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## Consultation on proposed guidelines for Market Soundings – what is it?



### Background

Market sounding refers to the practice where market participants communicate information with potential investors to see if there might be any interest in a potential transaction of securities, or to obtain information to ascertain the size, pricing, structure and selling method of the potential transaction. However, other than the law relevant to insider dealing under the Securities and Futures Ordinance (Cap 571) ("**SFO**"), there is currently no regulation over how market soundings should be conducted. The Securities and Futures Commission ("**SFC**") also noted an increasing number of cases where some intermediaries might have taken advantage of this regulatory gap to make unjustified profits.

On 11 October 2023, following the thematic review done by the SFC in 2022, the SFC published a [consultation paper on the proposed guidelines for market soundings](#), which included the proposed guidelines for market soundings ("**Market Soundings Guidelines**"). The purpose of the Market Soundings Guidelines is to provide clarity on the SFC's regulatory expectations, deter substandard conduct, ensure a level playing field in the industry and assist intermediaries in upholding market integrity when doing market soundings.

## What is included

The Market Soundings Guidelines will apply to the communication of non-public information, irrespective of whether it is price-sensitive inside information or not, with potential investors prior to the announcement of a securities transaction, to gauge their interest in a potential transaction or assist in determining the specifications related to a potential transaction. Such activity is referred to as "**Market Soundings**".

A licensed or registered person may carry out Market Soundings in one of the following capacities:

- (a) as a person disclosing information during the course of a Market Sounding when acting on behalf of a Market Sounding Beneficiary, and is referred to as a "**Disclosing Person**"; or
- (b) as a person receiving information during the course of a Market Sounding, generally expected to be a buy-side firm as a potential investor, and is referred to as a "**Recipient Person**".

The Disclosing Person and Recipient Person are collectively referred to as a "**Market Sounding Intermediary**".

An intermediary can still be a Disclosing Person even when there is no formal appointment by, or no written agreement with, a Market Sounding Beneficiary (defined below). As long as there is some level of certainty in the potential transaction materialising, and an intermediary discloses non-public information of such potential transaction, then the disclosing intermediary is a Disclosing Person. The Market Soundings Guidelines also set out a list of factors to consider when determining the level of certainty.

"**Market Sounding Beneficiary**" will usually be a client, an issuer or an existing shareholder selling in the secondary market in a possible securities transaction.

However, the Market Soundings Guidelines will not apply to communications regarding:

- (a) speculative transactions or trade ideas without consulting with the potential Market Sounding Beneficiary or without any level of certainty;
- (b) transactions that are commensurate with ordinary day-to-day trade execution, such as a broker sourcing potential buyers or sellers after receiving an actual order instruction placed by a client with a genuine intent for execution; and
- (c) public offering of securities.

## Core principles

The Market Soundings Guidelines laid down 6 core principles:

- (a) CP1. Market integrity

A Market Sounding Intermediary should ensure confidentiality and prohibit trading on or using any non-public information passed or received during Market Soundings. The SFC also emphasised that the Market Soundings Guidelines do not intend to restrict legitimate hedging or proprietary trading activities but only intend to prevent any leakage of information.

- (b) CP2. Governance

There should be robust governance and oversight arrangements in place to effectively supervise Market Soundings. There should be a committee or person to independently monitor the front-line staff in respect of Market Soundings and to support senior management's oversight.

(c) CP3. Policies and procedures

There should be effective policies and procedures specifying the manner and expectation of how Market Soundings should be conducted. These should address the Market Sounding Intermediary's prescribed procedures, allocation of roles and responsibilities, and restrictions to prevent the misuse of non-public information.

(d) CP4. Information barrier controls

There should be physical and electronic information barrier controls, which should be reviewed periodically.

(e) CP5. Review and monitoring controls

There should be procedures and controls to monitor and detect suspicious behaviours, suspected misconduct, inappropriate or unauthorised disclosure or misuse of information and non-compliance.

(f) CP6. Authorised communication channels

Market Soundings should only be done through recorded communication channels.

### Specific requirements

In addition to the general principles, there are specific requirements applicable to all Market Sounding Intermediaries.

For Disclosing Persons:

- (a) Pre-sounding procedures. Before a Recipient Person or a potential investor is contacted for Market Sounding of a specific transaction, a Disclosing Person should:
- conduct assessments on information to be disclosed during different stages of Market Soundings, to determine whether the information would constitute non-public information;
  - obtain consent from the corresponding Market Sounding Beneficiary; and
  - determine, on a case-by-case basis, (i) the standard set of information to be disclosed to all Recipient Persons and potential investors, (ii) the appropriate timing to conduct Market Soundings, and (iii) the suitable number of Recipient Persons or potential investors.
- (b) Standardised script. There should be a set of pre-approved standardised scripts applicable to all Market Soundings, which should be sent to all Recipient Persons and potential investors. At a minimum, the script should include:
- a statement confirming that the communication is for the purpose of a Market Sounding, and the Recipient Person or the potential investor should keep the information confidential, and not trade on or use the information received for its own benefits;

- a statement confirming that the conversation is being recorded and request for the consent of the Recipient Person or the potential investor for such recording. No Market Sounding should proceed if such consent is not obtained;
  - a confirmation that the individual is the person designated to receive Market Soundings;
  - a statement confirming that the Recipient Person and the potential investor will receive information which is considered to be non-public, and request for their consent to receive such non-public information. No Market Sounding should proceed if such consent is not obtained; and
  - where possible, an estimation of when the relevant information will cease to be non-public.
- (c) Cleansing. Where non-public information is disclosed during a Market Sounding, a Disclosing Person should carry out assessments and maintain regular contact with the Market Sounding Beneficiary to determine if that information has ceased to be non-public, and inform the relevant Recipient Persons and potential investors in writing as soon as the information has ceased to be non-public.
- (d) Record keeping. A Disclosing Person should keep certain records in relation to its Market Soundings for a period of not less than seven years.

For Recipient Persons:

- (a) Handling of Market Sounding requests. A Recipient Person should (i) designate a specified person who is properly trained to receive information from Market Soundings, and inform the Disclosing Persons of such arrangement, and (ii) inform the Disclosing Persons whether it wishes to receive Market Soundings, whether in relation to all potential transactions or particular types of potential transactions.
- (b) Record keeping. Similar to the requirements applicable to a Disclosing Person, a Recipient Person is also required to keep certain records for a period of not less than seven years.

### What next?

The proposed Market Soundings Guidelines will be subject to a two-month public consultation. Anyone can submit comments to the SFC in writing at any time before 11 December 2023.

Thereafter, the SFC will finalise the Market Soundings Guidelines, which will become effective upon gazettal. All Market Sounding Intermediaries will be given a six-month transition period after gazettal to update their internal procedures.

We advise many clients in the financial sector on matters involving SFC regulations. Please get in touch if you are interested in discussing any of the above.

## Contact us



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