The Hong Kong Chartered Governance Institute

Submission

The Securities and Futures Commission (SFC)

Consultation Paper on
The Proposed Guidelines for Market Soundings

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By email: marketsounding_consultation@sfc.hk

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

Dear Sirs,

Consultation Paper on the Proposed Guidelines for Market Soundings

[Unless the context requires otherwise, the terms and expressions used in this submission shall have the meanings set out under the Consultation Paper.]

About HKCGI

The Hong Kong Chartered Governance Institute (HKCGI), formerly known as The Hong Kong Institute of Chartered Secretaries, is the only qualifying institution in Hong Kong and the Mainland of China for the internationally recognised Chartered Secretary and Chartered Governance Professional qualifications.

With over 70 years of history and as the Hong Kong/China Division of The Chartered Governance Institute (CGI), the Institute's reach and professional recognition extend to all of CGI's nine divisions, with about 40,000 members and students worldwide. The Institute is one of the fastest growing divisions of CGI, with a current membership of over 7,000, 300 graduates and 2,600 students with significant representations within listed companies and other cross industry governance functions.

Believing that better governance leads to a better future, HKCGI's mission is to promote good governance in an increasingly complex world and to advance leadership in the effective governance and efficient administration of commerce, industry and public affairs. As recognised thought leaders in our field, the Institute educates and advocates for the highest standards in governance and promotes an expansive approach which takes account of the interests of all stakeholders.

Overall Support

We support, in general, the SFC's consultation proposals on market sounding. Market sounding is an established mechanism by market participants to communicate pre-transactional information with potential investors to gauge their interests, typically for private placement and larger block trades. There is the potential for misuse of the information by intermediaries, as demonstrated in the Securities and Futures Appeals Tribunal (SFAT) case referred to under the

Consultation Paper, from non-public information, whether amounting to inside information or not. From the governance perspective, it is necessary to address this issue for market integrity and to ensure consistency. The Thematic Review has noted that intermediaries adopt their interpretations and requirements in designing and managing the risk controls over market soundings. The Proposed Guidelines are an appropriate approach to clarify the SFC's regulatory expectations, deter substandard conduct, ensure a level playing field in the industry and assist intermediaries in upholding market integrity during market soundings.

From the applied governance perspective, we agree that a Market Sounding Intermediary should have robust governance and oversight arrangements 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.

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

We agree. There is potential for non-public information to be misused. The Proposed Guidelines, by their nature, will have areas open for interpretation, and from the applied governance perspective, intermediaries and the buy and sell sides should be provided with more guidance, FAQs, and examples to clarify the scope of the regulatory framework, where appropriate.

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

The definition is a reasonable attempt to define the term, which, by nature of the subject matter, cannot be precisely defined, including for matters such as 'speculative transactions', 'trade ideas', 'level of certainty', etc. Again, we suggest more practical guidance and FAQs with examples to clarify the regulatory framework.

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?

It would be useful to clarify the considerations to apply where the Market Sounding Intermediary sounds a speculative idea and, after that, obtains the mandate from the Market Sounding Beneficiary as to when the speculative idea becomes market sounding and the corresponding obligations to update the speculative idea, if any.

Question 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.

We agree that a Market Sounding Intermediary has a clear duty to safeguard the confidentiality of non-public information shared or received during market soundings. This agreement stems from the core principles outlined in the Proposed Guidelines, particularly Core Principle 1, which emphasises the need to maintain strict confidentiality and not use such information for personal or others' benefit until it ceases to be non-public. This duty of confidentiality aligns with the industry norm and ensures trust and integrity within financial markets. Without such safeguards, there's a risk of information leakage, potentially leading to market abuse and eroding market trust.

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.

In line with the Code of Conduct, a Market Sounding Intermediary should refrain from trading on or using any non-public information obtained during market soundings for their benefit or financial advantage. The Proposed Guidelines, particularly Core Principle 1, underscore the importance of maintaining confidentiality and not trading on non-public information until it ceases to be non-public.

This stance is crucial to preserve market integrity and fairness. While some participants argued for restrictions on trading only in the case of price-sensitive inside information, the determination by the SFAT affirmed wider regulatory concerns. The focus should be on whether the conduct is in breach of the Code of Conduct, as undesirable conduct by intermediaries can harm the fairness and orderliness of markets and undermine investor confidence.

Furthermore, the proposal does not intend to limit intermediaries' legitimate hedging or proprietary trading activities, provided that effective information barriers are in place to prevent any information leakage and that such activities are not based on information acquired during market soundings. In this context, the proposal balances maintaining confidentiality and allowing legitimate trading activities.

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

We appreciate the contents of the Core Principles in the Proposed Guidelines. They provide a strong foundation for governing market soundings, emphasising robust governance, policies and procedures, information barrier controls, review and monitoring controls, and authorised communication channels. These principles align well with upholding market integrity and fairness.

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

There can be encouragement of Market Sounding Intermediaries to educate their clients about market-sounding processes and their rights and responsibilities, which can improve transparency and promote client trust.

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

We support the proposal for Disclosing Persons to adopt the use of a standardised script. The analysis highlights the varied practices among Disclosing Persons, including subjective judgements about what constitutes inside information and differences in consent-seeking procedures. A standardised script provides a clear and consistent framework for market-sounding communications. This ensures that essential information is consistently conveyed and enhances transparency and fairness. It significantly reduces the chances of discrepancies and misinterpretations, aligning with the broader objective of maintaining market integrity and protecting confidentiality.

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

The minimum content and sequence of information in the standardised script appear comprehensive and aligned with best practices in market soundings. The script appropriately emphasises the need for confidentiality, consent, and limiting the disclosure of specific security names during initial conversations.

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.

We 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 their consent. This practice aligns with the "leaf in a forest approach" described in the analysis, where information is disclosed on a "no-name" basis during initial conversations. This approach ensures that the confidentiality of the subject security is preserved until the Recipient Person or potential investor explicitly consents to receiving the non-public information. It is a fundamental step in safeguarding market integrity and fairness, preventing unintentional information leakage.

Question 11: Do you agree that Disclosing Persons should determine if non-public information they disclosed during market soundings has been cleansed? If not, please explain.

We agree that Disclosing Persons should have an obligation to determine if non-public information disclosed during market soundings has been cleansed. Cleansing non-public information is crucial to ensure it ceases to be non-public and can be disseminated without violating confidentiality. By requiring Disclosing Persons to conduct assessments and inform Recipient Persons or potential investors about the status of the information, the proposed guidelines enhance transparency and maintain market integrity. This obligation is essential to prevent the misuse or unauthorised disclosure of information and fosters trust in market soundings.

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.

We agree with the proposed periods of record keeping and the details of the records to be kept by Disclosing Persons. As recommended in the proposed guidelines, maintaining records for a period of not less than seven years ensures a comprehensive historical record of market-sounding activities. This is critical for transparency, accountability, and regulatory compliance. Including audio, video, or text recordings of market soundings, details of persons sounded, information and materials disclosed, and consent records is essential for thorough record-keeping. This practice helps protect against potential disputes or investigations, contributes to regulatory oversight, and ultimately strengthens the integrity of market soundings.

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

We agree that a Recipient Person should designate a properly trained person(s) to receive market soundings. This practice aligns with the best standards and the responsible handling of non-public information. Designating a trained individual ensures that the recipient fully comprehends the significance of market soundings, the need for confidentiality, and the associated obligations. Proper training helps the designated person(s) effectively assess the implications of receiving non-public information and make informed decisions. It is a proactive step to safeguard against potential mishandling of sensitive data and ensures that market soundings are conducted responsibly and ethically.

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.

We agree with the proposed periods of record keeping and the details of the records to be kept by Recipient Persons. Maintaining records for a period of not less than seven years is essential for transparency, accountability, and regulatory compliance. It ensures a comprehensive historical record of market-sounding requests and any non-public information received. Including audio, video, or text recordings of market soundings, details of persons sounded, and information and materials received is crucial for thorough record-keeping. These records are valuable for audits, compliance checks, and dispute resolution. They contribute to maintaining market integrity and instil confidence in the responsible handling of market soundings.

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.

We have no issue with the transition period of six months or otherwise gauged by the SFC from market consensus.

If there are any questions, please feel free to reach out to Ellie Pang FCG HKFCG(PE), Chief Executive, HKCGI or Mohan Datwani FCG HKFCG(PE), Deputy Chief Executive, HKCGI at 2881 6177 or research@hkcgi.org.hk.

Yours sincerely,
For and on behalf of
The Hong Kong Chartered Governance Institute

Ernest Lee FCG HKFCG(PE)
President