

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: 2018-2020 Fourth: 2021-2023 Subsequent compliance periods last three years.</p>
Overall cap & trajectory	<p>In 2021, the cap is 55.26 million, and will decrease by 1.235 million tCO₂e on average per year to reach 44.14 million tCO₂e 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, CH₄, 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\$17.71 in 2021, 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 voluntarily.</p> <p>Investors, brokers, consultants, offset credit promoters, and other unregulated participants allowed. Clearing houses allowed.</p>
Use of offsets and linking	<p>Only offset credits issued by the governments of Quebec or California are recognised.</p> <p>Offset protocols defined in the Quebec and California regulations 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 fine 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>As of 1 November 2020, the Electrification and Climate Change Fund (ECCF) replaces the former Green Fund.</p> <p>All proceeds from auctions go to ECCF which are being used to implement measures in the "2030 Plan for a Green Economy" and will cover ongoing commitments under "2013-2020 Climate Change Action Plan".</p> <p>The "2030 Plan for a Green Economy" is the electrification and climate change policy framework that will serve as the government's roadmap over the next 10 years. It replaces the 2013-20 Climate Change Action Plan, which expired on 31 March 2021.</p>

MAJOR DEVELOPMENTS

On 16 November 2020, the Quebec environment ministry unveiled the province's Green Economy Plan 2030 (GEP 2030) as well as the first Implementation Plan (IP), covering 2021-26. The GEP 2030 will contribute to achieving Quebec's emission reduction target for 2030, set at 37.5% below 1990 levels, and towards reaching carbon neutrality by 2050.

MAIN OBJECTIVES OF THE GEP 2030

- Reduce GHG emissions by 37.5% below 1990 levels by 2030
- Achieve carbon neutrality by 2050
- Put 1.5 million electric vehicles on the road by 2030
- No sales of new gasoline-powered vehicles starting 2035
- Electrify 55% of city buses and 65% of school buses by 2030
- Electrify 100% of government automobiles and 25% of government vans
- Reduce emissions from heating buildings by 50% by 2030
- Reduce emissions from the government's housing stock by 60% by 2030
- Ensure natural gas network contains 10% renewable natural gas by 2030
- Increase bioenergy production by 50% by 2030
- Provide 70% of the energy supply of stand-alone networks through renewable energies by 2025
- Ensure petrol is 15% renewable and diesel is 10% renewable by 2030

Quebec recently announced proposed updates to the free allocation rules from 2024 to 2030. The expected supplementary effort and the carbon pricing ratio were the most notable:

- The expected supplementary effort (a factor to decrease free allocations) depends on the relative risk of carbon leakage. Calculating the level of risk is determined by a three-step process. First, it involves determining whether the trade exposure ratio is greater than the threshold; second, attributing one of the six risk levels according to emission intensity; and third, increasing the risk level should the share of fixed process emissions exceed 50%.
- The carbon pricing ratio is calculated by Quebec’s carbon price relative to the global carbon price. The proposed adjustment to this value is to allow it to accelerate or decelerate the free allowance allocation decrease depending on the movement in the global carbon pricing.

MARKET COMMENTARY

The COVID-19 pandemic has resulted in considerable economic uncertainty and volatility across industries and markets. Due to the ramifications of the initial outbreak, the allowance price dropped from US\$17.94 on 28 February 2020 to US\$11.80 on 20 March 2020. In the WCI market, allowance prices on the secondary market were highly volatile as shelter-in-place orders were issued by California and Quebec (and across North America in general).

As the jurisdictions started to relax shelter-in-place orders for the summer, spurring some economic recovery, secondary market prices started to increase as well. The increase in economic activity increased emissions within the WCI system, increasing demand for allowances. As a result, the allowance price went above the floor price on 18 May 2020 and continued to slowly increase through the year.

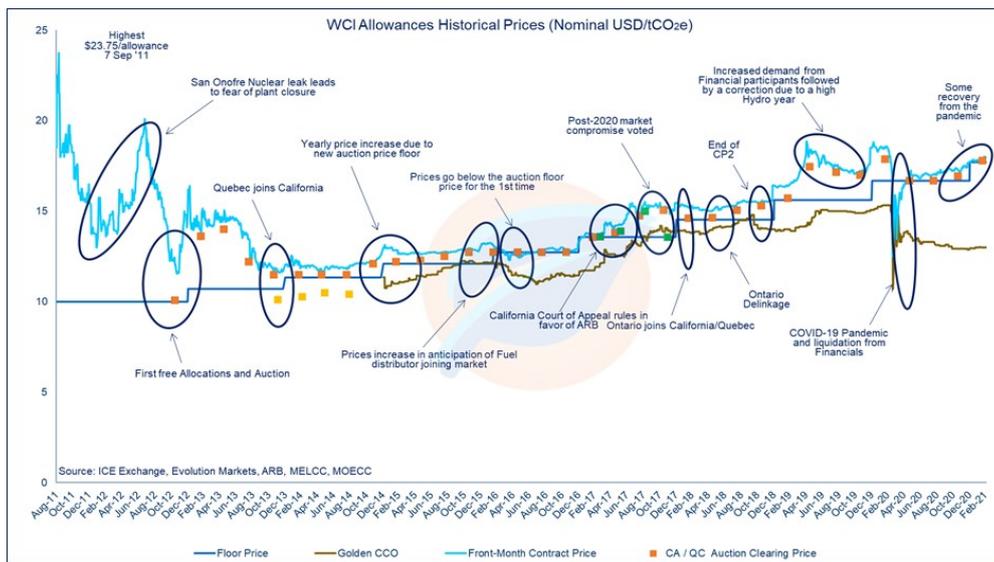


FIGURE 1
WCI Allowances Historical Prices (Nominal USD/tCO_{2e})

The increased allowance floor price (from US\$16.68 in 2020 to US\$17.71 in 2021) and the upcoming compliance deadline for Compliance Period 3 (1 November), have resulted in upward pressure on the price of allowances (as compliance entities look to cover their short positions).

During the pandemic, two categories of entities – financial players and compliance entities – pursued two opposite strategies: hedge funds reduced their positions when the pandemic hit, while compliance entities strengthened their positions by buying those allowances at cheaper prices.

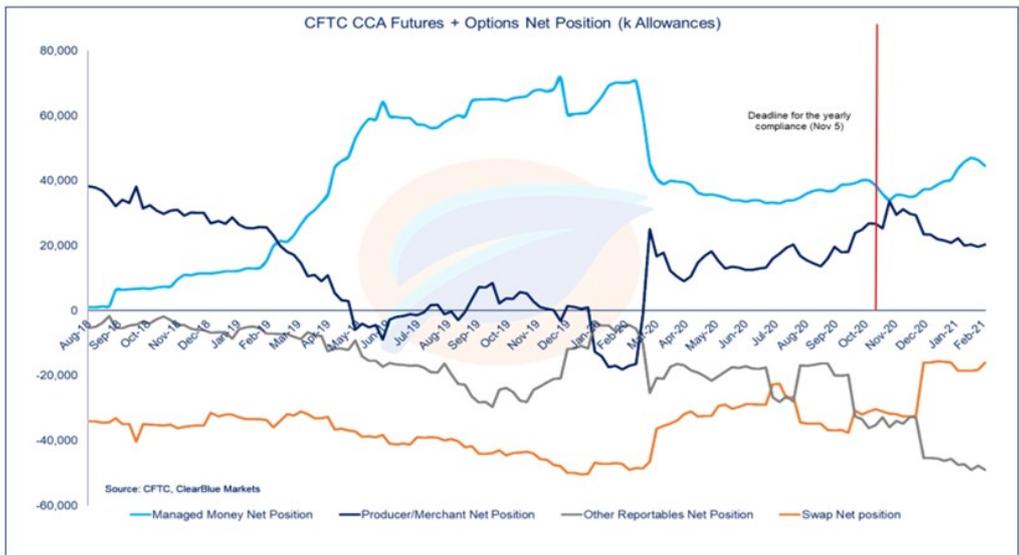


FIGURE 2
Commodity Futures Trading Commission (CFTC) California Carbon Allowances Futures + Option Net Position (k Allowances)

After a record high auction settlement price in February 2020, the pandemic caused secondary market prices to crater below the 2020 auction floor price. Decreased interest was observed in the subsequent May and August auctions (both of which settled at the price floor), in which 6.5 million unsold allowances were transferred to the Auction Holding Account for later auction. The lack of interest derived from weak fundamentals during this period, due to reduced economic activity and therefore emissions. The long-term outlook was unknown, forcing many compliance entities to postpone any new investment. The November 2020 and February 2021 auctions demonstrated recovering demand – both sold out at prices slightly above the auction price floor – despite weak signals seen in market fundamentals. Going forward, as COVID-19 restrictions are largely lifted, it is expected that fundamentals will recover quickly, with allowance prices to increase over the long-term.

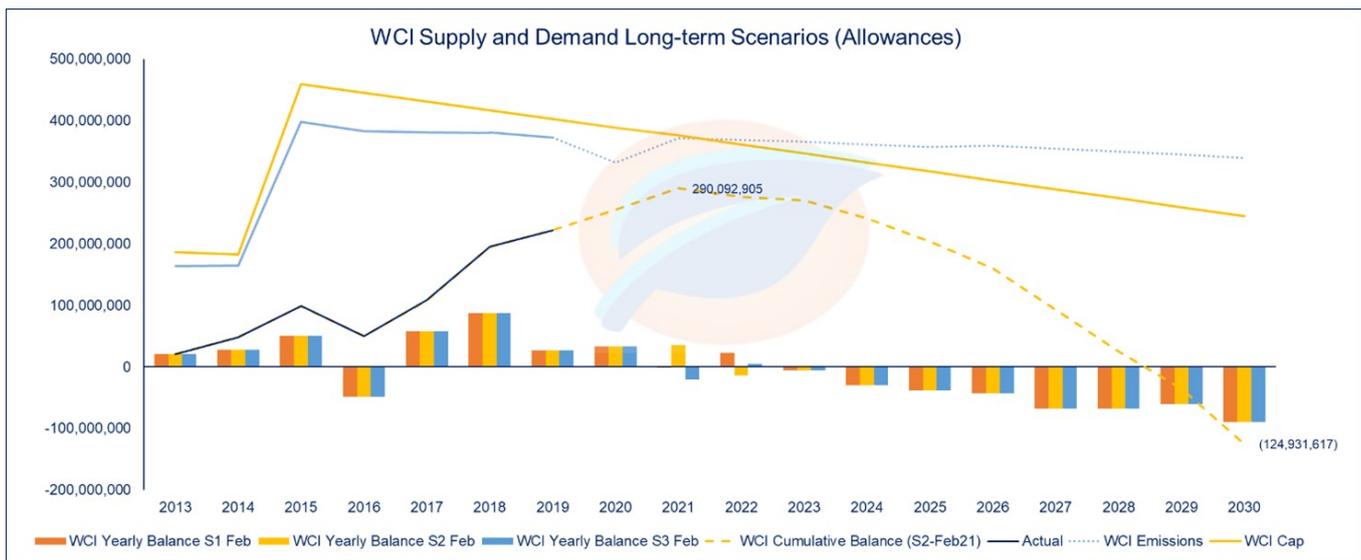


FIGURE 3
WCI Supply and Demand Forecast Scenarios (Allowances)

USEFUL LINKS

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

[ICAP ETS Quebec Factsheet \(updated February 2021\)](#)

REFERENCES

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

[May 2020 Auction #23 Summary Results Report](#)

[August 2020 Auction #24 Summary Results Report](#)

[November 2020 Auction #25 Summary Results Report](#)

[February 2021 Auction #26 Summary Results Report](#)

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