FOSSIL FREE FINANCE ACT (FFFA)

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1. Glossary of Technical Terms

You can find a glossary of technical jargon in this "Climate Finance Regulation Resource Hub".

2. What is the Fossil Free Finance Act?

The Fossil Free Finance Act is a bill [H.R. 2443 / S. 1138] reintroduced by Senator Ed Markey and Representatives Ayanna Pressley and Rashida Talib in the 118th Congress on March 30th, 2023.

The bill requires the Federal Reserve (Fed) — the U.S. central bank and a powerful banking regulator — to address the systemic risk that climate change and the energy transition pose to our financial system. These are known as climate related financial risks, and are usually referred to as physical and transition risks.

3. What does the Fossil Free Finance Act do?

Under the legislation, the Fed would be required to mandate, either through guidance or regulation, that the biggest banks stop financing the climate crisis and deforestation, and instead align their financing with science-based emissions targets that would keep global warming within 1.5°C. That's the threshold the Intergovernmental Panel on Climate Change has defined as necessary to avoid the worst impacts of the climate crisis.

The FFFA would not require the Fed to do anything it cannot already do under its current mandate to oversee bank safety and soundness and mitigate risks to financial stability. This bill simply directs the Fed to use its existing authority to protect individual banks and the financial system by reducing the amount of exposure that banks have to risky activities that produce greenhouse gas emissions.

4. How would the Federal Reserve implement the Fossil Free Finance Act?

Net Zero Plans for Biggest Banks

The Fed would require the largest banks, those with more than $50 billion in assets, to submit and follow a plan for achieving zero financed emissions by 2050. That's a key target that governments and private actors are increasingly pursuing in order to protect people from the most devastating impacts of the climate crisis.

Financed emissions are the greenhouse gas emissions produced by a bank's clients as a result of the bank's lending, investment or other support. Adopting and following emissions reduction plans will keep banks from taking undue risks to squeeze a few last quarters of profits out of high emissions assets that will become prematurely worthless as the world transitions to a low carbon future.

Milestones

To avoid a fire sale from banks trying to meet their financed emissions reduction obligations at the last minute, the banks' transition plans would need to include certain intermediate milestones, including:

- 50% reduction in financed emissions by 2030
- 100% reduction in financed emissions by 2050
- No financing of new or expanded fossil fuel projects 60 days after enactment
- No financing of all fossil fuel projects by 2030
- No financing of thermal coal projects or companies after 2025
- No financing of deforestation risk commodities

A fire sale is the sale of goods or assets at heavily discounted prices, usually because the seller is in financial distress. As the transition to a low carbon economy gathers speed, high emissions assets, particularly fossil fuels, will drop in value, with the potential to cause significant economic disruptions if not managed properly. That's why it's important for banks to set and meet the intermediate milestones listed above.

Environmental Justice

The bill mandates the Fed to require that banks' plans account for the needs of the communities suffering the most from environmental racism. It limits the use of false or unproven solutions, like carbon offsets or carbon capture and sequestration technology.

The plans must also prioritize removing funding from projects that cause disproportionate harm to vulnerable communities, as well as providing financing for companies to help workers affected by the transition to a low carbon future.

Shadow banks/ Nonbank Systemically Important Financial Institutions (SIFI)

The bill amends the Dodd-Frank Act to add financed emissions to the list of factors the Financial Stability Oversight Council considers when it determines whether a nonbank financial company is systemically important and should be supervised by the Federal Reserve, and it applies the transition plan requirements outlined above to designated companies.

Nonbank financial institutions include entities like insurers, private equity funds, and asset managers. These entities, commonly known as “shadow banks", are often lightly regulated, which contributed to the 2008 financial crash.

To help close the regulatory gap, The Dodd Frank Act created a designation process, whereby nonbank entities can be designated as "Systemically Important Financial Institutions." By adding financed emissions as a consideration, the bill makes sure that non-bank financial institutions don't just take over the role of financing risky high-emission assets from Wall Street megabanks.

Penalties

Updated plans must be submitted every two years. If banks do not submit plans that meet the law’s requirements, or fail to follow the plans they submit, the Federal Reserve is instructed to fine the bank and its executives and to require the bank to sell assets to bring its business in line with the plan’s requirements. Banks that fail to submit or adhere to Fed-approved emission reduction plans may also lose their deposit insurance from the Federal Deposit Insurance Corporation. Such penalties are rarely imposed, and only in serious cases of fraud, mismanagement or other dangerous or illegal conduct.

Reporting to Congress

To help with Congressional oversight, the Fed is required to report on its progress toward achieving the bill’s goals every two years. It’s also required to analyze the impact of the transition on workers and communities, and recommend ways that either the Fed or Congress can cushion that transition.

5. Why is the Fossil Free Finance Act important?

The Fossil Free Finance Act is a critical tool for directing the Federal Reserve to do its job and protect the financial system, our economy and ultimately our communities

from climate risks. So far the Fed has not taken any meaningful action to actually curb banks' financing of risky high-emissions assets.

Since the initial introduction of the Fossil Free Finance Act in the 117th Congress, U.S. financial regulators, including the Fed, have acknowledged that climate change and the energy transition are an emerging risk to the financial system. Still, regulators continue to drag their feet.

The Risks are Mounting

The climate crisis threatens the stability of our financial system, and the entire economy. And as the crisis worsens, so too will the risks. The physical impacts of climate change are already exacting a huge economic toll. From record shattering wildfires to massive hurricanes that bring local economies to a grinding halt, extreme weather events are hitting all parts of the country, leaving banks exposed to heightened risks if borrowers fail to repay loans, or for example when housing and farms are destroyed.

Yet, even as efforts to address the climate crisis accelerate in the U.S. and globally, banks continue to pour hundreds of billions of dollars into fossil fuel companies and projects that may soon become obsolete and non-performing. Moreover, a new study has found that financial institutions are underestimating the risks they face from climate change. And as the Inflation Reduction Act's green financing provisions and aligned state laws bolster the transition, fossil fuel volatility will only worsen, posing new risks to the banks that finance the industry.

Regulators Are Taking Too Long to Do Too Little

The Federal Reserve, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation, have all proposed guidance on how banks with more than $100 billion in assets should manage their climate risks. Unfortunately, the regulators have dragged their heels on taking the action needed to actually make sure that banks address these risks. Eighteen months after identifying climate change as a financial risk, none of the federal banking regulators have actually required banks to act in ways that reduce their risks.

The Fed is Lagging Behind Global Counterparts

Central banks across the world are moving forward in addressing climate related risks. The French central bank's governor, François Villeroy de Galhau, recently said that central banks have a "core duty" to fight climate change. And the European Central Bank's Frank Elderson has said that climate considerations "should not be seen as controversial". The Fed, however, has failed to keep up with its global counterparts and isn't showing signs of making any decisive progress in 2023.

Recent Banking Failures Are a Wake-Up Call

The sudden collapse of Silicon Valley Bank shows how a lagging regulatory response can threaten the safety of individual banks and have negative implications for the whole financial system. The risks posed by banks failing to adapt to the energy transition are similar: sudden revaluations of assets, collapsing deposit bases, and general lack of oversight and controls. As climate change worsens and the energy transition accelerates, these risks will only grow unless they are proactively addressed.

The Fed simply cannot afford to repeat the same mistakes with climate-related risks. A climate-driven financial crash could be irreversible and catastrophic, which is why proactive measures are essential.

We Need the Fossil Free Finance Act

Congress is now considering options for making regulators actually discharge their mandates. Failure to make sure that regulators adequately address climate risk will increase the chance of a new crisis.

The Fossil Free Finance Act would remove discretion from the regulators hands and make sure they do what is necessary to address the risks that banks face, and the risks they pose to the financial system.

6. Who has sponsored the Fossil Free Finance Act so far?

Senate Sponsors: Led by Sen. Ed Markey (D-MA) and cosponsored by Sen. Jeff Merkley (D-OR), Sen. Bernard Sanders (I-VT), Se. Elizabeth Warren (D-MA), and Sen. Peter Welch (D-VT)

House Sponsors: Led by Rep. Ayanna Pressley (D-MA-7) and cosponsored by Rep. Rashida Tlaib (D-MI-12), Rep. Pramila Jayapal (D-WA-7), Rep. Jamaal Bowman (D-NY-16), Rep. James McGovern (D-MA-2), Rep. Ilhan Omar (D-MN-5), Rep. Cori Bush (D-MO-1), Rep. Grace Meng (D-NY-6), Rep. Summer Lee (D-PA-12), Rep. Barbara Lee (D-CA-12), Rep. Raúl Grijalva (D-AZ-7), Rep. Alexandria Ocasio-Cortez (D-NY-14), Rep. Emanuel Cleaver (D-MO-5), Rep, Jamie Raskin (D-MD-8), Rep. Jared Huffman (D-CA-2), and Rep. Bonnie Coleman (D-NJ-12)

A full list of sponsors is available here.

7. Which groups support the Fossil Free Finance Act?

This bill is endorsed by almost 70 organizations including Public Citizen, 350.org, Americans for Financial Reform, Evergreen Action, Friends of the Earth, Giniw Collective, Greenpeace USA, Hip Hop Caucus, Positive Money US, Rainforest

Action Network, Seeding Sovereignty, Sierra Club, STAND.earth, Third Act, US. PIRG, Zero Hour and many state and local groups.

A full list of endorsing groups is available here.

8. Why should the Federal Reserve address climate risks?

The Fed's mandate includes supervising and regulating financial institutions, and promoting financial system stability. The climate crisis poses a direct threat to both financial institutions, and to the stability of the financial system as a whole. As one of the most powerful banking regulators, it is the Fed's responsibility and duty to address the financial risks created by climate change and the clean energy transition.

With comprehensive insight into the nation's largest and riskiest banks and their operations, the Fed is perhaps the most important banking regulator when it comes to preventing another financial crisis driven by climate change. Its job is to protect the economy from excessive risk-taking by megabanks and designated shadow banks, risks of the kind that drove the 2008 crash.

9. Does this bill change the Fed's current mandate, or give it new powers?

No. The Federal Reserve could implement the requirements in this bill based on its current mandates to oversee bank safety and soundness and mitigate risks to financial stability. Banking regulators have long had the authority to limit concentrations of credit exposure and require banks to transition away from unsafe lending practices. This bill directs the Fed to use those powers to address the risk that financing emissions poses to individual banks and the financial system.

Indeed, the Federal Reserve's Principles for Climate-Related Financial Risk Management for Large Financial Institutions recognize that banks should take climate change and the global efforts to limit rising temperatures into account when making business decisions. The Federal Reserve already expects banks that make climate commitments to keep them consistent with their internal strategies and risk management frameworks.

10. Does this bill make the Federal Reserve a climate policymaker?

No. The Fed is not a climate policymaker but it does have a critical role to play in addressing climate related financial risks. Addressing climate risks is key to fulfilling the Fed's core duty and responsibility to promote the safety and soundness of

individual financial institutions, and to protect the stability of the financial system overall. It is the Fed's job to supervise and regulate banks so that they do not engage in excessive risk taking with the potential to crash the economy. This is not the same thing as making climate policy, it is merely prudential regulation.

Moreover, the bill does not give the Fed any new powers or change its current mandate. Everything the bill would require the Fed to do, it can already do. It's just choosing not to by acting far too slowly for the level of risk our economy faces from climate change.

11. Why does this bill only cover the largest banks?

This bill uses $50 billion in assets as a threshold because that is what Dodd-Frank used for defining a bank big enough to potentially pose a risk to the entire financial system. Failure of a bank like this is much more dangerous for the financial system and requires additional safeguards like the ones required in this bill. Although a 2018 law raised that threshold to $250 billion, recent developments with Silicon Valley Bank show that this decision was ill-considered and increased the risk faced by banks in the $50 billion to $250 billion range, as well as the entire financial system.

Having said that, threats to financial stability aren't limited to threats posed by failure of the largest banks. Small to mid-sized banks, particularly community and regional banks, are also exposed to climate related financial risks. There are no scientific or economic reasons to assume that climate change will only affect the biggest banks.

12. How will changing the availability of bank financing affect fossil fuel production and other high emissions projects?

While it's true that profitable fossil fuel projects will continue to draw investment, losing bank financing will have a significant impact at the margins. Even before the COVID crisis induced a Federal Reserve bailout of the industry, most fossil fuel companies were unprofitable, relying on debt financing to keep the pumps running.

By shrinking the pool of available credit, the bill would eliminate many of these loser companies. Meanwhile, small banks and shadow banks will also require higher returns for even the portion of investment they can absorb, especially when they cannot rely on megabanks to provide a backstop or cheap leverage. This higher cost of financing will limit much of the risky fossil fuel expansion we see today.

13. What impact would this bill have on communities who are economically tied today to fossil fuel production?

The clean energy transition is already underway. As it continues, tens of thousands of fossil fuel industry workers will need to find new employment with the clean energy sector or elsewhere in the economy. The Inflation Reduction Act recognizes that further clean energy investment will accelerate this trend, and provides funding to help affected communities transition. Funding that transition will be harder if the trend away from fossil fuel sector jobs is compounded by additional hardships from a financial shock like the 2008 crisis, which would shrink the economy and increase unemployment.

This bill limits the danger of this worst-case scenario by keeping the pace of the transition on a science-based trajectory, so as to prevent sudden shocks. The bill also provides benefits to help cushion the transition for communities and workers tied to the fossil fuel industry, both by encouraging banks to finance activities that smooth the transition for these communities, and by using its own lending powers to help states and municipalities finance a just transition.

14. Are U.S. banks doing anything on their own to phase out fossil fuel financing?

U.S. banks like to talk a big game on climate change. But the 2023 Banking on Climate Chaos Report shows they are still the top financiers of the climate crisis. Despite having made public "net-zero by 2050" commitments, in 2022 banks gave oil and gas companies $684 billion dollars of financing. This was despite the fact that together fossil fuel companies made a historic $4 trillion in profits in 2022.

Since the Paris Climate-Accords were signed in 2015, the top four U.S. banks — J.P Morgan Chase, Bank of America, Citi, and Wells Fargo — have together given nearly $1.4 trillion to the fossil fuel industry. These four firms are the largest fossil fuel funders in the world, together accounting for one-quarter of all fossil fuel financing identified over the last six years.

While major banks in the UK and Europe have taken steps to restrict financing for fossil fuel projects and the companies building them, American banks have not adopted any ambitious policies to meaningfully reduce their exposure to the sector. While other major banks around the world have steadily increased the ambition of their climate targets and financing policies, no major North American bank has updated their oil and gas exclusion policies since October 2021.

The Banking on Climate Chaos Report reveals that although banks are unveiling fossil fuel exclusion policies and making net zero commitments, the policies are weak, still allowing for fossil fuel extraction and expansion, and contain major loopholes. The

Fossil Free Finance Act would close those loopholes.

Climate risk is financial risk, yet the Banking on Climate Chaos report exposes US banks for continuing to prop up the fossil fuel industry, threatening the stability of our financial system. The Fossil Free Finance Act would put an end to this by mandating that the biggest banks stop financing the climate crisis and instead lend and invest responsibility.