United States Senate

May 8, 2020

The Honorable Jerome H. Powell
Chairman of the Board of Governors
Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551

Dear Chairman Powell:

We write to follow up on our letter on April 20, to express our concern that the Federal Reserve (the Fed) is preparing to use its emergency lending facilities to provide financial relief to companies that pose a serious risk to the stability of the financial system. We originally wrote to you with our concerns about the Fed's corporate credit facilities,[1] but it seems the Fed is preparing to use its Main Street Lending Program to bail out overleveraged independent oil and gas producers, while ignoring these companies' role in increasing systemic risk. The Fed's recent changes to the program exactly mirror the changes sought by the oil and gas industry and its defenders. We urge you to reconsider these changes, and to take immediate steps to protect taxpayers and the financial system from the risks that oil and gas companies present. We also ask that you explain how the Fed justifies perpetuating climate-related financial risk in its facilities.

The Fed is making unprecedented moves into the realm of commercial lending, becoming a massive buyer of corporate debt virtually overnight. This may be a necessary step to maintain the flow of credit in the economy; but absent an effort to screen for climate risks in these facilities, the Fed's actions to support the economy now could undermine the future stability of the financial system. Worse, the Fed appears to be making deliberate accommodations for fossil fuel producers while its international counterparts are doing the exact opposite: incorporating climate risk assessment into their portfolio management,[2] and restricting their investment universes to exclude assets that present climate risks.[3]

The Fed purportedly established the Main Street program to "enhance support for small and mid-sized businesses that were in good financial standing before the crisis."[4] This was also Congress's intent in capitalizing the Main Street program in the *CARES Act*: to provide credit to businesses severely impacted by the pandemic. While the coronavirus-driven collapse in oil demand is undoubtedly a major source of distress for oil and gas companies, U.S. producers were also hit hard by the Saudi-Russian price war[5] that began on March 8—more than ten days before

[1] https://www.schatz.senate.gov/press-releases/schatz-whitehouse-senators-demand-transparency-in-federal-reserves-corporate-debt-purchases
[2] https://www.ngfs.net/en/communique-de-presse/ngfs-publishes-sustainable-and-responsible-investment-guide-central-banks-portfolio-management
[3] https://www.ngfs.net/sites/default/files/medias/documents/ngfs-a-sustainable-and-responsible-investment-guide.pdf, see "4.1 - Negative screening"
[4] https://www.federalreserve.gov/newsevents/pressreleases/monetary20200409a.htm
[5] https://www.cnbc.com/2020/03/08/opec-deal-collapse-sparks-price-war-20-oil-in-2020-is-coming.html

California became the first state to issue a mandatory stay-at-home order.[6] But more importantly for the Fed's purposes, these firms were not in sound financial condition before the pandemic or even the price war.

This pandemic was not the source of the oil and gas industry's dire financial condition, as is the case for countless small businesses with an urgent need for the Fed's assistance. This was just the final straw for an industry built on a foundation of distressed debt.[7] Producers took advantage of easy credit to accelerate drilling, outspending their cash flow with no concern for profitability or cost control. Many oil executives' annual bonuses were even tied to production growth targets, encouraging them to keep drilling even when there was no economic justification for doing so.[8]

That makes it all the more troubling that the Fed is prepared to lower the standards of the Main Street program to accommodate an industry that poses both a credit risk and a more profound climate transition risk to taxpayers. The Fed's modifications to the Main Street program seem tailor-made for the oil and gas industry:

- The Fed's original term sheet for the Main Street New Loan Facility required borrowers to attest that they needed financing "due to the exigent circumstances presented by the coronavirus disease 2019 ('COVID-19') pandemic."[9] On April 24, Senator Cruz criticized that requirement in a letter to you and Treasury Secretary Mnuchin: "…one of the conditions for using the existing facilities dictates that a borrower must attest they require financing because of circumstances attributed to COVID-19, and the proceeds must be used to maintain payroll and retain employees; in the context of energy, these requirements may prove to be too restrictive." The Fed removed the requirement from its updated term sheet.[10]
- The original terms for the Main Street Expanded Loan Facility set a maximum loan size of $150 million.[11] In an interview on April 17, U.S. Secretary of Energy Dan Brouillette said the maximum loan "really needs to be something closer to $200 or $250 million to be of any real benefit to [mid-tier U.S. energy companies]."[12] Brouillette added that he had just met with industry representatives to discuss the issue. The Fed has now raised the maximum loan size to $200 million.[13]
- The Fed created a new loan option, the Main Street Priority Loan Facility, which permits lending to borrowers with greater leverage. Originally, the program only allowed loans that, when added to existing debt, do not exceed four times a borrower's 2019 earnings before interest, taxes, depreciation, and amortization (EBITDA). The Fed raised the

[6] https://www.kff.org/other/slide/when-state-stay-at-home-orders-due-to-coronavirus-went-into-effect/
[7] https://ieefa.org/sp-u-s-oil-and-gas-industry-distressed-debt-now-at-all-time-high/
[8] https://www.wsj.com/articles/key-formula-for-oil-executives-pay-drill-baby-drill-1457721329
[9] https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200409a7.pdf
[10] https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200430a1.pdf
[11] https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200409a4.pdf
[12] https://www.reuters.com/article/us-health-coronavirus-usa-oil-credit/trump-administration-working-to-ease-drilling-industry-cash-crunch-idUSKBN21Z1JY
[13] https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200430a3.pdf

leverage cap in its new Priority Loan Facility to six times EBITDA. This was another request in Senator Cruz's letter.

- The Fed's original terms prohibited borrowers from using Main Street loans to repay outstanding debt. This was a logical restriction that helped ensure borrowers would use the funds to maintain payroll, retain employees, and otherwise offset the direct impacts of the pandemic on their business. However, it also rendered the program useless for overleveraged oil and gas producers hoping to use Fed financing to repay their other debt. This provision prompted the Independent Petroleum Association of America to write to you on April 15, asking you to "consider providing flexibility on this provision to otherwise Eligible Borrowers, such as independent producers," thereby "limiting the number of defaults that debt holders experience on those debts coming due."[14] The Fed removed this provision from the updated terms.

In altering the terms of this program to allow the purchase of oil and gas producers' debt, the Fed is contributing to the very risks to financial stability it is responsible for identifying and mitigating. We again urge you to reconsider these changes. We also ask that you provide the Fed's analysis and justification for increasing the risks to taxpayers and the financial system by expanding its extension of credit to these overleveraged companies that also pose serious climate-related financial risks.

Sincerely,

BRIAN SCHATZ
U.S. Senator

SHELDON WHITEHOUSE
U.S. Senator

SHERROD BROWN
U.S. Senator

DIANNE FEINSTEIN
U.S. Senator

ELIZABETH WARREN
U.S. Senator

JEFFREY A. MERKLEY
U.S. Senator

[14] https://www.ipaa.org/wp-content/uploads/2020/04/Main-Street-Lending-Letter-04-15-2020.pdf