The Honorable Jerome H. Powell
Chair
Board of Governors of the Federal Reserve System

The Honorable Lael Brainard
Vice Chair
Board of Governors of the the Federal Reserve System

The Honorable Michael S. Barr
Vice Chair for Supervision
Board of Governors of the Federal Reserve System

The Honorable Christopher Waller
Governor
Board of Governors of the Federal Reserve System

The Honorable Michelle W. Bowman
Governor
Board of Governors of the Federal Reserve System

The Honorable Lisa D. Cook
Governor
Board of Governors of the Federal Reserve System

The Honorable Philip N. Jefferson
Governor
Board of Governors of the Federal Reserve System

January 31, 2023

Positive Money US is writing to express our concerns about Chair Powell's recent remarks at the Symposium on Central Bank Independence in Sweden regarding the Federal Reserve's role in addressing the climate crisis. Chair Powell stated that, if the Fed is to maintain its independence, it cannot and "will not be a climate policymaker" and that "it would be "inappropriate for [the Fed] to use [its] monetary policy or supervisory tools to promote a greener economy."[1]

Given the impact of fossil fuels and climate change on all of the Fed's objectives, we consider this to be a shortsighted interpretation of the Fed's mandate and a misguided approach to what the Fed's independence means — independence from political cycles does not absolve the Fed of its responsibilities to serve the public. The climate crisis and ecological collapse are undermining the stability of our entire economy, and threatening the Fed's core duties of maintaining stable prices and promoting maximum employment. As such, the central bank has a critical role to play in addressing this crisis, and it does not risk its independence in doing so.

The climate crisis is increasingly threatening the Fed's core objectives of maintaining price stability and maximum employment. Climate change is already affecting both employment and prices, which lands this issue squarely under the Fed's remit.[2]

[1] Board of Governors of the Federal Reserve System, Panel on "Central Bank Independence and the Mandate—Evolving Views", January 10, 2023, https://www.federalreserve.gov/newsevents/speech/powell20230110a.htm
[2] Federal Reserve Bank of San Francisco, "Climate Risk and the Fed: Preparing for an Uncertain Certainty", Speech by Mary Daly, June 22, 2021, https://www.frbsf.org/wp-content/uploads/210622-Peterson-Institute_FINAL_1.pdf; E-Axes Forum, "Impact of Climate Change on Price Stability", July 2022, Diego Känzig et al., https://e-axes.org/wp-content/uploads/2022/08/PB_Price-Stability_8_2022.pdf

Climate-driven weather disasters erode infrastructure and supply chains, impact agriculture and food production, spur job loss, and reduce labor productivity, all of which add inflationary pressures.[3] Global droughts and other extreme weather events linked to climate change have led to rising food and energy prices (driven primarily by fossil fuel price volatility in an oligopolistic energy market), which have been exacerbated by the war in Ukraine and are contributing significantly to current inflation. Climate-driven supply shocks will only get worse as the crisis accelerates. Vice Chair Brainard recently acknowledged that increasingly frequent and severe climate events, and "frictions in the energy transition" could "lead to greater volatility of supply" and risks heralding “a shift to an environment characterized by more volatile inflation.”[4] In order to secure price stability and fulfill its primary mandates, the Fed should follow a growing number of central banks around the world in recognising climate as a core consideration in its policymaking.

A fossil fuel-based economy will drive further price volatility. In addition to exposing banks to transition risks, the continued financing of and dependence on fossil fuels contributes greatly to overall price instability.[5] By one estimate, 41% of overall inflation is directly attributable to fossil fuel prices and even more to the indirect effects of high energy prices on consumer goods.[6] Although the Fed cannot bring energy prices down, it can help reduce the private sector's reliance on fossil fuels, serving its price stability mandate in doing so. This would help build a more stable and resilient economy, and prevent another financial crisis.

Climate-related financial risks are mounting, threatening banks' safety and soundness, overall financial stability, and the wider economy. The physical impacts of climate change on communities, households and businesses are accelerating. Climate-related weather disasters cost the US economy more than $145 billion in 2021.[7] One report estimates that insufficient action on climate could cost the US economy $14.5 trillion over the next 50 years (equivalent to nearly 4% GDP), with nearly 900,000 jobs lost each year.[8] In addition to physical risk, transition risks are seriously underestimated and continue to grow as society makes the shift to a clean energy economy. Still US banks continue to increase their fossil fuel financing, investments that could become stranded

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[3] Positive Money US, "Tackling Fossilflation: A Toolkit for Price Stability and a Just Transition", Andrés Bernal, December 6, 2022, https://positivemoney.us/wp-content/uploads/Positive-Money-US-Tackling-Fossilflation-Report-Dec-2022.pdf

[4] Board of Governors of the Federal Reserve System, “What Can We Learn from the Pandemic and the War about Supply Shocks, Inflation, and Monetary Policy?”, Speech, November 28, 2022, https://www.federalreserve.gov/newsevents/speech/brainard20221128a.htm

[5] Roosevelt Institute, “Energy Price Stability: The Peril of Fossil Fuels and the Promise of Renewables”, Lauren Melodia and Kristina Karlsson, May 2022, https://rooseveltinstitute.org/wp-content/uploads/2022/05/RI_EnergyPriceStability_IssueBrief_202205.pdf

[6]Rewiring America, "Clean energy investments are the antidote to inflation", July 14, 2022 Noah Goldmann et al., https://content.rewiringamerica.org/reports/Clean%20Energy%20Provisions.pdf

[7] National Oceanic and Atmospheric Administration, "U.S. saw its 4th-warmest year on record, fueled by a record-warm December", January 10, 2022, https://www.noaa.gov/news/us-saw-its-4th-warmest-year-on-record-fueled-by-record-warm-december

[8] Deloitte Report, "Inaction on Climate Change Could Cost the US Economy $14.5 Trillion by 2070", January 25, 2022, https://www2.deloitte.com/us/en/pages/about-deloitte/articles/press-releases/deloitte-report-inaction-on-climate-change-could-cost-the-us-economy-trillions-by-2070.html

assets — five major US banks have provided $87 billion to fossil fuel developers since joining the Glasgow Financial Alliance for Net Zero, despite making public commitments to achieve net-zero by 2050.[9] According to one estimate, unless capital requirements are adjusted to adequately account for climate risks, the exposure of American banks to soon-to-be-stranded fossil fuel assets could trigger a major financial crisis, costing five million American jobs and triggering a public bailout of $2.3 trillion, or $6,500 per person, in a 'slow transition' scenario.[10]

Given the urgency of the moment, as the intertwined climate and economic crises continue to unfold, we urge the Fed to consider the following policy options to address climate-related risks, help achieve long-term price stability and build a more resilient economy:

1. **Implement a Green Lending Scheme**

A transition to a clean energy economy will help mitigate climate change, and bolster price stability, and economic resilience. The Fed has the ability to provide loans to financial institutions under its discount window lending authority, which it can use to encourage climate-aligned financing. The Fed can incentivize private banks to channel their lending by bringing the discount rate into negative territory or below the federal funds rate, and offer banks this preferential rate if they use the funds for green lending.[11] As a start, the Fed's green lending scheme can help decarbonize the real estate sector, which accounts for nearly a third of greenhouse gas emissions in the US.[12] The Fed can do this by working closely with the Federal Housing Finance Agency (FHFA), which regulates Freddie Mac and Fannie Mae, that already offer loans to encourage sustainable lending for projects like energy and water efficiency.

In a 2022 working paper, Fed economists proposed using the discount window to provide "low-cost funding conditional on the banks meeting certain lending targets."[13] Turning this proposal into a green lending scheme would simply involve the inclusion of green lending targets, in line with credible science-based net-zero plans, which would promote the Fed's monetary policy objectives of maximum employment and stable prices. Such schemes have already been implemented elsewhere, including by the Bank of Japan, and are under consideration at the highest levels of the European Central Bank.[14]

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[9] Reclaim Finance, "Throwing fuel on the fire: GFANZ members provide billions in finance for fossil fuel expansion", January 17th 2023, https://reclaimfinance.org/site/en/2023/01/17/throwing-fuel-on-the-fire-gfanz-members-provide-billions-in-finance-for-fossil-fuel-expansion/; Banking on Climate Chaos, "Fossil Fuel Finance Report", 2022, https://www.bankingonclimatechaos.org/

[10] One For One, "Banking on Bailouts: Sizing the social costs when the fossil fuel bubble bursts", January 2023, https://oneforonenow.org/bankingonbailouts

[11] Project Syndicate, "How the Fed Could Go Green Faster", Meghan Greene, April 9, 2021, https://www.project-syndicate.org/commentary/fed-targeted-lending-to-fight-climate-change-by-megan-greene-1-2021-04

[12] Rocky Mountain Institute (RMI), "Hot Property: Why the Financial Sector Must Lead Real Estate Decarbonization", September 15, 2022, https://rmi.org/financial-sector-must-lead-real-estate-decarbonization/

[13] Federal Reserve Board, "Considerations regarding the use of the discount window to support economic activity through a funding for lending program", Mark Carlson and Rebecca Zarutskie, July 2022, https://www.federalreserve.gov/econres/feds/files/2022070pap.pdf

[14] Green Central Banking, "Japan's green lending scheme presents opportunities and challenges", Sayuri Shirai, August 2, 2022,

2. Adjust the Collateral Framework

Likewise, the Fed should adjust its collateral framework to account for the riskiness of assets backed by high emissions activities when setting eligibility requirements and haircuts for discount window operations.[15] The Fed's collateral framework is a potentially powerful tool that affects prices in the financial market and the allocation of capital more broadly. The Fed should either apply higher haircuts to assets backed by high emissions or exclude such assets from its collateral framework altogether. This would help decarbonize the financial system, and help reduce systemic physical financial risks.[16]

3. Implement Climate Calibrated Capital Requirements

Climate risks are uniquely complex, involving tipping points and feedback loops, and cannot be quantified, extrapolated from past data or 'efficiently' priced into market activities. Given this uncertainty and the potential for catastrophic social, economic, and financial consequences, the Fed should adopt a precautionary approach and adjust banks' capital requirements in proportion to climate risk, increasing the amount of equity a bank is required to hold to fund carbon-intensive lending.[17] Higher capital requirements would act as a buffer against the risk of stranded assets, protecting the public's deposits, and lowering the financial sector's contribution to the build-up of systemic climate risk in the first place.

The Basel Committee Committee on Banking Supervision (BCBS), the primary global standard setter, recently issued guidance detailing that banks should be required to incorporate climate-related risk into their internal capital adequacy assessments, and adopt a precautionary approach when assessing those risks.[18] The Fed is part of the Basel Committee and has committed to prioritizing the implementation of BCBS recommendations. As such, the Fed should incorporate the BCBS's guidance into its plans for regulating climate-related risks, meeting its mandate to address threats to bank safety and soundness and financial stability.

4. Finalize Climate Risk-Guidance and Strengthen Scenario Analysis

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https://greencentralbanking.com/2022/08/02/japan-green-lending-scheme-sayuri-shirai/; Green Central Banking, "Lagarde seeks ECB green targeted lending", Graham Caswell, June 10, 2022, https://greencentralbanking.com/2022/06/10/lagarde-seeks-ecb-green-targeted-lending/

[15] Public Citizen, "How Green is the Fed?", Yevgeny Shrago, March 29, 2021, https://www.citizen.org/article/how-green-is-the-fed/

[16] Inspire, "Greening collateral frameworks", Yannis Dafermos et al., August 2022, https://www.inspiregreenfinance.org/wp-content/uploads/2022/08/4257AB-INSPIRE-Paper-7-v2.pdf

[17] UCL IIPP, "Climate-related financial policy in a world of radical uncertainty: Towards a precautionary approach", Hugues Chenet et al., 2019, https://www.ucl.ac.uk/bartlett/public-purpose/sites/public-purpose/files/iipp-wp-2019-13-climate-related-financial-policy-in-a-world-of-radical-undertainty-web.pdfl; Center for American Progress, "Addressing Climate-Related Financial Risk Through Bank Capital Requirements", Gregg Gelzinis, May 11, 2021, https://www.americanprogress.org/article/addressing-climate-related-financial-risk-bank-capital-requirements/

[18] Basel Committee on Banking Supervision, "Frequently asked questions on climate related financial risks", December 8, 2022, https://www.bis.org/bcbs/publ/d543.pdf; see Public Citizen, "Climate, Capital, and Caution: The Basel Global Standard on Climate-Related Financial Risk", Yevgeny Shrago, January 26, 2023, https://www.citizen.org/article/climate-capital-and-caution/#_ftn2

The Fed's proposed "Principles for Climate-Related Financial Risk Management for Large Financial Institutions"[19] is a welcome first step. We urge the Fed to quickly finalize and strengthen the guidance by: including risks to community and regional banks, smaller insurers, and related implications for marginalized communities who are disproportionately impacted by climate change; incorporating requirements for large banks to reduce financed emissions and establish credible, science-based net-zero transition plans; and accounting for heightened transition risks for large banks resulting from policies like the Inflation Reduction Act.

We also urge the Fed to address the gaps in its pilot scenario analysis exercise, a critical assessment tool that needs to be robust in order to accurately gauge the level of risk and inform the relevant regulatory steps.[20] At present, the scenarios are inadequate. Amongst other issues, the current scenarios underestimate both physical risk and transition risk (and how they interact), they do not consider the risk of financial contagion triggered by major extreme weather events (like hurricanes) or a rapid low-carbon transition, and they only consider a portion of a bank's portfolio (real estate and corporate loans), when climate risks affect every sector.

Conclusion

While the Fed is not expected to lead the fight against climate change, it does have a critical role to play in ensuring the financial system it supervises is aligned with a 1.5 °C pathway. All of the Fed's core duties are deeply impacted by and entangled with the climate crisis, including keeping unemployment low and guarding against inflation. Adopting monetary and supervisory measures aligned with climate targets is not the same thing as making climate policy. Ignoring the climate crisis and its risks would mean deviating from the Fed's congressionally given mandates. We urge the Fed to take the steps outlined in this letter to address climate change, and help build a more resilient economy in the long-run.

Sincerely,

Positive Money US

For questions please contact Akiksha Chatterji at akiksha.chatterji@positivemoney.us.

About Positive Money
Positive Money US is a new research and campaign organization working towards a money and banking system which supports a fair, democratic and sustainable economy.
www.positivemoney.us

[19] Board of Governors, "Principles for Climate-Related Financial Risk Management for Large Financial Institutions", December 02, 2022, https://www.federalreserve.gov/newsevents/pressreleases/other20221202b.htm
[20] Board of Governors, "Pilot Climate Scenario Analysis (CSA) Exercise", January 17, 2023, https://www.federalreserve.gov/newsevents/pressreleases/other20230117a.htm