

December 31, 2008

Corporate Communications Department
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 Price Control Mechanism during the Closing Auction Session in the Securities Market (the "Consultation Paper")

We write in response to the Consultation Paper on the proposed introduction of a price limit during the closing auction session.

We believe a closing auction is the most common way to improve liquidity and price discovery at the close. It also gives investors an opportunity to trade at the closing price, while minimizing impact on the market and in theory reducing price volatility. However, a number of factors may impair its effectiveness and we agree that the Exchange should consider further enhancing the existing closing auction framework.

On the other hand, we disagree with all three suggestions in the Consultation Paper to introduce a price control limit of one form or another. A tight bid/ask price limit will give a false impression that there will be a closing price within a tight spread limit which can clear all demands and supplies whereas a wide bid/ask price limit will render the mechanism effectively useless.

Given the Exchange is predominantly concerned about excessive price movements arising from manipulative behaviours during the closing auction, we suggest the Exchange to consider a few features which are widely adopted internationally in developed markets to enhance the auction process.

Random Closing

The Exchange raised "Random Closing" as an alternative during the consultation in March 2007 although it was not adopted in the end. This feature is in fact widely adopted by many international exchanges around the world such as London Stock Exchange, Deutsche Börse etc. We strongly believe that it is one of the most effective and widely accepted ways to guard against market manipulation during an auction trading session and we suggest the Exchange to implement this feature into the closing auction session.

Extension Sessions

Extension session is another feature adopted by some global exchanges such as the London Stock Exchange. It is a mechanism where the closing auction will be prolonged when the closing prices exceed certain price threshold or when market imbalances occur in order to provide the market with more time to react. The extended sessions give participants a chance to review the prices of their orders entered during the original auction period before the auction match occurs. Participants may also enter limit and market orders to correct these imbalances. The extra time of such an extension period also draws attention to the imbalance and gives other participants a chance to enter orders if they deem that price to be reasonable and wish to trade against it thereby correcting the market imbalance.

Pre-Order Matching Period

The current Pre-Order Matching Period allows only at-auction orders to be entered and all existing orders cannot be modified or cancelled. We suggest removing the Pre-Order Matching Period to have only one order inputting session where all orders are allowed to be inputted, amended and cancelled. We understand the Exchange's intention of having the current restrictions in the Pre-Order Matching Period is to avoid significant changes in the prices due to withdrawal of orders immediately before the commencement of order matching. However, experiences show that market orders can also have significant effects on prices. Hence, the inability to amend and/or cancel orders during the Pre-Order Matching Period even when prices moved significantly against them inhibits the price discovery process. For similar reasons, we also believe that limit orders should continue to be allowed as legitimate buyers and sellers may wish to limit their exposure to sharp movement in prices by entering limit orders instead of market orders. These limit orders may also have the advantage of restricting movements in prices when comparing to market orders. To address the Exchange's concern, we believe the best way to guard against the manipulative behaviour will be a Random Closing mechanism.

We believe the Exchange should consider adopting these features into the closing auction. We also understand the Exchange is considering suspending or removing the closing auction. Experiences show that the median methodology was similarly prone to manipulation and volatility. However, if the Exchange really considers removing the closing auction, we suggest adopting a VWAP methodology instead of the previous 5 snapshots median approach.

We are happy to provide further information if needed. If you have any questions, please contact me at [REDACTED].