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Via Electronic Submission

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

Re: **Proposed Rule: Regulations Q and Y; 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 Investments (Docket No. R-1547 and RIN 7100 AE-58)**

Dear Mr. Frierson:

Cheniere Energy, Inc. ("Cheniere") appreciates the opportunity to respond to the captioned Proposed Rule¹ issued by the Board of Governors of the Federal Reserve Bank (the "Board").

Cheniere is a Houston-based energy company involved in the development and operations of liquefied natural gas ("LNG") terminals. Cheniere is currently developing the \$18 billion Sabine Pass Liquefaction Terminal ("Sabine Pass") located in Cameron Parish, Louisiana, and the \$13 billion Corpus Christi Liquefaction Terminal on the north side of Corpus Christi Bay, Texas. In connection with the development and operation of its LNG terminals, Cheniere participates in the physical and financial commodity markets and depends on counterparties in both markets to supply natural gas feedstock to its LNG Terminals and to manage its risks.

Cheniere previously expressed some of its concerns in response to the Board's 2014 Advance Notice of Proposed Rulemaking on this issue (the "ANOPR").² We reiterate and expand on those concerns in this letter, including those concerns not specifically addressed in the Proposed Rule. Cheniere trades with Financial Holding Companies ("FHCs"). In Cheniere's

¹ See Proposed Rule, *Regulations Q and Y; 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 Investments*, 81 Fed. Reg. 67,220 (Sept. 30, 2016) available at: <https://www.gpo.gov/fdsys/pkg/FR-2016-09-30/pdf/2016-23349.pdf>.

² Comments of Cheniere Energy, Inc., *Proposed Rule, Complementary Activities, Merchant Banking Activities and Other Activities of Financial Holding Companies Related to Physical Commodities*, 79 Fed. Reg. 3329 (Jan. 21, 2014), available at: https://www.federalreserve.gov/SECRS/2014/April/20140428/R-1479/R-1479_041414_121272_600151508933_1.pdf.

opinion, the Proposed Rule would detrimentally impact the physical commodity trading markets, primarily by forcing FHCs to stop engaging in trading activity and to leave those markets (as some already have done). Cheniere and other energy companies and commercial end-users of derivatives explained in response to the ANOPR that FHCs enhance the liquidity of physical and financial commodity markets and provide a range of services that would be difficult to obtain from other counterparties. The same is true today.

Therefore, Cheniere respectfully requests that the Board decline to adopt the Proposed Rule. Alternatively, if the Board finds that new regulatory action is necessary to achieve the Proposed Rule's policy objective, then Cheniere respectfully requests that the Board reconsider the requirements contained in the Proposed Rule so as not to impose limitations that would effectively compel FHCs to discontinue their role in providing enhanced liquidity in physical and financial commodity markets.

I. Background

Under Section 4(k) of the Bank Holding Company Act of 1956 ("BHCA"),³ bank holding companies (*i.e.*, companies that own or control U.S. banks) and their non-bank affiliates may conduct certain non-banking activities, such as trading in physical commodities in certain circumstances. For FHCs to qualify, the Board must determine that such activity: (i) is complementary to a financial activity, and (ii) does not pose a substantial risk to the safety and soundness of depository institution subsidiaries of the FHC or the financial system generally ("Complementary Activity").⁴ Complementary Activity includes making spot purchases and sales of physical commodities, and delivering physical commodities in settlement of derivatives transactions. The Board has granted Complementary Activity authority to a limited number of FHCs.⁵

These qualified FHCs are important trading partners to commercial companies like Cheniere. However, if adopted, the Proposed Rule would: (i) impose onerous limitations on the ability of FHCs to engage in Complementary Activity by increasing capital requirements on such FHCs, and (ii) effectively lower the 5% cap on physical commodity holdings of FHCs by requiring an FHC to "count" commodities held in its consolidated organization toward that 5% cap, rather than only those held in the FHC itself.

II. FHCs Play a Vital Role in the Physical Commodity Markets.

A. The Board's Analysis of the Impact of the Proposed Rule is Inconsistent with Cheniere's Experience in these Markets.

The Proposed Rule posits that its increased capital requirements would have a limited impact on FHCs and physical commodity markets because, among other things, FHCs' "shares

³ 12 U.S.C. §§ 1841-43.

⁴ 12 U.S.C. § 1843(j)(2).

⁵ Separately, Goldman Sachs Group, Inc. and Morgan Stanley, Inc. are authorized under the BHCA's Section 4(o) grandfather authority to engage in a broader range of physical commodity activities than other FHCs. 12 U.S.C. §1843(o).

in physical commodity markets are quite low and typically represent less than 1 percent of the market.”⁶ It acknowledges, however, that information on physical commodity markets is “relatively scarce.”⁷

This characterization is inconsistent with Cheniere’s actual experience in these commodity markets. For example, Cheniere has trading relationships with several FHCs and enters into transactions with FHCs on a daily and monthly basis. In Cheniere’s experience, most commercial counterparties do not have the capability to offer the variety of products that FHCs offer and that Cheniere requires to provide natural gas feedstock to its LNG Terminals in order to meet its existing LNG sales obligations. To the extent that FHCs are forced out of the physical marketplace, the number of counterparties able to provide tailored, complex, physical and financial products is substantially reduced.

B. FHCs are Valuable Counterparties to Cheniere in its Own Physical Commodity Activities and its Efforts to Reduce Risk.

Regardless of their share of the market, the presence of FHCs in the physical commodity markets benefits commercial companies like Cheniere, in several respects.

First, FHCs generally have stronger balance sheets and better credit ratings compared to commercial entities. This means that FHCs are generally not subject to cost-prohibitive margin requirements on their related hedging transactions, which in turn helps to reduce transaction costs for end-user companies like Cheniere.

Second, Cheniere has found that FHCs are more readily available counterparties for transactions desired by Cheniere than other commercial entities, and facilitate transactions between counterparties by serving as effective intermediaries between buyers and sellers. The practical effect is a reduction in costs, as FHCs create additional liquidity in the market. Other counterparties, even if they have the ability to enter into the desired transaction, would likely charge higher costs to provide the same terms as those of an FHC.

Third, unlike many commercial users, FHCs are skilled at developing custom transactions, which makes Cheniere’s physical commodity trading more efficient and reduces its overall credit risk. In particular, FHCs have the ability to provide both cash-settled and financially-settled products. Further, in being familiar with their customers’ businesses, FHCs can offer customized instruments that are most effective for companies like Cheniere to meet risk management needs.

Fourth, Cheniere relies on FHCs or their affiliates to serve as market makers for various transactions. Commercial entities, in contrast, typically enter into trades only when such transactions suit their commercial purposes – and when they do so, these transactions are often limited to specific locations and times. FHCs, on the other hand, leverage their expert knowledge

⁶ Proposed Rule, 81 Fed. Reg. at 67,229.

⁷ *Id.* (“Information on physical commodity markets, in particular those covered by this proposal, is relatively scarce”).

of the physical and financial markets to enter into almost any product, regardless of location, timing or delivery mechanisms.

Finally, FHCs often are safer counterparties (from a default risk perspective) than commercial entities because they are: (i) sophisticated counterparties with strong compliance programs including robust policies, procedures, and risk management abilities, and (ii) subject to a number of capital and other regulatory requirements. For example, qualified FHCs must obtain a determination from the Board that the FHC's activity does not pose a substantial risk to the safety and soundness of depository institution subsidiaries of the FHC or the financial system generally. Thus, when Cheniere trades with such FHCs, it is reducing the risk that inheres in all trading activities. By contrast, even if commercial counterparties are available to Cheniere, such entities prove less desirable as counterparties because they typically are unregulated and pose enhanced credit and counterparty risk to Cheniere.

In sum, Cheniere's physical commodity transaction experience with FHCs is inconsistent with the *de minimis* role of FHCs suggested in the Proposed Rule. Regardless of overall market share, FHCs are nonetheless valuable trading partners to Cheniere in its physical trading activities and risk management efforts.

III. The Proposed Rule Will Likely Cause FHCs to Leave the Market, Causing Significant Harm to Cheniere and Other Commercial Entities.

Again, the Proposed Rule would directly reduce FHCs' Complementary Activities by applying the existing 5% cap on physical commodity holdings to the *consolidated organization*. Applying the rule to the entire consolidated organization significantly exacerbates the Proposed Rule's capital requirement proposal. The Proposed Rule projects that its capital provisions would result in only \$4.1 billion of increased capital requirements on FHCs.⁸

Notably, these capital requirements would be imposed on top of other increases in the capital requirements for banks under the Dodd-Frank Act and the Basel III reform measures – which, according to comments on the ANOPR, have already made FHCs less likely to be active in the physical commodity markets.⁹ The Proposed Rule itself even recognizes that such increased capital requirements would likely negatively impact FHCs' participation in the physical commodity markets: “[I]f FHCs consider their physical commodities trading on a standalone basis, the proposed increases in capital requirements could make this activity significantly less attractive based on its return on capital, and could result in decreased activity.”¹⁰

We believe the significant proposed increase in capital requirements for FHCs would likely represent the “last straw” before FHCs exit the market. The impact to physical commodity markets would be profound and adverse to companies like Cheniere that participate in, and

⁸ Proposed Rule, 81 Fed. Reg. at 67,229.

⁹ See, e.g., Comments of the Futures Industry Association (“FIA”) in response to the Board’s ANOPR at 2 (April 9, 2014), available at https://www.federalreserve.gov/SECRS/2014/April/20140424/R-1479/R-1479_040914_114967_569566386546_1.pdf.

¹⁰ Proposed Rule, 81 Fed. Reg. at 67,229.

depend upon, these markets. The effect would be to deprive Cheniere of its valued trading partners, and the benefits of trading with such counterparties described above – *e.g.*, trading with FHCs because they are financially stronger, sophisticated, and well-regulated, are effective intermediaries in providing liquidity to the markets, provide customized products, and have an ability to transact regardless of their existing commercial need.

Moreover, the unintended consequences of the Proposed Rule would be debilitating to the commodities markets, including causing: (i) a less liquid and well-functioning market, (ii) increased risks in running a physical commodity business, and (iii) higher costs to hedge or mitigate those risks. These consequences are discussed, in turn, immediately below.

First, FHCs exiting the market due to the Proposed Rule would lead to a less well-functioning market. For example, FHCs are among the few entities with the financial and risk management capabilities to offer long-term fixed price transactions. Long-term fixed priced transactions are commonly used in the physical commodity markets to enable companies like Cheniere to manage market-based price volatility and thereby obtain economic certainty for their business. If FHCs exit the physical commodity business, Cheniere and other commercial entities will not be assured of counterparties willing and able to enter into such transactions. This leads to less liquidity in the bid/ask spread, greater price volatility, and economic uncertainty.

Second, ironically, the Proposed Rule actually could create more market risk by driving FHCs out of the physical commodity markets. As noted above, in Cheniere’s experience, non-FHCs do not offer, and do not have the capability to provide, the variety of customized products that Cheniere requires. But even if other commercial entities could step up to replace the role that FHCs currently perform, Cheniere’s risk would be greater because it would be trading with a counterparty that is less regulated, less creditworthy, and has less market knowledge than its current FHC counterparties.

Finally, FHCs would likely be less willing to enter into financial transactions with companies like Cheniere if they are not involved in the physical markets as well. This, in turn, would likely increase the cost of hedging for Cheniere, forcing it to either bear that greater cost to mitigate the risk of its physical operations, or bear the risk of leaving some operations unhedged.

IV. The Board Should Not Finalize the Proposed Rule or, Alternatively, Should Address Its Concerns in a Tailored Manner that Does Not Result in Unintended Consequences for Commercial Companies like Cheniere.

If, after considering these comments, the Board still determines that the Proposed Rule’s policy objectives must be satisfied by a rulemaking, then Cheniere requests that the Board tailor the cap and increased capital requirements on FHCs’ physical commodity activities only to those activities that pose the greatest risk that the Board seeks to address.

The Proposed Rule explains that its objective is to reduce potentially catastrophic risk (primarily legal liability resulting from an environmental disaster) that FHCs can face due to certain physical commodity activities. However, Cheniere believes that the Proposed Rule sweeps too broadly in imposing its cap and capital requirements on FHCs’ physical commodity

activities. A more narrowly-tailored proposal could achieve the Board's policy objective while minimizing the risk of a negative impact on Cheniere and other commercial entities (and their customers) that are not the source of the risk the Board seeks to address. For example, instead of tightening the cap and heightening the capital requirements on FHCs' physical commodity activities, which could effectively push FHCs out of the physical commodity markets altogether, the Board could require FHCs to hold a greater amount of insurance coverage against the environmental risk that is the focus of its concern.

Or, the Board should direct any change that it makes to the cap or capital requirements towards the physical commodity activities of grandfathered FHCs that are at the greatest risk of environmental catastrophe. The scope of permissible physical commodity activities for entities eligible for the statutory grandfather authority is broader than the scope of permitted Complementary Activity, as grandfathered FHCs can directly own or operate facilities and vessels that manage, refine, store, transport, extract, and/or alter physical commodities. As the Proposed Rule observes, both environmental and reputational risks are higher for activities permissible only under grandfather authority than for Complementary Activity.¹¹ Yet, the Proposed Rule would impose its cap and capital requirements on Complementary Activity and grandfathered activities of FHCs alike.

To be sure, the Proposed Rule would assign a risk weight of 300% to covered physical commodities held under the Complementary Activity authority, in contrast to the 1,250% risk weight for those held solely under grandfathered authority. The rationale for this risk weight stated in the Proposed Rule is to "ensure that FHCs engaged in commodity trading have a level of capitalization for such activities that is roughly comparable to that of nonbank commodities trading firms."¹² Respectfully, though, this is a flawed rationale because it compares "apples-to-oranges."¹³ The Proposed Rule does not consider the characteristics that differentiate FHCs from nonbank commodity trading firms. For example, unlike nonbank commodity trading firms, FHCs are highly-regulated institutions with sophisticated and superior risk management frameworks. Moreover, the proposed capital requirements would be additive to other capital requirements like Basel III and Dodd-Frank, whereas similar requirements do not exist for non-FHCs. For these reasons, a 300% risk weight to achieve higher capital requirements for FHCs engaging in Complementary Activity cannot be justified in comparison to a parallel percentage for nonbank commodity trading firms, and is not warranted.

V. Conclusion

Cheniere appreciates this opportunity to comment on the Proposed Rule. We respectfully request that, before promulgating any final rule to limit FHCs' Complementary Activity, the Board consider the direct impact and unintended consequences of such an action on commercial companies like Cheniere, as discussed in these comments. More specifically, Cheniere requests that the Board not adopt the Proposed Rule or, alternatively, that the Board appropriately tailor

¹¹ Proposed Rule, 81 Fed. Reg. at 67,227.

¹² *Id.*

¹³ We note that the tighter 5% cap on physical commodity activities would apply to all FHCs.

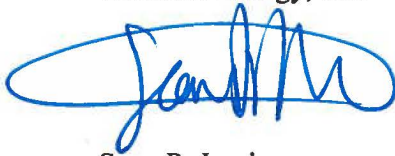
any final rule so as not to harm commercial participants in the physical commodity markets such as Cheniere.

If you have any questions or would like to discuss these comments, please do not hesitate to contact Corey Grindal at (713) 375-5000 or corey.grindal@cheniere.com, or Sean Jamieson at (713) 375-5284 or sean.jamieson@cheniere.com.

Sincerely,



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