

Carbon scheme seen as tough sell for HK

Plans for emission futures contract win praise but city will need to catch up with rivals

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Plans by Hong Kong Exchanges and Clearing to launch a carbon emissions futures contract have been given the thumbs-up by the carbon credit industry, but experts say established competitors and uncertainty on what role mainland companies may play leaves the exchange with a tough job ahead of it.

HKEx chief executive Paul Chow Man-yiu on Tuesday said that launching carbon emissions futures trading was one of the exchange's 12 goals for next year. Futures contracts allow investors to bet on the future price movement of a commodity and are often used to offset potential price changes that could hurt the profits of firms such as electricity producers and other large carbon emitters.

"More and more businesses are interested in a broader range of applications for finance and the environment," said Andrew Thomson, chief executive of the Business Environment Council. "Having more certainty of a clear price for carbon and having that mechanism held by a good institution with strong governance is a good thing, and that makes Hong Kong a good place to launch these futures."

Hong Kong faces tough competition from markets in countries where carbon offsetting and carbon trading have been established for several years. Most of the carbon credit activity in the mainland is Europe-driven, with European buyers coming to Asia to buy credits and then trade them on continental exchanges.

"Most of the existing compliance buyers are also currently European, so it may be a challenge for them to invest in Hong Kong-based futures products," said Josh Carmody, manager of the Asia Pacific Carbon Fund and a climate change specialist at the Asian Development Bank.

The board of directors of the exchange yesterday reviewed a report by consultants that a source within the exchange said highlighted these concerns, as well as the costs involved with launching a new product.

Oslo-based power exchange Nord Pool started trading a futures-like product in 2005, with International Petroleum Exchange and the Amsterdam-based European Climate Exchange following months later with their own carbon emissions futures contract. The Chicago Climate Futures Exchange offers a range of United States and European carbon emissions hedging products.

And there are many other contracts launching and quietly dying every year as exchanges around the world try to tap into the new investment theme.

"It's nice to see lots of new products, but it is the nature of these things that there will only be one or two winners in the end," said Richard Edwards, head of trading for London-based

Sindicatum Carbon Capital. "But so far, there is no dominant carbon exchange and secondary trading is still relatively new."

The World Bank in May released a report that estimated the global carbon offset market had tripled over the past year to US\$30 billion, the majority of which occurs via the EU Emissions Trading Scheme. However, China is now the largest carbon-emitting nation, making it clear that some of that trading action is likely to move east.

"If the central government would support the carbon emission trading and if it would allow mainland airlines and power firms to trade the carbon emission quotas in Hong Kong, the city has a good potential in such a market," the exchange source said.

The exchange board will hold another meeting in January to make a decision on the launch of the new product.

HKEx timed its announcement well, with some 190 nations meeting in Bali to devise a new agreement to counter global warming after the Kyoto Protocol ends in 2012.

Among the requirements outlined in the draft of the new plan are calls for new financing and investment to help countries adapt to the impacts of climate change, and carbon emissions futures would fall within that category.

Uncertainty over what the new carbon emissions rules will be have left the UN carbon credit trading market under a cloud of doubt while the voluntary market has been booming.

The voluntary market is where companies buy credits to appease shareholders and their own conscience, instead of doing it to meet UN-set emissions quotas.

HKEx has not specified if its futures would use voluntary or quota-based carbon credits as their underlying assets.

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