

CARBON MARKET BUSINESS BRIEF

QUEBEC

QUEBEC'S CAP-AND-TRADE SYSTEM AT A GLANCE

Years in operation	<p>First compliance period: 2013-14 Second: 2015-17 Third: 2018-20 Subsequent compliance periods last three years.</p>
Overall cap & trajectory	<p>Started at 62,300,000 tCO₂e in 2015, with a 2,110,000 tCO₂e decline per year to reach 44,140,000 tonnes in 2030.</p>
Target(s)	<p>20% reduction from 1990 levels by 2020. 37.5% reduction from 1990 levels by 2030.</p>
Sectors covered	<ul style="list-style-type: none"> • Installations emitting 25,000 tCO₂e per year • Fossil fuel distributors • Electricity producers and importers
GHGs covered	<p>CO₂, methane, N₂O, HFCs, PFCs, SF₆, NF₃ and other fluorinated GHGs</p>
# of covered entities	<p>126</p>
Allocation method	<p>Allowances are allocated for free, purchased at auctions, or sold by mutual agreement with the Minister.</p> <p>Participants must have a CITSS account to bid at auction. Auctions are held jointly with California.</p> <p>The auctions have a reserve price, set at US\$16.68 in 2020, which increases 5% each year plus inflation. There is no maximum price. Allowances are auctioned in lots of 1000.</p>
Trading rules	<p>Establishments emitting more than 10,000 tCO₂e but less than 25,000 tCO₂e may register to participate.</p> <p>Investors, brokers, consultants, offset credit promoters, and other unregulated participants allowed. Clearing house allowed.</p>
Use of offsets and linking	<p>Only offset credits issued by Government of Quebec or California are recognised.</p> <p>Offset credit protocols in Quebec regulation and in California are the only project types eligible.</p> <p>8% limit on use of offsets to meet compliance obligations.</p> <p>Linked with California via the WCI in 2014.</p> <p>Declaration signed in 2019 with Chile to allow collaboration on carbon markets and other matters.</p>

Other features	<p>Holding limits to restrict the number of GHG emission units that can be held by any given emitter or participant. The holding limit is calculated based on the cap.</p> <p>Allowance purchase limits per bidder set at each auction.</p> <p>Allowances must be surrendered by 1 November following the end of the compliance period.</p>
Penalties for non-compliance	<p>Suspension of the entity's account and a sanction of three additional allowances must be surrendered for each allowance short at the end of the compliance period.</p> <p>Persons legally responsible can be fined for non-compliance and 18 months jail time for individuals. Fines double in second offence.</p> <p>Allocation can be suspended for non-compliant emitters.</p>
Use of revenues	<p>All proceeds from auctions go to the Green Fund to finance the 2013-20 Climate Change Action Plan activities:</p> <ul style="list-style-type: none"> • GHG reductions • Climate change adaptation • Transition to low-carbon economy

MAJOR DEVELOPMENTS

Free allocation of allowances for 2021-23 will be determined based on trade exposure and emissions intensity. Proposed allocation reform for 2024-30.

Joint auction #22 took place 19 February 2020, which included 2017 and 2020 vintages, and an advance sale of 2023 vintage allowances. Quebec offered a total of 9,068,906 allowances under the current auction, of 2017 and 2020 vintages; and offered 1,319,750 of 2023 vintage units in the advance auction. The total amount of offered allowances by Quebec for all vintages were sold.

Join auction #23 with California will take place on 20 May 2020. Quebec and California will offer a combined total of 57,540,731 allowances of 2017 and 2020 vintages. The Advance auction will see a combined total of 8,672,250 vintage 2023 allowances for sale.

MARKET COMMENTARY

Prices have remained close to the annual auction floor price due to the increasing oversupply of allowances since the inception of the programme. After the system was extended to 2030 in 2017, market certainty grew and this drew outside interest. In August 2018, financial market participants' interest in the market increased though they did not hold a significant position in the market.

After the February 2019 auction, more financial participants – including several hedge funds – started taking large positions in the market. The position of these participants kept growing until reaching a high of nearly 71 million tonnes in futures and options on the exchanges by 10 March 2020. This increase in demand pushed prices well above the auction floor price over this period, to around US\$20/t.

However, the COVID-19 outbreak in March 2020 quickly led to market uncertainty as California and Quebec both enforced jurisdiction-wide travel restrictions and business closures. As a result, many market participants – especially financial participants – liquidated a large portion of their positions. This drove prices down to unprecedented lows, far

below the 2020 auction floor price of US\$16.68.

Throughout April 2020, market prices slowly returned to the auction floor price as selling pressure eased. However, the lack of demand expected due to ongoing COVID-19 lockdowns will likely keep market prices close to the auction floor price going forward. In addition, the economic disruptions caused by the lockdowns have led Canada into a recession and will likely do the same to the US, which will prolong reduced emissions levels and thus allowance demand.

Demand over the remaining 2020 auctions will likely be low, diverting unsold allowances to the 2021 and 2022 quarterly auctions. If demand remains low going into 2021, some allowances could be diverted to the APCR, which would be bullish in the long run. Prices are expected to uncouple from the floor price in 2022, when the market begins seeing growing yearly deficits.



FIGURE 1

WCI Supply and Demand Forecast Scenarios (Allowances)

USEFUL LINKS

[Programme details, Quebec Environment and Climate Change Ministry](#)

[ICAP ETS Quebec Factsheet](#)

REFERENCES

[Regulation respecting a cap and trade system for GHG allowances \(updated January 2020\)](#)

[February 2020 Auction #22 Summary Results Report](#)

[May 2020 Joint Auction Notice Environment and Climate Change Canada, Output-Based Pricing System Regulations](#)

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