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By Fax and by hand

May 7, 2007

Hong Kong Exchanges and Clearing Limited  
12<sup>th</sup> Floor, One International Finance Centre  
1 Harbour View Street  
Central  
Hong Kong

Dear Sirs

Re: Consultation Paper on the Introduction of a Closing Auction Session

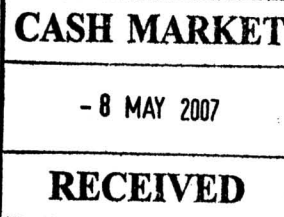
We are pleased that the HKEx has taken this opportunity to invite us to share our thoughts on the Exchanges' proposal to introduce a closing auction session in Hong Kong. We would firstly like to say that we support the creation of a closing auction session. However, we believe that improvements can be made, with references to the practices and experiences in other markets, to make the closing auction more efficient in terms of establishing the equilibrium prices and increasing the order completion rates.

Please find our further thoughts on the Exchange's proposed closing auction session below. Should you have any questions to our response, please do not hesitate to contact me.

Yours faithfully

A handwritten signature in black ink, appearing to read 'Simon Wong'.

Simon Wong  
Director, Senior Compliance Officer  
Office of General Counsel





**1. Do you have any other comments on the application of a closing auction session? Please explain your view.**

Please refer to below sections.

**2. Do you support the proposal to introduce a closing auction session? Why or why not? Please explain your view.**

Merrill Lynch supports the Exchange's proposal to introduce a closing auction session for the Hong Kong market. In addition to all the reasons mentioned in the Exchanges consultation paper, we believe with the introduction of a closing auction session this would take away some of the concerns traders and compliance officers may have on activities near or at the close.

**3. Are there any other suggestions on the proposed features / trading arrangements of the closing auction which we ought to consider? Please explain your view.**

One area of concern our business has expressed is how they could ensure orders that are entered to be executed during the closing auction period would actually get filled. As an example, we could have a large number of "market on close" orders from clients where the client is expecting us to achieve the closing price. At the moment, it can be quite tense to get them all filled in the last few minutes before the close. In theory, having a closing auction session relieves this pressure as we have the whole closing auction session to enter our closing price orders. However, if the orders are not filled, we are then left with the same issue with how we can complete the orders.

If the matching mechanism of the Hong Kong's closing auction session mirrors that of the existing pre-open auction session, our business has expressed strong reservations about the feasibility of the proposed closing auction given their experience with the current pre-open auction. Our business pointed out that the auction market order completion percentage rate for mid and small cap stocks in the pre-open auction session is fairly low. This percentage is very unfavorable when compared with the closing auction order completion rates of other markets such as Taiwan, Korea and Singapore. If auction market orders entered in the closing auction session cannot be filled, our business may have to execute their orders in the continuous trading session to ensure completion, which then would defeat the whole purpose of having the closing auction.

Given these concerns, we wonder whether the Exchange have conducted any simulations to study and compare the order matching results for the Hong Kong market using the closing auction methodologies of these other markets to assess whether any improvements can be made to increase the order completion rate.



**4. What would be the estimated lead time required for changes to systems and operations of your firm to cater for the proposed closing auction session?**

*Systems requirements:* as we expect the systems requirements to be much the same as that of the pre-open session, we do not expect that we would require much more than two or three days of lead time to make any necessary systems changes.

*Operations:* however, there could be more impact to our operations processes should the extended market hours from a closing auction session lead to delays in when CCASS is able to make reports available to market participants. For example, we currently receive from CCASS our 'end-of-day marks' report at around 4:35PM. We use this report to determine our funding needs with our Treasury unit, but a delay in receiving this report could affect our ability to manage and meet our funding deadlines. At present, there does not appear to be much information in this regard and it would be helpful if further detailed information could be provided to market participants so that market participants like ourselves can better assess the extent of impact – if any – to better prepare and implement the necessary changes.

**5. Do you have any comments on the random closing approach? Please explain your view.**

We believe the current proposal of a fixed closing auction session is sufficient for the Hong Kong market. A random closing session may not necessarily result in additional benefits and may instead result in less transparency and more uncertainty.

**6. Are there any other issues regarding the introduction of a closing auction session not mentioned in this consultation paper that we ought to consider? Please explain your view.**

Please refer to our response under item #3.