



30 September 2004

Hong Kong Exchanges and Clearing Limited
11th Floor, One International Finance Centre
1 Harbour View Street
Central, Hong Kong

Dear Sirs,

Consultation Paper on the Reduction of Minimum Spreads

We would like to summarize our views on your Consultation Paper on the captioned subject.

Firstly, we have doubt on the assumption that trading interest will be stimulated and the market liquidity will be improved by the reduction of minimum spread. Trading interest and market liquidity will be influenced by a number of factors such as the prevailing economic conditions, the monetary policy in force, outlook of the business, prospects for growth as well as confidence of the investors. However, reduction of the minimum spread does not necessary have an influence. On the contrary, as only 5 order queues can be displayed on each bid/ask side, the reduction in minimum spread will cause lowering in transparency of the market depth and investors will hesitate to trade under uncertainty. Increasing the market depth will not improve the situation, as 10 reduced spreads may only be equivalent to 2 or 3 spread under the existing system. The market depth will then be less useful a tool to discover trend or momentum of the market than the present arrangement. Psychologically investors may also hesitate to trade when a large number of spreads have to move before profit can be made. All such adversary effects tend to dampen the market instead of increasing its liquidity.

Secondly, we consider that the increase in cost will be a major concern for brokers. Computer system has to be modified to cope with the new requirement. More system upgrading cost will have to be incurred when the HKEx implements the change in stages. More importantly, the proposed narrowing in spread will also increase brokers' daily operating cost. The smaller the change in spread is, the more frequent investors have to ask for quotations in order to determine whether there are sufficient movements in share prices before profit can be made. The number of quotations required by investors before a trade is executed will become higher. As a consequence, extra cost will have to be incurred as more human and computing resources as well as RTQ cost which is charged on per quotation basis have to be paid merely for handling quote enquiries. These extra costs will be committed for sure while the benefits of the reduction in minimum spread are still assumptions only or can only be enjoyed by those who participate mainly in the institutional business at the expense of the rest of the greater part of the industry.

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At present, some of the brokers are employing the services provided by external BSS bureaus to whom commissions or charges are payable on per execution basis. When a market order for moderate quantity of a share is placed under the reduced minimum spread, it may have to hit a range of prices, instead of one or two, before it can be filled. Higher transaction costs have to be paid to external BSS bureaus due to the increase in the number of executions in such instance.

This Association regards that the existing minimum spread arrangement which has been working fine since its inception should be maintained. We appreciate the chance for the Association to express its views on the subject matter and please feel free to contact us should you require a further discussion on the captioned subject.

Yours faithfully

For and on behalf of

The Hong Kong Association of Online Brokers



Steve Chan
Chairman