

## **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?

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- (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.

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- (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 have highlighted a number of concerns in our response to Question 2. However, a number of the world's major financial institutions, which are key participants in the global carbon markets, have substantial presences in Hong Kong. A significant number of Chinese entities are familiar with the carbon markets and, in particular, the CDM. Carbon is increasingly treated as a commodity like any other, albeit with particular characteristics driven by the fact that it is a policy-driven product. Given these factors we do not believe that lack of knowledge will, in itself, be a barrier to the establishment of an exchange.

- (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)?

Norton Rose Group is not a financial intermediary - question does not apply.

- (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?

Norton Rose Group is not a financial intermediary - question does not apply.

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

Norton Rose Group is not a financial intermediary - question does not apply.

- (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.

We understand that it is intended that the proposed exchange will closely follow the "European" model. However, there are a number of important issues that are not covered in the consultation. These include the nature of the documentation that exchange participants would be required to sign up to, fees, the conditions for participation in the exchange and information relating to data protection.

Whilst we understand that such details would be released at a later stage, they are likely to be of interest to anyone taking a view as to whether participation in any exchange would be desirable.

Further, we note that the use of CERs for compliance purposes in different jurisdictions is likely to become increasingly complicated by the imposition of different qualitative standards. We would therefore recommend that an ability to address such requirements in an efficient manner be built into the exchange architecture from the outset.

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

- End -

## **ADDITIONAL PAGE 1**

### **Answer to Question 1**

**Norton Rose Group notes that this consultation response should not be taken to suggest our support of any specific trading platform over other platforms. This consultation response seeks to provide input into a number of commercial considerations that we believe Hong Kong Exchanges and Clearing Limited should take into account in determining whether or not to proceed with implementing a CER exchange.**

Norton Rose Group recognizes the challenges posed to the carbon markets by the ongoing climate change negotiations. However, we hope and believe that the CDM will continue to play a role in the global carbon markets for a considerable time to come. The EU Emissions Trading Scheme, presently the world's largest carbon market, foresees the use of CERs as a compliance instrument throughout its third Phase until 2020.

Norton Rose Group believes that the establishment of a CER exchange in the Asia-Pacific region in the near-term would send out a positive signal about the future of the CDM. The exchange would provide the platform, institutions and knowledge required to help implement a "full service" carbon market in Asia.

Though there are not currently compliance-driven buyers in the Asia-Pacific region, this is unlikely to remain to be the case in the medium-term. The development of an exchange in Hong Kong would place Hong Kong well to support such new markets in the future. We also note that there are a number of potential Sellers of CERs in the region. Further, the establishment of a new exchange would also put that exchange in a strong position in relation to supporting the development of any new mechanisms (including, for example, a sectoral mechanism) that may be put in place as a result of a future climate change agreement.

Finally, it is our understanding that other jurisdictions in the Asia-Pacific region are also contemplating the introduction of a CER exchange.

## ADDITIONAL PAGE 2

### Answer to Question 2

We have set out the reasons that we believe it to be important for new exchanges to be established in the Asia-Pacific region above.

There are a number of reasons why Norton Rose Group believes that Hong Kong has the success factors required to develop a commercially viable CER trading platform. These include:

- Hong Kong has always been an innovative market which has been at the cutting edge of the development of new products. The establishment of a CER exchange would be a natural progression for Hong Kong, rather than a radical leap into unknown territory.
- The success of the CDM in China and likelihood that China will play a significant role in the future global carbon market.
- Hong Kong has a regulatory environment that will be attractive to participants in a CER exchange.
- Relative to existing exchanges in the People's Republic of China, Hong Kong is in an advantageous position as it is not subject to currency controls, has a different regulatory system, and has increased access to international investors.
- Increasing numbers of compliance buyers are likely to be located in similar time zones and relative geographical proximity to Hong Kong in the future (for example under an Australian emissions trading scheme).
- China is already the world's leading jurisdiction for the origination of CERs.
- Exchanges have typically developed in proximity to the source of both *supply* and demand for the products that are traded on them. It therefore appears consistent for exchanges to be developed in the Asia-Pacific region.
- There is likely to be interest in using an exchange as a marketplace for selling CERs.

However, we acknowledge that volumes traded on a Hong Kong CER exchange are unlikely to be substantial in the near-term. Reasons for this include:

- The CER market is very "thin" and there are risks associated with further splitting liquidity.
- There are few existing compliance requirements in the region. The main market drivers are in Europe and the US, neither of which is suited to an Asian time zone.
- Most financial institutions in Asia involved in carbon trading are already established in other locations.
- The potential future Australian market is accustomed to managing trading requirements in other time zones.
- There are a number of competitors for the Australian trading market already (including the Australian Securities Exchange).
- There are already a number of exchanges in Asia, none of which is liquid.

The establishment of a new exchange in the Asia-Pacific region should therefore be seen as an important means of preparing for the future. If there are concerns about the viability of an exchange given anticipated levels of volume, we would recommend that an independent study is commissioned in order to assess likely levels of volume over different timeframes.