

## 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?**

CMIA recognizes the challenges posed to carbon market participants by the ongoing climate change negotiations. However, we believe that the CDM will continue to play a role in the global carbon markets in the medium term. The EU Emissions Trading Scheme (EU ETS), presently the world's largest carbon market, foresees the use of CERs as a compliance instrument throughout its third Phase (2012-2020).

CMIA believes that the establishment of a CER exchange in the Asia-Pacific region would send a positive signal about the future of the CDM. An exchange would provide the platform, institutions, and build market participant knowledge with the aim of creating a "full service" carbon market in Asia.

Though there are currently no compliance-driven buyers in the Asia-Pacific region, this is unlikely to remain the case in the medium term. In view of this prospect, the development of an exchange in an Asian city would best place that first-mover city to support this emerging international market in the Asia-Pacific region.

Furthermore, the establishment of an exchange in the short-term would carry a similar first-mover advantage, and would place that exchange in a strong position to support the development of any new mechanisms that may be put in place by a future climate change agreement.

It is our understanding that other jurisdictions in the Asia-Pacific region are contemplating the introduction of CER exchanges. We would support all of these initiatives.

- 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.**

In the prior question, we have set out the reasons as to why it would be important for a new exchange to be established in the Asia-Pacific region: the likelihood of Asia-Pacific based compliance buyers in the medium term, and the creation of a full-service carbon market in Asia.

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

- The success of the CDM in China and the likelihood that China will play a significant role in the future global carbon market.
- Hong Kong has historically been an innovative market, at the cutting edge of new product the development. The establishment of a CER exchange would be a natural progression for Hong Kong.

- Hong Kong has a regulatory environment that will be attractive to participants in a CER exchange.
- 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 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.

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 current CER market is very "thin" and there are risks associated with further dividing 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 various timeframes.

**3. If you are a financial intermediary, please respond to the following questions: NA**

**4. 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, 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 detailed knowledge will, in itself, be a barrier to the success of an exchange.

**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 prepare and accept, fees payable, conditions for participation in the exchange (including in respect of margin/collateral, etc.), 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 in Hong Kong 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? NA**

**ENDS**