environmental defence

Submission to Environment and Climate Change Canada

Response to the Discussion Paper on Driving effective carbon markets in Canada

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Introduction: Why Industrial Carbon Pricing Must Be Strengthened

The industrial carbon price is foundational to Canada's climate ambition. In 2024, it was expected to achieve anywhere from 20 to 48 per cent of greenhouse gas (GHG) emissions reduction by 2030.[1] Since then, the Government of Canada has repealed the carbon tax, cancelled the oil and gas emissions cap and paused the EV mandate, making the industrial carbon price even more critical in reducing Canada's domestic emissions.

Globally, carbon pricing is understood to be one of the most cost-effective tools for reducing emissions when it is broadly applied, predictable and stringent. The Intergovernmental Panel on Climate Change (IPCC) has consistently found that economy-wide carbon pricing, when combined with complimentary policies, plays a central role in driving emissions reductions at low cost.[2]

In this context, it is essential that the industrial carbon pricing systems include coverage of electricity generation. With the repeal of the carbon tax, industrial carbon pricing is now one of the primary remaining tools to drive emissions reductions in the electricity sector. Effective coverage of electricity is critical to ensure continued decarbonization, particularly as the federal government considers potential changes to the Clean Electricity Regulations. Excluding electricity from the coverage would risk locking in higher-emitting generation and undermining economy-wide emissions reductions.

Canada's federal backstop has been instrumental in establishing a national minimum standard for industrial carbon pricing while allowing provincial and territorial flexibility. This flexibility, however, carries risk. Weak coverage, excessive credit banking, broad exemptions, and oversupplied credit markets can significantly dilute the carbon price signal, delay decarbonization and lock in higher emissions trajectories.[3] Furthermore, some provincial systems are not aligned with the federal benchmark, as Alberta has frozen its carbon price at $95/tonne and Saskatchewan has applied a carbon price of $0/tonne on its industries. For this policy to be effective in reducing industrial emissions, the Government of Canada must be willing to enforce the federal backstop on the provinces that are out of step with national standards.

Canada faces a closing window to align industrial activity with its climate objectives. The 2030 emissions reduction target is already out of reach. However, a stronger and more robust industrial carbon pricing can ensure that Canada doesn't miss any more climate targets and holds industries accountable for their pollution.

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[1] Canadian Climate Institute (2024). Which Canadian Climate Policies will have the biggest impact by 2030? Available: https://440megatonnes.ca/wp-content/uploads/2024/03/440-ERP-followup-V3-no-embargo.pdf
[2] Intergovernmental Panel on Climate Change (2022). Climate Change 2022: Mitigation of Climate Change. Available: https://www.ipcc.ch/report/ar6/wg3/downloads/report/IPCC_AR6_WGIII_FullReport.pdf
[3] Canadian Climate Institute (2025). A roadmap to modernize Canada's large-emitter trading systems. Available: https://climateinstitute.ca/wp-content/uploads/2025/02/Roadmap-to-modernize-Canadian-LETS.pdf

Equally important, the method for determining whether provincial systems meet the federal benchmark must be strengthened. Provincial systems should be tested on an outcomes-based test, which ensures that the provincial systems achieve outcomes aligned with the federal standard. The federal government must establish clear, independent, and transparent criteria for benchmark assessments and for decisions to apply the federal backstop. Without predictable and enforceable assessment rules, market confidence is weakened and provincial divergence is allowed to persist.

Following this review, the industrial carbon pricing systems must:

- Enforce a strong and incrementally increasing carbon price, including with a post 2030 trajectory
- Prevent an oversupply of credits that dilute the credit markets and disincentivize decarbonization
- Harmonize the various industrial carbon pricing systems across Canada to ensure consistent coverage and effectiveness
- Ensure electricity generation is fully and effectively covered under industrial carbon pricing to maintain emissions reductions in the sector
- Provide transparent public reporting, including clear, independent, and transparent criteria for benchmark assessments and backstop implementation
- Align with Canada's climate commitments

The following is Environmental Defence's response to the discussion questions posed by the Government of Canada in the "Discussion paper: Driving effective carbon markets in Canada".

Cohesive and efficient: broad coverage

Question 1: What are the considerations for covering smaller facilities (between 10kt and 25kt) in industrial and manufacturing sectors? For example, how to account for administrative burden?

Covering industrial and manufacturing facilities with annual emissions between 10kt and 25kt CO2e is an important design choice that directly affects the environmental effectiveness, fairness and market function of industrial carbon pricing systems. As identified in the discussion paper, lowering the coverage threshold from 25kt to 10kt would substantially increase the number of covered facilities and activities, supporting more robust market function.[4] On the other hand, systems with high thresholds and exclusions weaken industrial carbon pricing by shrinking market depth and leaving meaningful emissions unpriced that can undermine investment signals for decarbonization.[5]

[4] Government of Canada (2025). Discussion paper: Driving effective carbon markets in Canada. Available: https://www.canada.ca/en/environment-climate-change/corporate/transparency/consultations/comment-driving-effective-carbon-markets/discussion-paper.html#toc18

[5] Canadian Climate Institute (2025). Five choices that are breaking industrial carbon pricing. Available: https://climateinstitute.ca/five-choices-that-are-breaking-industrial-carbon-pricing/

Administrative burden is frequently cited as a reason to exclude smaller facilities, but this concern is overstated relative to the climate benefits of broader coverage. Many facilities in this emissions range already quantify and report emissions under federal or provincial reporting programs, meaning that the incremental administrative burden of inclusion can be limited if reporting and verification requirements between the various carbon pricing systems in Canada are well-aligned. Administrative complexity should be reduced and should not serve as a justification for not covering smaller facilities.

Competitiveness and intra-sectoral equity are also key considerations. Excluding facilities below a higher threshold can create uneven treatment within the same sector, where similar products face different carbon costs depending on facility size. Currently, the Technology Innovation Emissions Reduction (TIER) system in Alberta, has a much higher threshold for coverage than the federal Output Based Pricing System (OBPS), leading to inter-provincial inequity between facilities in the same sector.

This is why harmonization across the federal and provincial systems is essential. Significant variation in thresholds across jurisdictions has contributed to uneven stringency and coverage, leaving substantial emissions unpriced. The federal benchmark should therefore set a clear threshold for broad coverage, at minimum down to 10kt with activity-based consideration as well, and immediately apply the federal backstop where provincial systems fall out of step. This approach will balance administrative feasibility with the need to deliver real, economy wide emissions reductions consistent with Canada's climate targets.

<u>Question 2:</u> What should the minimum coverage threshold be for small oil and gas facilities? What are the considerations for covering small oil and gas facilities emitting less than 10kt annually?

For the oil and gas sector, which remains Canada's largest source of GHG emissions, there is no defensible case for leaving facilities unpriced simply because they are considered small emitters. Although individual oil and gas facilities that emit less than 10kt CO_2e per year may be small relative to large producers, the federal government's own analysis shows that collectively they make up a third of upstream oil and gas emissions.[6] This is a substantial share of Canada's GHG emissions that must be addressed to meet its climate targets.

If the federal benchmark simply incorporated a 10kt threshold without special provisions for small oil and gas facilities, a large portion of upstream emissions would remain unpriced, weakening market incentives and distorting competitiveness within the sector.

Exempting these facilities risks undermining emissions outcomes and public confidence, especially as the Government of Canada has already shown preferential treatment to the oil and

[6]Government of Canada (2023). Regulatory Framework for an Oil and Gas Sector Greenhouse Gas Emissions Cap. Available:https://www.canada.ca/en/services/environment/weather/climatechange/climate-plan/oil-gas-emissions-cap/regulatory-framework.html

gas sector by moving away from the long-promised oil and gas emissions cap. Broad coverage, in the case of the oil and gas facilities, must include oil and gas facilities that emit less than 10kt CO2e per year.

<u>Question 3:</u> What are the impacts on intra-sectoral competitiveness (competition between facilities in the same sector) of covering only some facilities, e.g. covering only facilities emitting 10kt or more? How would this affect international and interprovincial competitiveness?

Covering only some facilities within a sector that are above a threshold has negative implications for intra-sectoral competitiveness. This is because threshold based coverage alone creates cost asymmetries between facilities producing similar goods within the same sector. Facilities just above the threshold would face a carbon cost that competitors just below the threshold avoid, despite engaging in the same activities and selling similar products. Uneven coverage, which can be caused by high thresholds, can weaken price signals and distort competition within sectors. Alternatively, broadening the coverage can improve the effectiveness of the carbon pricing system[7] and remove competitiveness issues.[8]

Interprovincial competitiveness is undermined when coverage thresholds vary across jurisdiction. Inconsistent thresholds and opt-in systems enable regulatory arbitrage, allowing facilities in provinces with weaker coverage to gain artificial cost advantages over comparable facilities elsewhere in Canada, even when serving the same market. This reinforces the need for a consistent, nationalized standard to harmonize the various carbon pricing systems.

Although certain sectors in Canada, such as the steel and aluminum producers, are currently facing additional pressures due to U.S. trade measures, this risk should be addressed through targeted policy design (e.g. a carbon border adjustment mechanism) rather than through excluding facilities from carbon pricing altogether. Jurisdictions with stronger and more comprehensive carbon pricing are increasingly better positioned in low-carbon markets. This is due to an on-going global shift towards decarbonization to fight climate change. Therefore, a robust application of carbon pricing can enhance the competitiveness of Canadian industries as global demand for goods produced with low emissions increases. This is doubly important as Canada continues to expand its export markets in the wake of the U.S. trade war.

<u>Question 4:</u> What are the advantages and disadvantages of a threshold-based approach, an activity-based approach, or a combination of the two?

A threshold-based approach would offer administrative simplicity but risks arbitrary exclusions. Fewer facilities are regulated, which can lower compliance and enforcement costs, particularly for jurisdictions with limited administrative capacity. The discussion paper notes that higher

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[7] Organisation for Economic Co-operation and Development (2023). Effective Carbon Rates 2023. Available: https://www.oecd.org/en/publications/effective-carbon-rates-2023_b84d5b36-en.html

[8] European Commission (2025). EU Emissions Trading System. Available: https://climate.ec.europa.eu/eu-action/carbon-markets/eu-emissions-trading-system-eu-ets_en

thresholds reduce the number of regulated entities and associated reporting obligations. However, threshold-based systems create sharp distortions in costs between facilities producing similar goods, leading to intra-sectoral competitiveness issues and incentives to remain below thresholds through operational restructuring rather than emissions reductions. Threshold-only approach also risks leaving a substantial share of emissions unpriced, undermining overall emissions objectives.

An activity-based approach, where coverage is tied to specific emissions intensive activities regardless of facility size, has the advantage of improving competitive neutrality within sectors. It reduces distortions by ensuring facilities engaged in the same activities face comparable carbon pricing obligations, even if their absolute emissions differ. It is better suited to capturing emissions across fragmented or emissions-intensive sectors, such as the oil and gas sector. However, they require clear and careful definition of covered activities and robust administrative capacity to ensure success.

The combined approach, as per the federal government's own research, offers the most coverage of emissions, the most participants for better market function, while mitigating some of the competitiveness risks.

Environmental Defence supports a combined approach as the most environmentally robust option. However, coverage design alone is insufficient to deliver emissions reductions if key safeguards are absent:

- **Transparency:** It is essential to increase transparency, which must include public reporting on the generation, banking, trading and the use of credits to ensure that emissions reductions are real and additional and to maintain confidence in carbon markets.
- **Benchmark design:** Benchmark design is equally important in strengthening the industrial carbon pricing system. The only way to drive sustained emissions reductions is when benchmarks are periodically and predictably tightened. Without declining benchmarks, systems risk locking in historical performance and delaying investments in decarbonization.
- **Establishing a price corridor:** Maintaining high and rising credit prices, with a strong and predictable headline carbon price with a minimum price floor that increases over time is essential for the effectiveness of the industrial carbon pricing mechanism.[9] Low or volatile prices provide further uncertainty for investors. However, a rising floor can create a stable investment environment that incentivizes decarbonization.

In addition to these key safeguards, the federal government must apply the federal backstop when provincial systems fail to meet benchmark expectations. As mentioned above, uneven provincial stringency undermines interprovincial competitiveness and weakens the overall

[9] Canadian Climate Institute (2025). One simple fix for Canada's industrial carbon pricing systems. Available: https://climateinstitute.ca/one-simple-fix-canada-industrial-carbon-pricing-systems/

credibility of the carbon pricing framework. The backstop must ensure comparable stringency and prevent a race to the bottom.

<u>Question 5:</u> What are your views on the options in the Annex A? Do you have alternative options to propose?

Environmental Defence broadly supports the combined approach that pairs a 10kt threshold with activity based coverage for emissions intensive sectors, including the explicit inclusion of smaller oil and gas facilities. This approach best balances emissions coverage, competitiveness and administrative feasibility, while avoiding the predictable distortions associated with threshold only systems. However, as mentioned above, coverage must be paired with increased transparency, a periodically and predictably tightening benchmark and a price corridor.

Carbon pricing systems are most effective when firms can anticipate not only near-term obligations but also the future direction of the policy. This is particularly important given the long investment cycles in sectors such as oil and gas, steel and cement, where capital decisions made this decade will shape emissions well beyond 2030. Recent analysis shows that while carbon pricing systems are expanding, price expectations remain too low and uncertain to drive the scale of industrial investment required for deep decarbonization, reinforcing the need for clearer long-term price signals and policy trajectories that extend beyond the current compliance period.[10]

For this reason, the most critical priority when considering the stringency of the industrial carbon pricing systems in Canada must be the establishment of a clear post-2030 industrial carbon pricing trajectory, supported by a combined threshold/activity based coverage approach. Expanded coverage alone will not deliver sustained emissions reductions without long-term certainty that carbon pricing will continue to strengthen beyond 2030.

Environmental Defence recommends that the federal government develop a stringent post 2030 industrial carbon pricing pathway and require provincial jurisdictions to demonstrate alignment with that trajectory. This will help ensure that the price on pollution continues to increase in line with Canada's climate commitments.

<u>Incentivize decarbonization investment</u>

<u>Question 6:</u> What approaches, if any, could allow systems to incorporate ERAs and similar mechanisms that would both maintain the price signal and protect demand in OBPS markets? Can you provide evidence or supportive analysis, and what changes to the benchmark criteria would be needed to enable them?

Emissions Reduction Accounts (ERAs) are compliance mechanisms used in some provincial industrial carbon pricing systems. Rather than purchasing surplus carbon credits from other regulated facilities, firms may pay funds into ERAs for their pollution. In theory, ERAs can

[10] International Emissions Trading Association (2025). Carbon Markets in Transition: The Path to 2030. Available: https://www.ieta.org/uploads/wp-content/2025/10/IETA_PwC.Report_25.V4_compressed.pdf

function as a compliance substitute for market-based carbon credits. However, in reality, ERAs diminish the demand for tradable credits, therefore, weakening the credit market and leading to oversupply. This in turn weakens the effective trading price of the credits in those jurisdictions.

Carbon pricing systems are most effective when emissions reductions are driven by a transparent, economy-wide price signal, supported by real market demand for credits. Suppressing the credit demand through excessive compliance flexibility, i.e. ERAs, reduces the incentive for facilities to invest in emissions reductions. Furthermore, ERAs can lead to delays in emissions reductions, as wealthy companies can defer action by paying into an account and writing it off as a cost of doing business, without reducing their emissions.

In Environmental Defence's view, ERAs are fundamentally incompatible with a robust industrial carbon pricing system. The industrial carbon pricing system must function as a real market for credits and an incentive to invest in emissions reduction directly, not a deferred spending program. Preserving the carbon price signal is essential to delivering the emissions reductions required to meet Canada's climate commitments.

Question 7: For instance, could any of the following conditions on the use of ERAs protect the price signal and market?

Environmental Defence does not support the inclusion of ERAs or similar payment-based compliance mechanisms in the industrial carbon pricing systems. Policies that allow facilities to avoid paying the full carbon price for their pollution, whether it's through exemptions, rebates or alternative compliance pathways, reduce the effective carbon rates and weaken incentives to reduce emissions.[11] ERAs function as an alternative compliance mechanism, which allows facilities to meet obligations without purchasing compliance credits or reducing emissions, and therefore weakening the demand for carbon credits in the market.

Stringency of output-based pricing systems

Question 8: Beyond the elements described above and in Annex B, are there other market design elements that should be accounted for in the net demand test?

Beyond the elements already described in the discussion paper, the net-demand test should account for several additional market design features that can influence whether industrial carbon pricing systems deliver a clear and reliable price signal in practice. Focusing solely on whether forecast demand exceeds supply risks overlooking design choices that can weaken prices, delay compliance or flood the market with usable credits even when a system appears to meet the benchmark on paper.

Assessing surplus credits and how quickly they are used is essential, but how those credits can be used matters just as much as how many exist. Long banking periods, wide eligibility for older credits or the ability to borrow from future compliance periods can keep prices low by making

[11] Organisation for Economic Co-operation and Development (2023). Effective Carbon Rates 2023. Available: https://www.oecd.org/en/publications/effective-carbon-rates-2023_b84d5b36-en.html

large volumes of credits readily available. In the EU Emissions Trading System, large banks of unused allowances depressed prices for years, until active measures were introduced to reduce surplus and restore a meaningful price signal.[12]

The net-demand test should also account for how other climate policies interact with industrial carbon pricing. Regulations such as methane rules, clean electricity standards or other sector-specific performance requirements can reduce emissions covered by the OBPS, which in turn reduces demand for credits. Without adjustments to the benchmark or the supply of the credits, these interactions can leave markets oversupplied and prices weak.[13]

The net-demand test should also consider price stability tools that shape the real cost of compliance. Price floors, price corridors and mechanisms that adjust supply help prevent long periods of very low prices caused by market shocks or policy uncertainty. Systems such as the EU ETS, California[14] and Regional Greenhouse Gas Initiative (RGGI)[15] rely on these tools to maintain credible price signals over time.

Finally, transparency should be treated as part of net demand itself. Public reporting on credit issuance, holdings, trading and use is necessary for market confidence and oversight, and to ensure that a finding of net demand translates into a strong and credible compliance price.

<u>Question 9:</u> Are there complementary or alternative tests to the forward-looking annual net demand test that should be considered when assessing the OBPS stringency criteria?

A forward-looking annual net demand test is a helpful starting point, but it can't alone determine whether an OBPS is delivering real stringency over time. Two complementary tests are particularly important to ensure systems maintain a credible price signal and drive emissions reductions.

First, a price outcome test should be used alongside projected net demand. Even if a system appears to be in net demand on paper, persistently low credit prices disincentivizes emissions reduction. Global reviews on carbon markets consistently emphasize that observed prices, not just modelled outcomes, are central to understanding whether carbon pricing is influencing behaviour and investment decisions. Markets with sustained low prices struggle to drive emissions reductions, particularly where banking and flexibility are extensive.[16]

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[12] European Commission (2025). About the EU ETS. Available: https://climate.ec.europa.eu/eu-action/carbon-markets/about-eu-ets_en
[13] Canadian Climate Institute (2025). 2024 Independent Assessment of Carbon Pricing Systems. Available: https://climateinstitute.ca/wp-content/uploads/2025/02/2024-Independent-expert-assessment-carbon-pricing.pdf
[14] International Carbon Action Partnership (2026). USA - California Cap-and-Trade Program. Available: https://icapcarbonaction.com/en/ets/usa-california-cap-and-trade-program
[15] Regional Greenhouse Gas Initiative (2024). RGGI Program Review Updates. Available: https://www.rggi.org/sites/default/files/Uploads/Program-Review/2024/Third_Program_Review_Update_9-23-2024.pdf
[16] World Bank Group (2025). State and Trends of Carbon Pricing 2025. Available: https://www.worldbank.org/en/publication/state-and-trends-of-carbon-pricing

Second, a benchmark trajectory test should assess whether performance standards are tightening at a pace consistent with Canada's emissions targets. A system can meet near-term net demand criteria while still locking in current emissions performance if benchmarks decline too slowly or remain static. The absence of clear, long-term signals in industrial carbon pricing systems creates uncertainty for investors.[17] Assessing whether benchmarks are on a transparent, declining trajectory would help ensure stringency increases predictably rather than relying on future policy corrections.

Together, a price outcome test and a benchmark trajectory test would complement the annual net demand assessment by focusing on whether OBPS systems are delivering real incentives today and steadily increasing ambition in line with Canada's climate objectives.

<u>Question 10:</u> Would markets be more stable and outcomes more certain if systems were designed to have annual demand exceed supply by a given amount (i.e. designed with a net demand 'buffer')?

Yes. Designing systems so that demand for credits clearly exceeds supply each year would make carbon markets more stable and reliable. When markets operate close to balance they are vulnerable to unexpected changes, such as economic slowdowns or forecasting errors. When this happens, surplus credits can quickly build up and push prices down, weakening the incentive to reduce emissions.[18] A 10 per cent buffer on net demand test would ensure more resilience to credit oversupply in case of unforeseen circumstances.[19]

<u>Question 11:</u> What are the key considerations that affect decisions by credit generators on when to sell or use banked credits in current systems?

Decisions by credit generators on when to sell or use banked credits are shaped by price expectations, policy certainty, and compliance needs. Facilities weigh whether current credit prices are high enough to justify selling now versus holding credits for future use or sale. Expectations about future prices, driven by the headline carbon price trajectory, benchmark tightening, and overall supply of credits plays a central role. If future prices are expected to rise, firms have a strong incentive to bank credits. Alternatively, if prices are expected to remain persistently low or volatile, facilities math choose to use or sell credits.[20]

Policy design also matters. Long banking horizons, eligibility of outdated credits, and flexible compliance timelines make it easier to hold credits for extended periods, while short compliance

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[17] Canadian Climate Institute (2025). A roadmap to modernize Canada's large-emitter trading systems. Available: https://climateinstitute.ca/wp-content/uploads/2025/02/Roadmap-to-modernize-Canadian-LETS.pdf
[18] European Commission (2025). Market Stability Reserve. Available:https://climate.ec.europa.eu/eu-action/carbon-markets/eu-emissions-trading-system-eu-ets/market-stability-reserve_en
[19] Canadian Climate Institute (2025). A roadmap to modernize Canada's large-emitter trading systems. Available: https://climateinstitute.ca/wp-content/uploads/2025/02/Roadmap-to-modernize-Canadian-LETS.pdf
[20]World Bank (2024). State and Trends of Carbon Pricing 2024. Available: https://openknowledge.worldbank.org/server/api/core/bitstreams/253e6cdd-9631-4db2-8cc5-1d013956de15/content

periods and banking limits encourage earlier use or sale. Interaction with other policies can also reduce future compliance needs, making banking less attractive.

Stronger net-demand requirements, clearer benchmark trajectories, and a stringent federal backstop would shift behaviour towards earlier use and more active trading of credits by increasing confidence that the credits will retain value and that future scarcity is real. A strong and rising price signal reduces the incentive to hoard credits defensively and support a healthier market liquidity.

However, this reinforces the need for greater transparency and public reporting of credit use in the system. Regular disclosure of credit issuance, banking levels, trading volumes and compliance use would improve market confidence and allow participants to better assess whether banking behavior reflects genuine investment planning or structural oversupply.

<u>Question 12:</u> What evidence and data points to the role of different considerations (price trajectory, market supply and demand, etc.)?

There are several data points that point to how price trajectories, market balance and policy design shape the behaviour of facilities in terms of when to bank, sell or use their credits.

Analysis compiled in State and Trends of Carbon Pricing reports by the World Bank track observed price levels in emissions trading systems and show that markets with low or uncertain future prices tend to see limited trading activity and rapid use of credits for compliance rather than strategic holding. By contrast, systems with clear upward price paths exhibit higher banking and more active secondary markets, reflecting expectations of future scarcity.[21]

Supply and demand balance and surplus credits levels are another key driver. Data from the European Union Emissions Trading System shows that large accumulation of surpluses following the 2008-2012 period coincided with prolonged low prices and weak trading, prompting the development of the Market Stability Reserve to absorb excess supply. Subsequent reductions in the allowance surplus were followed by sustained price increases and more active market behaviour, illustrating the link between surplus management and credit banking decisions.[22]

Policy certainty and benchmark tightening also shape expectations. Recent analysis from the International Emissions Trading Association highlights that uncertainty around future stringency discourages trading and investment, while clearer long term signals support banking and liquidity.[23]

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[21] World Bank (2024). State and Trends of Carbon Pricing 2024. Available: https://openknowledge.worldbank.org/server/api/core/bitstreams/253e6cdd-9631-4db2-8cc5-1d013956de15/content

[22] European Commission (2025). Market Stability Reserve. Available:https://climate.ec.europa.eu/eu-action/carbon-markets/eu-emissions-trading-system-eu-ets/market-stability-reserve_en

[23] International Emissions Trading Association (2025). Carbon Markets in Transition: The Path to 2030. Available: https://www.ieta.org/uploads/wp-content/2025/10/IETA_PwC.Report_25.V4_compressed.pdf

Question 13: What metrics should be considered for assessing the risk that banked credits will depress market prices?

As noted in earlier responses, the size of the credit bank relative to expected compliance demand and observed credit prices relative to the federal headline price are core indicators of whether banking is weakening market scarcity.
Beyond those baseline metrics, additional indicators that can assess the risk of banked credits depressing market prices include:

- Credit concentration and trading activity: High concentrations of banked credits among a small number of firms, combined with low trading frequency, can delay price response and mask oversupply.
- Benchmark tightening rate relative to bank size: Slow or uncertain benchmark tightening extends the lifespan of surplus credits and amplifies their price depressing effects.

Question 14: What volume of banked credits can be maintained in a functional market without a significant risk of depressing market prices?

There is no fixed volume of banked credits that can be maintained without price risk. They must be considered in relation to projected demand, flexibility rules and system design. The TIER system in Alberta allows banking and flexible compliance pathways, and recent policy changes around direct investment compliance are contributing to oversupply and low credit prices in the market.[24] Similarly, in the EU ETS, large accumulated banks were associated with prolonged low prices until surplus was actively managed through the Market Stability Reserve. These examples show that a functional market requires a clearly declining bank of credits relative to demand, supported by tightening benchmarks and limits on alternative compliance pathways.

Question 15: How do credit expiry rules affect the manageable volume of credits?

Credit expiry rules play a key role in determining how large a credit bank can grow without undermining market prices. By placing time limits on how long credits can be used for compliance, expiry rules reduce the effective supply of credits, shorten banking horizons, and encourage earlier use. All of these help maintain scarcity and price strength.

If credits don't expire, facilities can accumulate banked credits over multiple compliance periods, increasing the risk that future compliance is met largely with banked credits rather than new emissions reductions. Expiry rules also affect behaviour as shorter validity periods reduce incentives to hoard credits defensively and instead promote timely compliance.

[24] Canadian Climate Institute (2025). How to fix Alberta's broken carbon market. Available: https://climateinstitute.ca/how-to-fix-albertas-broken-carbon-market/

<u>Question 16:</u> How should the benchmark consider the supply of offset credits and banked allowances that cap-and-trade participants can use for their compliance obligations when assessing emissions caps against benchmark criteria?

When assessing an emissions cap-and-trade system against the benchmark, the benchmark should evaluate the stringency of the cap after accounting for all compliance instruments, including offsets and banked allowances, because these determine the real scarcity and market prices, not just the cap. This is most relevant in Canada for Quebec's cap-and-trade program, however, the same stringency logic must also be applied to other price-based systems currently in place in Canada.

A strengthened benchmark should require jurisdictions to demonstrate, using transparent, publicly available data, that their systems are stringent after accounting for:

- <u>Offsets:</u> Quebec allows offsets for up to 8 per cent of each entity's compliance obligation.[25] The benchmark should explicitly treat offsets as a reduction in allowance demand when assessing stringency and expected price outcomes, and require public reporting of offset volumes by compliance period.
- <u>Banked allowances:</u> The benchmark should require a multi-year demonstration that the banked credits are declining relative to the expected demand under the cap trajectory, with clear triggers for corrective action when the banked credits continue to persist over the demand levels.

It is important to recognize that offsets often lack credibility, weaken carbon price signals, and fail to deliver verifiable and additional emissions reductions. As a result, offsets use should be strictly limited under the federal benchmark, with clear and enforceable eligibility rules. Furthermore, facilities must meet strict public reporting requirements on the use of offsets, bank size, market volumes and prices. The federal benchmark must also implement a price corridor as a safe guard where offset supply and banking risk undermining high, durable prices. In cases where a provincial system can't demonstrate effective stringency and adherence to the federal benchmark, the Government of Canada must immediately apply the backstop to ensure harmonized standards across the country.

<u>Transparency</u>

<u>Question 17:</u> What type of credit price information is required to support decision making?

Minimum/maximum and average volume-weighted prices are a helpful starting point, but they're not sufficient for decision making in the OBPS credit markets. To support compliance planning and investment decisions, there should be reporting on the following as well:

[25] Government of Quebec (2025). Carbon Market. Available: https://www.environnement.gouv.qc.ca/changements/carbone/credits-compensatoires/index-en.htm

- **Time-series prices:** This shows how credit prices change over time rather than reporting a single average for the year. Prices should also be segmented by instrument type (offsets, credits) and by the year the credit was issued. This will help increase public confidence in the system, and help facilities with planning and investment decisions as it would show whether the credit markets are providing a stable and credible signal over time.
- **Trading volume and liquidity indicators:** Increasing market transparency, which includes the number and frequency of trades over a given period is also important. Low trading activity can mean prices are being set by a small number of transactions which may not reflect actual supply and demand. Low trading volumes may also signal that firms are defensively banking credits because they lack confidence in future system direction.
- **Market balance disclosures:** Disclosing the number of issued credits, used credits and banked credits per year is helpful in determining the availability of credits in the market. This is helpful in understanding if the market is becoming scarcer over time or if it is being dominated by an oversupply of credits. Large and growing banks of credits often indicate that compliance is being met with past surplus rather than new emissions reductions, which can keep prices low. Clear market balance information can help explain why prices are moving, or not moving, in certain directions, and whether policy changes are having the intended effect.

Together, transparent price, trading and market balance information allows regulated companies, the public and governments to see whether carbon pricing systems are creating real incentives to reduce emissions. In current provincial and federal systems, there is a lack of transparency,[26] and opaque markets and low prices are barriers to effectiveness.[27] More public and detailed transparency can solve that issue.

<u>Question 18:</u> What challenges exist in reporting these metrics?

One of the biggest challenges that exist across the federal and provincial systems is the inconsistent data standards and reporting requirements across the various jurisdictions, which makes it difficult to compare information on prices, trading activity, banking and credit use in a consistent way.

Another challenge is the reluctance to mandate public disclosure from the federal and provincial systems. This could help reveal price signals, oversupply, or design flaws. Transparency gaps often persist, not because data isn't collected, but rather because governments are hesitant to expose outcomes that could trigger political pressure to tighten systems or apply the federal backstop.

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[26] Office of the Auditor General of Canada (2022). Report 5—Carbon Pricing—Environment and Climate Change Canada. Available: https://www.oag-bvg.gc.ca/internet/English/parl_cesd_202204_05_e_44025.html

[27] Clean Prosperity (2025). Market Force: How Canada's carbon markets can be an engine of growth. Available: https://cleanprosperity.ca/wp-content/uploads/2025/07/Market-Force_-How-Canadas-carbon-markets-can-be-an-engine-of-growth-July-2025.pdf

Finally, the lack of willingness to enforce the backstop, especially when provincial systems underperform undermines reporting credibility. Without clear expectations and consequences, reporting risks becoming a formality rather than a tool for accountability and improvement.

<u>Question 19:</u> Is information on trading volumes required?

Yes, as mentioned above, information on trading volumes is required to understand whether reported prices reflect real market conditions or are based on a small number of transactions. Price data alone is insufficient without context on how frequently credits trade and in what quantities. Low or sporadic trading can signal thin markets, oversupply, or lack of confidence in future policy, even when average prices appear stable. Trading volume data can assess market health, price credibility, and whether the carbon pricing system is functioning as intended.

<u>Question 20:</u> What other metrics should systems consistently publish?

Beyond metrics already discussed above (prices, trading volumes, banking levels, and market balance), systems should consistently publish credit concentration data, forward compliance coverage, and use of alternative compliance pathways as well to strengthen oversight and benchmark assessments.

- **Credit concentration data:** The share of banked credits should be disclosed consistently to assess if credits are being concentrated by the largest participants. Concentrated holdings can allow a small number of firms to influence prices or delay market adjustment, distorting the carbon market integrity and competitiveness.
- **Forward compliance coverage:** Reporting on how many future compliance years can be covered by the existing bank of credits in the market can help regulators and the public understand when compliance is being covered by past surplus, rather than new reductions in emissions .
- **Use of alternative compliance pathways:** Publishing data on the use of offsets or funds-based compliance in systems is essential as they directly reduce demand for credits and weaken prices if not strictly managed and reported.

<u>Question 20:</u> For systems where compliance periods extend beyond a single year, what interim reporting requirements could be implemented to ensure timely access to relevant market data?

For multi-year compliance periods, interim reporting should ensure governments, regulators, participants and the public can see whether markets are liquid, whether surplus is building and whether prices reflect real scarcity.

At minimum interim reporting should be published quarterly, which is the frequency of auction reporting published many markets including RGGI[28] and the California and Quebec Cap-and-Trade systems.[29]
In the OBPS systems, interim reporting should be more frequent than the current annual timeline. For example, Alberta's TIER program publishes annual compliance reporting[30] but this should be complemented with quarterly disclosures on credits issued, credits expired, total bank size and aggregate trading volumes. This should then be harmonized across all pricing systems in Canada to ensure harmonized reporting.

<u>Question 21:</u> What reporting frequency, for instance quarterly or annually, is feasible for OBPS carbon markets, and what operational or technical constraints could impact this schedule?

Quarterly reporting is feasible for OBPS markets and is consistent with how some systems already collect and manage data, as mentioned above. While annual verification of facility level emissions will still take time, aggregate market indicators (prices, trading volumes, credit issued and banked) can be reported quarterly with minimal technical burden. A delay of 30 days is reasonable to allow for validation of data, while still ensuring information is timely and useful. Delays longer than this risk rendering reports backward looking and limiting their value for compliance planning, market oversight, and early intervention when markets are underperforming.

<u>Question 22:</u> What operational, technical, or regulatory constraints might limit a jurisdiction's ability to publish this data, and what solutions would be recommended to address those constraints?

Key constraints include inconsistent data systems across jurisdictions, concerns about confidentiality for facility-level information, limited regulatory mandates for public disclosures. These challenges are largely manageable. Aggregate, market level data can be published without revealing commercially sensitive information, as demonstrated by other carbon markets. Clear federal guidelines, standardized reporting templates, and explicit disclosure requirements in regulations would address other barriers.

<u>Question 23:</u> Which methods or strategies, such as data aggregation, masking, or delayed publication, would be most effective to maintain confidentiality when reporting price and market trade data while ensuring meaningful transparency?

The most effective approaches combine data aggregation, anonymization and short publication delays. Reporting market level prices and trading volumes avoids revealing firm identities.

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[28] Regional Greenhouse Gas Initiative (2025). Allowance Prices and Volumes. Available: https://www.rggi.org/auctions/auction-results/prices-volumes
[29] California Air Resource Board (2025). Auction Information. Available: https://ww2.arb.ca.gov/our-work/programs/cap-and-trade-program/auction-information
[30] Government of Alberta (2025). Compliance Reporting. Available: https://www.alberta.ca/technology-innovation-and-emissions-reduction-regulation#jumplinks-6

Publishing results with a 30 day delay further reduces commercial sensitivity while preserving relevance. Where markets are thin, i.e. less participants, masking techniques can be used to report price ranges instead of single point prices in transactions.

Question 24: What should be considered justifiable grounds for limiting publication of transaction data due to competitiveness concerns for individual facilities?

As a general principle, competitiveness concerns should not justify limiting publication of transaction data, where information can be reported in aggregated or anonymized form. Withholding market data undermines confidence in the system, weakens oversight, and limits the ability of governments and the public to evaluate whether the systems are functioning as intended. Transparent price, volume and market balance information is essential for assessing stringency, identifying design flaws, and making timely policy adjustments. Confidentiality concerns should be addressed through the various methods and strategies mentioned above, including aggregation and delayed publication of 30 days.

Benchmark assessment process

Question 25: Should the next benchmark assessment cover a shorter or longer timeframe? What are the advantages/disadvantages?

The next benchmark assessment should cover a shorter time frame, complemented by clear interim checkpoints. A shorter assessment window improves accountability by ensuring that weak design choices, surplus accumulation, or declining price signals are identified and corrected sooner.

Longer timeframes carry a clear risk of delayed accountability. Without frequent checks, weak provincial systems can drift further out of alignment for years while still claiming benchmark compliance. This risk can be addressed with timely oversight and corrective action when climate policies underperform.[31]

Question 26: How often do systems need to be reassessed to ensure designs are generating sufficient demand to maintain credit prices?

Systems should be reassessed on a regular two year schedule, with annual outcome checks focused on prices, credit supply and banking trends. Annual checks provide early warning of underperformance, while the two year assessment allows for timely structural adjustments to benchmarks and flexibility rules to ensure they are tightening fast enough to sustain demand and align with national targets. This approach balances predictability with responsiveness and prevents prolonged periods of weak demand or low prices.

[31] Office of the Auditor General of Canada (2022). Report 5—Carbon Pricing—Environment and Climate Change Canada. Available: https://www.oag-bvg.gc.ca/internet/English/parl_cesd_202204_05_e_44025.html

<u>Question 27:</u> Is the current minimum four-year backstop application period sufficient to provide clarity for investment decisions?

A minimum four year backstop application period remains important for investment certainty. However, stability does not require infrequent assessments. A two year benchmark assessment cycle with annual checks ensures systems remain aligned within the backstop period, while the backstop provides continuity if a provincial system is found to be non-compliant.

Furthermore, to ensure investors have the confidence that governments are committed to the industrial carbon pricing systems over the long term, the federal government must establish a strong and rising headline carbon price path beyond 2030.[32]

<u>Question 28:</u> Should the government publish details of benchmark assessments? If so, which information is needed to support market function and at what step in the process?

Yes, publishing benchmark assessment details is essential to support market function, credibility and enforceability. Transparency should be built into each step of the assessment process, not limited to a final determination.

At the start of the process, the federal government should publish the assessment criteria, data inputs, and thresholds that will be used (price outcomes, banking trends, flexibility use). This gives markets clarity on what alignment means and anchors expectations. During the assessment, the government should release interim findings, which include preliminary views on price performance and effective stringency, so jurisdictions and market participants can anticipate outcomes and adjust behaviour. At the conclusion, the governments should publish a clear rationale for decisions, including how evidence was weighed and why systems were deemed to be aligned or not.

Furthermore, benchmark assessments and backstop decisions must be governed by independent and transparent criteria. Provinces should be required to demonstrate, using publicly available data, how their systems meet benchmark requirements. Where systems fail to meet those criteria, the backstop should be applied automatically. Clear assessment rules and consequences are essential to maintain policy credibility, investor confidence and harmonized national standards.

[32] Clean Prosperity (2025). Market Force: How Canada's carbon markets can be an engine of growth. Available: https://cleanprosperity.ca/wp-content/uploads/2025/07/Market-Force_-How-Canadas-carbon-markets-can-be-an-engine-of-growth-July-2025.pdf