



1. This paper prepared by the Carbon Market Workstream<sup>1</sup> of the Green and Sustainable Finance Cross-Agency Steering Group (CASG) provides a preliminary assessment of feasibility for Hong Kong to pursue carbon market opportunities. The paper discusses why Hong Kong's strengths as an international financial centre, the gateway to Mainland China, and a regional certification hub can potentially add value to carbon market development. In addition, the paper makes recommendations to CASG on t14(i)5(ca)13(t)-4(i)5(on)3( )-26c3(r)7(5 695.26 Tm[ ])TJET EMC 00)

5. In addition, derivatives structured around carbon credits and allowances play an essential role in hedging emissions costs and enhancing market transparency.<sup>5</sup>

- (ii) Establish a GBA Unified Carbon Market;
  - (iii) Explore international participation in the GBA Unified Carbon Market and potential linkage between the GBA Unified Carbon Market and the national ETS; and
  - (iv) Develop Hong Kong into the Mainland's offshore risk management centre for carbon market development, in line with the policy objective to strengthen Hong Kong as a global risk management centre. In 2021, HKEX invested in and signed a cooperation agreement with the Guangzhou Futures Exchange.<sup>11</sup>
10. In addition, it is believed that Hong Kong may take up further roles, such as compiling carbon trading indices and developing carbon-themed ETF products.

### Vision for a GBA Unified Carbon Market



which aims to provide a secure and transparent financial system and impose stricter regulations on financial markets to curb price speculation and any market misconduct.

23. Carbon credits and emission allowances, as well as the dealing in these products, are currently not regulated in Hong Kong. Carbon derivatives on the other hand may potentially fall within the SFC's regulatory remit, depending on the details of a derivative and its underlying asset.
24. Provisions of carbon credits, emission allowances and carbon derivatives may potentially be included in the legislation e.g. the Securities and Futures Ordinance (SFO). The Financial Secretary has the power under section 392 of the SFO to prescribe, either generally or in a particular case that any interests, rights or property are to be regarded as securities, futures contracts, structured products or over-the-counter derivatives products, by notice published in the Gazette. Alternatively, a separate regime may be set up for carbon products. Further studies on which is a more appropriate legislative solution are required.
25. From an accounting perspective, international accounting bodies such as the International Accounting Standards Board have yet to develop a robust framework that establishes guidance for corporates pertaining to recording carbon credits and emission allowances in their financial statements. This lack of standardisation may hamper interest in carbon trading as it makes it hard for businesses to present themselves to the market, and for the market to understand the financial consequences of emissions on companies' balance sheets. A recent survey of companies participating in the EU ETS shows the use of several different methods for recording allowances on their financial statements.<sup>16</sup>

*Job creation:*

26. Banks and capital market players provide trading platform for customers to access carbon markets, and act as market makers for carbon products, advisors for market participants, and financing provider and facilitator for developers of underlying projects that generate carbon credits. Other service providers, such as verifiers and auditors, legal and advisory professionals, and technology experts, also help facilitate trades.
27. There are already some carbon market experts and related service providers in Hong Kong to establish the market initially. As the carbon market grows, further promotion and training are needed to cultivate a local talent pool and develop carbon finance<sup>17</sup> industry in Hong Kong.

*Green economy, technology, and innovation:*

28. VCMs channel funding for projects that generate carbon credits by avoiding, reducing, or removing GHG emissions. Most of these underlying projects will likely be in other GBA cities, Mainland China or overseas due to limited land supply in Hong Kong. A GBA Unified Carbon Market can help promote opportunities mentioned in the Hong Kong's Climate Action Plan 2050, such as innovation, technological development and re-industrialisation, and facilitate the application of decarbonisation technologies and green research and development. Overall, these can bring opportunities to support sustainable development and enhance the competitiveness of Hong Kong, the GBA and the broader Mainland China.
29. **Carbon markets can support Fintech development in Hong Kong.** Blockchain

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<sup>16</sup> [Emissions trading systems: The opportunities ahead](#), PwC, 2021.

<sup>17</sup> Refers to investments in GHG emission reduction companies and projects, and the creation of financial instruments that effectively put a price on carbon emissions.

technology could be leveraged to enhance the transparency of carbon market transactions (both trading and post trade). Robust trading infrastructure is needed for the listing and trading of carbon-related products, registries for post-trade services, data infrastructure for information collection and dissemination, and connectivity for access by the participant base. A digital platform which utilises smart contracts for the automated generation and trading of carbon credits could be considered. The platform may also utilise distributed ledger technology to digitalise the full carbon credit lifecycle to optimise operational efficiency, as well as to maintain the registry to enhance transparency and traceability.<sup>18</sup> On the payment side, fiat money, stable coins or Central Bank Digital Currencies could be used as appropriate.

### **Recommendations on the Way Forward**

30. Based on the analysis above, the Carbon Market Workstream is of the view that the carbon market opportunities set out in paragraph 9 alone are preliminarily feasible, subject to the overcoming of the potential obstacles and risks by applying experiences from successful carbon markets and working in close cooperation with relevant authorities and stakeholders. Hong Kong cannot possibly develop a sizable carbon market without establishing linkage with the Mainland markets given Hong Kong's small local market size, economic structure and limited natural resources.

**Factor in adding value to global carbon markets therefore lies in our close links with the Mainland, which enables us**

**in services and familiarity with both Mainland and international standards will enable us to serve as a bridge to the world for China which in turn, will enhance the quality of its carbon markets.** Notably, Hong Kong should explore opportunities to link up international investors with the Mainland's carbon markets if we can develop the appropriate market structure and regulatory models.

31. The Carbon Market Workstream therefore intends to proceed with the following next steps in parallel with a view to developing Hong Kong invietsET EMC /P A/CID 89302n-USInp