



December 15, 2016

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

Re: Federal Reserve System, Docket No. R-1547 and RIN 7100 AE-58 (Risk-based Capital and Other Regulatory Requirements for Activities of Financial Holding Companies Related to Physical Commodities and Risk-based Capital Requirements for Merchant Banking Investment)

Dear Mr. Frierson:

The Natural Gas Supply Association¹ ("NGSA") submits the following comments in response to the Federal Reserve System (the "Federal Reserve") September 23, 2016 proposal to adopt additional limitations on physical commodity trading activities conducted by financial holding companies (FHCs) and amend risk-based capital requirements to reflect risks associated with a FHC's physical commodity activities (the "Proposal"). According to the Federal Reserve, the capital requirements would apply to physical commodity activities that have the potential to expose the FHC to environmental liability.

NGSA urges the Federal Reserve to reconsider. As proposed, the new requirements would impose significant capital requirements on covered physical commodity activities, unnecessarily sidelining capital away from productive investments that fuel economic growth. In addition, if implemented, the new requirements would effectively prohibit many of the FHC's activities in physical commodity markets, thereby reducing liquidity and efficiency in markets where FHCs play a unique role in facilitating physical commodity and related financial market counterparty diversity. Lower liquidity results in higher costs and increased credit risk

¹Established in 1965, NGSA encourages the use of natural gas within a balanced national energy policy, and promotes the benefits of competitive markets, thus encouraging increased supply and the reliable and efficient delivery of natural gas to U.S. customers. NGSA is the only Washington, D.C.-based trade association that solely focuses on producer/marketer issues related to the downstream natural gas industry.

for end-users, increased volatility in physical and financial markets, and a reduction in consumer choice for counterparties.

Furthermore, end-user counterparties generally enter into transactions to pursue their own business needs, not to accommodate counterparty demand, and thus are generally less willing and able to make two-way markets. For this reason, FHCs play a unique role in the market. If the Proposal were implemented, bank holding company (BHC) and FHC physical transactions with commercial parties for hedging and other purposes would become cost-prohibitive. Consequently, the ability of BHCs and FHCs to engage in financial transactions that correspond to physical commodities would also be impaired. Increased hedging costs would translate to higher commodity costs for consumers, both directly and indirectly. For example, in addition to generating electricity and providing space heating, natural gas is an input for millions of household products as diverse as pantyhose and fertilizer.² Responding to U.S. natural gas supply growth, U.S. manufacturing industry is expected to invest \$100 billion over the next half decade to restart previously shuttered industrial facilities or expand approximately 100 new U.S. facilities in the fertilizer, steel, petrochemical and paper industries.

Although unclear, to the extent the Proposal affects bank financing, end users and the economy may be even more broadly impacted. End users rely heavily on financing from banking organizations for construction of energy infrastructure. Subjecting these transactions to heightened capital requirements would result in a reduction in the capacity for banking organizations to provide these financing services to end users. The potential impact extends well beyond energy to agricultural commodities as well.

Potential legal, reputational and financial risks exist with *any* investment and commodity trading activity. Likewise, risks change as markets and technologies evolve and regulations shift, and are mitigated through counterparty credit due diligence, investment diversification, regulatory certainty, robust compliance programs and deep insight into underlying market fundamentals to name a few. Given the dynamic nature of investments, it would be cost-prohibitive to attempt to mitigate all risk via capital set-asides. Importantly, risks are inherently linked to one's perspective on the market.

If implemented, the proposal may limit important bank participation in commodity markets, decreasing liquidity and elevating hedging costs for end users. If the proposed changes extend to or impact lending practices, the impacts could be devastating for the infrastructure investment essential to economic growth and the achievement of environmental objectives. Natural gas and market participant

² See NGSA "Stuff of Everyday Life – Understanding the Uses of Natural gas in Industrial Process" issue paper illustrating consumer products made from natural gas available at www.ngsa.org.

investment in natural gas-related infrastructure is critical to achieving environmental objectives.

In fact, U.S. energy-related carbon dioxide (“CO₂”) emissions totaled 2,530 million metric tons in the first six months of 2016. This was the lowest emissions level for the first six months of the year since 1991, as mild weather and changes in the fuels used to generate electricity contributed to the decline in energy-related emissions and as prices for electricity and fuel remained low by historic standards. The Department of Energy – Energy Information Administration’s Short-Term Energy Outlook projects that energy-associated CO₂ emissions will fall to 5,179 million metric tons in 2016, the lowest annual level since 1992.³ A 2014 report from the U.S. National Oceanic and Atmospheric Administration (“NOAA”) found significant reductions in the emissions of CO₂, nitrogen oxides (“NO_x”) and sulfur dioxide (“SO₂”) as a result of increased use of natural gas in the electric sector.

Dramatic changes in natural gas markets over the last decade stemming from technological breakthroughs in production have revolutionized the affordability and sustainability of carbon reduction initiatives. Market-driven increases in natural gas consumption to generate electricity have already helped the U.S. reduce power sector carbon emissions to the lowest levels in decades. Natural gas remains the most economically and environmentally sound power generation investment available today.

Proven by experience, greater use of natural gas for electricity generation has produced significant reductions in U.S. carbon emissions. Over its lifecycle, natural gas emits only about half the CO₂ of other fossil fuels when combusted, whether to make electricity, forge steel or provide heat. With these and additional advantages over other fuels in SO₂, mercury, nitrogen oxide and particulate matter emissions, natural gas is poised to become an even more important part of energy portfolios. Beyond serving as highly reliable baseload and peaking units, natural-gas fired power generation also provides necessary back-up that is essential to ensuring reliability for intermittent renewable resources such as wind and solar. Energy reliability is one example of an operating risk that is mitigated through natural gas power generation. FHCs and BHCs play vital roles in these markets.

The Business Council for Sustainable Energy (“BCSE”) 2016 Sustainable Energy in America Factbook highlights the role that market forces and natural gas have played in the record decarbonization of the electric power sector. BCSE says it perfectly: Achieving climate objectives requires three things – energy efficiency, natural gas and renewable energy.⁴

³See U.S. Department of Energy – Energy Information Administration, “Today in Energy,” October 12, 2016 at <http://www.eia.gov/todayinenergy/detail.php?id=28312>.

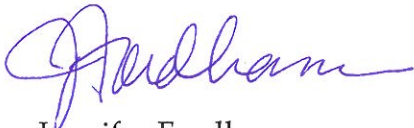
⁴Published by Bloomberg New Energy Finance and available at www.bcse.org.

Over the last five years, Lower-48 marketed natural gas production levels have increased more than 25 percent and the U.S. has emerged as a world leader in natural gas production. Even more notable, natural gas has positioned the U.S. to lead the world in cost-effective carbon emissions reductions.

Today, energy consumers and policymakers have at their fingertips the most cost-effective source of carbon emissions reductions and economic growth. Natural gas is not an environmental liability. It is an environmental boon. Environmental liability exists without natural gas, not because of it.

If we can provide any additional information regarding the role that natural gas plays in mitigating environmental liability, please do not hesitate to contact us.

Sincerely,



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