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Hong Kong's SFC Introduces New Market Sounding Rules

In response to industry feedback, the SFC has refined the Guidelines, which now impose fewer regulatory obligations than the SFC originally proposed. Set out below is a key overview of the Guidelines.

On October 31, 2024, Hong Kong' Securities and Futures Commission (**SFC**) published its conclusions[1] (the **Consultation Conclusions**) on Guidelines for Market Soundings[2] (the **Guidelines**). We previously published an alert[3] on SFC's consultation in October 2023.

Implementation Timeline

The Guidelines are set to take effect on May 2, 2025. The SFC takes the view that a six-month transition should be sufficient as intermediaries should have existing controls in place to safeguard confidential information. Where an intermediary is not able to enhance its existing system, policies and procedures after the Guidelines take effect, the intermediary should, at a minimum, put in place interim measures to comply with the Guidelines.

Overview of the Guidelines

The Guidelines set out four Core Principles and prescriptive requirements applicable to a Disclosing Person (usually a sell-side broker in possession of the market sounding information) and a Recipient Person (usually a buy-side firm in receipt of the market sounding information) when they conduct market sounding activities, i.e., the communication or information flow from sell-side to buy-side for the purpose of gauging interests in a potential transaction. Market sounding is most seen in block trades and private placements.

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Four core principles under the Guidelines

The four Core Principles under the Guidelines that apply to all intermediaries that conduct market sounding activities are:

1. ***Handling of Information:*** Safeguarding the confidentiality of market sounding information, and ensuring effective systems of functional barriers to prevent inappropriate disclosure, misuse and leakage of such information.
2. ***Governance:*** Putting in place robust governance and oversight arrangements to supervise market sounding activities.
3. ***Policies and Procedures:*** Establishing and maintaining effective policies and procedures with respect to market sounding activities.
4. ***Review and Monitoring Controls:*** Implementing controls to monitor and detect suspicious behaviors and potential misconduct, or potential unauthorized or inappropriate disclosure, misuse or leakage of market sounding information, or non-compliance with internal policies and procedures governing market sounding activities.

Key highlights of the requirements after considering industry feedback

1. ***Type of market sounding information:*** The Guidelines only apply to "*confidential information in connection with possible transactions in listed securities regardless of the listing venue, or transactions involving other securities that are likely to materially affect the price of listed securities."* This means that the Guidelines do not automatically apply to all non-public information, as the information must be "confidential" in order to fall within scope of the Guidelines. In the FAQ[4] issued by the SFC, the SFC provided examples of market sounding information, including the name or specific information of the subject security, identity of the Market Sounding Beneficiary (i.e., the issuer, client or existing shareholding of the security in question), the Market Sounding Beneficiary's intent to pursue a transaction or other specific terms relating to the transaction. The SFC made clear that routine discussions, such as speculative trade ideas or sourcing orders, remain outside the scope of the Guidelines.
2. ***In-scope "securities transactions":*** The Guidelines only apply to market sounding in connection with transactions involving listed securities (regardless of whether listed in Hong Kong or elsewhere) and securities (e.g., debt securities) which is likely to have a material effect on the share price of listed securities. This is a narrower scope of "securities" than the SFC initially proposed in its consultation paper, although the SFC will keep in view the need to expand the type of transactions.

3. ***Removal of the proposed requirements around "cleansing":*** Given the concerns of practical challenges to perform "cleansing" of market sounding information once it becomes public (e.g., the information may never become public if a transaction is cancelled), the SFC has removed this requirement from the Guidelines.

4. ***Record-keeping requirements only apply to the Disclosing Person:*** Under the Guidelines as refined, the Recipient Person is no longer required to keep records of the market sounding communications. Instead, only the Disclosing Person is required to keep such records through the use of authorized communication channels. The required retention period is also shortened to 2 years. Note that this is distinguished it from the shorter six-month retention period for regular telephone order instructions required under the SFC Code of Conduct.

Specific Requirements for Disclosing Persons

A Disclosing Person is required to obtain consent from the Market Sounding Beneficiary, determine in advance a standard set of information to be disclosed, and use standardized scripts to communicate market sounding information through authorized communication channels. At a minimum, the scripts should include a statement that the communication is for market sounding, and making a request for consent from the Recipient Persons (or potential investors) for receipt of the market sounding information, and agreeing to safeguard its confidentiality. Records of market sounding communications must be kept for not less than two years.

Specific Requirements for Recipient Persons

A Recipient Person should designate a person familiar with the internal polices on market sounding activities and inform the Disclosing Person who that person is upon being contacted by the Disclosing Person for market sounding. The Recipient Person should inform the Disclosing Person whether it wishes to, or not to, receive market soundings in relation to either all possible transactions or particular types of possible transactions from the Disclosing Person. Where the Disclosing Person does not specify whether the communication is a market sounding, the Recipient should use reasonable efforts to verify where it is in possession of market sounding information, for example, by making additional enquiries with the Disclosing Person and seek confirmation whether the information to be shared involves market sounding information.

Conclusions

The Guidelines only apply to intermediaries licensed by or registered with the SFC and do not have the force of law, However, the SFC highlighted that the Guidelines may be admissible in evidence in court proceedings under the Securities and Futures Ordinance (**SFO**) where relevant to questions that arise in the court proceedings. Failure to comply with the Guidelines may also call into question of fitness and properness of an intermediary or licensed/ registered individual, which may lead to investigations or disciplinary actions taken against the relevant persons by the SFC. Intermediaries should review and enhance their existing policies and procedures, and ensure that enhancements are implemented by May 2, 2025.

[1] https://apps.sfc.hk/edistributionWeb/api/consultation/conclusion?lang=EN&refNo=23CP6

[2] https://www.sfc.hk/-/media/EN/assets/components/codes/files-current/web/Guidelines-for-Market-Soundings/Guidelines-for-Market-Soundings_ENG.pdf?rev=-1

[3] https://www.gibsondunn.com/hong-kong-sfc-consults-on-market-sounding-guidelines/.

[4] https://www.sfc.hk/en/faqs/intermediaries/supervision/Market-Soundings/Guidelines-for-Market-Soundings

The following Gibson Dunn lawyers prepared this update: William Hallatt, Becky Chung, and QX Toh.

Gibson Dunn's lawyers are available to assist in addressing any questions you may have regarding these developments. If you wish to discuss any of the matters set out above, please contact any member of Gibson Dunn's Financial Regulatory team, including the following members in Hong Kong:

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