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New regulatory requirements for market sounding proposed

Scott Carnachan

The Securities and Futures Commission (**SFC**) has proposed requirements for market sounding that will affect both buy side and sell side market participants. The SFC consultation is available [here](#). The deadline to submit responses to the consultation is 11 December 2023.

This article outlines the proposed requirements for buy side participants.

Overview of proposals

Market sounding refers to discussions with potential investors to gauge interest in a potential securities transaction and/or the terms of a potential securities transaction, such as its potential size, pricing, structure and selling method.

The SFC notes it has seen an increasing number of cases regarding trading activities ahead of placings and block trades that appear to the SFC to indicate some intermediaries may have taken advantage or unfairly exploited information received during market soundings to make unjustified profits. As a result of these cases, in 2022 the SFC conducted a thematic review of market sounding practices and controls adopted by intermediaries. The SFC now proposes to issue Guidelines for Market Soundings (**Draft Guidelines**) to provide clarity on its regulatory expectations.

Key feature – application to non-public information

The key feature of the proposals is that they apply to provision or receipt of non-public information, whether or not such information is price-sensitive inside information.

What is market sounding for regulatory purposes?

The Draft Guidelines define market sounding as:

“the communication of non-public information, irrespective of whether this 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 as its potential size, pricing, structure and selling method [...], by a licensed or registered person acting in the following capacity:

- (a) as a person disclosing information during the course of a market sounding (Disclosing Person) (eg, this is generally a sell-side broker acting on behalf of a client, an issuer or an existing shareholder selling in the secondary market (Market Sounding Beneficiary) in a possible securities transaction); or

- (b) as a person receiving information during the course of a market sounding (Recipient Person) (eg, this is generally a buy-side firm that is sounded out by a Disclosing Person as a potential investor in a possible securities transaction) (collectively referred to as a “Market Sounding Intermediary”).”

There are carve-outs for certain types of communication. The following communications are not “market sounding” for the purposes of the Draft Guidelines:

- (a) speculative transactions or trade ideas put forward by a Disclosing Person without consulting with the potential Market Sounding Beneficiary or without any level of certainty of such transactions materialising;
- (b) transactions, in such size (e.g., in relation to average trading volume or market capitalisation), value, structure, or selling method, that are commensurate with ordinary day-to-day trade execution (e.g., a broker sourcing potential buyers or sellers to execute a trade after receiving an actual order instruction placed by a client with a genuine intent for execution); and
- (c) public offerings of securities.

Obligations of all market participants

Under the Draft Guidelines, all market participants are required to:

- (a) maintain confidentiality and not trade on or use any non-public information passed or received during market soundings for their own or others’ benefit or financial advantage until the information ceases to be non-public;
- (b) implement robust governance and oversight arrangements in place to ensure effective management supervision over their market sounding activities;
- (c) establish and maintain effective policies and procedures specifying the manner and expectations in which their market soundings should be conducted;
- (d) implement adequate and effective physical and electronic information barrier controls to prevent the inappropriate disclosure, misuse and leakage of non-public information during the course of market soundings; and
- (e) establish effective procedures and controls to monitor and detect suspicious behaviours, suspected misconduct, inappropriate or unauthorised disclosure or misuse of information and non-compliance with internal guidelines related to market soundings.

Additional obligations for buy side participants

Under the Draft Guidelines, a buy side participant will also be required to:

- (a) designate a specified person(s) who is properly trained for that purpose to receive market soundings, and inform Disclosing Persons of such arrangement upon being contacted by Disclosing Persons for the purpose of market soundings;
- (b) inform Disclosing Persons whether it wishes to, or not to, receive market soundings in relation to either all potential transactions or particular types of potential transactions from the Disclosing Persons;
- (c) keep records of:
 - (i) any notifications given to Disclosing Persons of its wish to or not to receive market soundings;
 - (ii) audio, video or text recordings of market soundings received; and
 - (iii) a list of all internal and external person(s) (including legal and natural persons) who possess non-public information as a result of the market sounding, including details on the date and time of sounding, name and contact details of persons sounded, and information and materials received.

When will the requirements come into effect?

The requirements are likely to come into effect in the 2nd half of 2024.

The consultation period ends on 11 December 2023. The SFC will then consider the consultation responses and issue the final form of the guidelines. The guidelines will be published in the Gazette and will become effective on such publication.

The SFC has proposed a six month transition period for market participants to revise their policies and procedures to comply with the guidelines.

What should buy side participants do now?

Buy side participants should:

1. Review the SFC consultation paper (available [here](#));
2. Ensure key staff, such as relevant responsible officers and managers in charge, portfolio managers and compliance, are aware of the consultation and the proposed requirements;
3. Consider whether to make a submission on the Draft Guidelines to the SFC, either directly or through an industry body, on or before 11 December 2023;
4. Review their existing policies and procedures for market soundings against the Draft Guidelines to identify potential areas for enhancement; and
5. Develop a plan to implement necessary enhancements.

Hong Kong SFC licensing and compliance hints – October 2023

Counting down for CPT

[Joshua Lui](#)

The deadline for individuals licensed by the Securities and Futures Commission (**SFC**) to complete annual Continuous Professional Training (**CPT**) requirements is 31 December 2023.

Licensed representatives are required to undertake a minimum of 10 CPT hours while responsible officers are required to fulfil 12 CPT hours per calendar year. The CPT should cover topics relating to:

- Regulated activities for which the individual is licensed (5 out of the 10/12 CPT hours)
- Compliance or ethics related topics (2 out of the 10/12 CPT hours)
- Regulatory compliance (2 out of the 12 CPT hours for responsible officers)

Licensed corporations should start reminding their licensees of the CPT deadline and collect attendance records (e.g. attendance certificates or emails). All CPT attendance records should be kept for a minimum of three years and be made available for regulatory inspection upon request.

Lists of regulatory status of virtual asset trading platforms

[Joshua Lui](#)

On 29 September 2023, the Securities and Futures Commission (**SFC**) published several [lists](#) of the regulatory status of Virtual Asset Trading Platforms (**VATPs**) operating in Hong Kong or actively marketing their services to Hong Kong investors. The lists contain the following information:

- SFC-licensed VATPs
- VATPs that are applying to be SFC-licensed VATPs (and the applicants whose licence applications have been returned, refused or withdrawn)
- VATPs that are closing down their operations in Hong Kong (including VATPs required by law to shut down within a prescribed period)
- VATPs that are deemed to be licensed by the SFC as of 1 June 2024

On the same day, the SFC also issued a [list of suspicious VATPs](#) to help investors identify suspicious and unlicensed VATPs.

The lists aim to enhance information transparency and assist the general public in avoiding problematic VATPs following the JPX incident. Investors should clearly distinguish VAP applicants from SFC licensed VATPs, because the eligibility and compliance of VAP applicants have not been assessed by the SFC and therefore the applicants are yet to receive official licences to operate a virtual asset exchange in Hong Kong.

New enhancements to the GBA Wealth Management Connect Scheme

[Gabriel Shea](#)

On 28 September 2023, the Securities and Futures Commission (**SFC**) announced [enhancements to the Cross-boundary Wealth Management Connect Pilot Scheme](#) (the **Scheme**). The enhancements include:

- allowing more eligible residents in the Mainland cities in Guangdong-Hong Kong-Macao Greater Bay Area (**GBA**) and Hong Kong to participate in the Scheme;
- expanding the participating financial institutions to include eligible securities firms which, together with the initial participant banks, will be allowed to distribute investment products and provide relevant services to eligible GBA residents;
- increasing the eligible products and quota for investments by eligible GBA residents under the Scheme; and
- relaxing the promotional and sales arrangements for eligible financial institutions to provide financial services to eligible GBA residents.

Whilst the details of the Scheme enhancements have not yet been announced, Hong Kong licensed securities firms which intend to participate in the Scheme may prepare for the client-facing and compliance infrastructure for Scheme business in the GBA, which at a minimum should include:

- implementing remote client onboarding arrangements or revisiting existing client take-on procedures;
- revamping terms and conditions or agreements for clients;
- updating internal controls on KYC, product due diligence and rating, suitability assessment and record-keeping; and
- providing training for staff involved in the Scheme activities.

Importance of FRR compliance

[Gabriel Shea](#)

On 11 September 2023, the Securities and Futures Commission (**SFC**) revoked the licence of a licensed corporation (**LC**) for its failure to comply with the financial resources requirements under the Securities and Futures Ordinance (**SFO**) and the Securities and Futures (Financial Resources) Rules (**FRR**). The LC's responsible officer was also suspended for five years due to their supervisory failure.

The SFC took very severe disciplinary action because the LC failed to maintain its minimum required liquid capital for a consecutive period of 19 months; and despite becoming aware that its liquid capital was insufficient, the LC only notified the SFC 18 months later. More importantly, the LC failed to submit its mandatory financial resources returns on six occasions and annual financial statements and documents, and ignored the SFC's repeated reminders to do so.

The SFC considered the LC's failures were attributable to the failure of its responsible officer to discharge their duty as the senior management of the LC, and in particular, failing to ensure the maintenance of appropriate standards of conduct and adherence to proper procedures by the LC that also constituted a breach of General Principle 9 of the Code of Conduct.

Under the SFO and the FRR, LCs are required to comply with the liquid capital and paid-up share capital requirements, to submit financial resources returns (monthly or semi-annually), and to submit audited accounts and other required documents within four months after the end of each financial year.

Recent publications

[Hong Kong Courts' Approach to bankruptcy / winding-up proceedings involving arbitration clauses](#)

[Series on Family disputes relating to mental capacity issues: Testamentary capacity and potential challenges to Wills](#)

[Updates on Practice Direction regarding Bankruptcy and Winding-up Proceedings](#)

[China Is Expected to Relax its Ex ante Regulation on the Cross-border Data Transfers](#)

[China proposes to relax cross-border data transfer compliance requirements](#)

[Hong Kong Stock Exchange proposes GEM listing reforms](#)

Want to know more?

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