



**SECURITIES AND
FUTURES COMMISSION**
證券及期貨事務監察委員會

Consultation Paper on the Proposed Guidelines for Market Soundings

October 2023

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Personal Information Collection Statement

1. This Personal Information Collection Statement (PICS) is made in accordance with the guidelines issued by the Privacy Commissioner for Personal Data. The PICS sets out the purposes for which your Personal Data¹ will be used following collection, what you are agreeing to with respect to the SFC's use of your Personal Data and your rights under the Personal Data (Privacy) Ordinance (Cap. 486) (PDPO).

Purpose of collection

2. The Personal Data provided in your submission to the SFC in response to this consultation paper may be used by the SFC for one or more of the following purposes:
 - (a) to administer the relevant provisions² and codes and guidelines published pursuant to the powers vested in the SFC;
 - (b) in performing the SFC's statutory functions under the relevant provisions;
 - (c) for research and statistical purposes; or
 - (d) for other purposes permitted by law.

Transfer of Personal Data

3. Personal Data may be disclosed by the SFC to members of the public in Hong Kong and elsewhere as part of the public consultation on this consultation paper. The names of persons who submit comments on this consultation paper, together with the whole or any part of their submissions, may be disclosed to members of the public. This will be done by publishing this information on the SFC's website and in documents to be published by the SFC during the consultation period or at its conclusion.

Access to data

4. You have the right to request access to and correction of your Personal Data in accordance with the provisions of the PDPO. Your right of access includes the right to obtain a copy of your Personal Data provided in your submission on this consultation paper. The SFC has the right to charge a reasonable fee for processing any data access request.

¹ Personal Data means personal data as defined in the Personal Data (Privacy) Ordinance (Cap. 486).

² The term "relevant provisions" is defined in section 1 of Part 1 of Schedule 1 to the Securities and Futures Ordinance (SFO) (Cap. 571) and refers to the provisions of that Ordinance together with certain provisions in the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32), the Companies Ordinance (Cap. 622) and the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (Cap. 615).

Retention

5. Personal Data provided to the SFC in response to this consultation paper will be retained for such period as may be necessary for the proper discharge of the SFC's functions.

Enquiries

6. Any enquiries regarding the Personal Data provided in your submission on this consultation paper, or requests for access to Personal Data or correction of Personal Data, should be addressed in writing to:

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

7. A copy of the Privacy Policy Statement adopted by the SFC is available upon request.

Introduction

1. Market sounding is an established mechanism widely adopted by market participants to communicate information with potential investors prior to the announcement of a transaction, to gauge their interest in a potential transaction or assist in determining the specifications of a potential transaction, such as its potential size, pricing, structure and selling method. This is typically conducted in connection with capital market transactions such as private placements and large “block trades”. Market soundings can play an important role in the efficient functioning of financial markets and assist in price discovery.
2. In the past years, the SFC has observed an increasing number of cases regarding trading activities ahead of placings and block trades, amongst others. These cases appear to indicate that some intermediaries might have taken advantage of or unfairly exploited information received during market soundings to make unjustified profits whilst the same information was not generally available to the rest of the market.
3. In some cases, the behaviours of the persons involved were contrary to the general principle for intermediaries to conduct their business activities honestly, fairly, and in the best interests of their clients and the integrity of the market³.

Thematic review

4. In light of these observations, the SFC commenced a thematic review of the market sounding practices and controls adopted by intermediaries in Hong Kong in 2022 (Thematic Review) with the assistance of an external consultant. The objective of the Thematic Review is to assess the robustness of related controls established over market sounding activities and consider the need to issue additional guidance to the industry.
5. The Thematic Review covered areas including governance and supervision, controls over disclosure and receipt of inside information⁴ and other non-public information, wall-crossings, prohibitions on trading, and record keeping requirements in connection with market soundings.
6. The Thematic Review was conducted in phases, including engagement with selected intermediaries from both buy side and sell side, through survey requests and focus group discussions to understand the current industry practices and challenges in relation to market soundings, as well as to collate preliminary industry feedback on potential guidance from the SFC.

³ General Principle 1 (Honesty and Fairness) of the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (Code of Conduct).

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

SFC disciplinary action

7. On 29 September 2022, the SFC announced its suspension of a hedge fund manager for two years after the Securities and Futures Appeals Tribunal (SFAT)⁵ upheld the SFC's disciplinary action against him for breaches of the SFC's Code of Conduct (SFAT determination)⁶.
8. The SFC's disciplinary action followed administrative proceedings against the fund manager in South Korea, where the Korean regulatory authorities found that he had breached Korean legislation by dealing in shares based on information obtained during a market sounding call that preceded the public announcement of a block trade. The SFC found that the fund manager's conduct was such that he was not a fit and proper person to continue to be licensed, having regard to General Principles 1 and 7 of the Code of Conduct, and suspended his licence.
9. In its determination, the SFAT made clear that the case was about the substandard conduct of a regulated person:

“The Code of Conduct... seeks to ensure the integrity of all regulated persons and by that means to secure the overall integrity of the securities and futures industry. By definition, integrity requires adherence to ethical principles and to both fair and honest conduct. It is fundamental, therefore, that the SFC is not required to establish that a regulated person is culpable of a specific offence under the [SFO]... it is sufficient if the conduct is such that, having regard to the provisions of the Code of Conduct, the SFC is justified in determining that the regulated person can no longer be trusted (as a fit and proper person) to discharge the responsibilities imposed by the Code of Conduct.”

“In the light of these findings, it is not necessary to determine whether the information given... constituted ‘inside information’ as the term is understood in Hong Kong law. That has never been the issue. The issue has been whether the... conduct breached the Code of Conduct.”

Upholding market integrity

10. Although the recent SFAT determination provided some clarity on the subject matter, the SFC is cognizant that there is currently no specific regulatory requirement covering market soundings in Hong Kong and it may be difficult for market participants to measure their conduct against the general principles in the Code of Conduct.
11. Throughout the Thematic Review, the SFC noted a divergence in practices as intermediaries apply their own interpretations of the conduct requirements in designing their risk controls over market soundings. For example:
 - (a) for market soundings involving inside information, most intermediaries already follow existing practices with policies and procedures established to govern how

⁵ The SFAT is a statutory tribunal established under section 216 of the SFO, to review the SFC's regulatory decisions made under the SFO and hear and determine any questions or issues arising out of or in connection with its reviews. Its statutory purpose is to act as a safeguard to ensure that regulatory decisions made by relevant regulatory authorities including the SFC are reasonable and fair.

⁶ The SFC's announcement on [29 September 2022](#).

inside information should be handled to prevent themselves from falling afoul of market misconduct offences such as insider dealing⁷; whereas

- (b) some intermediaries adopt a broader and more prudent approach by applying their established policies and procedures to cover the handling of all non-public information during market soundings, irrespective of whether it constitutes inside information or not.
12. With the SFAT affirming that it is not necessary to determine whether information given during market soundings constitutes inside information in considering the conduct of an intermediary, and the SFC noting an increasing number of cases concerning behaviours that are below the standards expected of intermediaries, the SFC considers further guidance necessary to strengthen and protect the integrity and soundness of our capital markets and meet the SFC's regulatory objectives⁸.
 13. Given the above, the SFC proposes to introduce a set of specific Guidelines for Market Soundings (Proposed Guidelines) (see Appendix) to provide clarity on our regulatory expectations, deter substandard conduct, ensure a level playing field in the industry and assist intermediaries in upholding market integrity during market soundings.
 14. The Proposed Guidelines reflect existing practices already adopted by most firms in the market regarding the communication of inside information during market soundings, and expand these practices to cover the communication of any non-public information during market soundings, which have already been adopted by some firms in the market.
 15. The SFC invites comments on the Proposed Guidelines from market participants and other interested parties.

⁷ Parts XIII and XIV of the SFO.

⁸ Under section 4 of the SFO, the SFC's regulatory objectives include: (i) to maintain and promote the fairness, efficiency, competitiveness, transparency and orderliness of the securities industry; and (ii) to provide protection for members of the public investing in or holding equities and debt securities.

Proposed Guidelines for Market Soundings

Overall framework

16. The Proposed Guidelines will be issued under section 399 of the SFO to set out the principles and regulatory expectations in relation to market soundings. They aim to provide tailored guidance to assist intermediaries in their compliance with the general principle to conduct their business activities honestly, fairly, and in the best interests of its clients and the integrity of the market⁹ during market soundings.
17. In formulating the Proposed Guidelines, the SFC took into consideration local and overseas market practices and regulatory requirements, as well as information gathered and preliminary feedback received from intermediaries during the Thematic Review.
18. The Proposed Guidelines will apply to all SFC-licensed or registered persons engaging in market soundings. Failure to comply with the Proposed Guidelines may cause the SFC to consider whether such failure adversely reflects on the person's fitness and properness¹⁰ to remain licensed or registered.

Scope of application (*paragraphs 1.2 and 1.3 of the Proposed Guidelines*)

19. During the Thematic Review, the SFC noted that although many intermediaries maintained policies and procedures for market soundings, practices and views on their applicability diverged. For example:
 - (a) some firms applied their policies only when disclosure of inside information is involved, whereas others applied theirs whenever disclosure of any non-public information is involved; and
 - (b) some firms applied their policies only after a client, an issuer or an existing shareholder selling in the secondary market (Market Sounding Beneficiary) formally mandated them to conduct market soundings, whereas others applied theirs if the nature of their communication constituted a market sounding.
20. Despite the divergence in practices, the SFC found that most participants acknowledged that determining what information constituted inside information often involved complex judgement and interpretations. Some participants even pointed out that it was not uncommon for parties involved to arrive at different conclusions.
21. Given the difficulty in determining what constitutes inside information, firms that only apply their policies to inside information may run the risk of potential misconduct from an inaccurate determination. In light of the SFAT determination, the Proposed Guidelines will apply to the communication of any non-public information during market soundings.

⁹ General Principle 1 of the Code of Conduct.

¹⁰ Under section 129 of the SFO, in considering whether a person is a fit and proper person, the SFC shall have regard to the person's (i) ability to carry on the regulated activity competently, honestly, and fairly; and (ii) reputation, character, reliability and financial integrity; amongst others.

22. The SFC also understands it is not uncommon for intermediaries to conduct market soundings before receiving a formal mandate from the Market Sounding Beneficiary given the speed (a matter of hours in some cases) at which deals can be completed. In view of this, the Proposed Guidelines will apply to the communication of any non-public information, and if the nature of the communication constitutes a market sounding (subject to certain carve-outs), irrespective of whether a formal mandate is received.
23. During our focus group discussions, sell-side brokers expressed concerns about the types of conversations to be covered by the scope of the Proposed Guidelines, as the nature of their service involved frequent conversations with investor clients. Many of these conversations were communication of speculative trade ideas put forward solely by sell-side brokers and had not been discussed or pitched with the issuers or secondary sellers yet, or these conversations were simply associated with ordinary day-to-day trade execution that were not generally considered market sounding. In this regard, the SFC proposes to carve out speculative trade ideas or conversations not associated with market soundings from the Proposed Guidelines.
24. Under the Proposed Guidelines, a market sounding is defined as the communication of non-public information, irrespective of whether the information is price-sensitive inside information or not, with potential investors prior to the announcement of a securities¹¹ transaction, to gauge their interest in a potential transaction or assist in determining the specifications of a potential transaction, such as its potential size, pricing, structure and selling method, by a licensed or registered person acting in the following capacity:
- (a) as a person disclosing information during the course of a market sounding (Disclosing Person) (eg, a sell-side broker acting on behalf of a Market Sounding Beneficiary in a possible securities transaction); or
 - (b) as a person receiving information during the course of a market sounding (Recipient Person) (eg, a buy-side firm sounded out by a Disclosing Person as a potential investor in a possible securities transaction)
- (collectively referred to as a “Market Sounding Intermediary”).
25. 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 (eg, in relation to average trading volume or market capitalisation), value, structure or selling method that are commensurate with ordinary day-to-day trade execution (eg, a broker sourcing potential buyers or sellers to execute a trade after receiving an actual order instruction placed by a client with a genuine intent for execution); and
 - (c) public offerings of securities.

¹¹ As defined in Part 1 of Schedule 1 to the SFO.

26. The “level of certainty” of the corresponding potential transaction materialising will be considered when determining whether a Disclosing Person is conducting market soundings on behalf of a Market Sounding Beneficiary. Examples of the factors to consider include the extent to which the Market Sounding Beneficiary has orally or in writing:
- (a) expressed an interest with the Disclosing Person in proceeding with a possible transaction;
 - (b) shared any particulars with the Disclosing Person in relation to the possible transaction (eg, timing, size, pricing or structure); or
 - (c) mandated, requested or consented to the gauging of investor appetite by the Disclosing Person.

Questions:

1. Do you agree with the scope of application of the Proposed Guidelines? If not, please explain.
2. Do you consider the definition of “market soundings” to be clear and appropriate? If not, please explain.
3. Do you have any comments on the examples of factors to consider when determining the level of certainty of the corresponding potential transaction materialising in connection with a market sounding?

Core principles (*section 2 of the Proposed Guidelines*)

27. By nature, market soundings involve communications of information regarding securities transactions that may be confidential and generally unavailable to the rest of the market. An industry norm is that Market Sounding Intermediaries are subject to a duty of care to safeguard the confidentiality of the information entrusted to them and not to abuse it.
28. Through the survey and focus group discussions held as part of the Thematic Review, a regulatory concept was put forward to require Market Sounding Intermediaries to safeguard the confidentiality of, and not to trade on or use, non-public information passed or received during market soundings for their own or others’ benefit or financial advantage until the information ceases to be non-public.
29. Most participants agreed that Market Sounding Intermediaries had a duty to safeguard the confidentiality of non-public information entrusted to them during market soundings. However, opinions were divided when it came to requiring Market Sounding Intermediaries not to trade on or use such non-public information that they came into possession with during market soundings if the information was not price-sensitive inside information.
30. Participants in favour of this requirement reasoned that it would protect the general public, promote a level playing field and enhance market integrity as it was fundamentally inappropriate to trade on information which was not yet available to the rest of the market.

31. Participants against it contended that any restrictions on trading should apply only if the non-public information was price-sensitive and constitutes inside information, in order to align with the insider dealing regime under the SFO. While the participants disapproved of firms trading on non-public information other than inside information, they considered the issue to be one of ethics and morality, rather than one of regulation.
32. However, the SFAT determination affirmed that this is indeed a regulatory issue and that it is not necessary to determine whether information given during market soundings constitutes inside information in considering an intermediary's conduct as the issue at hand is whether the conduct in question is in breach of the Code of Conduct. As discussed in paragraphs 3, 13 and 21, the Proposed Guidelines aim to deter substandard conduct and uphold market integrity as part of intermediaries' obligations under the Code of Conduct. Irrespective of the potential market impact arising from trading on any non-public information, undesirable conduct by intermediaries can affect the fairness and orderliness of our markets and undermine investor confidence in them.
33. The SFC would like to emphasise that the proposal to restrict trading on non-public information passed or received during market soundings is not intended to restrict intermediaries' legitimate hedging or proprietary trading activities. Intermediaries can still engage in these activities as long as effective information barrier controls are in place to prevent any leakage of information and these activities are not conducted based on information passed or received during market soundings.
34. Based on the survey responses and focus group discussions held during the Thematic Review, the SFC understands the existing controls and practices of Market Sounding Intermediaries vary. Key highlights and contrasts are as follows:
 - (a) Most participants designated a specific committee or person(s) with the overall responsibility for overseeing market soundings;
 - (b) Most Disclosing Person participants maintained formal policies, procedures and controls in relation to market soundings, including information barrier controls to prevent inappropriate disclosures of non-public information. However, these were relatively less formalised for Recipient Person participants;
 - (c) Some participants reported that only inside information was subject to their established policies and procedures on market soundings, including corresponding restrictions on trading, while other participants reported that both inside information and other non-public information were subject to these established policies and procedures; and
 - (d) For Disclosing Person participants, a majority of their market soundings were carried out through recorded communication channels (eg, telephone, e-mail or chatrooms). For Recipient Person participants, most of their market soundings were received through similar recorded channels, while some were received through unrecorded channels.
35. Against this background, the SFC proposes to introduce a common set of Core Principles which all Market Sounding Intermediaries should comply with in conducting market soundings.

Core Principle 1 – Market integrity

36. A Market Sounding Intermediary should maintain the strictures of confidentiality and not trade on or use any non-public information passed or received during market soundings for its own or others' benefit or financial advantage until the information ceases to be non-public.

Questions:

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

Core Principle 2 – Governance

37. A Market Sounding Intermediary should have robust governance and oversight arrangements over its market sounding activities. This would include designating a committee or person(s) sufficiently independent from the "front-office" to monitor market soundings in support of senior management's oversight.

Core Principle 3 – Policies and procedures

38. A Market Sounding Intermediary should establish and maintain effective policies and procedures specifying the manner and expectations in which its market soundings should be conducted. This would include its prescribed procedures of market soundings, allocation of roles and responsibilities, and restrictions to prevent the firm and its staff from misusing non-public information associated with its market soundings.

Core Principle 4 – Information barrier controls

39. A Market Sounding Intermediary should implement adequate and effective physical and electronic information barrier controls to prevent the inappropriate disclosure, misuse and leakage of non-public information during the course of market soundings. This would include information sharing principles for staff and keeping track of individuals who have received non-public information as a result of market soundings.

Core Principle 5 – Review and monitoring controls

40. A Market Sounding Intermediary should establish effective procedures and controls to monitor and detect suspicious or inappropriate behaviours or unauthorised disclosure or misuse of information related to market soundings. This would include periodic trade and communication surveillance controls.

Core Principle 6 – Authorised communication channels

41. A Market Sounding Intermediary should only use recorded communication channels that were authorised by senior management or independent functions to conduct market soundings.

Questions:

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

Specific requirements for Disclosing Persons

42. As the party that proactively initiates a market sounding, the initial responsibility lies with a Disclosing Person to ensure any associated non-public information is properly safeguarded and disclosed during its market sounding process in accordance with expected standards of conduct.
43. Based on the survey responses and focus group discussions during the Thematic Review, the SFC understands the existing controls and practices of Disclosing Persons vary. Key highlights and contrasts are as follows:
- (a) Most Disclosing Person participants assessed if the information to be disclosed by them constituted inside information. However, some participants pointed out that subjective judgement and interpretations might be required when determining what was inside information and it was not uncommon for parties involved to arrive at different conclusions.
 - (b) Some Disclosing Person participants sought consent from the Market Sounding Beneficiary to commence market soundings, while others did not.
 - (c) All participants reported that certain information must be provided during initial conversations to allow recipients to decide whether or not to consent to receiving non-public information and subjecting themselves to associated restrictions on trading. In this regard, most Disclosing Person participants considered it a common practice to adopt a “leaf in a forest approach” during initial conversations prior to receiving the said consent, where information was disclosed on a “no-name” basis and broad enough to avoid the name of the subject security to be identified or deduced. However, there were instances where some Recipient Person participants had been told the name of the subject security during these initial conversations;
 - (d) All Disclosing Person participants reported the use of standardised scripts to carry out their market soundings; and
 - (e) All Disclosing Person participants had record keeping policies and procedures regarding market soundings, most of which were maintained for five years or more.

44. In view of this, the SFC proposes to introduce a common set of specific requirements for Disclosing Persons as guidance for how market soundings should be carried out.

Pre-sounding procedures (paragraph 3.1 of the Proposed Guidelines)

45. Before initial contact with Recipient Persons or other potential investors, a Disclosing Person should:
- (a) conduct assessments and determine whether the information to be disclosed during market soundings would constitute non-public information;
 - (b) obtain consent from the Market Sounding Beneficiary to engage in market soundings regarding their possible transaction; and
 - (c) determine a standard set of information to be disclosed to all Recipient Persons or other potential investors, an appropriate timing to conduct market soundings and a suitable number of Recipient Persons or other potential investors to contact for each market sounding.

Standardised script (paragraph 3.2 of the Proposed Guidelines)

46. A Disclosing Person should adopt the use of a pre-approved standardised script during all market sounding communications. At a minimum, the script should include and follow the sequence of information set out in the Proposed Guidelines. This would include, for example:
- (a) a statement that the communication is for the purpose of a market sounding and that the Recipient Person or other potential investor is obliged to keep confidential any non-public information disclosed and not to trade on or use the information received for its own or others' benefit or financial advantage until the information ceases to be non-public; and
 - (b) a request for the Recipient Person's or other potential investor's consent to receive non-public information – any preliminary information provided prior to receiving the said consent should be sufficiently broad, limited, vague and anonymised to minimise the chance for the Recipient Person to be able to guess or avoid revealing the name of the subject security.

Cleansing (paragraph 3.3 of the Proposed Guidelines)

47. A Disclosing Person should conduct assessments to determine if the information disclosed during market soundings has ceased to be non-public and inform the Recipient Persons or other potential investors accordingly as soon as possible.

Record keeping (paragraph 3.4 of the Proposed Guidelines)

48. A Disclosing Person should keep records in relation to its market soundings for a period of not less than seven years. This would include audio, video or text recordings of market soundings conducted, details of persons sounded, information and materials disclosed and all relevant consents obtained.

Questions:

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

Specific requirements for Recipient Persons

49. As a party that receives market soundings, a Recipient Person also has the responsibility to ensure any associated non-public information that comes into its possession during market soundings is properly safeguarded in accordance with expected standards of conduct.
50. Based on the survey responses and focus group discussions during the Thematic Review, the SFC understands the existing controls and practices of Recipient Persons vary. Key highlights and contrasts are as follows:
 - (a) Most Recipient Person participants have designated a specific person(s) to receive market soundings; and
 - (b) Most Recipient Person participants have record keeping policies and procedures regarding market soundings, most of which are maintained for five years or more.
51. In view of this, the SFC proposes to introduce a common set of specific requirements for Recipient Persons as guidance for how market soundings requests should be handled.

Handling of market sounding requests (*paragraph 4.1 of the Proposed Guidelines*)

52. A Recipient Person should designate a specified person(s), who is properly trained for that purpose, to receive market soundings and, upon being contacted, inform Disclosing Persons whether it wishes to, or not to, receive market soundings.

Record keeping (*paragraph 4.2 of the Proposed Guidelines*)

53. A Recipient Person should keep records in relation to market soundings for a period of not less than seven years. This would include audio, video or text recordings of

market soundings received, details of persons sounded and information and materials received.

Questions:

13. Do you agree that a Recipient Person should designate a properly trained person(s) to receive market soundings? If not, please explain.
14. Do you agree with the proposed periods of record keeping and details of the records to be kept by Recipient Persons? If not, please explain.

International comparison

54. As part of our process to develop guidance for the industry, the SFC often undertakes international comparisons to study how other major international financial centres tackle regulatory issues of concern. This provides us with useful information when proposing guidance tailored to the features of the Hong Kong market. However, direct comparisons between jurisdictions are bound to have inherent limitations as each jurisdiction has its own unique legislative framework and scoping, legal definitions and market characteristics. For example, the definitions of “insider dealing” differ from one jurisdiction to another.

In Hong Kong,

Sections 270 and 291 of the SFO set out that insider dealing in relation to a listed corporation takes place, amongst others, when a person who has information which he knows is inside information and which he receives, directly or indirectly, from a person who he knows is connected with the corporation and whom he knows or has reasonable cause to believe held the information as a result of being connected with the corporation, deals in or counsels or procures another person to deal in the listed securities of the corporation, its derivatives, or those of a related corporation.

Sections 247 and 287 of the SFO set out that a person shall be regarded as connected with a corporation if he is a director, employee or a substantial shareholder of the corporation or a related corporation, occupies a position which may reasonably be expected to give him access to inside information, has access to inside information by reason of his connection with another corporation if the information relates to a transaction, or was at any time within the six months preceding any dealing, a person who would be regarded as connected with the corporation.

Sections 245 and 285 of the SFO set out that inside information means specific information that is about the corporation, a shareholder or officer of the corporation or the listed securities of the corporation or their derivatives, and is not generally known to the persons who are accustomed or would be likely to deal in the listed securities of the corporation but would if generally known to them be likely to materially affect the price of the listed securities.

55. In developing the Proposed Guidelines, we have considered the regulatory approaches adopted by other major jurisdictions. A summary of their regulatory approaches is set out below.

(a) European Union (EU)

Article 8 of the Market Abuse Regulation¹² sets out that insider dealing arises where a person possesses inside information and uses that information by acquiring or disposing of, or cancelling or amending an order of, for its own account or for the account of a third party, directly or indirectly, or recommending or inducing another person to acquire or dispose of, or amend or cancel an order of, financial instruments to which that information relates.

¹² Regulation (EU) No 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse (Market Abuse Regulation).

Article 8 of the Market Abuse Regulation applies to any person who possesses inside information as a result of, amongst others, being a member of the administrative, management or supervisory bodies of the issuer, having a holding in the capital of the issuer, having access to the information through the exercise of an employment, profession or duties, or other circumstances where the person knows or ought to know that it is inside information.

Article 7 of the Market Abuse Regulation sets out that inside information shall comprise, amongst others, information of a precise nature, which has not been made public, relating, directly or indirectly, to one or more issuers or to one or more financial instruments, and which, if it were made public, would be likely to have a significant effect on the prices of those financial instruments or on the price of related derivative financial instruments – which shall mean information a reasonable investor would be likely to use as part of the basis of his or her investment decisions.

Article 11 of the Market Abuse Regulation and its supplementary provisions¹³ and guidelines¹⁴ (collectively, the “EU MAR”) set out specific regulatory requirements on market soundings. The EU MAR prescribed requirements on, amongst others:

- establishing internal procedures relating to market soundings and disclosure of information;
- assessing whether inside information is involved;
- determining a standard set of information to be disclosed to all recipients;
- following a script with a prescribed sequence, which includes obtaining the recipients’ consents to receive information that may or may not be inside information, and informing recipients of their obligation to keep inside information confidential and not to trade on the basis of it;
- cleansing of inside information; and
- keeping of corresponding records (eg, list and details of all persons who received information in the course of market soundings, and recordings or minutes of market sounding communications) for at least five years.

(b) United Kingdom (UK)

The EU MAR has been “onshored” into UK law (UK MAR)¹⁵ with effect from 1 January 2021 upon the expiry of the Brexit transition period. The UK MAR is largely the same as that of the EU MAR, except for certain technical changes.

¹³ Including (i) Commission Delegated Regulation (EU) 2016/960 of 17 May 2016 supplementing Regulation (EU) No 596/2014; and (ii) Commission Implementing Regulation (EU) 2016/959 of 17 May 2016.

¹⁴ MAR Guidelines - Persons receiving market soundings published by the European Securities Markets Authority on 10 November 2016.

¹⁵ Through the European Union (Withdrawal) Act 2018 (as amended), as supplemented by The Market Abuse (Amendment) (EU Exit) Regulations (SI 2019/310).

(c) Australia

Section 1043A of the Corporations Act 2001 defines insider trading as prohibited conduct. It states that if a person possesses inside information and knows, or ought reasonably to know, that the information is inside information, they must not (whether as principal or agent) apply for, acquire, or dispose of related financial products or enter into an agreement to do so, procure another person to do these actions, or directly or indirectly, communicate the information to another person they know or ought reasonably to know would or would be likely to do these actions.

Section 1042A of the Corporations Act 2001 sets out that inside information means information that is not generally available, and if the information were generally available, a reasonable person would expect it to have a material effect on the price or value of related financial products — which shall mean that the information would, or would be likely to, influence persons who commonly acquire the related financial products in deciding whether or not to acquire or dispose of the financial products.

The Australian Financial Markets Association (AFMA) has published specific guidelines for handling market soundings related to Equity Capital Markets¹⁶ and Debt Capital Markets¹⁷ (collectively, the “AFMA Guidelines”). The AFMA Guidelines prescribed requirements on, amongst others:

- establishing internal procedures relating to market soundings and handling of confidential and potentially price-sensitive information;
- obtaining client’s approval before conducting market soundings;
- conducting market soundings as close as reasonably practicable to the proposed time of launch of the transaction, outside of trading hours, and with as few recipients as reasonably necessary;
- following a script to cover key points, which include obtaining the recipients’ consents to receive confidential information and to keep the information confidential and, where information is potentially price-sensitive, reminding recipients of their obligation to comply with applicable insider trading laws; and
- keeping of corresponding records regarding the above for market soundings conducted.

56. Certain aspects of our Proposed Guidelines may differ from the regulatory approaches adopted by other jurisdictions. A summary of these differences are set out below.

- (a) Both the EU MAR and the AFMA Guidelines contain provisions to remind recipients of their obligations to comply with applicable insider trading laws and

¹⁶ Equity Capital Market Guidelines for Handling Confidential Information & Soundings published by AFMA in March 2016.

¹⁷ Handling Inside Information & Market Soundings Guidelines for Institutional Debt Capital Markets published by AFMA in November 2016.

not to trade on inside information received during market soundings. In this regard, there are inherent limitations to direct comparisons between jurisdictions because of jurisdictional differences. For example, the same set of circumstances may constitute insider dealing in one jurisdiction but not in another.

Furthermore, the SFAT has now affirmed that it is not necessary to determine whether information given during market soundings constitutes inside information in considering an intermediary's conduct and that the issue at hand is whether the conduct in question is in breach of the Code of Conduct, for instance, the abuse of non-public information an intermediary is entrusted with during market soundings. For that reason, the Proposed Guidelines will set out a core principle that 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.

- (b) Under the EU MAR, communications of all information, including public information, are in-scope. The SFC proposes that only communications of non-public information are in-scope under the Proposed Guidelines.
- (c) The EU MAR allows market soundings to be conducted through unrecorded channels (eg, unrecorded telephone lines or face-to-face meetings). Where unrecorded channels are used, minutes must be prepared by the discloser and agreed with (and signed by) the recipient within five business days. If an agreement is not reached, the recipient should provide its own version of those minutes to the discloser for record keeping. In light of current communications technology and to avoid over-burdening Market Sounding Intermediaries with requirements to agree on and sign off minutes with multiple external parties, the SFC proposes all market soundings to be conducted and received on authorised and recorded communication channels.

Implementation timeline

57. The proposals set out in this paper will be subject to a two-month public consultation. Taking into account the respondents' comments, a consultation conclusions paper will be issued together with the final Proposed Guidelines, which will become effective upon gazettal.
58. The SFC understands that the industry may need to update their internal procedures and controls after the Proposed Guidelines are finalised. We propose to provide a six-month transition period for the industry to ensure compliance after the gazettal of the above.

Questions:

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

Seeking comments

59. The SFC welcomes any comments from the public and the industry on the proposals made in this paper and the indicative draft of the Proposed Guidelines for Market Soundings set out in the Appendix. Please submit your comments to the SFC in writing no later than 11 December 2023.

Proposed draft of the Guidelines for Market Soundings

1. Introduction

- 1.1. These Guidelines are published by the Securities and Futures Commission (SFC) under section 399 of the Securities and Futures Ordinance (SFO) to set out the principles and regulatory expectations in relation to market soundings. These Guidelines provide guidance to licensed or registered persons in their compliance with the general principle to conduct their business activities honestly, fairly, and in the best interests of its clients and the integrity of the market¹⁸ during market soundings.
- 1.2. These Guidelines apply to the communication of non-public information, irrespective of whether this is price-sensitive inside information¹⁹ or not, with potential investors prior to the announcement of a securities²⁰ transaction, to gauge their interest in a potential transaction or assist in determining the specifications related to a potential transaction²¹, such as its potential size, pricing, structure and selling method (referred to in these Guidelines as “market sounding(s)”), by a licensed or registered person acting in the following capacity:
- (a) as a person disclosing information during the course of a market sounding (Disclosing Person) (eg, this is generally a sell-side broker acting on behalf of a client, an issuer or an existing shareholder selling in the secondary market (Market Sounding Beneficiary) in a possible securities transaction); or

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

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

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

¹⁸ General Principle 1 of the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (Code of Conduct).

¹⁹ As defined in sections 245 and 285 of the SFO.

²⁰ As defined in Part 1 of Schedule 1 to the SFO.

²¹ Market soundings are typically conducted in connection with capital market transactions, such as private placements and large “block trades”.

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

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

1.3. These Guidelines do not apply to communications regarding:

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

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

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

- (c) public offerings of securities.

1.4. Unless specified otherwise:

- (a) the provisions in these Guidelines apply to both Disclosing Persons and Recipient Persons; and
- (b) terms used in these Guidelines bear the same meaning as defined in the SFO.

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

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

- (a) shall not by itself render it liable to any judicial or other proceedings, but in any proceedings under the SFO before any court, these Guidelines may be admissible in evidence, and if any provision set out in these Guidelines appears to the court to be relevant to any question arising in the proceedings, it may be taken into account in determining the question; and
- (b) may cause the SFC to consider whether such failure adversely reflects on the person’s fitness and propriety²² to remain licensed or registered.

²² Under section 129 of the SFO, in considering whether a person is a fit and proper person, the SFC shall have regard to the person’s (i) ability to carry on the regulated activity competently, honestly, and fairly; and (ii) reputation, character, reliability and financial integrity; amongst others.

2. Core principles

CP1. Market integrity

A Market Sounding Intermediary should maintain the strictures of confidentiality and not trade on or use any non-public information passed or received during market soundings for its own or others' benefit or financial advantage until the information ceases to be non-public.

CP2. Governance

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

- (a) senior management assuming overall responsibility for the oversight of market soundings and their related risks and outcomes;
- (b) establishing appropriate governance arrangements for market soundings, which are commensurate with the size and complexity of the Market Sounding Intermediary's business;
- (c) designating a committee or person(s), with roles, responsibilities and reporting lines clearly defined, to monitor market soundings in support of senior management's oversight. Such a committee or person(s) should be properly trained for this purpose and sufficiently independent from the "front-office"; and
- (d) developing and implementing appropriate managerial and supervisory processes, procedures and control measures to ensure that matters related to market soundings are promptly brought to the attention of senior management and designated committee or person(s) for review and follow-up actions to be taken, where necessary.

CP3. Policies and procedures

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

- (a) market sounding policies, specifying circumstances when they become applicable as well as the timing and prescribed procedures of market soundings;
- (b) allocation of roles and responsibilities among staff involved in market soundings, including senior management, in the context of its "three lines of defence", and ensuring they are properly trained for this purpose;
- (c) firm and staff personal dealing policies and procedures and restrictions to prevent the firm and its staff from trading on or misusing non-public information they become aware of in their professional capacity during market soundings for their own or other's benefit or financial advantage;

- (d) circumstances and protocols for escalation of matters regarding market soundings to senior management or independent functions, such as Legal and Compliance;
- (e) consequence management framework, with appropriate sanctions or disciplinary measures imposed for non-compliance with market sounding requirements;
- (f) policies and procedures to define, categorise, identify and handle different types of information gathered during the course of market soundings (eg, non-public information); and
- (g) record keeping requirements governing market soundings.

CP4. Information barrier controls

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

- (a) physical segregation between staff on the public and private sides;
- (b) system user access controls (eg, segregation of access rights between staff on the public and private sides in compliance with the “need-to-know” principle);
- (c) information sharing policies and procedures describing the information sharing principles to be followed by staff (eg, market sounding information should be restricted to authorised personnel on a “need-to-know” basis and disclosed only through authorised communication channels); and
- (d) developing and maintaining a list of internal and external individuals who possess non-public information as a result of market soundings as well as a “Restricted List” to prohibit the trading on non-public information received during market soundings. These lists should be updated promptly when changes occur.

CP5. Review and monitoring controls

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

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

CP6. Authorised communication channels

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

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

3. Specific requirements for Disclosing Persons

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

3.1. Pre-sounding procedures

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

- (a) conduct assessments, subject to appropriate review by senior management or independent functions such as Legal and Compliance, on information to be disclosed during different stages of market soundings and determine whether the information would constitute non-public information;
- (b) obtain consent from the corresponding Market Sounding Beneficiary to engage in market soundings regarding their possible transaction; and
- (c) determine in advance, on a case-by-case basis:
 - (i) a standard set of information to be disclosed to Recipient Persons or other potential investors in each market sounding and disclose the same standard set of information with all Recipient Persons or other potential investors throughout that market sounding;
 - (ii) an appropriate timing to conduct market soundings (eg, as close as reasonably practicable to the time of launch of the proposed transaction, and where reasonably practicable, outside of the trading hours during which the securities associated with the market sounding may be traded); and
 - (iii) a suitable number of Recipient Persons or other potential investors to contact, such that its market soundings are limited to as few Recipient Persons or other potential investors as it deems reasonably necessary for the purpose of gauging their interests and specifications on the proposed transaction.

3.2. Standardised script

A Disclosing Person should adopt the use of a standardised script pre-approved and regularly reviewed by senior management or independent functions, such as Legal and Compliance, during initial and subsequent market sounding communications. Where

the standardised script is modified to tailor for a specific transaction, an appropriate approval should be obtained.

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

- (a) A statement that the communication is for the purpose of a market sounding and that the Recipient Person or other potential investor is obliged to keep confidential any non-public information disclosed and not to trade on or use the information received for its own or others' benefit or financial advantage until the information ceases to be non-public;
- (b) A statement that the conversation is being recorded and a request for the Recipient Person's or other potential investor's consent* for recording the conversation;
- (c) Confirmation that the individual is the person designated to receive market soundings;
- (d) A statement that the Recipient Person or potential investor will receive information which the Disclosing Person considers to be non-public and a request for their consent* to receive the non-public information; and

Note: A Disclosing Person should ensure any preliminary information provided prior to receiving the said consent from the Recipient Person or other potential investor (eg, preliminary information to allow them to assess and determine if they wish to provide such a consent) is sufficiently broad, limited, vague and anonymised to minimise the chance for the Recipient Person or other potential investor to guess or avoid revealing the name of the subject security to the Recipient Person or other potential investor. Care should be taken in determining the amount of information to be provided where the subject security may be identified even with the provision of only limited information (eg, for narrow industry sectors).

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

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

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

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

3.3. Cleansing

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

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

3.4. Record keeping

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

- (a) consent obtained from the corresponding Market Sounding Beneficiary to engage in market soundings regarding the possible transaction;
- (b) a list of Recipient Persons or other potential investors who have informed the Disclosing Person that they do not wish to receive any market soundings;
- (c) audio, video or text recordings of market soundings conducted;
- (d) its assessment considerations, rationales, discussions with the Market Sounding Beneficiary (if any), and conclusions of whether:
 - (i) the information to be disclosed by it during market soundings would constitute non-public information; and
 - (ii) any non-public information disclosed during market soundings has ceased to be non-public;
- (e) a list of all internal and external person(s) (including legal and natural persons) who possess non-public information as a result of market soundings by the Disclosing Person, including details on the date and time of sounding, name and contact details of persons sounded, information and materials disclosed and all relevant consents obtained; and
- (f) notifications to inform Recipient Persons or other potential investors when information ceases to be non-public.

4. Specific requirements for Recipient Persons

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

4.1. Handling of market sounding requests

A Recipient Person should:

- (a) designate a specified person(s) who is properly trained for that purpose to receive market soundings, and inform Disclosing Persons of such arrangement upon being contacted by Disclosing Persons for the purpose of market soundings; and
- (b) inform Disclosing Persons whether it wishes to, or not to, receive market soundings in relation to either all potential transactions or particular types of potential transactions from the Disclosing Persons.

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.