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Morgan Stanley

February 7, 2011

VIA ON-LINE SUBMISSION AND E-MAIL: dfadefinitions@CFTC.gov

Mr. David A. Stawick, Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581.

Re: Treatment of Illiquid Products under CFTC Proposed Rule under Section 763 of the Dodd-Frank Wall Street Reform and Consumer Protection Act
(File No. S7-34-10)

Dear Mr. Stawick:

We are responding to proposed Rule 17 CFR Part 43[1] ("*Proposed Rules*"), in which the Commodity Futures Trading Commission (the *"Commission" or "CFTC"*) solicited comments on certain proposed rules relating to Real-Time Public Reporting of Swap Transaction Data implementing certain statutory provisions enacted by Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("*Dodd-Frank*").

Morgan Stanley fully endorses the comment letter submitted to the Commission on February 7, 2011 by the International Swaps and Derivatives Association, Inc. and the Securities Industry and Financial Markets Association (the "*SIFMA Comment Letter*")[2] with respect to, among other topics, the proposed real-time reporting requirements for swap transactions under the Proposed Rules, and appreciates the opportunity to supplement that letter by giving feedback based on Morgan Stanley's particular experience with less liquid markets.[3]

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1 CFTC, 17 CFR Part 43 Real-Time Public Reporting of Swap Transaction Data; Proposed Rule, Federal Register, Vol 75, No. 234, 76139, December 7, 2010.

2 Comment Letter dated February 7, 2011 to the CFTC from The International Swaps and Derivatives Association, Inc. and the Securities Industry and Financial Markets Association regarding (1) RIN 3038–AD08 - Real-Time Public Reporting of Swap Transaction Data; (2) RIN number 3038–AD19 - Swap Data Recordkeeping and Reporting Requirements; and (3) RIN number 3038–AC96 - Reporting, Recordkeeping, and Daily Trading Records Requirements for Swap Dealers and Major Swap Participants.

3 Morgan Stanley is a highly-diversified, global financial services firm that, through its subsidiaries and affiliates, provides risk management and investment products and services to a large and diverse group of clients and customers. In turn, Morgan Stanley relies extensively on the futures and swaps markets to hedge the risks associated with these products and services.

The Proposed Rules clearly intend to improve the price transparency of over-the-counter ("*OTC*") derivatives markets while preserving and enhancing market liquidity and reducing systemic risk, goals that we wish to emphasize that we support. However, some unintended consequences of the Proposed Rules may well undermine those objectives, in particular with respect to certain products in markets that may be illiquid due to their unusual tenor, size, structure or other properties. An appropriate balance must be struck between increasing price transparency and maintaining confidentiality to prevent situations where information disseminated to the market might impact the effectiveness of hedging strategies, create potential "front running" and ultimately adversely affect the depth and breadth of the markets. As such, we feel strongly that relief must be granted from the stringent timing requirements in the Proposed Rules for trades in illiquid markets. We believe that trades in illiquid markets should be subject to different reporting requirements than those applicable to trades in more liquid markets. Although we agree that all relevant trading activity regarding trades in illiquid markets should be promptly and fully reported to the regulators, we believe it is in the best interest of the markets, including end users who rely on them for hedging purposes, that such information be provided on a confidential basis and not be made public, at least not without a significant time delay.

Background

The OTC swaps market developed and expanded over time to address the specific risk management needs of American and global businesses that seek to mitigate risks that cannot be easily or fully hedged using futures contracts. The current availability of liquid instruments with which corporations are able to manage their market risks exists as a result of an evolutionary process that has seen demand for new products be met with custom instruments provided by dealers. Because OTC swaps can be customized to address specific risks, they bridge the gap between actual market risks and standardized futures markets. Depending on the size of the underlying physical market, these OTC markets can become relatively large and actively traded. As trade volume in smaller and less frequently traded markets grows, so too does price transparency, ease of execution and the number of market participants. Most current exchange traded futures contracts evolved from these beginnings. The markets are never static however. Some of the highly liquid and actively traded markets of tomorrow are only being developed today, and these nascent markets will require careful treatment by regulators if they are to become important market resources in the future. Additionally, some smaller markets never develop a scale large enough to enjoy this level of activity and liquidity, either because the underlying physical market is too small or for other market structure reasons. The development of hedging products in these markets therefore involves the transfer and assumption of various basis risks, based on differences in product grade, delivery location or other features of the physical market product and the related futures product. As market makers, dealers provide an essential service by absorbing these basis risks and hedging them through offsetting transactions or other related transactions.

Morgan Stanley is concerned about the application of the proposed real-time reporting rules in the context of these less liquid but nevertheless very important markets. In particular, when a risk transfer occurs, *i.e.* when an end-user trades with a dealer, the dealer might not be able to

transfer this risk position to the broader market immediately due to the liquidity constraints and basis risks, but instead may warehouse this risk for a period of time – measured in hours, days, weeks or even months – before finding appropriate counterparties with whom to undertake trades. Even then, the offsetting trades will likely be imperfect, and residual risk will remain with the dealer.

Public disclosure of the terms of transactions, which may be executed as infrequently as only a few times a week, or even less, will place the dealer in a difficult position because the only complete hedge of market risk in this context is an offsetting transaction or transactions. However, if an offsetting trade or trades is available in the market, once the price of the initial trade has been disclosed, and a potential counterparty to the offsetting trade has had an opportunity to observe it, the dealer will likely be able to execute the offsetting trade only at the price of the original transaction, or even at a lower price if the counterparty has the advantage of being one of the few parties willing to trade in the illiquid market and it knows that the dealer must execute the offsetting trade. This means that the dealer will be highly unlikely to realize any profit for taking on the risk, and will only be able to exit the transaction at a price that is either breakeven or a loss. Additionally, because the offsetting trade might not occur until some time after the initial trade, executing the hedge at the same or a lower price will amplify the material adverse effect on the market marker. Thus, as the previously confidential trade details become very quickly available to all market participants, the "risk premium" that market makers will need to charge end-users in order to be compensated for taking on risk will necessarily increase in response. This increased risk premium will cause wider bid/offer spreads, which will likely result in less market activity, which in turn will reduce market liquidity to the detriment of all market participants. Alternatively, when the transfer of risk from an end-user to a dealer is kept confidential, the dealer has time to hedge the risk in an orderly manner and is able to price this risk transfer more competitively than when this risk transfer is immediately broadcast to the broader market. The Proposed Rules, however, make no distinction between markets or derivatives with different degrees of liquidity. As proposed, the real-time reporting requirements would be the same for liquid natural gas swaps referencing Henry Hub, LA, as they are for less liquid natural gas swaps referencing NWP Rockies or New York Citygate.[4]

We therefore urge the Commission to consider the needs of those market makers who operate, and end-users with hedging needs, in smaller and less liquid markets and we recommend that the Commission establish timing requirements with respect to transaction reports that will promote liquidity and effective hedging in these less liquid markets. In order to protect the development of these markets and support both the ability of market makers to engage in trades in illiquid markets and the ability of end-users to access such markets, public reporting of trades in illiquid

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[4] While the examples described in this letter mostly involve bilaterally negotiated, uncleared OTC commodity derivatives transactions with end-users, the same concerns exist in the case of cleared transactions in illiquid markets, both in the case of OTC derivatives that reference commodity prices as well as products in other asset classes. There are varying degrees of liquidity. Certain credit default swaps ("CDS") may be liquid enough to clear, because clearing only requires theoretical valuations for margin purposes, but not liquid enough to tolerate the proposed real-time reporting requirements without adversely affecting prices. For example, under the Proposed Rules, a transaction involving a cleared but relatively illiquid high-yield single name CDS would be subject to the same real-time reporting requirement as are liquid "plain vanilla" interest rate swaps.

products should only occur after sufficient time has passed, with the exact reporting time delays based in each case on liquidity in the relevant product.[5] Market participants seeking to offset trades in illiquid markets by executing transactions in smaller increments over a period of time need to be afforded some reasonable period of time for reporting, both from an operational perspective and also to avoid signaling their trading strategy to the market. Unless there is a significant time delay in reporting trading information related to illiquid products, public reporting of this information is likely to create "front running" issues, either because larger trades will need to be executed in a series of transactions or because market makers will need to implement hedging strategies over time and, in either case, the market will be signaled as to trades that will take place. Under such circumstances, market makers will likely alter their trading practices in a manner that limits their ability to engage in certain hedging transactions, forces them into less efficient transactions, or leaves them to refrain from trading in illiquid markets altogether, ultimately resulting in further decreasing overall liquidity in the market and increasing hedging costs to end-users as market makers factor the risk of not being able to offset the transaction into the price, to the detriment of all market participants.

Dodd-Frank recognizes the impact that public disclosure may have on market liquidity and that a balance may need to be struck, evidenced by its instruction to the Commission to "take into account whether the public disclosure will materially reduce market liquidity" in formulating the implementing rules. There is an enhanced risk that application of the proposed real-time reporting rules will impact liquidity in less liquid markets given that under the Proposed Rules, the only mechanism whereby public reporting of swap transaction pricing data is not required to occur "as soon as technologically practicable" is the proposed "block trade and large notional swap" rule which, as currently formulated, would not cover the liquidity issues raised by thinly traded, less liquid markets. Another alternative that could be used by dealers to address these issues would be to engage in hedges in anticipation of a transaction. However, under the Commission's proposed rulemaking related to Business Conduct Standards for Swap Dealer and Major Swap Participants with Counterparties[6] dealers potentially would be precluded from engaging in anticipatory hedges.

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[5] Although this letter focuses on liquidity, the Commission may consider a number of factors related to liquidity in determining an appropriate time delay for large notional swaps, namely by reference to: (i) liquidity in the relevant commodity, including consideration of the commodity itself, the type of the transaction (physical/financial settlement) and the tenor of the transaction; (ii) trade volume and open interest: and (iii) the counterparty to the transaction. Moreover, the Commission should consider regulating disclosure of information with respect to large notional swaps in an incremental manner, by reference to the most liquid contracts first. Then, after conducting a more exhaustive study, the Commission may consider whether less liquid swaps should be disclosed and the appropriate time delay for such products as part of a regime that is phased-in on a considered basis. This method of regulation should also provide for flexibility in adjusting the requirements to the extent that liquidity or the price discovery function is impacted. For a discussion of a phased-in approach generally, see our Comment Letter dated November 1, 2010 to the CFTC and Securities Exchange Commission regarding Implementation of Certain Provisions of Title VII of Dodd-Frank Wall Street Reform and Consumer Protection Act.

[6] CFTC, 17 CFR Parts 23 and 155, Business Conduct Standards for Swap Dealers and Major Swap Participants With Counterparties; Proposed Rule, Federal Register, Vol 75, No.245, 80638, December 22, 2010.

Another unintended consequence of the public reporting requirement in the Proposed Rules in the context of illiquid markets is the potential for market participants to be able to identify the identity of end-users that enter into illiquid OTC derivatives with dealers. This risk is particularly of concern if the OTC derivative transaction references a product with characteristics, such as delivery location and product grade, that may be unique to the hedging needs of only one or a few producers or end users, such as in the case of an oil refinery or power plant in a remote location far from the liquid trading hubs. The likelihood that market participants and the public at large will be able to identify the corporate hedger behind a publicly announced transaction in an illiquid market may put the corporate hedger at risk of allowing its hedging activity to become public before it has had the opportunity to file with securities regulators its own public disclosure of a material event if it determines it is required to do so under federal securities laws. Moreover, the impact of requiring public reporting that will allow others to identify the corporate hedger behind the transaction runs contrary to the mandate in Dodd-Frank that the Commission develop a public reporting scheme that preserves the anonymity of the parties to the transaction.[7]

In order to elaborate on the comments provided in the *SIFMA Comment Letter* and provide some illustration of the potential negative impacts of the real-time reporting requirements as contained in the Proposed Rules on trades in illiquid markets, we will discuss four examples below. Although these examples focus on physical commodity related swap transactions, these examples are not exhaustive of the issues raised by the proposed real-time reporting requirements for illiquid markets and we believe that comparable issues exist for other asset classes. It is important also to emphasize that the liquidity standard for any particular market should be based on the needs and circumstances of that market and should not be "one-size-fits-all."

Examples

1. Hedging the Revenues of Natural Gas Production

In recent years, there has been an impressive increase in the quantity of U.S. natural gas reserves as a result of active development efforts and the application of new technology. This provides the United States with an important strategic economic advantage relative to other large economies globally as these natural gas reserves offer the potential for a very large and important source of clean, domestically sourced energy and are critical to both national energy self-sufficiency goals as well as President Obama's recently announced Clean Energy Standard[8].

The exploration and production efforts that led to the discovery and development of these reserves were undertaken by private sector corporations that deployed large amounts of capital to fund their acquisitions of property and drilling programs as well as expenditures on research and

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7 Section 727 of Dodd-Frank.

8 In his State of the Union speech to Congress in January 2011, President Barack Obama proposed the United States produce 80 percent of its electricity from clean energy sources, such as wind, solar, "clean" coal and nuclear, by 2035.

development that resulted in the innovative technologies that made many of these discoveries possible. Faced with uncertain earnings due to the volatility of natural gas prices, many of these corporations made significant use of the OTC derivatives market to hedge the revenues earned from their natural gas production. Certainty of revenues due to these hedging activities has greatly expanded these corporations' access to capital, and has also increased the value of proven reserves that are from time to time sold in order to fund development work. The increase in value of these proven producing properties is due to the fact that the buyers of these properties are able to hedge the revenues and therefore sharply reduce the risk profile associated with the acquisition.

The mechanics of the hedging activity associated with these acquisitions is critically important. The hedge must be large enough in volume and long enough in term to mitigate the bulk of the market price risk associated with the acquisition. Further, it must be completed very quickly, as the negotiated price of the property is contingent on the value of the hedges and, once the sale has been concluded, the entire risk is transferred to the new property owner. In order for these large volume hedge transactions to be concluded quickly, an OTC market must be available to the corporate hedger.

In this instance, the corporate hedger will turn to a dealer who is an active market maker in natural gas swaps and seek to sell the required volumes to that dealer. The dealer, upon transacting with the hedger, will assume a large amount of market risk, and so will charge a price to the hedger that includes a charge that is commensurate with the market risk that the dealer is taking on from the transaction. The dealer will then engage in transactions in the broader market to reduce this risk. The amount charged to cover the risk will be subject to competitive pressures. Other dealers may be willing to accept a lower risk charge, depending on their assessment of the market risks at that point in time. This will include a view on the available liquidity and anticipated market reaction to their activity.

The Proposed Rules would require that all these transactions, including the initial trade between the corporate hedger and the dealer, be publicly reported to the broader market. If the initial trade rises to the level of "block trade" or "large notional swap" status by virtue of its large size, there would be a brief delay (the current time period in the Proposed Rules is 15 minutes) between the time of the transaction and the reporting; however, for trades such as these, a dealer might reasonably expect to take many hours and potentially many days to manage the market risk associated with this initial trade. When this trade is reported to the market, other traders in the market – speculative traders and market makers alike – will know that this trade has occurred in a relatively illiquid market, and that a dealer now holds significant market risk that they seek to mitigate through open market trades. Such parties will reasonably anticipate, in this example, that market prices as a result will trend lower in the short term, and therefore will be less likely to buy, and in fact more likely to sell in the market themselves. As a result, the dealer associated with the initial transaction will now face a market in which it will be much more difficult to find buyers, and will therefore incur increased hedging costs. Knowing this to be the case, the dealer will have charged the corporate end-user a much greater amount up front in order to compensate for this more challenging environment. Eventually, the risk will be disseminated and buyers will appear at the new lower price level. These (typically speculative) buyers will have received the

benefit of a temporarily lower price environment, and the corporate end-user will have borne this cost.

The overall result will be lower prices for properties and less value to the corporate end-user, and generally less liquid markets as bid/offer spreads reflect this new reality. Similarly, airlines and other energy buyers will face increased hedging costs when they seek to mitigate their market risks.

Moreover, the risk described in the introduction of this letter that market participants and the public will identify the identity of the corporate hedger that entered into the initial trade with the dealer is particularly acute in the case of the developer of natural gas reserves. This risk is great due to the combination of unique characteristics involving location and product grade of the hedging transaction that may make the hedger's identity obvious, particularly because the developer of the reserves will have previously made numerous public filings with various federal, state and municipal agencies to obtain title to the reserves and secure necessary licenses and permits for the project.

2. ***Financing of Natural-Gas Fired Power Plants***

The Proposed Rules will have a similar impact on potential developers of natural gas-fired power plants. Currently, end-users that are planning to either build or acquire a natural gas-fired power plant generally must secure financing through various loan facilities. Morgan Stanley's investment banking and project finance groups are often called upon to arrange a finance facility for such parties. In order to secure its ability to repay the loan, the prospective plant owner must demonstrate a stable revenue stream – specifically, the value it will earn based on the spread between the price it pays for natural gas and the revenues received from the power that will be generated. Morgan Stanley's commodities desk assists prospective plant owners in this situation by structuring and executing the following arrangement: Morgan Stanley enters into a swap transaction with the power plant, whereby the plant owner pays a floating price and Morgan Stanley pays a fixed price on the spread between natural gas and power prices. This transaction locks in the spread which generates the power plant's margin, and thereby creates the stable cash flow needed to support the power plant company's debt obligation. Morgan Stanley assumes the risk based on the spread between the fixed price sale of natural gas and on the fixed price purchase of power.

In order to provide this service and manage these price risks, Morgan Stanley then typically hedges its long-term power purchase and long-term natural gas sale exposure in one of two ways. First, it may sell fixed-price power to a wholesale reseller of power or to a municipal utility to offset its purchase of the long term power. Second, it may buy natural gas futures contracts and enter into OTC natural gas derivatives transactions with other market participants to hedge the fixed price of the natural gas swap. The natural gas prices referenced in the hedge may consist of a combination of positions referencing prices for delivery at Henry Hub and less liquid locations that may offset the geographic basis risk associated with the difference in prices between Henry Hub and the location of the power plant. If natural gas prices should subsequently rise, the loss Morgan Stanley incurs on the obligation of the initial swap position

will be offset by the increase in value of its long position in futures and the other offsetting OTC derivatives.

Typically, these are long-term deals, and, in the case of natural gas, the requisite notional quantity of futures contracts and offsetting derivatives in the hedge described above would be approximately equivalent to the notional quantity of natural gas in the initial swap, which may approximate the total amount of natural gas that a large power plant will consume over a five- or ten-year period. Depending upon the liquidity of the natural gas market throughout the five or ten year forward curve, Morgan Stanley might choose to hedge its risk using futures contract months and swap settlement months that may not be perfectly aligned with its monthly natural gas swap settlement obligations over the term of the sale to the power plant company. With time, Morgan Stanley will realign its overall position by trading out of the more liquid components of its hedge and establishing new positions reflecting the less liquid months and locations that are more closely aligned with the monthly natural gas settlement obligations of the initial swap with the power plant.

Essentially, Morgan Stanley is assuming the basis risk that results from the difference in time between the natural gas swap settlements and the natural gas futures contract months. Morgan Stanley also is assuming the geographic basis risk of the difference between natural gas prices delivered at Henry Hub and the delivery point of the swap that may be tied to deliveries at the power plant's location. Similarly, the long fixed price power position, although mitigated in this example, will most certainly not be perfectly offset by the fixed price power sales. Residual basis risk will remain to be managed by Morgan Stanley.

Without an intermediary like Morgan Stanley assuming the temporal and geographic risks as part of its market maker role, the prospective power plant owner would not likely be able to achieve its goal of entering into the long-term hedge necessary to secure the financing to construct the power plant. There may be insufficient liquidity in the exchange listed natural gas contracts beyond the front several months, and it is possible that there is no listed futures contract, or at least no liquid listed futures contract, with the delivery point reflecting the power plant's future consumption of natural gas. Thus, the end-user would not find the other natural side in the market by itself. Moreover, the frequency with which power plant projects are commenced is obviously low, and similarly, there is a low frequency of other end-users seeking to enter into long-dated hedging transactions at remote delivery points.

If information regarding the original swap transaction with the project developer were immediately conveyed to the public in real-time, it would be nearly impossible for an intermediary like Morgan Stanley to manage the risk associated with the swap transaction. Morgan Stanley would not be able to transfer effectively its positions from the more liquid to the less liquid months and locations after the initial trade is made public. This is because other market participants will buy the less liquid months and locations knowing that a dealer will need to transfer its existing liquid position into those less liquid positions, which will result in the dealer incurring no gain and more likely a loss on the initial transaction unless the dealer charged the project developer a sufficient additional amount to cover this risk. Thus, the application of the real-time reporting rules as currently proposed would render the provision of such products unworkable or cause the amount charged to developers for such a swap product to increase

drastically as a result of the increased risk. This of course will lead to an increase in the hedging costs and or market risks incurred by developers of new power plants, by other end-users, by energy producers, and, ultimately, an increase in costs incurred by consumers and by the economy as a whole.

Additionally, the real time reporting of the initial swap is most assuredly going to result in the ability of market participants and the public to identify the corporate hedger that is seeking to develop a power plant located in a remote region of the country where it may be the only end user that is likely to be purchasing natural gas on a newly developed or minor pipeline that is far away from Henry Hub or any of the other major natural gas pipelines. The power plant developer will have previously submitted numerous filings with federal, state and municipal agencies in connection with recording title to the real estate and obtaining various environmental and health and safety permits and other licenses. If the initial trade required for the financing of the project is based on prices for the delivery of natural gas at the remote point of a minor pipeline where public records evidence the approvals of a power plant development project, the real time reporting of the initial swap will not protect the anonymity of the corporate hedger as mandated by Dodd-Frank.

3. *Financing of Energy Projects, Including Alternative Energy Projects Such as Wind Farms*

Clean energy is at the forefront of the U.S. political and economic agenda, with President Obama proposing in his 2011 State of the Union address that the United States produce 80 percent of its electricity from clean energy sources, such as wind, solar, "clean" coal and nuclear, by 2035. However, as President Obama noted in the address, "clean energy breakthroughs will only translate into clean energy jobs if businesses know there will be a market for what they're selling". Not only must developers of alternative energy projects be sure that there will be a market for the product, but the investors that are supporting the development of alternative energy products also require assurances that there will be a stable revenue stream to support the repayment of loans or other financing facilities extended to the project.

Developers of clean energy sources increasingly will need to rely on the futures and swap markets in connection with initiatives that promote investments in renewable energy resources. Morgan Stanley participates actively in the development of alternative fuel markets. As illustrated in part in the natural gas-fired power plant example above, Morgan Stanley has long functioned as a hedge counterparty to entities pursuing various energy projects, acting as a market maker and, through swaps, providing the certainty with respect to pricing necessary to support financing for large projects. Morgan Stanley has already been involved in financing wind farm projects, both through provision of financing and commodities hedges. Morgan Stanley offers risk management services for developments of renewable energy projects similar to those it provides for natural gas-fired power plants described above and supports renewable energy projects such as wind, solar or tidal power generation projects by entering into long-term power purchases and using the futures and OTC swaps markets to hedge such purchases.

The application of the timing requirements in the Proposed Rules would impact on Morgan Stanley's ability to support such alternative projects, as the mechanism by which it provides this

support would be disrupted by immediate public dissemination of information regarding the related hedging transactions. For example, in 2008, Morgan Stanley helped a renewable energy project developer finance the construction and operation of a 210 megawatt wind farm in Montana. In order to secure the financing necessary to construct the project, an energy price hedge was required to provide assurance of adequate revenues to finance the debt obligations. Morgan Stanley provided an energy price hedge in the form of a financial put option linked to the price of power in the region in which the output of the wind farm would be sold. Without this hedge in place, the wind farm would have not been financed and, therefore, would never have been built. Given that this energy price hedge concerned long dated Montana power, the market was very illiquid. To manage the market price risk it incurred in providing this financial hedge, Morgan Stanley sold futures contracts and swaps across a variety of instruments, including natural gas and power. Morgan Stanley also entered into option contracts to manage the risk associated with the short options position that was created when the hedge was provided. Even though power prices had subsequently declined, the wind farm's revenues remained sufficient to service the debt load because Morgan Stanley provided it with a financial hedge.

These specialized types of hedges can only be made available when the market maker – here Morgan Stanley – is able to manage adequately the risk it is taking on. There was, for example, no buyer in Montana interested in entering into an eight year contract to purchase fixed price electric power that could have been used as an offset to the risks associated with the hedge. However, through a combination of Mid Columbia power, SP 15 power and natural gas swaps and futures contracts, Morgan Stanley was able to hedge effectively, over time, the risks associated with providing this hedge to the wind farm. The strategy for managing the risk associated with such a hedge relies heavily on the swap markets for the illiquid portions of the trade, and cannot be achieved using solely futures contracts. If Morgan Stanley was required to disseminate information publicly about the original hedge in real-time, other market participants would be alerted to the risk Morgan Stanley was trying to manage, and could anticipate Morgan Stanley's strategies and interfere with Morgan Stanley's efficient risk management. This would lead to an increase in the hedging costs and or market risks incurred by developers of alternative energy projects. In addition, similar to the natural gas-fired power plant, the public record of permits and licenses for the wind farm project will likely result in the market and public being able to identify the identity of the developer and thus the real time reporting of the initial swap will not protect the anonymity of the corporate hedger as mandated by Dodd-Frank.

4. Purchase of Distressed Commodities Portfolios

Often, when a large market player is in distress and needs to liquidate or reduce its exposure, its assets are sold off as portfolios rather than individually. When a buyer takes on a large portfolio of distressed assets, it takes time for that buyer to resell the various pieces of the commodities portfolio efficiently, especially if there are assets that trade in illiquid markets, as it may take time to find appropriate counterparties. If the transfer of certain assets that trade in illiquid markets to buyers of distressed commodities portfolios were required to be reported in real-time as contemplated under the Proposed Rules, other market participants may be able to front run these positions before they are able to be risk managed. This would disincentivize prospective purchasers from taking on the positions and create a liquidity drain in the market. Particularly in the context of transactions that would be large relative to the normal trade volume in the relevant

product's market, reduced capacity to execute trade volumes quickly could become a serious constraint that potential purchasers of distressed commodities portfolios would need to consider in deciding whether to take on the portfolio. The unwillingness of other market participants to assume the portfolio would amplify the systemic risk associated with the failure of a large market player and the resulting forced and immediate liquidation of the portfolio upon the party's default. Buyers of large, distressed commodities portfolios will be much less inclined to step in to undertake a risk transfer, and a natural market mechanism to reduce systemic risk will have been compromised.

Specific Recommendations Regarding Public Reporting of Trades in Illiquid Markets

We urge the Commission to implement a separate regime of timing requirements for public reporting of information regarding trades to be applied to illiquid markets, one that would significantly extend the permitted time delay for public reporting of trades. As stated above, we agree that all relevant trading activity regarding trades in illiquid markets should be promptly and fully reported to the regulators; however, we believe that this information should be provided on a confidential basis and that information concerning such trades should not be made public, at least not without a significant time delay.

Morgan Stanley further suggests that the determination of what constitutes an illiquid market should be based on the number of reported transactions, and that any market in which the average number of transactions (measured annually) is less than 5 transactions per day be deemed to be "illiquid".[9]

Alternatively, if the "block trade and large notional swap" rule remains the only mechanism whereby public reporting of swap transaction pricing data is not required to occur "as soon as technologically practicable", then this mechanism will have to be much more broadly applied to thinly traded, less liquid markets. Morgan Stanley suggests that for these types of markets, most standard sized transactions should be exempt from public reporting "as soon as technologically practicable" and instead be captured by weekly reports, to be published to the public. As such, the "block trade" definition for illiquid markets should be defined as applying to standard sized trades, which should be defined as all but the smallest 20% of all reported trades. Similarly, the "large notional swap" definition for illiquid markets should not require that there exist a swap instrument with a minimum block size available to reference in order for a swap in an illiquid market to qualify as a large notional swap that is eligible for a time delay in reporting.[10]

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[9] The Commission's rules regarding significant price discovery contracts also uses a five transactions per day standard, listing "averaged five trades per day or more over the most recent calendar quarter" as one of the conditions for determining whether a contract is sufficiently liquid to be considered a significant price discovery contract in CFTC Regulation 36.3(c)(2)(i). CFTC Regulation 36.3, 17 CFR 36.

[10] In order to implement this recommendation, it would be necessary to delete the sentence included in Proposed Rule 43.5(j) which states that "[i]f there is not a swap instrument with an appropriate minimum block size available to reference, then such swap between the parties shall not qualify as a large notional swap or for any time delay in reporting".

We appreciate the opportunity to comment to the Commission on the proposed real-time reporting requirements and would be pleased to discuss any questions the Commission may have with respect to this letter. Any questions about this letter may be directed to William McCoy, Managing Director (william.mccoy@morganstanley.com; 914-225-5540).

Respectfully submitted,

Simon T.W. Greenshields
Managing Director
Global Co-Head of Commodities