



BY HAND & BY FAX (Fax No. 2868-5223)

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6 October 2004

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

THE HONG KONG EXCHANGE
OF SECURITIES LIMITED
11/F, ONE INTERNATIONAL FINANCE CENTRE
HONG KONG

Dear Sirs

Re: Consultation Paper on the Reduction of Minimum Spreads

On behalf of Kingsway Financial Services Group Limited, we refer to your Consultation Paper On The Reduction of Minimum Spreads dated August 2004 (the "Consultation Paper") inviting comments from market participants on the subject Consultation Paper and are pleased to provide the following comments for your consideration:-

1. We believe that the proposed reduction of the minimum spread, as set forth in the Consultation Paper, will have the adverse effect of reducing trading volume and market liquidity. We note that a significant volume of trading activity is made on behalf of large institutional investors. We believe that the reduction of the minimum spread would have the unintended consequence of reducing the number of shares available at the "inside" quote, which means that large institutional investors looking to execute large orders would find it necessary to make several smaller trades instead, which would potentially increase their overall trading costs.

Additionally, we believe that in the event the proposed reduction of the minimum spread is implemented, there will be less incentive for certain traders, who place buy orders at the best bid and sell orders at the best ask, with one spread in between and earn a profit due to the bid-ask spread, to engage in trading activities, which would again result in reduced trading volume and market liquidity.

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2. We concur with those commentators in Section 8 of the Consultation Paper who suggests that investors prefer a spread that is of sufficient size to cover their transaction costs in buying and selling shares. If the spread is not sufficient to cover the costs, we believe investors' interest in trading in the market would be diminished.

3. As an Exchange Participant, we also note that the current minimum spreads have been in use since 1994 and since no particular problems have arisen we believe that there is no overwhelming need to change the system. As noted by the Hong Kong Stockbrokers Association Limited in their statement issued on 6 September 2004, when The Stock Exchange of Hong Kong Limited ("SEHK") implemented a similar minimum spread reduction in 1994 there was such confusion, market operations were nearly suspended and as a result, the SFC and the SEHK had to revert to the original minimum spread system.

4. We also concur with the view that since the current stock pages can display the market depth of the best five order queues on each bid/ask side, a reduction of minimum spreads may lower transparency of market depth as market depth is spread over more price levels. We note that when the US converted to trading in decimals, which in effect lowered the spread, it was reported that the inside market size for issues quoted on the NYSE and Nasdaq had experienced a significant degradation of market visibility.

In conclusion, we are of the opinion that a reduction of the minimum spreads would not be beneficial to the Hong Kong securities market and we would therefore oppose the implementation of the proposed reduction.

Yours faithfully,

Vincent W.S. Lai

Director, Legal & Compliance

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