

# CONSULTATION CONCLUSIONS

## CERTIFIED EMISSION REDUCTION FUTURES

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Hong Kong Exchanges and Clearing Limited  
香港交易及結算所有限公司

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# EXECUTIVE SUMMARY

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1. Since 2007, HKEx has been exploring possible long-term business opportunities in carbon emission trading in Hong Kong. HKEx engaged an external consultant group for advice on the carbon emission trading business and a cross-departmental working group was formed to study the feasibility of offering Certified Emission Reduction (CER) futures. To seek views and comments from parties interested in carbon emission markets (including financial intermediaries, investors, Clean Development Mechanism (CDM) project participants, academics and public policy makers) on the feasibility of developing a carbon emission trading platform in Hong Kong and the product concept of CER futures, HKEx conducted a public consultation in the third quarter of 2009. This paper presents the responses received and HKEx's conclusions following the public consultation period.
2. HKEx received 24 submissions, including 5 late submissions. Respondents included financial intermediaries (carbon trading desks from investment banks and a financial services company), CDM project advisory companies, carbon trading companies, industrial and professional associations, utility companies in Hong Kong, an overseas governmental body and two individuals.
3. HKEx did not receive any responses from its Exchange Participants, though four respondents were their overseas affiliates. Major stakeholders of the CER market, like CDM project developers and compliance buyers, did not respond to the consultation paper.
4. Most of the respondents believed that CERs should be the core carbon emission product in Asia. However, there was uncertainty as to whether Hong Kong was the right place and as to the right development timeframe.
5. The feedback on success factors can be classified in 2 types, general and specific success factors. For general success factors, respondents saw Hong Kong as a mature and well-regulated marketplace with good investor relationships. Several respondents believed the active participation of Mainland CER sellers in HKEx's marketplace would be required for Hong Kong to successfully develop a CER futures trading platform. That would in turn depend on Mainland policies. Although Mainland China is the largest supplier of CERs in the world, there is no secondary trading market in Mainland China for CERs as the National Development and Reform Commission (NDRC) requires CDM project developers to have contractual agreements with CER buyers before the CDM project developers can obtain the approved CERs. As there is no local compliance buyer community in the Mainland, the CER buyers are overseas institutions. There has not been any sign of change in the policies that would facilitate the development of a secondary market for CERs.
6. A majority of the respondents indicated that the knowledge and experience of the Hong Kong investing community and its practitioners regarding carbon emission trading was still low. A few overseas carbon market players indicated interest in a CER futures trading platform in Hong Kong, but the number did not suggest a critical mass was likely at this time for the development of trading liquidity.
7. In summary, although CER futures are seen to be a potential product for Hong Kong to consider if it wants to pursue entry into emissions market trading, there was no positive feedback from major stakeholders, including CDM project developers, compliance buyers and Exchange Participants. Given the Hong Kong investing community's low knowledge and experience levels in carbon emission trading and Mainland China's policy in approving CER origination, HKEx has concluded there is no imminent need for a CER futures market in Hong Kong at this time.

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8. Nevertheless, HKEx reckons the carbon emission markets may become much more important in the long term, and it will continue to monitor the development of emission policies on the Mainland, in other Asian markets and in other parts of the world which might favour more secondary markets for carbon emission trading. One of the policy developments HKEx will examine in the near term is the potential changes to the development of emission policies in different countries resulting from the United Nations Climate Change Conference in Copenhagen. If any policy changes in carbon emission trading arise in future that seem favourable for Hong Kong, HKEx will revisit the product concept of CER futures. To improve market knowledge in carbon emission trading, HKEx will cooperate with relevant organizations in providing education and training to Hong Kong investing community in relation to carbon emission trading.

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# PART A: INTRODUCTION

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## Background

1. Since 2007, HKEx has been exploring possible long-term business opportunities in carbon emission trading in Hong Kong. HKEx employed an external consultancy firm to conduct a consultancy study on the strategies it could consider in relation to participating in the growing carbon emissions market. Based on that study, HKEx formed a cross-departmental working group to assess the feasibility of developing a CER futures market in Hong Kong (CERs are carbon emission credits generated from CDM projects under the Kyoto Protocol, which can, subject to some conditions, be used to fulfil carbon emission compliance requirements in some developed countries). CER futures provide trading and risk transfer opportunities to CER market participants. At HKEx, the likely market participants would be based in the Asian time zones.
2. In the first half of 2009, HKEx executives spoke with carbon emission market players in Hong Kong, Singapore, Australia and the UK to seek their views and comments, and assess their views and interest in participating in a CER futures market in Hong Kong.
3. In late June 2009, HKEx started a broad-based public consultation on CER futures by issuing a consultation paper to seek comments from all parties interested in carbon emission markets (including financial intermediaries, investors, CDM project participants, academics, and public policy makers) on the feasibility of developing a carbon emission trading platform in Hong Kong and the product concept of CER futures.
4. This consultation paper invited public comments on the business need for a carbon emission trading platform in Hong Kong and the appropriate pace of its development if one was needed. Specifically, HKEx invited public comments on the success factors required for Hong Kong to develop a commercially viable carbon emission trading platform and how HKEx could add value to the business processes of the CER market.

## Consultation Process

5. HKEx published the consultation paper on CER futures on 26 June 2009 and invited interested persons to submit their views. The consultation paper was posted on HKEx's website at: <http://www.hkex.com.hk/consul/marketconsultation.htm>.
6. To get the attention of relevant parties which might be interested in carbon emission trading in Asia to submit their comments, HKEx notified Exchange Participants, financial intermediaries, investors, compliance buyers, CDM project developers, advisory companies, carbon trading companies, environmental bodies and public policy makers about the publication of the consultation paper.
7. During the consultation period, HKEx organised a media workshop to help reporters better understand the carbon emission market and the product concept of CER futures. Thirty-five journalists attended the workshop.
8. The consultation period ended on 31 August 2009. HKEx received 24 submissions from respondents with a variety of backgrounds (a list of the respondents is provided in Appendix I). The submissions are posted on the HKEx website at: <http://www.hkex.com.hk/consul/response/cp200906dmr.htm>.

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9. Information on the backgrounds of respondents and a summary of the comments received is set forth in Part B – Overall Market Feedback.
  10. HKEx would like to take this opportunity to thank all those who shared their views and suggestions during the consultation process.

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## **PART B: OVERALL MARKET FEEDBACK**

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### **The Respondents**

1. The business backgrounds of respondents can be grouped into the following categories:

<b>Category</b>	<b>Number of Respondents</b>
Exchange Participants	0
Financial Intermediaries	5
Investors and Compliance Buyers	0
CDM Project Developers	0
Academics	0
Public Policy Makers	1
Others:	
CDM Project Advisory Companies	8
Carbon Trading Companies	3
Industry and Professional Associations	3
Individuals	2
Utility Companies in Hong Kong	2

### **Summary of Responses to the Consultation Questions**

2. Six consultation questions were set forth in the Consultation Paper on CER Futures and the responses to each question are summarised in the third column of the following table.

<b>No.</b>	<b>Question</b>	<b>Responses</b>
1	Do you think CERs should be the core carbon emission product to pursue in Hong Kong now or in a few years' time?	Many respondents regarded CER as the core carbon emission product to pursue in Hong Kong. The details are as follows:  a) 19 respondents said CER should be the core product to pursue in line with the global trend, given the strong supply of CDM projects in Mainland China and the potential growth of the CER market, but not many respondents commented on whether Hong Kong is the right place for CER trading or now is the good time for CER trading in Hong Kong.

		<p>b) 2 respondents were in doubt about the future development of the CER market due to uncertainties about the outcome of the Copenhagen conference in December 2009.</p> <p>c) 1 respondent did not think that CER should be the core product to pursue unless CDM and CERs were made easier to administer and manage.</p>
2	<p>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?</p> <p>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?</p> <p>Do you think Hong Kong possesses the success factors? Please explain your view.</p>	<p>Only a few respondents expressed opinions on the value that Hong Kong can add, the way to attract carbon emission trading participants and the specific success factors required for Hong Kong to develop into a CER futures trading centre. The details are as follows:</p> <p>a) 5 respondents believed that a regulated CER market in the Asia-Pacific time zone could add value in the longer term as a bridge between international CER buyers and Mainland CDM developers.</p> <p>b) Based on the respondents' comments, the success factors required to develop a commercially viable CER futures platform can be classified as follows:</p> <p>General success factors:</p> <ul style="list-style-type: none"> <li>i) Mature and regulated market in trading futures and options; and</li> <li>ii) Good investor relationships.</li> </ul> <p>Specific success factors:</p> <ul style="list-style-type: none"> <li>i) High liquidity and market makers participating in carbon emission trading;</li> <li>ii) Mainland China policies which facilitate Mainland CDM project developers' use of a secondary CER market in Hong Kong; and</li> <li>iii) Mainland CER sellers with access to HKEx's marketplace.</li> </ul> <p>c) In summary, respondents were of the view that Hong Kong possesses the general success factors listed above. However, none commented on whether Hong Kong possesses the specific success factors mentioned. Although Mainland China is the largest supplier of CERs in the world, there is no CER secondary trading market in Mainland China as the NDRC requires CDM project</p>

		<p>developers to have agreements with CER buyers before the CDM project developers can obtain the approved CERs. There has not been any sign of changes in the policies that would facilitate the development of a secondary CER trading platform.</p>
3	<p>Do you consider Hong Kong investing communities have sufficient knowledge in carbon emission trading and are they ready to participate in trading CER products? Please explain your view.</p>	<p>Many respondents pointed out that Hong Kong investing community lacks knowledge in carbon emission trading. The details are as follows:</p> <ul style="list-style-type: none"> <li>a) 8 respondents opined that the knowledge and experience of carbon emission trading within Hong Kong's investing community is low.</li> <li>b) 1 respondent thought that there is a lack of relevant market players in Hong Kong.</li> </ul>
4	<p>If you are a financial intermediary, please respond to the following questions:</p> <p>(i) Do you see any potential in the asset class of carbon emission and how would you rank the priority of carbon emission trading business among your other business initiatives? (high, medium or low)?</p>	<p>The 9 respondents to this question classified themselves as financial intermediaries. They included banks, CDM project agencies, carbon trading companies and professional associations, but there were no responses from Exchange Participants of Hong Kong Futures Exchange (HKFE). Their responses can be summarised as follows:</p> <ul style="list-style-type: none"> <li>a) 5 respondents regarded the priority as high.</li> <li>b) 1 respondent regarded the priority as medium to high.</li> <li>c) 2 respondents regarded the priority as increasing.</li> <li>d) 1 respondent did not rank the priority.</li> </ul>
	<p>(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?</p>	<p>There were 9 respondents to this question and the feedback can be summarised as follows:</p> <ul style="list-style-type: none"> <li>a) 6 respondents had carbon trading experiences overseas, but not in local markets.</li> <li>b) A respondent from a CDM agency on the Mainland said the agency's clients are interested in trading in the CER market.</li> <li>c) A respondent from a professional association said some of the group's members are CER buyers.</li> <li>d) 1 respondent provides advisory services to clients.</li> </ul>
	<p>(iii) Are you located in Hong Kong and if so are you an Exchange Participant of Hong Kong Futures Exchange?</p>	<p>The 9 responses on this question can be summarized as follows:</p> <ul style="list-style-type: none"> <li>a) 7 respondents are located in Hong Kong or have offices in the city.</li> </ul>

		<p>b) 1 respondent stated that it is not located in Hong Kong.</p> <p>c) 1 respondent did not indicate its location.</p> <p>No response was received from existing HKFE Exchange Participants.</p>
5	<p>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.</p>	<p>The key issues raised by respondents are summarised below:</p> <p>a) There are concerns about payment risk and project risk among CER sellers and developers.</p> <p>b) A respondent suggested the introduction of spot CER contracts.</p> <p>c) A respondent suggested HKEx should hold auctions for CERs.</p> <p>d) A respondent suggested renminbi-denominated CER futures to meet the demand from Mainland China players.</p> <p>[HKEx's response: Mainland project developers do not require auctions as they have to identify committed CER buyers before they can obtain CERs.]</p>
6	<p>Do you have any other comments in relation to the overall development of emission or pollutants trading markets in Hong Kong?</p>	<p>The key comments of respondents are summarised as below:</p> <p>a) Product related</p> <ul style="list-style-type: none"> <li>▪ HKEx should introduce other carbon markets, e.g. EUA*, SO<sub>2</sub>*, COD* products and voluntary carbon markets.</li> </ul> <p>b) Market related</p> <ul style="list-style-type: none"> <li>▪ HKEx will have a role within the Asian time zones if multiple trading schemes are operated in the future.</li> <li>▪ Competition will be keen later and cooperation may be required between HKEx and climate exchanges in Mainland China.</li> </ul> <p>c) Global development</p> <ul style="list-style-type: none"> <li>▪ The development of trading schemes in US and Australia will be important to the development of the emission trading market.</li> </ul> <p>d) Local development</p> <ul style="list-style-type: none"> <li>▪ Hong Kong does not have any heavy industry requiring an emission trading mechanism.</li> </ul>

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\* EUA = European Unit Allowance, a right that allows industries that fall under the regulations of the European Emission Trading Scheme to emit one metric ton of carbon dioxide; SO<sub>2</sub> = Sulphur Dioxide; COD = Chemical Oxygen Demand.

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# PART C: CONCLUSION

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## Consultation Conclusions

1. Since 2007, HKEx has been exploring long-term business opportunities related to the development of a carbon emission market in Hong Kong. The initiative involved the engagement of an external consultancy study, an internal cross-departmental working group study on the operational feasibility of CER futures trading in Hong Kong and discussions with various market participants and emission trading entities. Furthermore, HKEx conducted this public consultation to ascertain public interest, market demand and market readiness for carbon emission trading and collect market feedback on the product concept of CER futures.
2. In summary, respondents considered carbon emission trading likely to be a growth market in the future, with CERs as a core carbon emission product in Asia. However, they considered demand for a market for CERs in Hong Kong to be limited at this time, which is in line with the results of HKEx's informal consultation with market participants.
3. HKEx's Exchange Participants did not respond to the public consultation. In addition, responses to the consultation indicated the knowledge level of the Hong Kong investing community and practitioners regarding carbon emission trading is still low. There are also no regulatory requirements in the region (except Japan) that can generate natural demand for CERs.
4. There was no response from CDM project developers, which reflected little secondary trading interest from CER originators. It is understood that Mainland CDM project developers do not require a secondary market for trading CERs, as they are required to have sale agreements with primary CER buyers overseas before they can obtain CERs.
5. A few respondents highlighted the fact that Mainland China's policy and Mainland CER sellers' access to HKEx's marketplace would be major success factors required for Hong Kong to successfully develop a CER futures trading platform. Although Mainland China is the largest supplier of CERs in the world, there is no secondary market in Mainland China for CER trading, as the NDRC requires CDM project developers to have agreements with CER buyers before the CDM project developers can obtain approved CERs. As there is no local compliance buyer community in the Mainland, these CER buyers are overseas institutions. There has not been any sign of change in the policies that would facilitate the development of a secondary market for CER trading.
6. A few overseas carbon market players indicated interest in trading CER futures in Hong Kong, but the number does not represent a critical mass for development of trading liquidity in an exchange-traded market.
7. In summary, although CERs are considered the right product to pursue, no positive feedback regarding CER futures was received from major stakeholders including CDM project developers, compliance buyers and Exchange Participants. Given the low knowledge level regarding carbon emission trading in the Hong Kong investing community and Mainland China's policy in approving CER originations, HKEx has concluded there is no strong demand for a CER futures market in Hong Kong at this time.
8. Nevertheless, HKEx reckons the carbon emission markets may have long term importance, and it will continue to monitor the development of policies on the Mainland, in other Asian economies and other parts of the world which may favour the development of more secondary markets for CERs. One of the policy developments HKEx will examine in the near term is the potential changes to the development of emission policies in different countries resulting from the United

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Nations Climate Change Conference in Copenhagen. If any policy changes in carbon emission trading arise in future that are favourable for Hong Kong, HKEx will revisit the product concept of CER futures. To improve market knowledge in carbon emission trading, HKEx will cooperate with relevant organizations in providing education and training to Hong Kong investing community in relation to carbon emission trading.

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# APPENDIX I: LIST OF RESPONDENTS

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## Exchange Participants

Nil

## Financial Intermediaries

1-5. Financial intermediaries which requested anonymity

## Investors and Compliance Buyers

Nil

## CDM Project Developers

Nil

## Academics

Nil

## Public Policy Makers

6. British Government

## Others

### CDM Project Advisory Companies

7. Biocarbon Capital Limited
8. Carbon Rooster Advisory Services BV
9. Deloitte Consulting (Hong Kong) Limited
10. SGS Hong Kong Limited
11. Mallesons Stephen Jaques and Climate Focus
12. Norton Rose Group
13. Xiamen Europe Power Investment Advisory Co Ltd
14. A CDM project advisory company which requested anonymity

### Carbon Trading Companies

15. Orbeo
16. Sagacarbon, SA
17. A carbon trading company which requested anonymity

### Industry and Professional Associations

18. Carbon Markets & Investors Association
19. The British Chamber of Commerce in Hong Kong
20. The Hong Kong Institute of Certified Public Accountants

### Individuals

21. Anthony Yuen
22. Michael W Leung

### Local Utility Companies

- 23-24. Local utility companies which requested anonymity

