

## PART B: DETAILED QUESTIONS FOR RESPONSE

Please indicate your preference by providing comments as appropriate. Where there is insufficient space, please attach additional pages as necessary.

- (1) The first commitment period of the Kyoto Protocol will expire in 2012. The continuity of CERs as recognized carbon emission offsetting credits under the Kyoto Protocol is subject to a new international framework for the second commitment period under negotiation with a target completion in the United Nations Climate Change Conference in Copenhagen in December this year. Meanwhile, the US appears to be committed to develop a US emission trading scheme, but the details of the scheme are subject to further announcement and the relevance of CERs is uncertain. Against this background, do you think CERs should be the core carbon emission product to pursue in Hong Kong now or in a few years' time?

CER is designated as credit for offsetting GHG emissions bound by the Kyoto Protocol. As the commitment period of the Protocol will be ended by 2012, the criteria for the generation and application of CER will be subject to significant change pending for the discussion at UNFCCC's Copenhagen Conference this December. Therefore, we consider any premature decision before the Copenhagen Conference is not appropriate and suggest pushing back to mid 2010 or when there are clearer roadmaps for both China and Hong Kong before conducting another consultation.

- (2) At this stage, the global CER market is dominated by European participants connected to the EU ETS and the delivery of CERs is based on the EU standard. Mainland China is the major supplier of CERs, which focuses on clean development projects and CER origination. Under Mainland China's policy, CERs are usually engaged by foreign investors based on forward sale agreements before they are issued by the United Nations. As such, the secondary CER trading market is not developed. European participants are using CER markets in Europe to manage their carbon emission trading needs and risk exposure. Under the existing market conditions, in what way can Hong Kong add value to the business process of the CER market and attract carbon emission trading participants to the Hong Kong marketplace? What are the success factors for Hong Kong to develop a commercially viable CER trading platform that can attract trading activities and develop trading liquidity? Do you think Hong Kong possesses the success factors? Please explain your view.

Hong Kong possesses the business-friendly environment, well established rule of law and comprehensive financial platform supporting the development of all economic activities. Nonetheless, given the uncertainty of CER for 2012 and beyond, it is prudent to review the subject matter after the negotiation of international agreement on combating climate change is concluded end this year at Copenhagen. It is envisaged as a new financial product to local investors and with no strong local trading need, it is questionable a trading platform could attract the necessary volume and liquidity.

- (3) Do you consider Hong Kong investing communities have sufficient knowledge in carbon emission trading and are they ready to participate in trading CERs products? Please explain your view.

Hong Kong investing communities in general enjoy and share free flow of local and international information which are of interest and concern to them. The communities can acquire the information and knowledge without any difficulty once a need and mature market are there. Yet CER financial products are still something very new to the local communities thus exposing them to the risk of making decision under imbalanced information against overseas counterparts. The high volatility coupled with occasional dormancy seen in overseas CER markets will likely deter HK investing communities following the bitter experience on financial derivatives in the past year. There are also insufficient experiences in particular if new post 2012 international agreements on climate change are only established after Copenhagen.

- (4) If you are a financial intermediary, please respond to the following questions:

- (i) Do you see any potential in the asset class of carbon emissions and how would you rank the priority of carbon emission trading business among your other business initiatives? (high, medium or low)?

N/A

- (ii) How would you assess your clients' interest in carbon emission trading? Do you have the know-how and expertise in handling carbon emission trading related operations and providing advisory services to your clients?

N/A

- (iii) Are you located in Hong Kong and if so are you an Exchange Participant of Hong Kong Futures Exchange?

N/A

- (5) Are there any other issues regarding the introduction of CER futures not mentioned in this consultation paper that we ought to consider? Please explain your view.

Given the short history of CER trading in overseas markets, it would be more comprehensive to elaborate the market development and trend of EU ETS from 2005 to now as reference, especially the price volatility of EAU during 2006. In addition, the compliance requirements for entities under the EU jurisdiction and the emission allowance allocation policy of different EU members should be described.

- (6) Do you have any other comments in relation to the overall development of emissions or pollutants trading markets in Hong Kong?

The introduction of emissions trading has attracted fierce debates amongst advocates worldwide. For example, in Australia, the emissions trading legislation had been recently voted down as concerns were expressed that the emissions trading would reduce Australian living standards by increasing unemployment and substantially raising the electricity charges with zero environmental gain. Advocates pointed out that regards should be given to the outcome of the Copenhagen conference to be held in December this year and it would be reckless to act before the rest of the world (in particular, the United States) do so. In addition, due to the recent worldwide financial tsunami, both the carbon emissions level and carbon price had been seen to have decreased substantially, which in turn lowered the demand for emission credits. Therefore, it is questionable whether this is an appropriate time to introduce carbon trading. Hong Kong should take a wait-and-see approach and not to pursue carbon emission trading without knowing the outcome of the political development of the issue as well as the actions undertaken by other countries.

Further, the initiative to develop emissions or pollutants trading markets in overseas is primarily to provide a mechanism to encourage near term emission reduction for large industrialized countries with the financial function of trading as secondary. There is practically no heavy industry in Hong Kong making counter-party trading for the benefit of emission reduction unlikely.

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