundings (e.g., where reasonably practicable, outside of the trading hours during which the securities associated with the market sounding may be traded). For market soundings on securities listed in other jurisdictions, is it recommended that market soundings be performed outside the trading hours of that jurisdiction, if it falls outside Hong Kong trading hours?

Appendix
Examples of Practical Challenges

1. **ECM scenario**: Private side (e.g., ECM team) engaged in market soundings on behalf of a selling shareholder for the disposal of its shares in a Hong Kong listed company. The stake in question is approximately 1% of the number of issued shares, so the information regarding the proposed disposal would not constitute Inside Information.

   (a) *Practical difficulty 1*: If the deal turned out to only be a "club" deal, and the HK listed company is not going to be make any announcement, how could the "non-public information" be cleansed?

   (b) *Practical difficulty 2:* What if the deal did not go ahead in the end – how could the "non-public information" be cleansed? It would be appreciated if the SFC could confirm whether asking the selling shareholder to stand down (i.e., not doing the trade) for the next few weeks would constitute sufficient cleansing.

2. **DCM Scenario:** Debt capital markets team engaged in market soundings on behalf of an investment grade bond issuer which routinely issues bonds. Each bond issuance is not material so the information would not constitute Inside Information.

   (a) *Practical difficulty*: What if the deal did not go ahead in the end – how could the "non-public information" be cleansed? Would like to get the SFC to confirm that asking the issuer to stand down (i.e., not issuing the bonds) for the next few weeks would constitute sufficient cleansing.

3. **Structured transaction for listed company/ affiliate** – stake-building, risk management, liquidity management e.g., shareholder publicly announced they will look to sell within the year a stake (e.g., 5%), then a month later approaches a broker to sell within the month, or 6-months. Does this still fall within the definition of non-public information?

4. **Indication of interest**: An investor approaches a broker with an indication of interest (security name and estimate size) without committing to a firm trade. The proposed transaction is not material in size (e.g., 5%) nor is the investor an insider. If these conversations fall in-scope by reason of being mere "non-public information", this will impact the ability for the firm (as liquidity provider) to offer liquidity to other clients, and may affect their hedging activities.

5. **Dual listings:** Company A has a dual listing in Hong Kong and the United States stock exchanges. Company A is developing a promising new technology in its field and market expectations based on public research, and the company will need to raise new equity to invest in this technology. Broker B's banking team approaches Company A to ask if it wishes to receive feedback from investors around willingness and valuation expectations for investment in Company A. Company A advises Broker B that it would like to receive feedback, although it does not disclose any expectations of a resultant transaction, nor is a formal mandate received. Broker B is uncertain of Company A's intention. Under the Proposed Guidelines, 'market sounding' is defined as the communication of

non-public information irrespective of whether the information is price-sensitive, and the intermediary may need to restrict trading. If Broker B were to attempt to solicit feedback from potential investors in Hong Kong, its activities may be considered as market sounding, especially if in the future Broker B used this feedback to proceed with a transaction even if the likelihood of a transaction at the time of solicitation was uncertain. With this uncertainty in Hong Kong, Broker B is likely to undertake the market sounding activity in a different jurisdiction.

6. **Block trades and series of transactions:** A client approaches a bank to sell a large "block" of securities on a discretionary basis. In the secondary equities sales and trading business, it is common to have sizable 'block' transactions that could be relatively large compared to a "usual" trade order size, but these will typically not be sufficiently material to attract any market sounding requirements (as compared with transactions handled by the capital markets space). This would potentially be subject to the Proposed Guidelines on market sounding. The deal is not "material" from an insider perspective, but the communication and instruction is non-public information. If the bank is unable to sell in one transaction, or is asked to sell in a number of smaller transactions (e.g., for the purpose of being discrete) over a period of time, at what point can the bank cleanse the original non-public information where an announcement is not made?

7. **Block trades and cleansing of information*:*** A client approaches a firm and requests to do a large block trade. The firm approaches three investors to see if any of them would be willing to buy or sell, one investor agrees. The block trade is done off exchange and not published by the exchange.

   (a) *Practical difficulty:* How would this be cleansed, and would the firm be obliged to go to the other two investor clients to let them know? A public cleansing would not be possible in this case, because such trades would not normally be disclosed to the market unless certain conditions are met, for example if the size of the trade exceeds local large shareholding reporting thresholds. Sell-side brokers are also expected to keep information about the trade non-public post-execution, due to client confidentiality obligations.

8. **Connected Persons:** A client who is a 'connected person' under the SFO approaches a bank indicating an ongoing intention to sell down from their stake in an issuer, however there are no further terms in place. There is no indication as to timing from the individual, the sale/sales may not materialise for an extended period, or there may be a change in intention to sell. Would the expression of interest from the individual be caught as non-public information, and how could investors be cleansed in this scenario?