United States Senate

September 30, 2020

The Honorable Brian Brooks
Acting Comptroller of the Currency
400 7th Street S.W.
Washington, D.C. 20219

Dear Acting Comptroller Brooks:

We are writing about your stated intention[1] to investigate certain financial institutions for deciding not to finance new drilling projects in the Arctic. These institutions assessed the risks and decided against funding new drilling projects in the Arctic because of reputation and climate financial risks. Federal financial regulators do not have the legal authority to pressure banks to fund specific projects. It would be highly inappropriate to use official tools of supervision, enforcement, and rulemaking to apply such pressure, particularly when the lending in question runs counter to banks' own risk assessments.

These firms' risk-based concerns are well founded—and they have abundant reason to believe new oil and gas development presents significant credit risk as well. The U.S. oil and gas industry has experienced financial distress for years, well before the sharp drop in demand caused by the COVID-19 pandemic.[2] For example, the industry's reliance on junk-rated debt precedes the COVID-19 crisis: energy companies have been the single largest issuers of junk bonds in ten of the past eleven years.[3]

The high level of junk debt and weak financial performance in this sector pose serious credit risks for lenders. Since 2016, more than 200 oil and gas companies have gone bankrupt, representing over $120 billion in debt[4]—and the trend will likely intensify in 2020. By the second quarter of this year, 23 U.S. oil and gas companies have already filed for bankruptcy, compared to 42 throughout 2019 and 28 in 2018.[5]

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[1] https://bankingjournal.aba.com/wp-content/uploads/2020/07/brian-brooks-occ-letter-sen-dan-sullivan.pdf

[2] Matt Phillips, Clifford Krauss, "American oil drillers were hanging on by a thread. Then came the virus," The New York Times, March 20, 2020, https://www.nytimes.com/2020/03/20/business/energy-environment/coronavirus-oil-companies-debt.html; *see also* John Baffes and others, "The Great Plunge in Oil Prices: Causes, Consequences, and Policy Responses" (Washington: World Bank Group, 2015), http://pubdocs.worldbank.org/en/339801451407117632/PRN01Mar2015OilPrices.pdf (cited in Gregg Gelzinis, Michael Madowitz, and Divya Vijay, *The Fed's Oil and Gas Bailout Is a Mistake*, Center for American Progress, July 2020, https://www.americanprogress.org/issues/economy/reports/2020/07/31/488320/feds-oil-gas-bailout-mistake/)

[3] Matt Phillips, Clifford Krauss, "American oil drillers were hanging on by a thread. Then came the Virus," *The New York Times*, March 20, 2020, https://www.nytimes.com/2020/03/20/business/energy-environment/coronavirus-oil-companies-debt.html

[4] *Id.*

[5] Haynes and Boone, LLP, "Oil Patch Bankruptcy Monitor," June 30, 2020, https://www.haynesboone.com/-/media/Files/Energy_Bankruptcy_Reports/Oil_Patch_Bankruptcy_Monitor

Future risks loom for the oil and gas industry that financial institutions are correct to take into account. For example, clean energy sources such as solar and wind are seizing market share from the oil and gas industry due to lower costs and an increase in demand.[6] U.S. renewable energy consumption surpassed coal for the first time in 130 years,[7] and forecasts for 2020 estimate that renewable energy sources will account for nearly 21 percent of U.S. electricity, up from 10 percent in 2010.[8] Considering these trends, a financial institution could rationally be expected to avoid financing expensive new extraction projects in untested petroleum plays[9] that would increase the global oil glut and further depress prices.

Financial institutions have also cited reputational risks as a reason for not financing new drilling in the Arctic, for good reason. There has been substantial public opposition to drilling in the Arctic. For example, of the 1 million public comments submitted to the Bureau of Land Management, 99 percent opposed drilling in the Arctic National Wildlife Refuge (ANWR),[10] and in polls, two out of three registered voters opposed drilling in ANWR.[11] Members of Indigenous communities including the Gwich'in and Inupiat have also repeatedly called on major banks around the world to respect their rights to sovereignty and food security and not finance Arctic drilling.[12] And, a group of institutional investors representing $2.52 trillion in assets under management wrote letters to oil companies and banks expressing grave concerns about the climate, environmental, and financial risks of Arctic drilling.[13]

These risks fall within the definition of "reputation risk" in the Comptroller's Handbook: "[r]eputation risk is the risk to the current or projected financial condition and resilience arising from negative public opinion."[14] Decisions that undermine a financial institution's public

[6] Nick Cunningham, "Renewable energy is seizing market share during the pandemic," *OilPrice.com*, July 22, 2020, https://oilprice.com/Energy/Energy-General/The-Pandemic-Has-Been-A-Major-Boon-For-Renewable-Energy.html; see also Deloitte, "2020 Renewable Energy Industry Outlook," 2019, https://www2.deloitte.com/content/dam/Deloitte/us/Documents/energy-resources/us-2020-renewable-energy-industry-outlook.pdf

[7] Mickey Francis, "U.S. renewable energy consumption surpasses coal for the first time in over 130 years," U.S. Energy Information Administration, May 28, 2020, https://www.eia.gov/todayinenergy/detail.php?id=43895

[8] Ivan Penn, "Oil companies are collapsing but wind and solar energy keep growing," *The New York Times*, April 7, 2020, https://www.nytimes.com/2020/04/07/business/energy-environment/coronavirus-oil-wind-solar-energy.html

[9] Steve Eder and Henry Fountain, "A Key to the Arctic's Oil Riches Lies Hidden in Ohio," *The New York Times*, April 2, 2019, https://www.nytimes.com/2019/04/02/us/arctic-oil-drilling-well-data.html

[10] Jenny Rowland-Shea and Sung Chung, "Trump Administration is suppressing science and public opinion to drill the Arctic refuge," Center for American Progress, June 26, 2019, https://www.americanprogress.org/issues/green/news/2019/06/26/471433/trump-administration-suppressing-science-public-opinion-drill-arctic-refuge/

[11] Matthew Ballew, et al., "Americans oppose drilling in the Arctic National Wildlife Refuge, Yale Program on Climate Change Communications, September 26, 2019, https://climatecommunication.yale.edu/publications/americans-oppose-drilling-arctic-national-wildlife-refuge-2019/

[12] Yessenia Funes, "Alaska Natives call on banks to protect the Arctic National Wildlife Refuge from drilling," Gizmodo, October 26, 2018, https://earther.gizmodo.com/alaska-natives-call-on-banks-to-protect-the-arctic-nati-1830022296

[13] Letter from investors re. Arctic National Wildlife Refuge drilling, May 14, 2018, https://www.sierraclub.org/sites/www.sierraclub.org/files/blog/Investor%20Arctic%20National%20Wildlife%20Refuge%20Letter%205.11.pdf

[14] Office of the Comptroller of the Currency, "Comptroller's Handbook: Corporate and Risk Governance," Version 2.0, July 2019, p. 7, https://www.occ.gov/publications-and-resources/publications/comptrollers-handbook/files/corporate-risk-governance/index-corporate-and-risk-governance.html

standing can cause depositors to withdraw their money and borrowers or other clients to take their business elsewhere. Given the surging demand for sustainable investment in recent years,[15] the reputation risk of financing new oil extraction projects in vulnerable landscapes is an important consideration.

Financial institutions are also increasingly taking into account the financial risks from climate change, which could destabilize the financial system and our economy. Climate-induced disasters cost banks, insurers, and investors billions of dollars each year, and those direct losses will increase dramatically over time. Markets would become more volatile if they suddenly revalue assets or entire industries to reflect future losses—or even uncertainty about future losses.

The market could also experience a "climate Minsky moment" as investors realize that to avert an irreversible climate crisis, the transition to a clean energy economy is inevitable. At that point, unburnable fossil fuel reserves will become "stranded assets." A disorderly transition in which "stranded assets" are rapidly devalued could wipe out $18 trillion from the market.[16] A sudden and significant decrease in the value of fossil fuel-related assets, including reserves, presents a significant risk to financial institutions that fund companies and projects in the oil and gas industry. Indeed, an analysis of European financial institutions found that many would fare poorly were fossil fuel-related asset values to rapidly decline in value, and that this could present a systemic risk to the broader economy.[17] Instead of pressuring banks to lend more to this sector, the OCC should use its supervisory authority to require banks to better account for climate financial risks and factor in the possibility of stranded assets when underwriting loans.

With respect to managing climate financial risks, the OCC has fallen behind its global peers. Dozens of central banks and bank supervisors from around the world—organized as the Network for Greening the Financial System (NGFS)—are already working together to develop supervisory tools, such as scenario analyses and stress tests, to assess financial institutions' exposure to climate financial risk.[18] Unfortunately, U.S. financial regulators have not joined this group or taken serious steps to incorporate climate financial risks into their supervisory work.

Notwithstanding these serious risks, you have said that you are concerned about the decisions that certain banks have made to not finance new drilling in the Arctic. According to your letter, "the OCC intends to seek additional information from the banks involved to understand the rationale for these decisions." You further warn that this information will be used to "analyze whether these actions violate any duty or obligation under federal law," specifically 12 U.S.C. Sec. 1(a), which provides a general statement of purpose for the OCC. As you note, this general statement of purpose provides that the OCC is "charged with assuring . . . fair access to financial

[15] Elliot Smith, "The numbers suggest that green investing 'mega trend' is here to stay," *CNBC*, February 14, 2020, https://www.cnbc.com/2020/02/14/esg-investing-numbers-suggest-green-investing-mega-trend-is-here.html
[16] Network for Greening the Financial System, *Macroeconomic and financial stability implications of climate change*, July 2019, p.16. https://www.banque-france.fr/sites/default/files/media/2019/08/19/ngfs-report-technical-supplement_final_v2.pdf
[17] Stefano Battiston, "A climate stress-test of the financial system," *Nature Climate Change* 7, pgs. 283-88, *available at* https://www.nature.com/articles/nclimate3255
[18] Network for Greening the Financial System (NGFS), *First Progress Report*, 11 Oct. 2018. https://www.ngfs.net/en/first-progress-report

services, and fair treatment of customers" by the institutions that it supervises. Based on this provision of law, you say that the OCC will "examine the possibility of issuing regulations defining fair access."[19]

We are concerned that the OCC's actions as you describe them lack a sound legal basis. To our knowledge, in the 10 years since 12 U.S.C. Sec. 1(a) was added to the U.S. Code, this provision of law has never been cited as imposing a legally enforceable requirement on banks. Nor has it ever been interpreted as delegating authority for the OCC to undertake a rulemaking. On its face, it is a statement of the general purposes of the OCC.[20] There is also no law or regulation that we are aware of that prohibits a bank from deciding not to finance specific projects, such as new drilling in the Arctic. It would be extremely troubling if the OCC attempted to use its supervisory or rulemaking authority to pressure banks to finance projects they otherwise deemed too risky to fund. In fact, such actions would run counter to the first purpose of the OCC, which is "assuring the safety and soundness" of the institutions under its jurisdiction.

Financial regulators have powerful tools at their disposal, such as the ability to request information from banks, take enforcement actions, and issue new rules. As you note in your letter, it is inappropriate for financial regulators to use their authority to "discriminate against businesses"—we would point out that it is equally inappropriate for regulators to use their authority to favor certain businesses by threatening financial institutions when they reduce lending based on an objective assessment of risk.

To help us understand the OCC's intended actions and ensure that the OCC continues to conduct itself with independence and within the bounds of its legal authority, we request answers to the following questions by October 26, 2020:

1. In your letter, you state that you share concerns about "recent decisions by certain financial institutions to stop lending to new oil and gas projects in the Arctic." What are your concerns about those decisions specifically? How many of these financial institutions were actually lending to new oil and gas projects, and then stopped?
2. What additional information is the OCC seeking from these financial institutions? What is the relevance of information on the "effect [of the decisions on Arctic drilling] on our national economy and local communities"?
3. Is it your view that 12 U.S.C. Sec. 1(a) establishes an obligation on banks to lend to every industry or sector of the U.S. economy?
4. Has the Chief Counsel's Office at the OCC produced a legal opinion on the obligations, if any, imposed on banks by 12 U.S.C. Sec. 1(a)? If yes, please provide a copy of the legal opinion. If no, then what is the basis for this legal interpretation?
5. Is it your view that the OCC could engage in a rulemaking to define "fair access"? Could you provide any precedent for basing a rulemaking on 12 U.S.C. Sec. 1(a)?
6. Has the Chief Counsel's Office at the OCC produced a legal opinion on the powers, if any, delegated to the OCC by 12 U.S.C. Sec. 1(a)? If yes, please provide a copy of the legal opinion. If no, then what is the basis for this legal interpretation?

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[19] https://bankingjournal.aba.com/wp-content/uploads/2020/07/brian-brooks-occ-letter-sen-dan-sullivan.pdf

[20] Adam Levitin, "OCC suggests "fair access" rulemaking to require banks to finance the oil and gas industry," *Credit Slips*, August 4, 2020, https://www.creditslips.org/creditslips/2020/08/occ-suggests-fair-access-rulemaking-to-require-banks-to-finance-the-oil-and-gas-industry.html

7. Is there legislative history that indicates Congress intended this provision of law to be a delegation of authority to the OCC?
8. What is your expected timeframe for gathering information from these financial institutions and analyzing their position on Arctic drilling?
9. Has the OCC discussed this issue with any company or representative from the oil and gas industry? If yes, please provide all records of such meetings, including detailed information on participants, issues discussed, and any documents or materials presented.
10. Has the OCC discussed this issue with any other government officials outside the agency, including but not limited to, other financial regulators, the Department of Energy, other offices within the Treasury Department, and the White House?
11. What steps is the OCC taking to account for the systemic financial risks from climate change?

Thank you for your consideration. We look forward to your response.

Sincerely,

BRIAN SCHATZ
United States Senator

SHELDON WHITEHOUSE
United States Senator

DIANNE FEINSTEIN
United States Senator

CORY A. BOOKER
United States Senator

JEFFREY A. MERKLEY
United States Senator