證 券 商 協 會 有 限 公 司
THE INSTITUTE OF SECURITIES DEALERS LTD.

October 5, 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

After careful consideration of the captioned consultation paper and extensive consultation with the members of The Institute of Securities Dealers Limited (the "Institute"), it is of our opinion that the reduction of minimum spreads should not be introduced.

The Institute is of the opinion that:

1. There is no evidence that the current minimum spreads is a cause of concern for either local or overseas investors. There is simply nothing wrong with the current level of minimum spreads;

2. Market reactions should not be underestimated. In 1994, attempts made to reduce minimum spreads of certain stocks caused market confusion and a number of original spreads had to be reinstated after only being introduced for one month. The lesson should not be forgotten;

3. The consultation paper stated that some market participants believe that a reduction of minimum spreads may help increase liquidity and improve market efficiency. We are of a different opinion in that for medium to long-term investors, reducing minimum spreads is unlikely to further stimulate their investment desires and for short-term investors, reducing minimum spreads may even have an adverse effect on market efficiency, leading to a reduction in trading volume;

4. There is no substantiating evidence which indicates that the current minimum spreads system has caused any outflow of investment from Hong Kong;

5. We should learn from other markets in the US and Japan which experienced negligible effect on trading volume after reduction of minimum spreads;

- 1 -

6. Dramatic increase in work load for brokerage firms resulting from increased incidents of bid/ask price order changes would be expected as the US markets experienced when the minimum spreads were reduced;

7. Market confusion may arise from a change in trading behaviors;

8. Market participants will need to make changes to their current trading systems with the introduction of reduction of minimum spreads and that means increase in their investment and operating costs. Given that there is no evidence that a reduction of minimum spreads will stimulate more investments, there is very little commercial sense to make changes to the current level of minimum spreads; and

9. Reduction in minimum spreads would lead to reduction in market depth as experienced by Euronext and would make the Hong Kong market being easily subjected to manipulation by large overseas speculators and that will have a detrimental effect on local investors and economy.

In addition, the Institute has also received comments from a large number of investors who have voiced concerns over the possibility of increased transaction costs resulting from the reduction of minimum spreads.

Before making any far-reaching changes to the existing system, we must realise that the Hong Kong market is much smaller in size than other established overseas markets and that overseas models, however successful, may not yield the same desirable results when adopted in Hong Kong. We believe that the Hong Kong Exchanges and Clearing Limited (the "HKEx"), together with our Government, has a duty to ensure that Hong Kong remains competitive by retaining its own charisma and should refrain from being tempted to blindly follow "international standards". The HKEx also has a duty of care to look after the interest of ALL market participants and certainly not just the multinational brokerage firms and funds.

Since there is no clear benefit to small to medium sized market participants and the investors in general, it is therefore the opinion of the Institute that the reduction of minimum spreads should not be introduced.

Yours faithfully,
For and on behalf of
The Institute of Securities Dealers Limited

Cham Yau Nam *(Chairman)*

- 2 -

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