EVOLUTION
MARKETS

10 Bank Street
White Plains, NY 10606
T 914.323.0200
F 914.328.3701
www.evomarkets.com

VIA ELECTRONIC MAIL

David Stawick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, D.C. 20581

Re: Core Principles and Other Requirements for Swap Execution Facilities. Federal Register, Volume 76 Issue 5 (Friday, January 07, 2011)

March 08, 2011

Mr. Stawick:

Evolution Markets Inc. (Evolution Markets) has reviewed the Commodity Futures Trading Commission's (the Commission) notice of proposed rulemaking regarding core principles for swap execution facilities. As a long-time participant in several U.S. commodity markets, Evolution Markets recognizes the importance of the regulations under consideration by the Commission, and welcomes an opportunity to provide its perspective on the impact these regulations may have on the markets it serves. The company also appreciates the opportunity to comment on potential changes to the proposed rules that Evolution Markets believes will ensure properly functioning markets.

Evolution Markets provides over-the-counter brokerage and structured transaction services in global environmental and energy markets and the clean energy sector. Since its founding in 2000, the company has specialized in facilitating transactions on behalf of clients in green markets, including the global carbon, U.S. emissions (SO_2, NO_x), renewable energy credit (REC), and weather derivative markets. We also act as an institutional brokerage for OTC coal, natural gas, nuclear fuel, and biofuels markets. Relative to other brokers in the markets Evolution Markets serves, the company is small and entrepreneurial in nature, with around 60 brokers and structured transaction professionals serving clients in more than 40 countries from offices in New York, San Francisco, London, and Beijing.

Evolution Markets plays a vital and unique role in emerging and niche commodity trading markets; markets that are slow to garner the attention of major transactional platforms. Many of Evolution Markets' core markets are created by government programs, typically to serve environmental objectives. As a pioneer in these markets, Evolution Markets often advises governments on sound

EVOLUTION
MARKETS

market design, educates potential market participants, assists in crafting contracts for tradable products, and structures trades in the new commodities.

Some of these markets emerge to become highly commoditized and highly liquid, others remain bespoke or illiquid. In all cases, Evolution Markets will continue to serve the market by providing transparency and an unbiased transactional marketplace.

Many of the markets served by Evolution Markets have been created with the specific purpose of enabling compliance with state or federal environmental laws. Other markets exist for physical procurement of a commodity or to manage price risk. In many cases, these markets lack sufficient transaction size, volume, or number of participants to remain viable under the regime envisioned by the CFTC.

In recognition that many of the transactions in niche environmental and energy markets currently served by Evolution Markets will be required to be cleared and transacted through a swap execution facility (SEF) or a designated contract market (DCM), Evolution Markets is concerned with the impact that proposed rules will have on the development of these markets and their continued ability to serve as viable venues for compliance and risk management.

Evolution Markets' general concerns are as follows:

- **Proposed Rules May Adversely Impact Liquidity in Smaller, Niche Markets**
  Some specific aspects of this proposed rule for SEF Core Principles and other requirements, in fact, may restrict liquidity by impeding the ability of market intermediaries to assist in price discovery and trade negotiations in markets were these services are essential. Intermediaries, such as introductory voice brokers, play an important role in emerging commodity markets by providing price transparency and the efficient facilitation of trades. This is a customized service electronic trading platforms cannot offer. The CFTC's proposed rules should ensure brokerage intermediaries are able to continue to provide this vital service as necessary.

- **Proposed Rules May Inhibit Efficient Trade Execution in Smaller, Niche Markets**
  The lack of flexibility in proposed rules (particularly relating to pre-trade price transparency) may actually impair price discovery and increase transaction costs in niche environmental and energy markets. Many of these markets do not easily conform to clearing requirements or electronic trading platforms. Counterparties that rely on intermediaries for assistance in finding the market clearing price might be restricted by an overly prescriptive approach to how transactions in these markets must be executed, and the result could be inefficient execution of trades such as hedging transactions and higher. Evolution Markets believes many niche markets can still have transparency (pre- and post-trade) without forcing transactions onto a platform for execution.

EVOLUTION
MARKETS

- **Proposed Rules May Unduly Burden Small Enterprises Serving Niche Markets**
  Various rules governing new transaction platforms, such as for SEFs, create barriers to entry, favor larger banks and interdealer brokers, and reduce competition among transaction platforms. Evolution Markets believes proposed rules for SEF operations would impose significant costs and inhibit the development of SEFs designed to serve emerging environmental and energy markets. Ultimately, this will restrict liquidity, increase risk to end user counterparties, and in many cases impair the ability of these markets to assist in meeting stated environmental objectives.

Evolution Markets' appreciates the opportunity to present its views on the impact the Commission's proposed rules may have on the markets it serves. To that end, we have reviewed the proposed rules for SEF core principles and our specific comments are as follows:

I. Permitted Execution Methods :: Sec. 37.9

Alternative Execution Methods to Order Books: Voice Brokerage

The Dodd Frank Act establishes the goals of bringing greater transparency to swap transactions, including mandating clearing of clearable swaps and trading of those swaps on regulated exchanges and trading platforms. In response, the Commission has focused on drafting rules that ensure the establishment of "trading systems or platforms in which multiple participants have the ability to execute or trade swaps by accepting bids and offers made by multiple participants in the facility".

The proposed rule directly stipulates that "required transactions", or swap transactions made available for trading and not block trades, may be executed on an order book or request for quote system.[1] Block trades, non-cleared swaps, and illiquid or bespoke swaps (a.k.a. "permitted transactions") may be executed by an order book, request for quote system, a voice-based system, or any other system for trading permitted by the Commission.[2]

However as the Commission correctly states in its proposed rule, swaps are currently traded in a number of methods, including trading systems that use, whole or in part, voice brokerage services. This is particularly true in the markets served by Evolution Markets, which tend to be be nascent, niche, small in size, and requiring assistance of intermediaries to achieve and maintain requisite liquidity. As would seem obvious, some of the contracts traded in these markets are bespoke and sufficiently illiquid to be considered "permitted transactions". But, others may be considered "required transactions" under the proposed rules and would be constrained by trading on either an Order Book or RFQ system.

[1] Section 37.9 (b.)(1.).
[2] Section 37.9 (c.)(1.).

EVOLUTION
MARKETS

Evolution Markets supports the Commission's goals of enhancing pre-trade transparency and increasing use of regulated trading platforms, and we fully support the underlying foundational tenant of multiple participant-to-multiple participant trading systems. We are, however, concerned that the proposed rule does not provide sufficient latitude or flexibility to permit the types of executions necessary to facilitate liquidity for swaps trading in smaller, niche commodity markets.

The Commission has requested comment from the public on whether there are trading platforms or systems other than Order Books that can meet the requirements of a multiple participant-to-multiple participant platform. Evolution Markets believes voice platforms operated by introductory brokerages that immediately input the off-platform executions directly into the trading system should receive careful consideration, while keeping in mind that the pre-trade price transparency desired by the CFTC is not compromised and the regulatory concerns are addressed.

It is important to make a distinction between the voice platforms operated by introductory brokers such as Evolution Markets and the single-dealer voice platforms the Commission has explicitly stated do not meet its "multiple-to-multiple" test. Introductory brokers do not trade and do not take positions in the markets they serve, which is often not the case with single dealer voice platforms. Introductory brokers simply assist counterparties in price negotiations, and once a price is agreed, the counterparties are directly matched.

Although introductory brokers are traditionally referred to as "voice brokers", they are actually hybrid trading systems that incorporate brokers using phone, email, Instant Messaging, and other electronic communications to communicate orders to multiple market participants, and often pairing these services with an electronic trading facility as defined by the CEA or a real-time electronic system for streaming quotes.

Evolution Markets agrees with the Commission that this type of hybrid market platform is necessary for "permitted transactions", which require the interaction of a broker to facilitate the structuring of trades, assist participants in finding the market clearing price, and effectively communicate with the market pre-trade orders and post-trade prices. Evolution Markets also believes voice brokerage should qualify as a platform for "required transactions" as they are:

- **Platforms offering multiple participant-to-multiple participant trading:** As a necessity of introductory brokerage services, brokers operate a multiple-to-multiple platform, taking orders from as many market participants as possible and making these orders available to as many market participants as possible.

- **Platforms offering impartial access:** Introductory brokers do not trade or take positions in the market, and therefore benefit from providing access to their trading systems to as many counterparties as possible. In fact, impartial access is essential to ensuring efficient execution and is a core tenant of such services.

- **Platforms offering pre-trade transparency:** Through the hybrid trading systems explained above, introductory brokers facilitate communication of pre-trade orders to market

EVOLUTION
MARKETS

participants. These communications occur in real-time as a process of facilitated price negotiations on behalf of clients, and Evolution Markets believes they can meet the standards for pre-trade transparency required by the Commission.

Request for Quotes Requirements [Sec.37.9 (a.)(1.)(ii.)]

The proposed rule allows for Request for Quote Systems (RFQ) to be used as market platforms for the execution of "required" and "permitted" swap transactions. These trading systems are designed to allow a market participant to show an order to a selection of market participants rather than to the entire market. The requester may seek quotes from these market participants, taking into account resting orders for the same contract.

Such RFQ systems can provide an important service to swap market participants, particularly for participants in smaller, niche markets such as those served by Evolution Markets. Evolution Markets has the following comments regarding the requirements of RFQ systems in the proposed rule:

- **Consideration of resting bids and offers.**
  The proposed rule stipulates that a trading system or platform transmitting a request for quote by a market participant must be able to take into account and communicate other resting bids or offers on the trading system. Evolution Markets agrees that participants seeking quotes through an RFQ process should be afforded the same pre-trade transparency as all other market participants.

  However, we are concerned that the language in the proposed rule may go beyond offering transparency. Evolution Markets does not fully understand what it means to "take into account" resting bids or offers, nor do we believe we can control the ability of a market participant to do anything with bids and offers beyond having access to view them.

  As a potential operator of a trading system or platform that must provide RFQ services, Evolution Markets suggests the language for this provision be modified so as to ensure clarity and avoid unintended consequences of non-compliance of a trading system based on legitimate trading decisions of its market participant.

  We suggest the following changes:

  Section 37.9 (a.)(1.)(ii.)
  "(A.) ...Any bids or offers resting on the trading system or platform pertaining to the same instrument must be ~~taken into account and~~ communicated to the requestor along with the responsive quotes..."

  And

  "(B.) A trading system or platform in which multiple market participants can both (i.) view real-time electronic streaming quote, both firm and indicative, from multiple counterparties on a centralized electronic screen; and (ii.) have the option to complete a transaction by (A) accepting a firm streaming quote, or (B.) transmitting a request for quote to no less than five market participants, based upon an indicative streaming quote~~, taking into account any resting bids or offers that have been communicated to the requester along with any responsive quotes~~. Such a system must also communicate to the requester any bids or offers resting on the trading system or platform pertaining to the same instrument; ..."

15 Second Timing Delay [Sec. 37.9 (b.)(3.)]

Under the proposed rule, SEFs must provide a general timing requirement applicable to brokers executing against a customer's trade or are entering a trade for two customers on opposite sides of a transaction. The Commission proposes a minimum pause of 15 seconds between entering one side of a matched order and the entry of the second side.

Evolution Markets believes this provision could inhibit development of liquidity in certain markets, and at a minimum would be disruptive to the efficient operation of a swaps marketplace. Again, a distinction must be made between brokers that are traders and introductory brokers that match counterparties but do not take a position in the marketplace.

Matching customer orders off a trading system or platform then bringing them to the SEF for execution is a legitimate practice that enhances liquidity, particularly in new, less liquid markets with fewer counterparties. Pre-trade price transparency is achieved through voice and electronic communications, as well as posting of real-time orders on an electronic system for streaming quotes. Introductory brokers play an important role in ensuring efficient execution in these types of markets, and the 15 second delay provision would impede their operations.

The rule also implies "discretion" on behalf of the broker matching orders, and that this implied discretion would allow for orders matched by the broker to be severed and presented to the SEF for potential alternate execution. Introductory brokers act as "agents for" their clients, and therefore do not have discretion on simultaneously matching buyer/seller. Orders matched in the over-the-counter market are considered by all counterparties to be executed, and any suggestion by the Commission that the trades be "un-matched" and subject to a minimum timing requirement could be disruptive to efficient market operation.

In smaller, niche commodity markets, an introductory broker plays an important role in facilitating liquidity and assisting market participants in finding a market clearing price. Counterparties believe the trades matched in this manner are executed. Uncertainty in the finality of their transactions under the 15 second delay rule may discourage their participation in a market and thereby inhibit liquidity.

Furthermore, Evolution Markets believes this rule is ultimately more focused on the issue of brokers as traders "trading with oneself" or trading with accounts or customers with which they have discretion over the placing of orders. In contrast, an introductory broker shows a simultaneous bid/ask in a multiple participant-to-multiple participant environment. If the intent is to focus on provide a pause when a trader is trading against a customer in order to ensure proper pre-trade price transparency, then the Commission should ensure this rule does not apply to the order matching services of introductory brokers.

Evolution Markets recommends the following change:

- The preamble of the proposed rule provides explanatory text for this provision[Section 37.9 (b.)(3)] states:

> "...SEFs must provide a general timing requirement applicable to traders such as brokers who have the ability to execute against a customer's trade or are entering a trade for two customers on opposite sides of the transaction. Under the proposal a broker would have to provide a minimum pause before entering the second side (whether for its own account or for a second customer), thus 'showing' other market participants the terms of a request for quote from its customer and provide other market participants the opportunity to join in the trade. The Commission proposes to require a minimum pause of 15 seconds between entry of two potentially matching customer-broker swap orders or two potentially matching customer-customer swap order on SEFs."

While, the preamble text references its applicability to "traders, such as brokers", Evolution Markets believes the Commission is referencing here broker dealers that trade in the market for their own accounts, as well as on behalf of customers. There is a clear distinction between broker dealers and introductory broker who, as stated above, do not take positions in the markets they serve but rather match buyers and sellers directly in an unbiased marketplace.

It should be noted that that the proposed regulatory language references "traders" but not explicitly brokers:

> **Section 37.9 (b.)(3):**
> "Swap execution facilities must require that traders who have the ability to execute against a customer's order or to execute two customers against each other be subject to a 15 second timing delay between the entry of those two orders, such that one side of the potential transaction is disclosed and made available to other market participants before the second side of the potential transaction (whether for the trader's own account or for a second customer), is submitted for execution."

EVOLUTION
MARKETS

To create the absence of doubt that the minimum timing provision not apply to orders matched by introductory brokers and placed on a SEF for execution, Evolution Markets proposes the Commission clearly state this in the preamble of the final rule. Evolution recommends the following edits to the preamble of the proposed rule:

> "...SEFs must provide a general timing requirement applicable to traders ~~such as brokers~~ who have the ability to execute against a customer's trade or are entering a trade for two customers on opposite sides of the transaction. Under the proposal a ~~broker~~ trader would have to provide a minimum pause before entering the second side (whether for its own account or for a second customer), thus 'showing' other market participants the terms of a request for quote from its customer and provide other market participants the opportunity to join in the trade. The Commission proposes to require a minimum pause of 15 seconds between entry of two potentially matching customer-broker swap orders or two potentially matching customer-customer swap order on SEFs. To be clear, this requirement does not apply to matching customer-customer swap orders facilitated by introductory brokers that do not have trading privileges on the SEF."

Swaps Made Available for Trading :: Sec. 37.10

The Dodd Frank Act requires swap transactions to be cleared, unless the Commission has not made a determination regarding the clearing requirement of the swap, an eligible counterparty avails itself of an exemption to clearing, or no DCM or SEF "makes the swap available to trade".

The Dodd Frank Act has allowed for certain less liquid or necessarily bespoke swap transactions to be exempt from clearing, and the Commission has acknowledged this exception. Evolution Markets is concerned, however, that leaving the discretion of whether a swap transaction is available to trade to the very types of facilities that benefit from the transaction being mandated to clear presents an opportunity for distortion of this provision to the potential detriment of market liquidity.

For example, in the months leading up to and subsequent to the passage of the Dodd Frank Act, DCMs have listed contracts for clearing on their exchanges at unprecedented rates. Current participants in select energy and environmental markets would argue that many of the contracts listed for clearing at these exchanges either do not meet the market's desired specifications or do not have sufficient liquidity to warrant their listing. In some cases, liquidity in these listed contracts is nearly non-existent, indicating trading in such products is better served on a bilateral basis in the over-the-counter market.

Yet, their listing by the DCM makes them "available to trade" in the first instance and therefore mandated to be cleared. This practice of parking contracts could be adopted by SEF operators, and

EVOLUTION
MARKETS

putting them in control of making the "availability to trade" determination could be counterproductive and potentially anti-competitive.

The proposed Section 37.10 rule mandates a periodic assessment of such contracts by the SEF, which will take into account the frequency of transactions, open interest, and whether the swap transaction has been deemed "available for trading" by another SEF.

Evolution Markets operates in niche environmental and energy markets in which liquidity and transparency thrives in the over-the-counter markets, despite similar contracts for some of these products being listed on a DCM. The reasons for this trading behavior are many, but largely can be attributed to the complex nature of the market, the number and sophistication of market participants, and the often non-standard size of transactions. Mandating some of these markets to clear and execute on a SEF will not change these factors and, should SEFs be a similarly ill-fitted platform for these markets as DCMs currently are for the corresponding futures transactions, liquidity will suffer.

Taking into account the issues presented above, Evolution Markets recommends the following changes to the proposed rule regarding the meaning of "made available for trading":

- Evolution Markets is concerned SEF operators may be incented to act in their self interest for competitive advantage and financial gain without regard for the overall market impact by listing contracts as "available for trading" despite the fact that they may find a more appropriate and liquid platform off the SEF. As such, Evolution Markets encourages the Commission to play a more active role in determining "availability to trade". This should include, but not be limited to, instituting a process whereby a market participant can petition the Commission to review the appropriateness of a SEF's determination that a particularly swap transaction or class of swap transactions are available to trade.

- Continuing to address the risk of a "perverse incentive" of SEFs finding contracts available to trade, Evolution Markets recommends deleting the criteria for such determination that states: "If at least one swap execution facility has made the same or an economically equivalent swap available for trading, all swap execution facilities are required to treat the swap as made available for trading."[3]

- Evolution Markets maintains that certain contracts, including many in emerging environmental and energy markets, find sufficient liquidity in over-the-counter markets in which interaction with intermediaries such as brokers allows contracts to evolve and develop. But, just because a contract finds liquidity in an over-the-counter market does not mean listing for trading on a DCM or SEF will provide similar liquidity. Therefore, Evolution Markets recommends the Commission clearly state that a SEF must consider only the "frequency of trading" on the SEF or other SEFs, or similar trading frequency on a similar contract in the futures market. The SEF should not be able to take into account the

[3] Section 37.10 (c.)(1.).

EVOLUTION
MARKETS

frequency of trading of a swap transaction in the over-the-counter market, where the bilateral nature of such a market is essential to the underlying liquidity.

- Evolution Markets recommends the Commission stipulate that the SEF must also take into consideration the notional value of open interest for a particular swap. If the market size is limited, then trading in the over-the-counter market where counterparties can negotiate privately or through the assistance of a broker might be more appropriate. Evolution Markets believes open interest is a useful metric for determining market viability in a SEF-listed contract, and we recommend the Commission establish an open interest threshold of at least $250 million in notional value, as averaged over a three month period before the annual "available to trade" review process. Should a swap contract not meet this threshold, it would be deemed by the Commission as not available to trade, allowing the swap transaction to occur on a SEF or other market platform.

- Evolution Markets recommends the Commission stipulate that the SEF must also take into consideration the size of trades of a particular swap. Swap transactions that occur in a variety of sizes, including odd lots, are typical to markets in which actors participate in order to comply with regulations (i.e. emissions allowance markets) or the market is used for fuel procurement or to hedge specific energy supply/demand needs (i.e. coal markets). Such market requirements are best served by the over-the-counter market, which can efficiently match these types of transactions.

Evolution Markets appreciates the opportunity to comment on proposed regulations for SEF core principles. We look forward to continuing to provide our perspective as the rulemaking process moves ahead.

Best regards,

Andrew Ertel

Andrew Ertel
President and Chief Executive Officer