July 30, 2020

The Honorable Jerome Powell
Chair
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue N.W.
Washington, DC 20551

Dear Chair Powell:

We, the 69 undersigned organizations, write to share our concern over the failure of the Board of Governors of the Federal Reserve System ("the Board") to fulfill its responsibility to serve the public interest and promote financial stability due to its investment in the fossil fuel sector. Through the purchasing of fossil fuel debt via the Secondary Market Corporate Credit Facility ("SMCCF"), the Board is potentially exacerbating the climate crisis and exposing the public to financial losses through credit risk, market risk, and operational risk.. Intensifying the problem is the fact that the SMCCF's exposure to fossil fuel value chain debt as defined by the Global Industry Classification Standard (GICS) is significantly higher than its exposure to other sectors based on several market weighting indicators.[1] This creates a portfolio with lower asset quality relative to the comparable portfolios created by international central banks to address the coronavirus COVID crisis.[2] The Board should be working to reduce systemic risk during this dual health and economic crisis. Instead, it is intensifying risks to financial stability by supporting the fossil fuel sector.

The Board itself has previously warned that fossil fuels create particular financial risks due to general legal liabilities. In a 2016 Proposed Rule, the Board warned of the inherent financial risks that fossil fuels create due to federal or state laws which impose liability should there be a " release of physical commodities, such as oil, distillate fuel oil, jet fuel, liquefied petroleum gas, gasoline, fertilizer, natural gas, and propylene" into the environment.[3] The Board also highlighted that "over the past decade, monetary damages associated with an environmental catastrophe involving physical commodities have ranged from hundreds of millions to tens of billions of dollars."[4] These risks are just as present to the public overall and the Board itself when it chooses to invest in fossil fuel companies. The Board is

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[1] "Is the Fed Being Sector Neutral?: A Financial Analysis of the US Federal Reserve's Corporate Bond Market Interventions," InfluenceMap, (July 17, 2020): https://influencemap.org/report/Is-the-Fed-Being-Sector-Neutral-3a1294e4de3b6275fae9370d6f68cc70

[2] Recovery Map database, a project of InfluenceMap (latest data from June 25, 2020) https://recovery.influencemap.org/corporate-debt; and Credit Ratings of Companies in the Bond Portfolios of Central Banks, InfluenceMap, https://pbs.twimg.com/media/EdJFsq4WoAAh1LM.png

[3] "Regulations Q and Y; Risk-Based Capital and Other Regulatory Requirements for Activities of Financial Holding Companies Related to Physical Commodities and Risk-Based Capital Requirements for Merchant Banking Investments," Board of Governors of the Federal Reserve System, (September 30, 2016): https://www.federalregister.gov/documents/2016/09/30/2016-23349/regulations-q-and-y-risk-based-capital-and-other-regulatory-requirements-for-activities-of-financial.

[4] Id

choosing to invest public dollars in the debt of the very companies it warned financial holding companies about in 2016.

The Board's own acknowledgement of the inherent risks fossil fuels create makes its overweighting in fossil fuel purchases all the more concerning. A new report by the nonpartisan group InfluenceMap analyzing corporate debt purchases in the SMCCF through July 10, 2020 found that the Board's purchases are heavily overweight in the oil, gas and coal value chain companies (the "fossil fuel sector") when compared to several market benchmarks.[5,6] The Board is 2 times overweight in the fossil fuel sector compared to the US corporate debt market overall, 3.5 times overweight compared to equity market sector weightings, and more than 4 times overweight compared to the employment generated by these sectors. No other sector exhibits this level of overweighting across all three indicators. To date, roughly 8 percent ($748 million) of the Federal Reserve's $9.5 billion of bond purchases are in the fossil fuel sector. From that, $134 million has occurred through the direct purchase of corporate debt, the rest through the purchase of Exchange Traded Funds (ETFs) that track corporate debt markets. A concerning amount of that debt (or the debt backing the ETFs) is made up of non-investment grade debt; $124 million of the $748 million (17 percent) of purchased energy bonds were junk-rated, compared to $856 million of 9.3 billion (9 percent) for purchases overall across sectors.[7]

This is a troubling and problematic trend, as the SMCCF's overweighting in the fossil fuel sector boosts an industry that is responsible for the ever-accelerating climate crisis. There are serious questions as to whether the Board is overweight in this sector due to the extensive lobbying by the Trump Administration, the IPAA, and Republican Senators on the

[5] "Is the Fed Being Sector Neutral?: A Financial Analysis of the US Federal Reserve's Corporate Bond Market Interventions," InfluenceMap, (July 17, 2020): https://influencemap.org/report/Is-the-Fed-Being-Sector-Neutral-3a1294e4de3b6275fae9370d6f68cc70

[6] For the "fossil fuel sector", we are referencing MSCI's Global Industry Classification Standard (GICS) Energy sector definition, https://www.msci.com/documents/1296102/1339060/GICSSectorDefinitions.pdf/fd3a7bc2-c733-4308-8b27-9880dd0a766f. (The GICS Energy Sector "comprises companies engaged in exploration & production, refining & marketing and storage & transportation of oil & gas and coal & consumable fuels. It also includes companies that offer oil & gas equipment and services.")

[7] This figure represents an updated calculation from InfluenceMap using corporate debt purchase disclosures as of July 10, 2020. Original calculation appears in "Necessary Intervention or Excessive Risk?:Corporate Bond Risk Before and After COVID-19 Amid the Fed's Market Interventions," InfluenceMap, (June 23, 2020): https://influencemap.org/report/Necessary-Intervention-or-Moral-Hazard-5e42adc35b315cc44a75c94af4ead29c

SMCCF and other lending programs.[8,9,10] Looking specifically at the Main Street Lending Program ("MSLP"), while the Board has denied it made the changes to the program at the behest of the fossil fuel lobby or the Administration, Energy Secretary Dan Brouillette went on Bloomberg TV and said the Board made the changes in response to a request from the Administration.[11] This raises very serious concerns about the Board's independence.

InfluenceMap's findings that the Board is overweight in the fossil fuel sector confirms the fears many of our organizations had when we responded to the announcement of the corporate debt facilities in March. In a March 27 letter signed by many of our organizations, we expressed concerns not only about the lack of conditions on public financial support for an industry whose practices harm the public good, but also the absence of adequate analysis of climate financial risk in the management and strategy of this program.[12] Several members of Congress expressed similar concerns when the Board announced it would begin purchasing corporate debt. In April, Senators Brian Schatz, Sheldon Whitehouse, Senate Banking Committee Ranking Member Sherrod Brown and six other Senators urged the Board to consider the long-term financial risks associated with climate change, and warned that the U.S. financial system's "blindness to climate financial risks means that our response to the current economic crisis will make a future climate crisis more likely."[13] It appears these fears were well founded.

The Board to date has utterly failed to account for climate risk. But the Board isn't just ignoring long-term climate risk, it is also taking excessive risk with the U.S. public's money

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[8] Goldstein, Alexis, "The Fed Just Changed Its Own Rules to Bail Out the Fossil Fuel Industry," *Truthout,* (May 5, 2020): https://truthout.org/articles/the-fed-just-changed-its-own-rules-to-bail-out-the-fossil-fuel-industry/

[9] The White House and Treasury Secretary Steve Mnuchin publicly pledged to increase financial support for the struggling oil and gas sector, including distressed oil drillers, despite their clear ineligibility for existing lending programs. See: Jennifer A Dlouhy, Ari Natter, and Saleha Mohsin, "Trump Developing Plan to Aid Oil Industry Despite Opposition," *Bloomberg*, (April 24, 2020): https://www.bloomberg.com/news/articles/2020-04-24/trump-developing-plans-to-aid-oil-despite-democrats-opposition?sref=gPAG2MJ8.

[10] The Independent Petroleum Association of America (IPAA) asked the Board to change the rules of the Main Street Lending Program to allow participants to use the relief funds to refinance or pay down existing debts. Senators Kevin Cramer and Ted Cruz requested a loosening of eligible issuer criteria of the SMCCF/PMCCF to make the programs more accessible to struggling oil and gas companies. https://www.cruz.senate.gov/files/documents/Letters/2020.04.21%20-%20Letter%20to%20Powell%20Mnuchin%20re%20Credit%20Facilities%20Energy%20-%20Final.pdf

[11] Mohsin, Saleha and Natter, Ari, "Energy Chief Says Fed Asked to Expand Lending for Oil Firms," *Bloomberg*, (May 12, 2020): https://www.bloomberg.com/news/articles/2020-05-12/energy-chief-says-fed-was-asked-to-expand-lending-for-oil-firms.

[12] Letter to Chair Powell regarding PMCCF/SMCCF concerns, (March 27, 2020): https://d17a0173-b97b-4c08-a2e3-f8ea72c0874b.usrfiles.com/ugd/d17a01_62f18f6e12614fddac890d692066aea8.pdf.

[13] Senator Brian Schatz, "Letter to Fed on Corporate Credit Facilities," (April 20, 2020): https://www.schatz.senate.gov/imo/media/doc/Letter%20to%20Fed%20on%20Corporate%20Credit%20Facilities%2004.20.2020.pdf. ("The U.S. financial system's blindness to climate financial risks means that our response to the current economic crisis will make a future climate crisis more likely... the facilities can use taxpayer dollars to help sustain industries that may drive a future climate financial crisis. The Board should accelerate its efforts to better understand and price climate financial risks before it is too late.")

by continuing to purchase increasingly junk-rated fossil fuel debt. Another report by InfluenceMap, found that the fossil fuel sector sector has seen its credit rating deteriorate 8 percent, more than any other sector, over the last 5 years.[14] The sector's credit rating declined 5 percent further in 2020. Within the Energy sector, the "Oil and Gas Drilling" sub-industry category has fallen by 44 percent, making it the largest decline in credit ratings over the last five years of all the 158 GICS categories. The report concludes the Energy sector, made up only of fossil fuel companies, exhibits secular decline over 20 year, 5 year, and post COVID eras significantly more than any other GICS sector and that the credit ratings of the companies in this sector on average are unlikely to recover long term based on the current trajectory.

Given the rash of fossil fuel company bankruptcies and high levels of leverage, this trend puts public dollars at unnecessary risk. It also violates the spirit of the 13(3) emergency lending authority, which prevents the Board from lending to insolvent companies. While the Board's corporate credit facility rules allow it to purchase the debt of "fallen angels" who lost their investment-grade rating after March 22nd, Chair Powell has invoked the desire not to violate "spirit" of 13(3) in a Congressional hearing where he explained why the Board would not lend to U.S. territories through the Municipal Lending Facility ("MLF").[15] The Board appears to be more ready to make exceptions for fossil fuel firms in the MSLP than it is for U.S. territories that are upwards of 90 percent minorities and wish to access the MLF.[16] This is particularly troubling given that climate change stands to disproportionately impact people and communities of color, and those living on island nations such as many of the U.S. territories. Wall Street analysts have also noted that the Board is lending to insolvent firms: Chief Investment Strategist at Charles Schwab & Co Liz Ann Sonders has commented that the Board has "provided liquidity even to insolvent companies."[17]

Chair Powell told Congress that the plan is to hold these assets until maturity.[18] The fossil fuel sector has experienced significant deterioration of credit risk over the last several years;

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[14] "Necessary Intervention or Excessive Risk?:Corporate Bond Risk Before and After COVID-19 Amid the Fed's Market Interventions," InfluenceMap, (June 23, 2020): https://influencemap.org/report/Necessary-Intervention-or-Moral-Hazard-5e42adc35b315cc44a75c94af4ead29c

[15] "Oversight of the Treasury Department's and Federal Reserve's Pandemic Response," 116th Congress, (June 30, 2020): https://twitter.com/RealBankReform/status/1278018423168040961. (Federal Reserve Chair Jerome Powell, responding to a question from House Financial Services Chair Maxine Waters about the Board's lack of lending to U.S. territories.) ("Some of the revenue based facilities that the -- that Guam has are -- are investment grade rated but below the minimum and we're -- we're actually reviewing our credit standards in the municipal liquidity facility at the moment to determine if there's a way to adjust the facility in a way that would make eligible some credit worthy issuers without -- without sort of violating the spirit or letter of section 133.")

[16] "Monetary Policy and the State of the Economy," 116th Congress, (June 17, 2020):(Representative Michael San Nicolas, questioning Federal Reserve Chair Jerome Powell about the Board's lack of lending to U.S. territories) (""You talked about the need to support minorities. Our territories have upwards of 90% minorities."") https://twitter.com/RealBankReform/status/1275457134117793792

[17] Liz Ann Sonders: https://twitter.com/LizAnnSonders/status/1280084247848550401

[18] "Monetary Policy and the State of the Economy," 116th Congress, (June 17, 2020): (testimony of Federal Reserve Chair Jerome Powell) https://twitter.com/RealBankReform/status/1273298136707092488. ("Ultimately we are generally a hold to maturity entity, it maybe that we sell some back into the secondary market down the road, but ultimately we're a buy and hold...")

numerous analyses predict the fossil fuel sector is not likely to significantly recover post-crisis, posing serious questions about the sector's ability to repay the public.[19] On this trajectory, the public could be left holding the bag with billions of dollars of debt the fossil fuel industry is simply unable to repay. Former Federal Reserve Governor Sarah Bloom Raskin has raised this concern explicitly, writing that the Board's actions "not only misdirects limited recovery resources" and sends a false price signal to investors, but it also "increases the likelihood that investors will be stuck with stranded oil and gas assets that society no longer needs."[20]

The Board is also leveraging public funds to invest in companies that are dependent on pipelines that face serious humanitarian, legal, regulatory, reputational, and environmental challenges.[21] In the span of just one week in July, three separate fossil fuel pipelines were either cancelled or faced existential challenges in court. The Board had already purchased the debt of companies that have backed troubled or cancelled pipelines, most notably Dominion Energy and Duke Energy (the Atlantic Coast Pipeline) and Energy Transfer Operating (the Dakota Access Pipeline).[22] The collapse of the Atlantic Coast Pipeline offers case study in the inherent risks the Board has chosen to undertake by investing in fossil fuel firms. The Board purchased the corporate debt of the two backers of the pipeline, Dominion Energy and Duke Energy, on June 22. Just thirteen days later, Dominion and Duke jointly announced the cancellation of the Atlantic Coast Pipeline, citing "an unacceptable layer of uncertainty and anticipated delays". The firm had originally estimated the pipeline would cost \$4.5 to \$5 billion; its costs were projected to grow to \$8 billion.[23] The abandoned project will cost the firm billions in sunk costs.[24] While Dominion itself was able to unload the

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[19] Jordan Blum, "Oil, Fossil Fuel Demand May Have Peaked in 2019 Thanks to Covid-19*," S&P Global Platts*, (June 23, 2020): https://www.spglobal.com/platts/en/market-insights/latest-news/electric-power/062320-oil-fossil-fuel-demand-may-have-peaked-in-2019-thanks-to-covid-19-report
And "Pandemic Crisis, Systemic Decline: Why Exploiting the COVD-19 Crisis Will Not Save the Oil, Gas, and Plastics Industries," Center for International and Environmental Law, (April 2020): https://www.ciel.org/reports/pandemic-crisis-systemic-decline/

[20] Sarah Bloom Raskin, "Why Is the Fed Spending So Much Money on a Dying Industry?," *NYTimes,* (May 28, 2020): https://www.nytimes.com/2020/05/28/opinion/fed-fossil-fuels.html.

[21] "Secondary Market Corporate Credit Facility: Program Terms and Conditions," (April 9, 2020): https://www.newyorkfed.org/markets/secondary-market-corporate-credit-facility/archive/secondary-market-corporate-credit-facility-terms-and-conditions-200409 ("The Facility will leverage the Treasury equity at 10 to 1 when acquiring corporate bonds from issuers that are investment grade at the time of purchase and when acquiring ETFs whose primary investment objective is exposure to U.S. investment-grade corporate bonds. The Facility will leverage its equity at 7 to 1 when acquiring corporate bonds from issuers that are rated below investment grade at the time of purchase and in a range between 3 to 1 and 7 to 1, depending on risk, when acquiring any other type of eligible asset.")

[22] The Board, through the Secondary Market Corporate Credit Facility, which is managed by BlackRock's FMA Group, purchased \$3 million worth of Dominion Energy Gas Holdings debt at a 2.5% rate, and \$2 million worth of Dominion Energy Inc debt at a 2.0% rate, both on June 22. It purchased \$4 million worth of Energy Transfer Operating debt, at 4.5% interest rate, and another \$4 million Energy Transfer Operating bond at a 3.6% rate, both on June 24.

[23] "Dominion Energy and Duke Energy Cancel the Atlantic Coast Pipeline," Dominion Energy, (July 5, 2020):https://www.prnewswire.com/news-releases/dominion-energy-and-duke-energy-cancel-the-atlantic-coast-pipeline-301088177.html

[24] *Id* (Thomas F. Farrell, II, Dominion Energy chairman, stated "We regret that we will be unable to complete the Atlantic Coast Pipeline. For almost six years we have worked diligently and invested

ongoing risk in its natural gas pipeline and storage business by selling to Berkshire Hathaway Energy, the public does not escape the risk; Berkshire Hathaway Energy is another firm in the Board's Broad Market Index. The Board should not be purchasing the debts of firms that accelerate climate change by expanding fossil fuels, create real risks of local environmental catastrophe, and threaten the lands of Indigenous people. But the problem is compounded by the additional financial and solvency risks these companies face due to future litigation for ill-advised pipeline projects.[25] The Board's investment in these firms means the public now also shares a part of these risks.

The legal, financial, and climate risks the Board is incurring with the SMCCF's fossil fuel sector purchases burden the public and endangers financial stability. To ameliorate these problems, we call on the Board to:

- End the purchase of corporate debt from the fossil fuel sector through the SMCCF, the Primary Market Corporate Credit Facility, or any other Board emergency facility;
- Analyze and disclose the climate risks of all firms represented in the emergency lending portfolio, including the level of greenhouse gas emissions;
- Apply meaningful conditions on the credit facilities: a ban on participating companies issuing dividends or buying back its shares, restricting executive compensation, and requiring the retention of workers well beyond making "commercially reasonable effort";
- Focus on mitigating climate risks in the Board's role as regulator instead of exacerbating them in the Board's role as lender of last resort.

The Board's decision to use public funds to subsidize the fossil fuel sector exposes the nation to significant financial losses, both due to sunk costs in failed projects and the fallout from lawsuits over environmental catastrophe. The Board stridently maintains that it is an independent, apolitical agency. But its decision to overweight the SMCCF's fossil fuel sector purchases relative to market benchmarks, despite the increased risks to financial stability that creates, leaves us deeply concerned about the state of the Board's independence and autonomy.

Sincerely,

Algalita Marine Research & Education
Amazon Watch
BankTrack
Bold Alliance
Call to Action Colorado

CatholicNetwork.US

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billions of dollars to complete the project and deliver the much-needed infrastructure to our customers and communities.")

[25] Jeff Brady, "Federal Court Orders Dakota Access Pipeline To Shut Down And Be Drained," *NPR,* (July 6, 2020): https://www.npr.org/2020/07/06/887925736/federal-court-orders-dakota-access-pipeline-to-shut-down-and-be-drained.

Center for Biological Diversity
Center for Environmental Health
Center for International Environmental Law
Choosing Green

Citizens' Climate Lobby — Ventura Chapter
Climate Hawks Vote
Data For Progress
Demand Progress Education Fund
Earth Action, Inc.

Earth Guardians
Elders Climate Action
ESG Transparency Initiative
Food & Water Action
Fossil Free California

FracTracker Alliance
Franciscan Action Network
Friends of the Earth
Green Latinos
Greenpeace USA

Indigenous Environmental Network
Indivisible CA-33
Indivisible California Green Team
Institute for Policy Studies Climate Policy Program
Keep A Breast Foundation

League of Conservation Voters
Long Beach Alliance for Clean Energy
Mt. Zion Community Outreach, Inc.
Natural Resources Defense Council
New York Communities for Change (NYCC)

Occupy Bergen County (New Jersey)
Oil Change International
Oxfam America
Physicians for Social Responsibility Pennsylvania
Progressive Democrats of America

Public Citizen
Publish What You Pay-US
Rachel Carson Council
Rainforest Action Network
Rapid Shift

Seeding Sovereignty
Seventh Generation, Inc.
Sierra Club
Sunrise Movement
Take on Wall Street

The Center for Oceanic Awareness, Research, and Education (COARE)
The Forbes Funds
The Sunrise Project
Union of Concerned Scientists
Women's Earth and Climate Action Network (WECAN)

Zero Breast Cancer
350.org
350 Brooklyn
350 Butte County
350 Colorado

350 Conejo / San Fernando Valley
350 Eastside
350 New Orleans
350 NYC
350 PDX

350 Sacramento
350 Seattle
350 Silicon Valley
350 Ventura County Climate Hub

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cc:
Dr. John Williams, President, Federal Reserve Bank of New York
The Honorable Maxine Waters, Chair, House Financial Services Committee
The Honorable Patrick McHenry, Ranking Member, House Financial Services Committee
The Honorable Mike Crapo, Chair, Senate Banking Committee
The Honorable Sherrod Brown, Ranking Member, Senate Banking Committee
Laurence Fink, CEO, BlackRock
Charles Hatami, Global Head of Financial Institutions Group and Financial Markets Advisory, BlackRock