Hong Kong SFC's Guidelines for Market Soundings to take effect on 2 May 2025

The Securities and Futures Commission (**SFC**) has published the Guidelines for Market Soundings **(Hong Kong Market Sounding Guidelines**) which will take effect on 2 May 2025, six months after their gazettal on 1 November 2024. SFC-licensed and registered intermediaries that conduct market soundings need to ensure that they comply with the Hong Kong Market Sounding Guidelines' requirements by that date. The SFC has also published Frequently Asked Questions on Guidelines for Market Soundings containing practical guidance and examples. This follows the publication of the SFC's Consultation Conclusions on the Proposed Market Guidelines for Market Soundings on 31 October 2024. For a summary of the SFC's original consultation proposals set out in its October 2023 Consultation Paper,[1] please see Charltons' November 2023 Newsletter.

While respondents to the consultation generally supported the setting of standards for market soundings, many objected to their proposed scope, in particular their proposed application to the disclosure of any non-public information during the course of market sounding, subject to various carve-outs. The final version of the Hong Kong Market Sounding Guidelines has scaled back many of the SFC's original proposals, including restricting their scope to confidential information disclosed during the course of market soundings.

The following provides a summary of the key provisions of the Hong Kong Market Sounding Guidelines.

Hong Kong Market Sounding Guidelines: Scope of Application

The Hong Kong Market Sounding Guidelines will apply to SFC-licensed or registered persons who disclose or receive "Market Sounding Information" in the course of a "Market Sounding" conducted in connection with a possible transaction in:

(i) shares that are listed on a stock exchange (whether in Hong Kong or elsewhere[2]); and

(ii) any other securities (as defined in Part 1 of Schedule 1 to the Securities and Futures Ordinance) which is likely to have a material effect on the price of shares that are listed on a stock exchange (whether in Hong Kong or elsewhere).

1 SFC. Consultation Paper on the Proposed Guidelines for Market Soundings. October 2023
2 See the response to Question 3 of the SFC's Frequently Asked Questions on Guidelines for Market Soundings ("Market Sounding FAQs") and paragraph 51 of the Consultation Conclusions on the Proposed Guidelines for Market Soundings

SFC-licensed or registered persons who disclose or receive Market Sounding Information in these circumstances are defined as "Disclosing Persons" and "Recipient Persons", which are referred to collectively as "Market Sounding Intermediaries".

"Market Sounding Information" is defined as confidential information that is entrusted to an SFC-licensed or registered person by its client, an issuer, or an existing shareholder selling or buying in the secondary market (a "**Market Sounding Beneficiary**"). Confidential information will be "entrusted" to an SFC-licensed or registered person where that person owes a duty of confidentiality to the provider of the information. The following are non-exhaustive examples of Market Sounding Information:

- the name of the relevant security or specific information that would enable its name to be deduced;
- the Market Sounding Beneficiary's identity;
- the Market Sounding Beneficiary's intention to undertake a possible transaction; and
- the terms or details of the possible transaction, for example its potential size, timing, pricing structure or trading method.

Market Sounding Information does not include routine conversations between SFC-licensed or registered persons and investors that are not connected with market soundings, such as:

- generic discussions about public information, market trends and sentiments, or other anecdotal or unverified information; and
- trade ideas put forward by a sell-side broker or reverse enquiries from a buy-side firm or investor without any indication (such as an acknowledgement, consent, confirmation or mandate) from a Market Sounding Beneficiary that they want to engage potential investors for feedback on a possible transaction.[3]

"Market Sounding" is defined as the communication of information with potential investors, prior to the announcement (if any) of a transaction, to gauge their interest in a possible transaction and assist in determining the terms and specifications related to it, such as its potential timing, size, pricing, structure and trading method.

The Hong Kong Market Sounding Guidelines set out four Core Principles that both Disclosing Persons and Recipient Persons are required to observe and additional obligations that apply separately to Disclosing Persons and Recipient Persons.

Hong Kong Market Sounding Guidelines - The Core Principles

Core Principle 1 – Handling of Information

A Market Sounding Intermediary will be required to protect and safeguard the confidentiality of Market Sounding Information, and ensure that it has in place an effective system of barriers to prevent inappropriate disclosures, leakage and misuse of this information. To this end, Market Sound Intermediaries should implement and maintain, among other measures:

- appropriate standards of conduct for staff handling Market Sounding Information, which should reflect the requirements under General Principles 1 (Honesty and fairness), 2 (Diligence) and 6 (Conflicts of Interest) and paragraph 9.3 (Front-running) of the SFC's Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission and paragraph 1.3 (Functional Barriers) of the SFC's Fund Manager Code of Conduct;
- clear and robust information sharing principles and processes for their staff; and
- physical and functional segregation of incompatible duties (e.g. between staff on the public and private sides of a transaction) and associated system user access controls in compliance with the "need-to-know" principle.

3 See the response to Question 4 of the SFCís Market Sounding FAQs

Core Principle 2 – Governance

A Market Sounding Intermediary will be required to have in place robust governance and oversight arrangements to ensure that its management effectively supervises its market sounding activities. These should include, without limitation:

- senior management assuming overall responsibility for overseeing market soundings;
- adopting governance arrangements for market soundings that are appropriate for the size and complexity of the Market Sounding Intermediary's business;
- designating a committee or person(s) to monitor its market soundings to support senior management's oversight. The committee or person(s) so designated should have defined roles, responsibilities and reporting lines and adequate knowledge of the Market Sounding Intermediary's policies and procedures on market sounding; and
- implementing processes, procedures and controls to ensure that matters related to market soundings are promptly escalated to senior management and the designated committee or person(s) for review and follow-up, where necessary.

Core Principle 3 – Policies and procedures

A Market Sounding Intermediary should establish, maintain and periodically review and update effective written policies and procedures specifying how market soundings are to be conducted. These will need to cover, among others:

- the timing and prescribed procedures for market soundings;
- the roles and responsibilities of staff engaged in market sounding and ensuring that they are properly trained;
- firm and staff dealing policies and procedures to prevent inappropriate disclosure, misuse or leakage of Market Sounding Information for benefit or financial advantage;
- circumstances and protocols for escalating market sounding-related matters to senior management or other independent functions, such as legal and compliance;
- sanctions or disciplinary measures for non-compliance with market sounding requirements;
- identifying and handling Market Sounding Information; and
- the record keeping requirements for market soundings.

Core Principle 4 – Review and monitoring controls

Market Sounding Intermediaries should have in place effective procedures and controls to monitor and detect suspicious behaviour, suspected misconduct, inappropriate or unauthorised disclosure, misuse or leakage of Market Sounding Information, and breach of their internal guidelines on market sounding. These should include, without limitation, periodic reviews of:

- firm and staff personal trading activities;
- voice and electronic communications; and
- unauthorised access to Market Sounding Information.

Hong Kong Market Sounding Guidelines – Specific Requirements for Disclosing Persons

Procedures before conducting market soundings

Before conducting market sounding, a Disclosing Person is required to obtain agreement or consent from the

Market Sounding Beneficiary to conduct market soundings regarding their possible transaction and to determine:

- a standard set of information to be disclosed in each market sounding;
- appropriate timing for conducting market soundings (e.g. close to the launch of the possible transaction and outside the trading hours for the securities associated with the market sounding); and
- an appropriate number of Recipient Persons or other potential investors to contact, such that market soundings are restricted to as few investors as necessary to gauge their interest in the possible transaction.

Use of authorised communication channels

A Disclosing Person should:

- only use recorded communication channels (e.g. telephone, video or text) authorised by its senior management or independent functions (such as legal and compliance) to conduct market sounding;
- keep recorded market sounding conversations as part of its records; and
- only use other methods (e.g. written minutes) to record market sounding conversations if its telephone recording system or other recorded communications channels are not available.

Standardised scripts for Hong Kong market soundings

Disclosing Persons must use a standardised script approved by their senior management or independent functions during market soundings. The minimum content and required sequencing for standardised scripts are as follows:

- an opening statement that the purpose of the communication is market sounding and a confirmation that the individual is the person authorised by the Recipient Person to receive market soundings; and
- a request for consent from the Recipient Person or other potential investor to:
    - o record the conversation if it is being recorded; and
    - o receive the Market Sounding Information, safeguard its confidentiality and prevent its inappropriate disclosure, misuse or leakage.

The SFC clarifies in the notes to the Standardised Script requirements that a Disclosing Person should not proceed with a market sounding if it has not received the required consents. Further, a Disclosing Person should only provide preliminary information to a Recipient Person or other investor before receiving the required consents (e.g. to enable them to decide if they want to consent) if the preliminary information is provided on a "no-name" basis and is sufficiently broad, limited, vague and anonymised to prevent the identification of the relevant security.

Following receipt of the required consents, Disclosing Persons are required to provide a written summary of the market sounding conversation to the Recipient Person or other potential investor.

Record keeping

A Disclosing Person is required to keep records of its market soundings for at least two years. These need to include:

- the Market Sounding Beneficiary's agreement or consent to the Disclosing Person's conduct of market soundings with respect to the possible transaction;
- a list of Recipient Persons or other potential investors who have rejected a market sounding request;
- audio, video or text records of market soundings conducted through recorded communication channels;
- written minutes of market soundings conducted through unrecorded communication channels; and

- a list of all internal and external persons (including legal and natural persons) who possess Market Sounding Information, including details of the date and time of market sounding, the name and contact details of persons sounded, information and materials disclosed and all relevant consents obtained.

Hong Kong Market Sounding Guidelines – Specific Requirements for Recipient Persons

Handling Requests for Market Sounding

A Recipient Person is required to:

- authorise an individual who has adequate knowledge of its internal policies on the receipt and handling of Market Sounding Information to receive market soundings;

- inform Disclosing Persons of the person authorised to receive market soundings on being contacted for the purpose of market sounding; and

- inform Disclosing Persons of whether or not it wants to receive market soundings in relation to all or only specified types of transactions.

If a Disclosing Person does not specify whether a communication is a market sounding, the Recipient Person is required to use reasonable efforts to verify whether it is in possession of Market Sounding Information.

Implementation Timeline

The Hong Kong Market Sounding Guidelines will take effect on 2 May 2025 which means that SFC-licensed and registered intermediaries that engage in market sounding need to comply with them by that date.

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