February 17, 2017

Robert deV. Frierson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551

Re: Physical Commodities: Complementary Activities, Merchant Banking Activities, and Other Activities of Financial Holding Companies (Docket No. 1479 and RIN 7100 AE-10)

Dear Sir:

Aidenvironment, Climate Advisers, Green Century Capital Management and Profundo (ACGP) are pleased that the Federal Reserve Board (the Board) may review the permissible commodities activities that Financial Holding Companies (FHCs) are allowed to engage in. ACGP shares the concerns of many members of Congress, other advocates, academics and regulators about the overbroad scope of activities that the Board is currently permitting FHCs to engage in, pursuant to language in the Gramm-Leach-Bliley Act (GLB). ACGP's concerns are that FHCs are not considering the material financial risks from environmental and social factors associated with these activities and their clear impact of the financial performance of these FHCs. As a result, we request that the Board ask FHCs to accurately account for these material financial risks.

Investigators studying GLB's effects have concluded that allowing FHCs to be involved in "complementary activities" and "merchant banking" has led to an expansion of their involvement throughout the entire chain of the commodities market, from production to transport to storage, as well as trading in the financial products related to those markets. This expansion has apparently allowed these institutions to not consider the material financial risks from environmental and social factors associated with these same activities. As former Senator Jim Leach, one of the GLB's authors, has said, "I assume no one at the time would have thought it would apply to commodities brokering of a nature that has recently been reported."

We understand that the Board has begun to recognize that these material financial risks associated with environmental and social factors are relevant to these FHCs under the Oil Pollution Act of 1990 (OPA), the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA) and the Clean Water Act (CWA). However, it is our understanding that the Board has not taken under consideration the impact of these material financial risks from the environmental and social factors caused by the economic drivers of deforestation.[1]

Material Financial Risks from Deforestation

Large-scale deforestation accounts for about 15 percent of greenhouse gas emissions globally each year. The economic drivers of tropical deforestation include palm oil, soy, timber pulp and paper and cattle production. In fact, 71 percent of deforestation is caused by these four activities.[2] Put simply, agriculture production and its associated greenhouse gas emissions threatens the viability of said agriculture production via the negative feedback loops associated with increasing emissions.

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[1] https://chainreactionresearch.com/reports/economic-drivers-of-deforestation-sectors-exposed-to-sustainability-and-financial-risks/

[2] https://chainreactionresearch.com/reports/economic-drivers-of-deforestation-sectors-exposed-to-sustainability-and-financial-risks/

For example, CDP recently reported, based on the self-reported disclosures from 187 corporations in 2016:

- Up to US$906 billion in revenue annually is at risk of from the economic drivers of deforestation.
- On average 24 percent of the reported corporate revenues in these disclosures depend on commodities linked to deforestation: cattle, palm oil, soy and timber. This makes these revenues vulnerable to the risks to the negative feedback loop from producing and sourcing commodities that are responsible for deforestation.
- Cost of goods sold could spike, potentially further impacting revenue, profits and future firm-wide financial valuation.
- More than 350 corporations have made zero-deforestation commitments yet it is unknown if FHCs are including these commitments in their financial advice.
- 47 percent of the companies considered deforestation as part of their enterprise risk management and operational risk strategies.[3]

A related study, by Global Canopy Programme (GCP), studied the 150 finance companies that own the $2.8 trillion in shares, loans, or bonds of the 250 companies operating in the same four key supply chains - cattle, timber, soy and palm oil. It found:

- Only four of these 150 banks have policies to ensure their financing does not fund forest destruction by those four industries.
- When financial institutions commit to halt deforestation, they often do not honor those commitments as three-quarters have still made loans to companies that lack the relevant zero-deforestation safeguards.

A similar recent yearlong analysis by Chain Reaction Research[4] and its partner organizations concluded:

- 6.1 million hectares of forests and peatland are "stranded assets[5]" on the balance sheet of Indonesian palm oil companies as it cannot viably be developed. This magnitude is potentially unknown to investors and bankers. Analysts may be mispricing these stranded assets into current financial valuations.
- With 365 zero-deforestation policies from traders and consumer goods companies, and new regulations from the Government of Indonesia, financial analysts need to change their financial modeling techniques to include stranded asset discounts arising from material financial risks associated arising from environmental and social factors.
- 95 identified palm oil company groups – 35 of which are publicly traded – each hold at least 1,000 ha of stranded land within their concessions.

Further recent Chain Reaction Research analysis demonstrated that 17 global banks were driving deforestation by 16 major palm oil companies in SE Asia, 2006-2015.[6]

These material financial risks are relevant to energy companies. In 2016, Chain Reaction Research demonstrated that Noble Group's impairments of palm oil assets and coal

[3] https://chainreactionresearch.com/2017/01/09/the-chain-industry-report-states-up-to-900-billion-revenue-at-risk-from-deforestation-impacts-cost-of-goods-sold/
[4] https://chainreactionresearch.com/about/partners/
[5] https://chainreactionresearch.com/reports/indonesian-palm-oils-stranded-assets/
[6] https://chainreactionresearch.com/reports/banks-finance-more-palm-oil-than-investors/

receivables[7] may reduce balance sheet equity value by US$400 million, or 12 percent. 33 percent of Noble's palm oil landbank is undevelopable as it is primary forest and possibly peat. Coal assets may be overvalued by 30 percent.[8]

Similarly, Chain Reaction Research's analysis of Sime Darby's recent expansion and investment into Liberia demonstrates that these same material financial risks from environmental and social factors were not addressed by lending institutions or Sime Darby itself. Sime Darby's Liberian investment is 22 percent of its global landbank. It is forecast to involve $3.1 billion in capital expenditures. This investment is financed via various means including US$4.329 billion in bank loans from multinational banks. These loans do not include analysis of the material financial risks from environmental and social factors relevant to the Liberian context.[9]

Systematically, these material financial risks systemically present risks to the financial system. As demonstrated by Chain Reaction Research,[10] the systemic financial risks driven by the economic drivers of deforestation include:

- Financial risks
- Reputational risks
- Regulatory risks
- Procurement risks
- Stranded assets risk
- Operational risks

Conclusion

Financial institutions themselves have recognized the risks to their institutions and to society from these activities, and have even adopted policies to address such risks. It is time for the Board to do the same, and to prevent FHCs from enabling the material financial risks associated with the economic drivers of deforestation under GLB.

Sincerely,

Leslie Samuelrich
President
Green Century Capital Management

Jan Willem van Gelder
Director
Profundo

Annemieke Beekmans
Director
Aidenvironment

Gabriel Thoumi, CFA, FRM
Director, Capital Markets
Climate Advisers

7 https://icebergresearch.files.wordpress.com/2016/05/report-4-credibility-b.pdf
8 https://chainreactionresearch.com/reports/noble-group-cost-of-capital-and-deforestation-risks-under-priced-revised/
9 https://chainreactionresearch.com/reports/sime-darby-liberian-crossroads/
10 https://chainreactionresearch.com/reports/palm-oil-frontiers-2/