

**From:** Brad Flaster <brad.flaster@parityenergy.com>  
**Sent:** Wednesday, December 15, 2010 11:00 AM  
**To:** SEFRules <SEFRules@CFTC.gov>; OTCDefinitions <OTCDefinitions@CFTC.gov>  
**Cc:** Gensler, Gary <GGensler@CFTC.gov>; Dunn, Michael <MDunn@CFTC.gov>; Sommers, Jill <JSommers@CFTC.gov>; Chilton, Bart <BChilton@CFTC.gov>; O'Malia, Scott <SO'Malia@CFTC.gov>; Charles Reyl <charles.reyl@parityenergy.com>; Sara Lesch <sara.lesch@parityenergy.com>  
**Subject:** Comments regarding the definition, structure and core principles of a SEF and the definition of a Swap  
**Attach:** Parity Energy Inc comments on the definitions of SEF and Swap.pdf

---

Attached please find a pre-comment period submission from Parity Energy, Inc. regarding the definition, structure and core principles of a SEF and the definition of a Swap. Thank you for your consideration of our submission and please do not hesitate to contact us with any questions.

Best regards,

Brad Flaster  
VP - Operations

--

Parity Energy, Inc.  
33 Whitehall Street | Floor 17 | New York, NY 10004  
Tel +1-646-867-1981 | Fax +1-212-227-1303  
[www.parityenergy.com](http://www.parityenergy.com)

# REGULATORY ISSUES RELATING TO THE EXECUTION OF ENERGY SWAPS

Comments of Parity Energy, Inc. relating to the  
Commodity Futures Trading Commission's rulemaking on the issues of:  
the definition, structure and core principles of a Swap Execution Facility  
and the definition of a swap.

Respectfully submitted: Wednesday, December 15, 2010.

# Parity Energy, Inc. - Background

Founded in 2006, Parity Energy, Inc. (“Parity”) operates the Parity Energy Platform (“PEP”) an Internet-based global electronic trading facility for commodity derivative products traded in the United States, with a primary focus on energy options.

Parity also provides voice brokerage support to increase market liquidity and to support the transition from voice brokerage to electronic trading in the energy option marketplace.



# Regulatory Status

- Since 2007, Parity has operated as an Exempt Commercial Market pursuant to Section 2(h) of the Commodity Exchange Act (7 U.S.C. § 2(h)).
- On September 17, 2010, Parity petitioned the CFTC pursuant to section 723(c) of the Dodd-Frank Act for grandfather relief to continue to operate as an Exempt Commercial Market for a limited period of time.
- Parity intends to apply to operate as a Swap Execution Facility (“SEF”) after the CFTC promulgates final rules relating to SEF registration and operating requirements.

# PEP Is Tailored To The Characteristics Of The Energy Options Market

In the market for energy options:

- Trading is fast moving, and is characterized by frequent trading in and out of positions;
- The universe of participants is limited, many of which are institutional and sophisticated;
- Traders typically both buy and sell; most are not committed to one side of the market; and
- Participants often trade instruments as strategies, with many degrees of freedom.

The Parity Energy Platform complements these market characteristics by:

- Drawing no distinction between market makers and market takers to ensure tighter bid-offer spreads for all PEP Participants (defined at page 9 below);
- Employing an open request for quote (“RFQ”) system that permits every PEP Participant to submit, view and respond to any RFQ and to trade on any order;
- Ensuring all orders are firm, all trades are cleared and all PEP Participants are anonymous;
- Enabling PEP Participants to place bids, offers and RFQs for an instrument as a whole, rather than for the instrument's component parts.



# The PEP SEF Model

The Parity Energy Platform combines:

- The Central Limit Order Book model,
- Price Streaming, and
- Open RFQ capability,

into one trading platform to ensure impartial access for all PEP Participants, as well as increased liquidity and transparency. The following diagram illustrates how all three of these elements function together on PEP.



# Central Limit Order Book

<a href="#">Home</a> <a href="#">Quotes</a> <a href="#">Trades</a> <a href="#">Admin</a> <a href="#">Logs</a> <a href="#">Back Office</a> <a href="#">User Guide</a>   <a href="#">Logout</a>									
Instrument	Bid			Offer			Last		
	Size	Ind.	Price	Price	Ind.	Size			
+Put +Call <span style="float:right">WTI SD0 - Same Day Option</span>									
12/14 F11 85.50 Put		-	—	0.06	-	100			
12/14 F11 86.00 Put		-	—	0.07	-	100+			
12/14 F11 86.50 Put		-	—	0.10	-	200			
12/14 F11 87.00 Put	200	-	0.04	0.16	-	100+			
12/14 F11 87.50 Put	+100	-	0.15	0.27	-	100+	0.11 (08:50)▼		
12/14 F11 88.00 Put	100	-	0.34	0.46	-	100			
12/14 F11 88.00 Call		-	—	—	-				
12/14 F11 88.50 Call	100	-	0.16	0.28	-	100	0.42 (08:53)▼		
12/14 F11 89.00 Call	+150	-	0.05	0.12	-	50+			
12/14 F11 89.50 Call	100	-	0.01	0.10	-	200+			
12/14 F11 90.00 Call		-	—	0.08	-	100+			
12/14 F11 90.50 Call		-	—	0.10	-	100			
+Put +Call <a href="#">More</a> ▼ <span style="float:right">WTI APO - Average Price Option</span>									
CAL11 85.00/100.00 Fence (to the put) vs 90.20 63d !	10/m	1.57	1.42	1.67	1.67	10/m			
+Put +Call <a href="#">More</a> ▼ <span style="float:right">WTI CS0 1M - Calendar Spread Option</span>									
F11/G11 -0.55 Straddle	50	0.13	0.10	0.30	0.33	50			
G11/H11 -0.55 Straddle		0.30	—	—	0.50		RFQ		
G11/H11 -0.50 Straddle		0.30	—	—	0.50				
H11/J11 -0.40 Straddle	50	-	0.45	0.70	-	50			
J11/K11 -0.25 Straddle	50	0.50	0.50	0.75	0.70	50			
G11/H11 -0.75 Put Live	+100	0.06	0.09	0.12	0.16	100	RFQ		

Continuous price streaming for liquid options

Open RFQ for illiquid options

# The Open RFQ

By their nature, energy options are enormously variable. As a result, in the over-the-counter market, only a small selection are quoted at any given time. PEP addresses this issue with its open RFQ system. Any PEP Participant seeking a market in an instrument that is not currently being quoted or streamed through the PEP central limit order book, can make an RFQ to solicit interest for any instrument at any time, without revealing direction. The PEP open RFQ promotes full pre- and post-trade transparency, price efficiency and impartial access by granting every PEP Participant equal access to view and respond to any RFQ and to trade on any order.

The following graph illustrates how the open RFQ process i) allows PEP participants to solicit interest on an arbitrary option (swap) and ii) provides transparency for all PEP participants.



Instrument	Bid		Offer		Last
	Size	Price	Price	Size	
+Put +Call <a href="#">More</a> ▼					
WNTR10 5.00/5.25 Call Spread vs 4.65 8d !					RFQ 10:01

1) Trader A defines swap of interest and then submits an open RFQ visible to all PEP Participants.

Instrument	Bid		Offer		Last
	Size	Price	Price	Size	
+Put +Call <a href="#">More</a> ▼					
WNTR10 5.00/5.25 Call Spread vs 4.65 8d !	50/m	0.0950	0.1050	50/m	RFQ 10:01

2) Trader B responds to RFQ with a firm two-way market available to all PEP Participants.

Instrument	Bid		Offer		Last
	Size	Price	Price	Size	
+Put +Call <a href="#">More</a> ▼					
WNTR10 5.00/5.25 Call Spread vs 4.65 8d !	+50/m	0.0975	0.1050	50/m +	RFQ 10:01
	50/m	0.0950	0.1075	50/m	

3) Trader C improves the bid and adds depth to the offer.

Instrument	Bid		Offer		Last
	Size	Price	Price	Size	
+Put +Call <a href="#">More</a> ▼					
WNTR10 5.00/5.25 Call Spread vs 4.65 8d !	+50/m	0.0950	0.1050	50/m +	0.0975 (10:11) ▼
			0.1075	50/m	

4) Trader D hits the best bid. Trade execution is visible to all PEP Participants.



# The PEP SEF Model Advances Dodd–Frank Act Objectives

PEP provides uniform viewing access to all PEP Participants. All statutorily eligible participants that sign a Parity Energy Participant Agreement and agree to be bound by its terms (such participants are “PEP Participants”) have equal viewing rights on the PEP screen. All PEP Participants may view all pending orders and RFQs as well as the day’s trading history on PEP. This feature:

- Ensures **impartial access** to all PEP Participants; and
- Promotes **both pre- and post-trade transparency** by allowing PEP Participants to view all interest and trading for the day.

All PEP Participants may view all bids and offers. Incompatible orders (for example, those from a trader with incompatible clearing) appear in gray text on screen, so PEP Participants know the terms of incompatible orders, but also understand not to trade on those orders. This feature:

- Promotes **pre-trade transparency** by allowing all PEP Participants to view all orders.

All trading on PEP is anonymous and cleared and all visible orders are firm and must satisfy a minimum lot requirement. These features:

- Promote **multiple-to-multiple** (aka many-to-many) trading where every PEP Participant may trade on every compatible order;
- Promote market efficiency by ensuring a level playing field with **impartial access** for all PEP Participants; and
- **Reduce** the risk of **market manipulation**.



# The PEP SEF Model Advances Dodd–Frank Act Objectives

All PEP Participants may trade on all compatible orders. This feature:

- Promotes **multiple-to-multiple** (aka many-to-many) trading where every PEP Participant may trade on every compatible order; and
- Improves **price efficiency** by leveling the playing field between PEP Participants.

Any PEP Participant may make an open RFQ without revealing whether it seeks to buy or sell. This feature:

- Improves **price efficiency** for all PEP Participants by reducing bias.

Any PEP Participant may view any RFQ. This feature:

- Improves **price efficiency** for all PEP Participants by providing impartial access to information.



# SEF Core Principles

In determining what role a SEF should play in monitoring market activity, in principle, Parity supports the appointment of a qualified self-regulatory organization (“SRO”) to coordinate and participate in this function and to ensure uniformity. To the extent SEF oversight responsibilities are not delegated to an SRO, in apportioning oversight responsibility to SEFs, Parity respectfully requests that the Commission take into account the distinct roles played by Execution Facilities and Clearing Houses.

Swap Execution Facilities SHOULD be expected to:

- have information concerning their own participants' specific pre-trade activity on their SEF (such as, for example, order history, including the bids and asks posted before a trade executed); and
- Monitor the safety, reliability and fairness of their own marketplaces.



# SEF Core Principles

HOWEVER, SEFs that do not serve a clearing function or act as a central counterparty DO NOT necessarily have access to information concerning participants':

- Trading practices across all markets;
- Trading positions across all markets, including the impact of those various positions on participants' position limits and open interest; and
- Credit with clearing firms.

SEF obligations to monitor markets should reflect that reality. A SEF's oversight obligations should be tailored to the information available to the SEF. Obligations to monitor and enforce, for example, position limits and open interest, should either be placed on clearing firms with access to all relevant information or in the alternative, clearing firms should be required to share such information with SEFs to facilitate oversight.



# Request For Clarification On The Definition Of The Swap

Section 721 of the Dodd-Frank Act creates a new sub-section (47) of 7 U.S.C. § 1a that defines swap broadly to capture most previously unregulated derivatives trading.

Appropriately, at new 7 U.S.C. §1a (47)(B), the Act carves out “any contract of sale of a commodity for future delivery” from the definition of a swap, in recognition of the existing futures regulatory regime.

However, section (47)(B) goes on to exclude from the definition of a swap “any contract of sale of a commodity for future delivery (*or option on such a contract,*)” (emphasis added).

# Request For Clarification On The Definition Of The Swap

The section (47)(B) exclusion could be read to incorporate option contracts that are traded over-the-counter (“OTC”) and cleared on CME ClearPort, yet are also exchange traded on CME's open outcry and Globex. As these contracts are by definition options on an underlying commodity future, a literal reading of the section (47)(B) exclusion would carve these options contracts out of the swap definition.

Prior to the passage of the Dodd-Frank Act, these options on commodity futures were regulated when they were exchange traded, but unregulated when they were traded OTC. In promulgating regulations relating to the definition of a swap, the Commission should clarify whether these OTC traded instruments are swaps and do not fall within the section (47)(B) exemption. Examples of the instruments in question appear on the next page.



# Request For Clarification On The Definition Of The Swap

- CME ClearPort Light Sweet Crude Oil Option – symbol LO
- CME ClearPort Henry Hub Natural Gas Option – symbol ON
- CME ClearPort Heating Oil Option – symbol OH
- CME ClearPort RBOB Gasoline Option – symbol OB
- CME ClearPort Gold Option – symbol OG
- CME ClearPort Silver Option – symbol SO