

Private & Confidential

Hong Kong Exchanges and Clearing Limited
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Hong Kong

By Hand

6 October 2004

Our Ref 我所文號 SMXF/EYYT

Dear Sirs

Comments on Consultation Paper on the Reduction of Minimum Spreads

We are writing to provide comments on the Consultation Paper on the Reduction of Minimum Spreads (the "**Consultation Paper**") on behalf of the group of 7 financial institutions listed below ("**Group**"). We are grateful to the HKEx for this opportunity.

The four sections below are in answer to the proposals for comment and in the order they appear in the Consultation Paper.

1 The Reduction Proposal

The HKEx has proposed for comment a reduction in minimum spreads in a phased approach and welcomes any alternative proposals. In summary, in phase 1, minimum spreads for shares priced above HK\$30 will be reduced by expanding the continuous range from HK\$5 to HK\$100, and reducing the spread to HK\$0.10 above HK\$100. In addition, it is proposed that prices from HK\$100 to HK\$9,996 would have ranges in which the maximum spread is 0.10% and the minimum spread is 0.05% or 0.04%.

In Phase 2, the HKEx has proposed two options:

SOLICITORS

Resident Partners

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Option A – to reduce spreads for shares priced between HK\$2 and HK\$20, resulting in a maximum spread of 0.25% or 0.20% and a minimum spread of 0.10% in each new range; or

Option B – to reduce spreads for shares priced between HK\$0.25 and HK\$20 on the same basis as Option A and introduce a continuous range from HK\$0.01 to HK\$1.00 in which the spread is HK\$0.001, followed by a range from HK\$1 to HK\$2 in which the spread is HK\$0.002.

The Group is strongly in favour of the HKEx's proposal to reduce minimum spreads. The Group believes that with a reduction of minimum spreads, both investors and market participants would benefit. In our view, it would stimulate trading interest and volume, and allow market participants to engage in hedging activities more efficiently. In addition, transaction costs would also be minimised as the bid-ask spread would be narrowed. In general, the Group believes that the economic benefits associated with a reduction of minimum spreads would outweigh the potential detriments flowing from the reduction and is therefore strongly supportive of the HKEx's proposal.

While the Group strongly welcomes the HKEx's proposal to reduce minimum spreads, it believes that the phasing in period should begin as soon as practicable and that it is unnecessary to adopt a phased approach in relation to the reduction process.

In relation to the proposed spreads, the Group suggests that the Hong Kong market should adopt a spread table similar to that of the markets in Australia and the United States where there are fewer ranges and minimum spread steps. The Group believes that adopting a simpler minimum spread structure would increase market turnover generally, enhance the attractiveness of the Hong Kong market, as well as improve market efficiencies.

2 Application to Equity Warrants, Derivative Warrants, etc.

The HKEx has invited comments in relation to the proposal to apply the proposed minimum spreads to the trading at HKEx of equity warrants, derivative warrants, Exchange Traded Funds, equity linked instruments and unit trusts.

The Group welcomes such application and believes that an enhanced scope of application of the proposed minimum spreads to these products would further increase trading interest and volume. Market liquidity will also be maximised as market participants may trade in various products at multiple spreads. Moreover, this proposal, if implemented, would complement the application of minimum spreads of HK\$0.05 to all debt securities already in effect.

3 Quotation Rules

The HKEx proposed for comment revision of the quotation rules in light of the reduction of minimum spreads and consequently, a reduction in the order input range. It is proposed for comment to relax the quotation rules from 8 spreads to 20 spreads for order input.

The Group supports the HKEx's proposal to relax the quotation rules from 8 spreads to 20 spreads for order input in light of the reduction of minimum spreads.

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4 Enhanced Limit Order ("ELO") and Special Limit Order ("SLO")

We understand that both ELO and SLO match up to two price queues at the same time under the current system. As a result of the reduction of minimum spreads, the maximum number of price queues for matching needs to be increased in order to maintain order matching efficiency. The HKEx has proposed for comment that the number of matchable queues be increased to five for both ELO and SLO.

The Group supports the HKEx's proposal to increase the number of matchable queues to five for both ELO and SLO.

The Group would be happy to meet with the HKEx to discuss the view set out in this letter. If you have any questions in relation to the comments set out above, please contact Stephen Fletcher at 2901 5350 or Elaine Tung at 2842 4873.

Yours faithfully

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On behalf of:

Citigroup Global Markets Asia Limited

Credit Suisse First Boston (Hong Kong) Securities Limited

Goldman Sachs (Asia) L.L.C.

JP Morgan Securities (Far East) Limited

Merrill Lynch (Asia Pacific) Limited

Morgan Stanley Dean Witter Asia Limited

UBS AG