

## 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?

If you wish to list an exchange contract for emissions on HKEX in 2009 then you have no real choice other than CERs. However, in order to see any sustained liquidity it will always be necessary to list CERs alongside EUAs.

In the longer term CERs will likely see degrading liquidity. And we would see Chinese sectoral credits as a more attractive long term listing. However, this obviously requires further legislation.

- (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.

HKEX has no structural advantages in launching emission contracts for CERs or EUAs. It is not the natural home of major market players/liquidity providers, it can offer no cross-margining advantages, and it faces hard competition from the legacy exchanges where liquidity is already established. Fees are not a significant issue for traders so the ability to compete on cost is also limited.

Perhaps HKEX may be more competitive in a China domestic emissions trading/sectoral trading environment where HKEX would be a more natural base for structural demand and supply. But this is again contingent on legislation.

- (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.

We see no evidence to support this. We see no significant emissions trading activity from the HK based investment community.

- (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)?

Emissions trading is an integral part of the commodities and energy trading portfolio.

- (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?

We have a large customer base across the whole emissions value chain. We are active in proprietary trading, customer risk management, origination, development of emissions products for financial investors and direct equity investments.

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

[REDACTED]

- (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.

No.

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

No

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