May 14, 2012

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

RE: **RIN: 3038-AD08, Further Notice Of Proposed Rulemaking On Procedures To Establish Appropriate Minimum Block Sizes For Large Notional Off-Facility Swaps And Block Trades**

Dear Secretary Stawick:

Parity Energy, Inc. ("Parity") appreciates the opportunity to provide comments to the Staff of the Commodity Futures Trading Commission (the "Staff" or the "Commission") regarding the further notice of proposed rulemaking on Procedures to Establish Appropriate Minimum Block Sizes for Large Notional Off-Facility Swaps and Block Trades (the "Further Proposed Rule"). Parity respectfully asks the Commission to clarify the proposed initial period[1] block sizes for natural gas swap transactions and to conform the proposed initial period block sizes for crude oil swap transactions more closely to current practices in the futures markets.

Parity owns and operates an internet-based global electronic trading facility for commodity derivative products traded in the United States, with a primary focus on energy options. Parity's electronic trading facility, the Parity Energy Platform ("PEP") has executed over one million option contracts since 2008. PEP currently operates as an Exempt Commercial Market and Parity intends to apply to be registered as a Swap Execution Facility ("SEF") when SEF registration becomes available under the Dodd Frank Act ("DFA").

[1] The term "initial period" in this comment letter refers to the initial portion of the phase-in period described in the Further Proposed Rule. See, e.g, 77 FR 51, p. 15466 - 7.

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Most transactions executed today on PEP are crude oil and natural gas options. Among other instruments, participants use PEP to execute transactions in same day and short term options, calendar spread options, American or European style options or to exchange options for options in either natural gas or crude oil. Under the Further Proposed Rule, Parity anticipates that the contracts executed today on PEP would probably fall under Part 43.6(b)(5)(i) as swap contracts: (i) belonging to the "other commodity" asset class; (ii) in which the underlying asset directly references or is economically related to futures contracts listed in appendix B to Part 43; and (iii) for which Designated Contract Markets ("DCMs") have established minimum block sizes. As Part 43.6(b)(5)(i) swaps, the minimum block sizes to be applied during the initial period to these PEP-executed swaps are set out in appendix F to the Further Proposed Rule.

The Minimum Block Sizes Established In The Further Proposed Rule For Energy Swaps Should Be Modified To Conform To Current Market Practices

The proposed minimum block sizes set by appendix F for natural gas and crude oil energy swaps do not reflect the realities of the energy options market. In the case of natural gas, the applicable block size is unclear. In the case of crude oil, the applicable block size is too low. If adopted as proposed, these block sizes could effectively vitiate the execution requirement created by the Dodd Frank Act for transactions in the energy options market during the initial period after the final version of the Further Proposed Rule becomes effective.

Transactions in the energy options market are typically fewer in number and larger in size than fixed price energy transactions. The universe of market participants is limited and most participants are sophisticated. Existing block sizes set by DCMs for options on energy futures reflect this reality. For example, the CME sets the following minimum block sizes for energy option contracts:

Light Sweet Crude Oil options transactions	1,000 contracts	1,000,000 BBL
Henry Hub Natural Gas options transactions	1,600 contracts	16,000,000 MMBtu
European-Style Natural Gas options transactions	550 contracts	5,500,000 MMBtu

These existing block sizes appropriately reflect the characteristics of the market for energy options trading. Similarly, for most contracts, Parity designed PEP to permit a minimum size increment of 50 contracts. This trading limit reflects the large sizes that typically characterize transactions in these instruments.

The Staff should revise the Further Proposed Rule's initial period minimum block sizes for energy options to more closely conform with the actual block sizes in effect today in the futures markets.

1. Appendix F Establishes A Confusing Standard When Applied To Henry Hub Natural Gas Minimum Block Sizes

Appendix F of the Further Proposed Rule sets out two minimum block sizes for natural gas swap transactions. Appropriately, the appendix draws a distinction, in the case of natural gas, between block sizes for fixed price swaps and those applicable to options. In keeping with standard practice in the futures markets and as a reflection of market realities, the minimum block size for natural gas options is set at a level substantially higher than the minimum block size for fixed price swaps in natural gas.

The final rule should make clear that the minimum block size set out at appendix F for natural gas options should apply to any natural gas swap with optionality, but the text of the Further Proposed Rule is ambiguous on this point. It advises that for § 43.6(b)(5)(i) swaps, "the initial appropriate minimum block size for such publicly reportable swap transaction shall be the appropriate minimum block size that is in appendix F to this part." [2] The term "appropriate" as used here is vague and difficult to apply.

Appendix F lists "Initial Appropriate Minimum Block Sizes" and "Related Futures Contracts." If the term "related" is meant to incorporate the definition of "economically related," then traders of natural gas swaps with optionality may well feel entitled to apply the appendix F block size associated with natural gas futures to their trades. The Further Proposed Rule defines "economically related" to be "a direct or indirect reference to the same commodity at the same delivery location or locations, or with the same or a substantially similar cash market price series."[3] By this definition, a swap that is economically related to a futures contract on an underlying commodity will be economically related to the options contract with the same underlying commodity, in virtually every case. As drafted, the Further Proposed Rule does not require a trader to apply the minimum block size associated with the most closely analogous instrument designated in appendix F.

Appendix F establishes a block size of 1,000,000 MMBtus for "Henry Hub Natural Gas (NYMEX) (futures), " and a block size of 5,500,000 MMBtus for "Henry Hub Natural Gas (NYMEX) (options)." Because market convention often equates a single contract to 10,000 MMBtus, the latter of these two limits appears to conform to the minimum block threshold set by CME clearing for the European style natural gas options.

The 550 contract block size for Henry Hub natural gas options is consistent with existing practice in both the futures and the Over The Counter markets and would be a reasonable block size for swaps trading in natural gas options. It will capture an appropriate volume of trades, but will leave the bulk of trades subject to the DFA's SEF or DCM execution requirements.

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[2] Proposed § 43.6(e)(1).
[3] Proposed § 43.2.

The 100 contract block size proposed for Henry Hub natural gas futures by the Further Proposed Rule for the initial period, by contrast, would be far too low if applied to natural gas options transactions. Its adoption would make block trades the rule rather than the exception for such swaps. A block size of 100 contracts is only 50 contracts above the *minimum* trade size permitted on the Parity Energy Platform for the European style natural gas option. An inappropriately low block size threshold for this significant contract will effectively exempt the bulk of trades in this important market from the DFA execution requirements during the initial period.

As the Staff is aware, the market for European style natural gas options is sizeable. Taken all together, traders on a typical day may exchange the rights to buy or sell 200,000 of such contracts - the equivalent of two billion MMBtus. The proposed 550 minimum block size should apply to natural gas options trading, but the vague terms of the Further Proposed Rule make that result far from certain. The final rule should expressly state that during the initial period, the 550 minimum block size associated with the Henry Hub natural gas (option) should apply to all natural gas swap transactions with optionality.

2. The Further Proposed Rule Sets The Minimum Block Size Too Low for Crude Oil Options

For crude oil – unlike natural gas – appendix F of the Further Proposed Rule does not draw a distinction between block sizes for options and futures transactions. Although the CME sets the block size for options transactions in light sweet crude oil at 1000 contracts, the only minimum block size for light sweet crude oil listed in appendix F to the Further Proposed Rule sets a minimum block size of 100 contracts. This limit, apparently taken from the CME's block size for crude oil futures contracts, is inappropriately low for crude oil options contracts. It understates the block size level established by the CME by a factor of 10.

An analysis of data available on the United States Energy Information Administration website, www.useia.gov, provides further evidence that the 100 contract block size for crude oil misses the mark. By comparing the ten year price average for natural gas and crude oil and controlling for contract size and notional value, this calculation shows that a block size of just under 500 contracts for crude oil would be comparable to the 550 natural gas block size listed on appendix F.

	Block Size	Price (10yr avg)	Contract Size	Notional
NG	550	5.80	10,000	31,900,000
WTI	484	65.87	1,000	31,900,000

Transactions in crude oil options are typically larger in scale and fewer in number than transactions in fixed price energy instruments. Setting the block size at 100 contracts will undermine the DFA's execution requirement in this significant market, where on a typical

day, taken all together, the rights to buy or sell 200,000 to 300,000 of such contracts may change hands. If the 100 contract minimum block size is not modified, traders in crude oil options will continue conducting business as usual, voice brokering the majority of transactions as block trades and effectively making an end run around the transparency and level playing field execution regime established by the Dodd Frank Act.

CONCLUSION

The Staff should conform block sizes in swaps to existing practice in the futures market to avoid the unintended distortion of swaps markets. During the initial period, the swap block size for crude oil should differentiate between block sizes for options contracts and futures contracts, as DCMs do today in the futures markets. The Staff should clarify the application of appendix F by stating expressly that a swap transaction must follow the block size associated with the listed instrument to which it is most closely analogous so that a natural gas swap with optionality must apply the minimum block size associated with natural gas options as listed in appendix F. Setting the minimum block sizes at the levels currently proposed for the initial period will negate the transparency and level playing field established by the DFA execution requirements in this crucial sector of the national economy.

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,

Charles Reyl
Chief Executive Officer
Parity Energy, Inc.