

MEMORANDUM

TO: File
FROM: James J. Thibodeau
RE: Meeting with representatives of Javelin Capital Markets, LLC
DATE: September 23, 2010

On September 23, 2010, Robert Cook, Peter Curley, Jack Habert, Jeffrey Mooney, Tom Eady, Leah Drennan, Alison Duncan, Iliana Lundblad, Nancy Burke-Sanow, Ann McKeehan, Steve Varholik, Michou Nguyen and James Thibodeau of the Securities and Exchange Commission and David Van Wagner, Adam Kezsbom, Swati Shah and Anthony Hays of the Commodities Futures Trading Commission met¹ with Jamie Cawley (CEO, Javelin Capital Markets, LLC), Chris Augustin (CIO, Javelin Capital Markets, LLC) and John Seher (Senior Legislative Advisor, Venable LLP) (collectively, “Javelin”).

The Javelin representatives discussed their view of the future of derivatives trading and the potential benefits that broad clearing may provide the marketplace. The Javelin representatives also discussed their view of the differences between central limit order book (“CLOB”) and a request for quotation (“RFQ”) trading systems and answered questions from SEC staff regarding potential swap execution facility (“SEF”) operations and block trading practices.

¹ The CFTC staff participated in the meeting via telephone.

Agenda

The primary issue to be discussed involves SEF's, its definition, registration requirements, core principles, execution models, pre & post trade transparency, transparency requirements and access.

Javelin: Presentation to the SEC and CFTC



javelin
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September 23rd 2010

Dodd Frank Wall St Reform Act 2010

SEC. 723 CLEARING

(3) *MANDATORY CLEARING OF SWAPS.*

(A) *STANDARD FOR CLEARING.*—It shall be unlawful for any person to engage in a swap unless that person submits such swap for clearing to a derivatives clearing organization that is registered under this Act or a derivatives clearing organization that is exempt from registration under this Act if the swap is required to be cleared.

TRADE EXECUTION

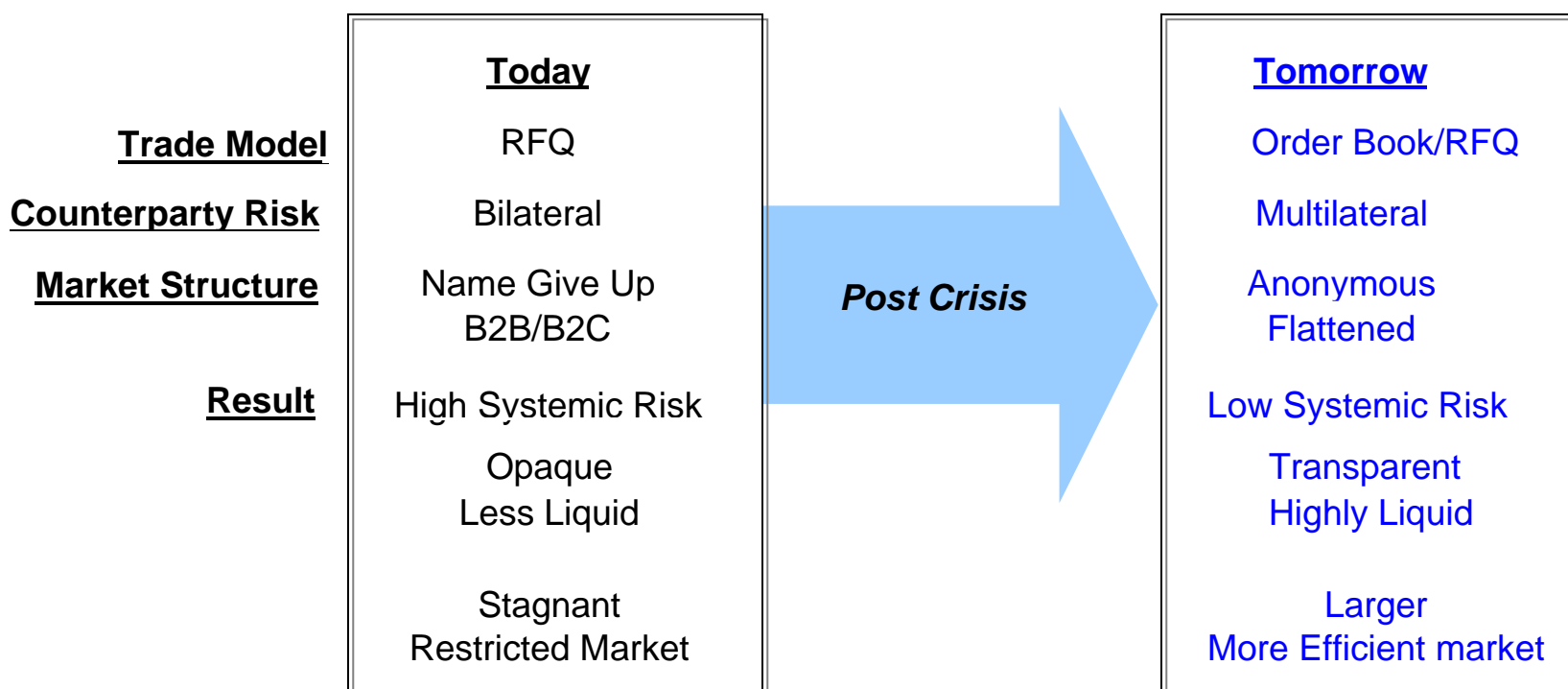
(A) ...With respect to transactions involving swaps subject to the clearing requirement of paragraph (1), counterparties shall—

- (i) execute the transaction on a board of trade designated as a contract market under section 5; or
- (ii) execute the transaction on a swap execution facility registered under 5(h) or a swap execution facility that is exempt from registration under section 5h(f) of this Act.

SEC. 5h. SWAP EXECUTION FACILITIES

(e) *RULE OF CONSTRUCTION.*—The goal of this section is to promote the trading of swaps on swap execution facilities and to promote pre-trade price transparency in the swaps market.

OTC Derivative Market Dynamic



Javelin: Core Principals for Cleared OTC Market:

1. Successful clearing of OTC derivatives is critical to lessening systemic risk.
2. Most OTC derivatives are eligible for central clearing.
3. The new OTC marketplace should be transparent to ensure investor confidence & better risk management.
4. Broad access to clearing: Multiple market makers, multiple clearing brokers means more liquidity and continuous markets especially in times of crisis.
5. Deeper liquidity lowers transaction costs and increases volumes.
6. Regulators should narrow participant, product & trade size exemptions.
7. Clearing houses must ensure open access to all SEF's and provide for objective, symmetrical workflows.
8. Clearing houses should have objective clearing broker membership standards
9. Clearing houses & SEF's should have truly representative and transparent governance structures.

Who is Javelin Capital Markets?

- Formed in late 2009.
- Pioneer in cleared OTC derivatives trading.
- **Central Limit Order Book** ('CLOB') not **Request for Quote** ('RFQ').
- True *Pro* Customer Solution: Low cost & fully anonymous execution.
- Product Verticals:
 - Credit Default Swaps
 - Interest Rate Swaps
- First executed cleared IRS trade via IDCG (August 2010).
- Electronic & Hybrid Electronic Technology.
- *Real Time* Straight Thru Processing & Trade Tape.
- Clearing House Agnostic (Early adopter CME in 12/09; pending ICE connectivity*).



Javelin User Interface

Javelin User Interface Screenshot

The interface displays multiple panels for trading and order management:

- REITS** and **HOMEBUILDERS** panels show market data with columns: Line, Term, Name, SNAC, CCP, Acct, Amt, Bid, Ask, Amt, Acct, Last.
- Daily Tape** panel displays a list of trades with columns: Time, Security, Sz, Acct, Px, Action.
- Trade History** panel shows trade details with columns: Customer ID, Customer Name, Trader Name, Broker Name, TradeDate, Trade ID, Time, TimeS, CCP, Amt, MM, Instrument.
- OrderVue** and **TradeVue** panels show order and trade details with columns: ID, Order ID, Sector, Security, Date, Trade ID, Time, TimeS, CCP, Amt, MM, Security.
- MAIN ORDER ENTRY** panel shows order entry details with columns: TKR, Mat, Term, Cpn, SNR, Restro, Bid, Offer, Amt.

The interface also includes a menu bar (File, View, Order, Price Data, Window, Help) and a toolbar with icons for Page List, Order Entry, OrderVue, Trade Entry, TradeVue, Trade Hist, Daily Tape, and Hist Tape.

Trading Model Comparison	Central Limit Order Book CLOB	Request for Quote RFQ
Price Transparency		
Pre Trade	Yes	No; but possible
At Trade	Yes	No
Post Trade	Yes	No; but possible
Multiple Participants	Dealer to Dealer Dealer to Customer Customer to Customer	Dealer to Customer
Liquidity	High	Low
'Best Price' Discovery	Yes	No
Execution Cost	Low	High
Anonymous Trading	Yes	No
SEF Compliant	Yes	Yes*
Best Model	Let the market decide	

Compliance with the Act: Access & Transparency

- Unified set of objective rules consistent with core principles of Act.
- SEF obligated to ensure safety and fairness of marketplace.
- SEF Access
 - Should be open to multiple participants.
 - Should be impartial but not 'anything goes'
 - SEF should have right to deny access based on objective standards but still comply with the Act.
- SEF Transparency
 - Customers entitled to best execution: One Price Fits All.
 - Orders and trades displayed on a tape on a real time basis.
 - Customers entitled to see trades as they occur and participate (work ups).
 - Block Trade exceptions above but substantially above 'round lot' trades.

Compliance with the Act: Market Surveillance

- Investor requirement: SEF's must be safe and fair marketplaces in which to trade
- Regulators charged with need to ensure investor safety, fairness and fair dealing
- Market Surveillance:
 - Regulators need data to enforce such fair dealing
 - Price data (order/trade, price, size, executed/not executed, time stamp)
- SEF Data solution must be proactive, not reactive—must act as deterrent to fraud and price manipulation—
- Delayed data link to regulators is reactive, slow and expensive.
- Javelin Solution: Real time data link to regulators that gives, time stamp, direction, amount, size and counterparty for trades and orders.

Compliance with the Act: SEF Risk Management

- Which Model? *Agency-Principal* or *Agency -Agency* Model
- Look to Exchange Model for leadership. Agency-Agency Model
- Javelin Measures to ensure to minimize trade failure:
 - Look to listed derivative market experience and trend.
 - Post Trade Measures: Clear rule sets in event of trade rejection
 - Clearing Agreement
 - Give Up Agreement: SDMA version (good symmetrical example)
 - Problem: Reactive
 - Pre Trade Measures: Act before trade problem occurs
 - Trade Day Approval: Daily Trade Clip Size Limits based on incremental margin.
 - Intraday Day Approval: Time Based, Event based.
 - Real Time Approval—Ultimate Goal with Low latency solution.
 - Challenge: FCM's must communicate with SEF on pre trade basis.

Conclusion: Industry & Regulatory Challenges

- OTC Derivatives still represent an unacceptable systemic risk to the global financial payments system.
- Marketplace must recognize that the *Dodd Frank Act* is here to stay.
- Clearing Houses, FCM's, Dealers and Buyside need to work together to address new challenges that affect us all.
- Javelin has already begun to work with certain buyside groups, dealers and FCM's to address new cleared OTC derivative settlement risk, documentation and trade flow issues.
- Javelin would welcome SEC and CFTC leadership to help champion certain industry challenges to ensure the success of OTC clearing of IRS and CDS.