

From: lavinia.li@sgcib.com
Sent: Wednesday, October 6, 2004 17:01
To: Feedback
Subject: Consultation Paper on the Reduction of Minimum Spreads

Dear Sirs,

As an active market participant, SG Securities (HK) Ltd is in favor of the proposed reduction of minimum spreads due to the following reasons:

Firstly, we share your view that reduction of minimum spreads can help to increase liquidity of the underlying stock. Using HSBC as an example, it is not uncommon that the best bid size and the best ask size match the daily turnover of HSBC. However, if a large number of orders are left unfilled, it is likely that more investors who are on the best bid/ask will trade HSBC if the minimum spread gap is narrowed. Secondly, since many activities, notably Index arbitrage, involves trading of index futures and its underlying stocks, we agree that reduction of minimum spreads may increase hedging and arbitrage activities in the market. Also, if the minimum spreads of Index and underlying stocks are consistent, erratic market movements will be reduced. Thirdly, it is true that the minimum spreads prescribed by the HKEx are the largest amongst the developed markets. As a result, many market participants are conducting alternative hedges on HSBC in London through HSBA due to smaller spread levels. The experiences of developed markets suggest that lower minimum spreads works and that the markets are able to cope with the necessary operational workload involved.

Although we are in support of the proposal, we would like to point out that special consideration should be given to the minimum spreads of covered warrants which represent a significant proportion of the SEHK's daily turnover. It is important to evaluate the potential market impact that reduction in minimum spreads will have on investors of covered warrants. In a nut shell, we believe that excluding shares/warrants priced below HK\$30 from Phase 1 of the minimum spreads reduction will give strong bias to different asset classes. While most of the covered warrants are trading below HK\$30, many of their underlying shares are trading above HK\$30. Only allowing minimum spreads of securities of a certain price range to be reduced will lead to disparity between the spreads of the covered warrant and its underlying share(s). As an illustration, if a covered warrant on Cheung Kong trades at HK\$0.485/0.49, the best bid/ask spread of the warrant may be 1% when Cheung Kong share's best bid/ask spread is 0.36%. After the implementation of Phase I, the stock spread will be reduced to 0.07% whereas the warrant spread will remain to be 1%. We believe that a warrant investor should be similiarly benefited as an investor of the underlying share.

We are happy to further discuss the above with you if necessary.

Yours truly,
For and on behalf of SG Securities (HK) Ltd
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