March 25, 2011

Mr. David A. Stawick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre 1155 21st Street, N.W.
Washington, D.C. 20581

Re: Commission Notice of Proposed Rulemaking on Core Principles and Other Requirements for Swap Execution Facilities dated January 7, 2011 (76 Federal Register 1214) (RIN Number 3038-AD 18)

Dear Secretary Stawick:

Parity Energy, Inc. ("Parity") submits this letter in connection with the rules proposed by the Commodity Futures Trading Commission (the "CFTC" or the "Commission") regarding the core principles and other regulatory requirements for swap execution facilities ("SEFs").[1] On March 8, 2011, Parity met with representatives of the CFTC to discuss the Proposed Rule and, as promised, Parity is submitting this letter to address certain issues raised. Parity appreciates the opportunity to provide this letter and respectfully requests that the Commission consider the comments contained herein.

Founded in 2006, Parity owns and 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. Currently operating as an Exempt Commercial Market, PEP has experienced 95% growth annually since going live in 2008. Today, PEP already complies with many of the structural SEF requirements set out in the Proposed Rule. PEP was designed from inception as a limit order book system which offers a level playing field to all market participants through impartial access and full pre- and post-trade transparency. All orders on PEP are firm and anonymous, and all trade executions are cleared. Also incorporated into PEP is an open RFQ system, whereby any PEP participant seeking a market in an instrument (whether it is currently being quoted or streamed through the PEP limit order book or not), can broadcast an RFQ to all market participants to solicit interest in such instrument at any time, without revealing direction. The PEP open RFQ promotes increased transparency, price efficiency and impartial access by granting every PEP

[1] Core Principles and Other Requirements for Swap Execution Facilities, Notice of Proposed Rulemaking. 76 FR 1214 (Jan. 7, 2011) (the "Proposed Rule").

Participant the same tools to view and respond to any RFQ and to trade on any order. As the CFTC staff has foreseen, the sort of level playing field found on PEP enhances transparency and removes restrictions to markets which may otherwise be opaque. Trading on PEP is growing at a robust rate and creating an open electronic marketplace consistent with the vision of the the Dodd-Frank Act (the "DFA")[2].

However, although PEP's existing design is well tailored to the structural requirements of the Proposed Rule, the regulatory framework mandated by the Proposed Rule is overly burdensome and will have a negative impact on Parity's business and its ability to innovate. The DFA was passed into law to promote the financial stability of the United States by, among other things, improving accountability and transparency in the financial system.[3] To further these goals in the derivatives markets, Commission rulemaking should create efficient systems, centralize market supervision and establish market protections proportional to market risks. The CFTC may meet the statutory mandate of the DFA by ensuring that the regulatory requirements imposed on a SEF are proportional to the risk that the SEF might pose to the financial system if the SEF were to fail.

Summary of recommendations:

- Obligations to coordinate swap information gathering should not be imposed on individual SEFs. Instead:
    - Place coordination responsibility in a separate third party to effectively centralize all swap information, including terms and conditions, real-time position limits and execution details;
    - Require each SEF to provide complete, accurate and timely information to a single separate third party only, and not to each other.
- Market-wide supervisory and compliance obligations should not be imposed on individual SEFs. Instead:
    - Place market-wide supervisory control in a separate third party;
    - Require each SEF to police trading that occurs on its own execution facility only.
- Where a SEF is one of many execution avenues for standardized swaps and its failure would have a minimal impact on market risk or stability, the Commission should interpret "operating costs of a swap execution facility for a 1-year period" to be the cost to the SEF of an orderly wind-down of operations.
- The Commission should tailor its financial and corporate structural requirements to a SEF's size and potential market impact.

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2 The Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111 -203, 124 Stat. 1376 (2010).

3 The preamble to the Act reads: "An Act To promote the financial stability of the United States by improving accountability and transparency in the financial system, to end "to big to fail", to protect the American taxpayer by ending bailouts, to protect consumers from abusive financial services practices, and for other purposes."

1. Characteristics of the Energy Swaps Market

Today, energy options may be executed on electronic execution platforms, such as the Parity Energy Platform, or through any of a number of over-the-counter voice brokerage firms. After the DFA comes into effect, these energy option execution firms will likely retool to offer trading through a variety of new swap execution facilities. However, in any such market where a large number of SEFs coexist to execute identical swaps, decentralized compliance and supervision located at the SEF level will be inefficient and ineffective.

2. Regulations Enacted Under the DFA Should Centralize Supervision and Compliance Functions to Maximize Efficiency and Effectiveness

A SEF can and should be required to police its own execution facility and trading platform for improper activity, but in a mature market where identical swaps may execute on any of a number of SEFs, an individual SEF will see only a portion of market activity and should not be held responsible for policing market activity as a whole.

Requiring SEFs in such a market to coordinate surveillance information will not be feasible in real time and is unnecessary. Consider the effect of holding each SEF responsible for market-wide surveillance in a market where five SEFs permit trading of the same swap which clears at a single clearing house. To coordinate effectively there must be fifteen lines of communication, and each individual SEF must communicate with five other entities. By contrast, if a single entity acts to coordinate surveillance of all swap trading information, the complexity, speed and accuracy of the interaction will be greatly reduced.

Where SEFs offer more than one widely executed swap, complexity increases. In such a case each SEF may potentially be required to identify and communicate with a different network of SEFs for each swap the SEF offers for execution.

SEFs in such networks attempting to share information will find that their effectiveness in meeting core principles will depend on the technical proficiency of their competitors.

Specific provisions in the Proposed Rule that potentially raise these issues include:

- § 37.201 (b)(1): requiring SEFs to establish and impartially enforce compliance with SEF rules establishing the terms and conditions of any swaps traded through or processed on or through the SEF.

  In a market where numerous SEFs permit the execution of identical swaps which are required to be cleared, an individual SEF that permits the execution of a swap may not control the terms and conditions of the swap as these are in fact created and enforced by the clearing house where the swap clears. The terms and conditions of the cleared swap which a SEF offers for trading merely piggybacks on those defined by the clearing house. As such, establishing the terms and conditions of cleared swaps should be vested in the clearing house that creates the cleared swap and not the SEF which permits execution of such cleared swap. Enforcing compliance with these terms and conditions should be the responsibility of the SEF, but only to the extent that these terms and conditions relate to trading on that SEF.

- § 37.203 Rule Enforcement Program and § 37.206 Disciplinary Procedures and Sanctions: provisions requiring SEFs to maintain an internal compliance staff, an internal enforcement staff, as well as internal Review, Hearing and Appeals Panels.

  In a market where numerous SEFs permit the execution of identical swaps, requiring each SEF to maintain a separate compliance, enforcement, hearing and appeals staff imposes unnecessary costs and creates unnecessary duplication and the possibility of conflicting rulings. In particular, separate enforcement and hearing and appeals staff is overly expensive and burdensome. An individual SEF that is privy to only a portion of market activity will face significant technical and practical difficulties if it attempts to investigate market-wide behavior. Competing SEFs may reach inconsistent rulings when attempting to investigate the same conduct from differing vantage points.

- § 37.400 et seq. Core Principle 4 – Monitoring of Trading and Trade Processing: provisions that require SEFs to collect and evaluate data on individual traders' market activity; to monitor and evaluate general market data to detect and prevent manipulative activity; to conduct real-time monitoring of trading to detect abnormal price movements, unusual trading volumes, impairments to market liquidity and position limit violations.

  To the extent these requirements may require a SEF to monitor activity in the market as a whole, they will raise the technical and practical difficulties discussed above in any market where multiple SEFs permit execution of identical swaps. Under these circumstances, monitoring of the market as a whole would be better served through a centralized third party organization. However, an individual SEF can and should be required to police this type of activity on its own trading platform or execution facility.

- § 37.402 provisions specific to physical-delivery swaps

  In a market where numerous SEFs permit the trading of identical swaps, requiring each SEF to monitor the adequacy, size and ownership of deliverable supply as well as the delivery locations and commodity characteristics is duplicative, unmanageable and creates the risk of conflicting conclusions. Oversight of these factors should not be conducted at the SEF level.

- §§ 37.403 and 37.404 provisions specific to cash-settled swaps and the ability to obtain information

  The effect of these requirements is that numerous SEFs need to coordinate information which raises the practical and logistical concerns discussed above.

- § 37.600(b)(2) provisions relating to position limits or accountability

  To the extent that these provisions require SEFs to police position limits in the market as a whole, they raise the same practical and logistical concerns discussed above for any market in which identical swaps may be executed on competing SEFs.

- § 37.703 provisions relating to the monitoring of financial soundness

  Participants trading exclusively cleared swaps should not be required to provide financial records to every SEF on which they trade. Rather, this monitoring authority should be vested with the clearing member of the participant and with the clearinghouses where such swaps are cleared.

The Proposed Rule should not impose market-wide supervisory and compliance obligations on individual SEFs. Especially in a market where multiple SEFs exist to execute identical swaps, such obligations should instead be placed on a third party organization that may coordinate enforcement between and among SEFs. Today in the energy options market, some of these surveillance functions are currently fulfilled by clearinghouses. The Commission may wish to follow this model or to place supervisory control in a separate third party. In either case, SEFs should be required to present information to the central supervisory organization, but SEFs should not be required to enforce market-wide rules that would require sophisticated coordination with a host of other competing entities.

Section 37.204 of the current Proposed Rule permits the outsourcing of certain SEF functions to a regulatory service provider, but continues to hold SEFs responsible for the adequacy of any regulatory services received. In many cases, effective oversight of a third party's surveillance of the market as a whole will present the same challenges that surveillance itself would pose, especially where a SEF sees only a portion of market activity. Instead, the Proposed Rule should require each SEF to police trading that occurs on its own trading platform or execution facility and to provide complete, accurate and timely information to a central supervisory organization.

3. Regulations Enacted Under The DFA Should Establish Financial Safeguards Proportional to Market Risks

As the Proposed Rule indicates, the DFA "was enacted to reduce risk, increase transparency and promote market integrity."[4] To meet these ends, the Commission should establish financial safeguards proportional to the risks presented.

The Proposed Rule should ensure that no SEF increases market risk or threatens market stability. A SEF that offers the sole avenue for the execution of a given swap might create instability and risk if it were to fail. By contrast however, where multiple SEFs permit the execution of identical swaps, the failure of a single SEF will have very little impact on market risk or stability. Under such circumstances, extensive corporate structural requirements and financial resource requirements will be unnecessary to satisfy the purposes of the DFA.

The DFA mandates that a SEF "have adequate financial, operational, and managerial resources to discharge each responsibility of the [SEF]" and further specifies that a SEF's financial resources "shall be considered to be adequate if the value of the financial resources exceeds the total amount that would enable the swap execution facility to cover the operating costs of the swap execution facility for a 1-year period, as calculated on a rolling basis."[5]

Commission rules relating to this requirement should reflect the impact of a SEF's failure on market risk and stability. Where a SEF is one of many execution avenues for standardized, cleared swaps and its failure would have a minimal impact on market risk or stability, the Commission should interpret "operating costs of a swap execution facility for a 1-year period" to be the cost to the SEF of an orderly wind-down of operations. Such an interpretation would meet DFA statutory requirements, without imposing disproportionate obligations on SEFs that could prevent the creation of new SEFs or threaten smaller SEFs already in existence. Similarly, the Proposed Rule's liquid financial assets requirement, set out in § 37.1305 – a requirement not mandated by the DFA – should be limited to SEFs that could impact market stability if they were to fail.

The Proposed Rule creates a number of corporate structural requirements that should also be modified to reflect a SEF's potential market impact. For a SEF which could fail without creating market risk or instability, it is unnecessary to require a multi-person board with specified committees and a Chief Compliance Officer who cannot serve in any legal capacity. By contrast, such requirements may be appropriate for a SEF that could have a substantial impact on market risk and stability if it were to fail. In short: the Commission should tailor its financial and corporate structural requirements to a SEF's size and potential market impact.

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[4] 76 FR at 1214.

[5] § 733 of the DFA.

Parity appreciates this opportunity to comment and respectfully requests that the Commission consider the contents of this letter as it develops a final rule.

Respectfully submitted,

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Parity Energy, Inc.