

SFC PUBLISHED CONSULTATION CONCLUSIONS AND GUIDELINES FOR MARKET SOUNDING PRACTICES

1. Introduction

Following the Securities and Futures Commission's ("SFC") **consultation** in October 2023 in relation to market sounding practices, on 31 October 2024 the SFC published its **Consultation Conclusions** and its related amended guidelines (the "**Guidelines**").

The Guidelines set out principles and requirements applicable to licensed or registered persons conducting market soundings in connection with capital market transactions, such as placings and block trades. In what will be welcome news to market participants, the SFC accepted certain feedback from respondents in the consultation process and has refined the scope of the Guidelines and made other amendments to reduce the complexity of the requirements.

The Guidelines were gazetted on 1 November 2024 and will take effect on 2 May 2025.

2. Consultation and Guidelines

Consultation Background

Amid the rise in private placements and block trades over recent years, the SFC acknowledged the important role of market soundings in assisting price discovery while noting a concerning increase in abuse cases. In particular, the SFC observed that some intermediaries have taken advantage of, or unfairly exploited, non-public information to make unjustified profits. This surge in abuse prompted the SFC to carry out the 2023 consultation in parallel to taking enforcement action against certain market participants.

Consultation Responses

The proposed draft Guidelines in the consultation captured communication by an intermediary of **non-public information (irrespective of whether such information is price-sensitive inside information)**, which represented a significant widening of the information handling requirements and the associated compliance implications.

Further, the draft Guidelines covered all securities transactions.

Whilst respondents were generally supportive of the implementation of the Guidelines for upholding market integrity during market soundings, some expressed concerns about certain requirements. Key concerns raised by respondents included:

- The proposed application of the Guidelines to the communication of **non-public information** (containing non-public non-confidential information, non-public confidential information, and inside information) which, if implemented, would hamper intermediaries' normal capital formation activities and would create a disproportionate compliance burden;
- The proposed restriction on trading on non-public information would have the effect of creating a new market misconduct offence akin to insider dealing without statutory backing; and
- The proposed scope covering market soundings for **all securities transactions** would be unnecessarily wide, as the risk of information abuse in some types of transactions (such as DCM transactions) is relatively lower.

Consultation Conclusions and Market Sounding Guidelines

A. Scope of application

In response to this feedback, the SFC has:

- Refined the scope of the Guidelines to now apply to confidential information entrusted by a "Marketing Sounding Beneficiary" (i.e., a client, an issuer, or an existing shareholder selling or buying in the secondary market) during the course of a market sounding ("**Market Sounding Information**"). Consequently, the proposed trading restrictions and requirements around

“cleansing” of non-public information have been discarded; and

- Narrowed the application of the Guidelines from covering “all securities transactions” to focusing on “*market soundings conducted in connection with a possible transaction in (i) shares that are listed on an exchange and (ii) any other securities which is likely to materially affect the price of the shares on an exchange*”.

The SFC has also adopted other amendments to accommodate proposals made by respondents.

B. Core principles

The Guidelines contain four core principles applicable to both:

- **Disclosing Persons** (a licensed or registered person who discloses Market Sounding Information); and
- **Recipient Persons** (a licensed or registered person who receives Market Sounding Information)

(collectively referred to as “**Market Sounding Intermediaries**”).

The core principles require:

- **Handling of information:** ensuring effective system of functional barriers to prevent inappropriate disclosure, misuse and leakage.
- **Governance:** implementing robust governance and oversight arrangement to ensure effective management supervision.
- **Policies and procedures:** maintaining effective policies and procedures specifying the manner and expectations in conducting market soundings.
- **Review and monitoring controls:** implementing effective controls to monitor and detect suspicious behaviours, misconduct, inappropriate or unauthorised disclosure, misuse and potential leakage.

C. Specific requirements

A Disclosing Person should:

- **Before** conducting market soundings, obtain agreement or consent from the Market Sounding

Beneficiary, and determine a standard set of information to be disclosed, timing for conducting market sounding and suitable number of persons to contact.

- **During** market soundings, adopt a pre-approved and regularly reviewed standardised script, and conduct market soundings through authorised communication channels, with the communication properly recorded.
- **After** market soundings, keep records for not less than two years.

A Recipient Person should:

- Designate a knowledgeable person for handling market soundings and inform Disclosing Persons of this arrangement;
- Communicate its preferences on receiving market soundings; and
- Use reasonable efforts to verify if a communication from a Disclosing Person is Market Sounding Information when not specified.

3. Legal Status of the Guidelines

Although failure to comply with the Guidelines do not by itself render the Market Sounding Intermediary liable or any judicial or other proceedings, the Guidelines may be admissible as evidence in court proceedings under the Securities and Futures Ordinance; it may also cause the SFC to consider whether such failure adversely reflects on the person’s fitness and propriety to remain licensed or registered.

4. Implementation Timeline

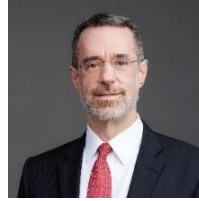
Market Sounding Intermediaries will have six months following the gazettal of the Guidelines on 1 November 2024 to improve their systems, policies and procedures in line with the Guidelines. Once the Guidelines take effect on 2 May 2025, Market Sounding Intermediaries that have not completed the corresponding enhancements should implement interim measures to meet the objectives of the Guidelines.

Please do not hesitate to contact us if you have any questions about the matters discussed in this bulletin.

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