

Morgan Stanley



May 15, 2007

Hong Kong Exchanges and Clearing Limited
12th 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 appreciate the opportunity to comment on the Consultation Paper on the Introduction of a Closing Auction Session (the “**Consultation Paper**”) proposed by the Hong Kong Exchanges and Clearing Limited (“**HKEx**”).

First and foremost, we would like to compliment the HKEx on the comprehensive review it has conducted in connection with the proposal contained in the Consultation Paper.

We wish to confirm from the outset that we are fully supportive of the HKEx’s proposal to introduce an end-of day closing trading session for all securities which allows the input of orders into AMS/3 for a single price auction (closing auction session) after the completion of the continuous trading session. We also support the proposal that the trading mechanism to be adopted for the closing auction session should be largely similar to that currently used in Hong Kong for the pre-opening session, which has operated smoothly since its introduction in 2002.

On points of detail, we set out below our comments in response to the list of questions set out at Appendix III of the Consultation Paper.

Do you have any other comments on the application of a closing auction session?

As correctly pointed out in the Consultation Paper, the popularity of a closing auction mechanism has increased in recent years and has become the international practice adopted by most equity markets. The introduction of a closing auction session in Hong Kong as described in the Consultation Paper will bring the Hong Kong securities market in line with leading international practice. We believe this to be beneficial to market participants and a great step forward in the development of the Hong Kong securities and futures markets as a whole.

2. Do you support the proposal to introduce a closing auction session? Why or why not?

We fully support the proposal to introduce a closing auction session for the following reasons:

- (a) We are of the view that the introduction of a single price closing auction session should provide a fairer mechanism to determine the closing price of a stock than the current closing price calculation mechanism. The closing price calculation mechanism in a single price closing auction session is also likely to be less susceptible to unscrupulous or manipulative devices.

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- (b) The closing auction session should have the effect of reducing price volatility towards the market close. The added market transparency in the closing auction mechanism should help reduce the undesirable price fluctuations towards market close experienced from time to time under the current closing mechanism, where market participants attempt to execute trades at a price proximate to the closing price. The reduced price volatility should be particularly noticeable on those trading days immediately ahead of an index rebalancing that takes place after the market close on the day.
- (c) The introduction of a closing auction session should further strengthen market participants' ability to trade near the close as the concern over price impact should be alleviated. Accordingly, we envisage a generally higher trading volume near the close following the introduction of a closing auction session.

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

(a) Duration of the closing auction session

We recommend that the closing auction session should end as soon as possible after the Order Input Period has finished. There seems to be room for reducing the proposed five-minute order matching period, during which traders are not allowed to input, modify or cancel any orders. It should be noted that a prolonged closing auction session delays the confirmation of executions to clients as the price of an executed trade could be based on the closing price or other prices dependent on the closing price such as VWAP.

(b) Market data and transparency

We suggest that the Exchange provide the same market depth information that is available during the market pre-opening session. The bid and offer price and corresponding quantity information is invaluable to all market participants. The Exchange should work to incorporate the at-auction orders into the detailed market data display.

(c) Closing prices of illiquid stocks

We agree that if the closing auction session does not generate a closing price or the Indicative Equilibrium Price (IEP), which may happen for certain illiquid stocks, the existing method should be adopted to calculate the closing price using the median of the five 15-second snapshots taken in the last minute of the continuous trading session.

(d) Closing time for derivatives market

We consider that the closing time for the derivatives market should be extended so that there is a ten-minute window between the time when the securities closing prices are disseminated to the market and the closing of the derivatives market. This ten-minute window will give index derivative and arbitrage traders an opportunity to rebalance their positions relative to the closing prices of the securities market.

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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?**

We estimate that at least 3.5 months' lead time is required for changes to our systems and operations to be completed to cater for the proposed closing auction. This includes the time required for development and the necessary testing on the systems.

5. **Do you have any comments on the random closing approach?**

In principle, we have no objections to adopting the random closing approach.

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?**

Our experience with the pre-opening session shows auctions promote an orderly, efficient and equitable securities market. Accordingly, we support the introduction of a closing auction session in Hong Kong.

If you have any questions regarding the forgoing, please do not hesitate to contact us.

Yours faithfully,

For and on behalf of

Morgan Stanley Dean Witter Asia Limited

Morgan Stanley Dean Witter Hong Kong Securities Limited



Sam Kellie-Smith
Managing Director