Morgan Stanley

September 30, 2011

VIA ELECTRONIC SUBMISSION

David A. Stawick
Secretary
U.S. Commodity Futures Trading Commission
1155 21st Street, N.W.
Washington, D.C. 20581

Re: Notice of Proposed Rulemaking Regarding Customer Clearing Documentation and Timing of Acceptance for Clearing (RIN 3038-AD51)

Dear Mr. Stawick:

On August 1, 2011 the Commodity Futures Trading Commission (the "**Commission**" or "**CFTC**") issued a Notice of Proposed Rulemaking regarding Customer Clearing Documentation and Timing of Acceptance for Clearing (the "**Proposed Rule**").[1] Morgan Stanley appreciates the opportunity to comment on the Proposed Rule.

Morgan Stanley affiliates are clearing members of most major derivatives clearing organizations ("**DCOs**") and expect to offer clearing of swap transactions that are executed between Morgan Stanley's customers, on the one hand, and affiliated and unaffiliated executing swap dealers ("**ESDs**"), on the other, in the over-the-counter ("**OTC**") markets, on designated contract markets ("**DCMs**") and on swap execution facilities ("**SEFs**") consistent with Section 723[2] of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("**Dodd-Frank Act**").[3] One or more Morgan Stanley affiliates may register with the Commission as a swap dealer and execute swap transactions in the OTC markets, on DCMs and on SEFs. Accordingly, the Proposed Rule will have a direct impact on the risk management practices and operations of Morgan Stanley and its affiliates.

Morgan Stanley's primary concern with the Proposed Rule is the Commission's intention to impose a blanket prohibition on the use of arrangements that would permit disclosure of the identity of a customer's ESD to its clearing firm, or limit the number of ESDs with whom a

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[1] *Customer Clearing Documentation and Timing of Acceptance for Clearing*, 76 Fed. Reg. 45730 (Aug. 1, 2011), corrected at 76 Fed. Reg. 47529 (Aug. 5, 2011).

[2] Commodity Exchange Act ("**CEA**") § 2(h)(1)(B) (as amended).

[3] Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111–203, 124 Stat. 1376 (2010).

customer may trade or the size of swaps executed with a particular ESD that a clearing firm will clear (the "**Proposed Prohibitions**"). The Proposed Prohibitions would bar the use of arrangements whereby a clearing firm contractually commits to an ESD to clear specified swaps on behalf of a customer ("**Tri-party Clearing Commitments**").[4] Morgan Stanley's view is that such contractual arrangements, which include the allocation of so-called "sub-limits" to ESDs, are critical tools for providing access to the swaps market to all but the largest buy-side institutions, including commercial end-users. By providing ESDs assurance that swaps will be accepted for clearing, Tri-party Clearing Commitments permit ESDs to broaden the universe of customers with which they will trade and reduce transaction costs for, and increase market liquidity available to, customers.

While customers should have the freedom to choose arrangements that provide anonymity as to their execution partners (and we agree that market-wide "real-time" clearing would facilitate their use), we see no reason why alternative voluntary arrangements employing Tri-party Clearing Commitments should not be available to customers for whom they may be extremely valuable. By prohibiting such arrangements, the Proposed Rule would effectively impair a customer's freedom of contract. Nor is it likely that market-wide "real-time" clearing and risk limit compliance verification can be developed quickly enough or provided with sufficient reliability to eliminate the functional benefits of these voluntary agreements. At a minimum, significant challenges in calculating and updating risk limits simultaneously across a variety of trading and clearing platforms and products would need to be overcome, and very substantial infrastructure would need to be built to aggregate, coordinate and communicate risk information before the full clearing process could be made sufficiently rapid on a market-wide basis to substantially eliminate fail-risk for ESDs.

As described further below, the Proposed Prohibitions would impair the risk management capabilities of clearing firms and ESDs, while increasing transaction costs and reducing market

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[4] The Commission specifically refers to certain annexes to the Cleared Derivatives Execution Agreement published by the Futures Industry Association ("**FIA**") and the International Swaps and Derivatives Association ("**ISDA**") on June 16, 2011 as a form of agreement that the Proposed Prohibitions are intended to address. These annexes can be used to add clearing firms to an agreement that is otherwise entered into by parties that will execute swaps (typically an ESD and its customer) and provide that the relevant clearing firm will commit in advance to clear specified trades on terms specified therein. While the template developed by the FIA and ISDA provides for a tri-party contract when an annex is used to add a clearing firm, as a general matter Tri-party Clearing Commitments and similar agreements used by prime brokers and ESDs in the uncleared derivatives market today can take a variety of contractual forms, including the execution of bilateral agreements between an ESD and a clearing firm at the request of a mutual customer. For purposes of this letter, the term "Tri-party Clearing Commitment" includes any arrangement whereby a clearing firm directly agrees with an ESD that it will clear specified swaps for a mutual customer, regardless of the contractual form.

access for all but the largest customers.[5] The costs of the Proposed Prohibitions (as well as the costs of developing a system that could largely eliminate the need for Tri-party Clearing Commitments) are not insignificant and are greatly underestimated by the Commission. By contrast, the Commission's stated concern that clearing firms could use knowledge of a customer's execution counterparties to "force the customer to execute with the clearing member's trading desk affiliate,"[6] is highly speculative. We therefore submit that Proposed Prohibitions are not justified at this time and request that they not be included in final rules.

I. Tri-party Clearing Commitments And Sub-Limits Enhance Risk Management and Open Access to Clearing

The primary function of Tri-party Clearing Commitments and similar agreements used in the uncleared derivatives market today is to provide market access to customers by mitigating counterparty credit risk for derivatives dealers that initially execute transactions with those customers.[7] In the context of the cleared derivatives markets, Tri-party Clearing Commitments mitigate so-called "fail risk," *i.e.*, the hedging and credit risk that ESDs incur when trades that they execute with counterparties fail to clear.[8] Tri-party Clearing Commitments provide ESDs with certainty that their counterparty has a contractual relationship with a clearing firm and that trades within specified parameters will be accepted by the clearing firm for clearing. Without a

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[5] As the Commission has previously recognized in proposed rules under the Dodd-Frank Act, market participants must be permitted to tailor risk management practices to their risk profile in light of the role of the market participant and the needs and market practices of its customers. *See, e.g.*, *Regulations Establishing and Governing the Duties of Swap Dealers and Major Swap Participants*, 75 Fed. Reg. 71397, 71399 (proposed Nov. 23, 2010).

[6] 76 Fed. Reg. at 45732.

[7] While the use of Tri-party Clearing Commitments with respect to cleared OTC swaps is relatively new, analogous agreements have long been used with respect to uncleared swaps. In the case of uncleared swaps, dealers frequently provide "derivatives prime-brokerage" arrangements whereby a customer will execute an OTC derivative with one dealer with the understanding that the customer's side of the transaction will be given-up to another. By accepting the give-up, the derivatives prime broker agrees to become the first dealer's contractual counterparty and simultaneously enters into a back-to-back derivative on the same economic terms with its customer, effectively intermediating credit exposure to the customer. Unlike the case with cleared derivatives, accepting give-ups with respect to uncleared derivatives in this manner exposes the derivatives prime broker to the credit risk of the executing dealer. Consequently, the conditions and circumstances under which a derivatives prime broker may be willing to provide contractual commitments to ESDs to accept trades for give-up in the OTC space ("**OTC Uncleared Tri-Party Give-Up Commitments**") may differ somewhat from those in which a clearing firm may be willing to enter into Tri-party Clearing Commitments.

[8] In the context of the uncleared derivatives market, Tri-Party Give-Up Commitments assure the ESD that the derivatives prime broker will accept a give-up and effectively step into the shoes of the customer as the ESD's counterparty.

clearing firm commitment to clear, ESDs would not know at the time of execution whether their credit counterparty will be the relevant DCO or the initial trading counterparty. Even where contractual arrangements between the ESD and its counterparty provide for failed trades to be immediately broken, post-execution market movements and liquidity constraints in unwinding transactions executed to hedge a customer swap can create significant exposures for ESDs, including the risk that counterparties will be unwilling or unable to make them whole for losses.[9]

In turn, the primary function of "sub-limits" in connection with cleared swaps is to facilitate the provision of clearing commitments by clearing firms to ESDs. Allowing a clearing firm to allocate and communicate ESD-specific sub-limits within a customer's overall credit limit mitigates the risk that a customer will either intentionally or unintentionally exceed the overall limit by simultaneously trading with multiple ESDs.[10] As the Commission notes in the Proposed Rule, "[c]learing members provide the portals through which market participants gain access to DCOs[,] as well as the first line of risk management."[11]

Sub-limits are used by prime brokers in the uncleared swaps market today in connection with OTC Uncleared Tri-Party Give-Up Commitments. To our knowledge, sub-limits are not imposed by derivatives prime brokers for the purpose of dictating a customer's execution relationships with ESDs (in fact, they do not affirmatively limit a customer's ability to trade with an ESD). Rather, they are a necessary device for customers and their derivatives prime brokers to distribute give-up commitments to ESDs. Consistent with this function, it is general market practice for derivatives prime brokers to set an overall position limit for customers based on the prime broker's credit analyses of the customer and to allocate sub-limits up to this aggregate position limit *at the instruction of the customer*, rather than for the prime broker to dictate allocation decisions.[12] Similarly, an agreement between a customer and its clearing firm regarding the allocation of clearing sub-limits among the customer's ESDs facilitates the

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[9] The Commission underestimates the degree of certainty that customers and ESDs demand regarding credit risk associated with trades. For example, with respect to trades where execution at a particular time is required for hedging purposes, or trades that are part of a larger structured transaction, fail risk can have a substantial impact on counterparties' decision about whether to enter into a trade at all. More sophisticated customers will demand enhanced protections from costs associated with trades that fail to clear, and the Commission should not prevent ESDs and clearing firms from providing customers services that enhance liquidity and efficiency in the market.

[10] Even under the Commission's proposed requirements for real-time clearing, a clearing firm would not be prohibited from dynamically managing its credit limits for a customer across SEFs and DCOs. Sub-limits represent a contractual commitment by the clearing firm to a customer and an ESD to refrain from rejecting trades for clearing within agreed parameters.

[11] 76 Fed. Reg. at 45731.

[12] Similarly, it is market practice for a derivatives prime-broker to allocate sub-limits to OTC derivatives dealers at the instruction of their customers.

customer's preferred approach to trading cleared products. It is not designed to limit the ESDs with whom the customer may deal.

Tri-party Clearing Commitments can also serve to provide clarity for clearing firms, ESDs, and customers, by coordinating the negotiation of rights and obligations in connection with the clearing process. Tri-party Clearing Commitments that include both the ESD and the clearing firm permit the allocation of liabilities in the event of broken trades, thereby enhancing each party's risk management. From a customer standpoint, coordination provides more efficient market access as a result of the clear allocation of roles, responsibilities and liabilities between ESDs and clearing firms relating to failed trades. Thus, customers have benefited from the use of tri-party arrangements to take advantage of this coordinating function, and we believe it is has contributed to the use of OTC Uncleared Tri-Party Give-Up Commitments in the uncleared derivatives markets and similar arrangements are used in the futures market.

II. The Proposed Rule Will Have An Unintended Negative Impact On The Commission's Goal of Fair And Open Access To Clearing

Because Tri-party Clearing Commitments are an important tool in managing fail risk to ESDs, their prohibition would likely have the unintended consequence of creating barriers to trading and limiting access to cleared products that would materially impact all but the largest customers. If clearing firms cannot communicate allocated clearing commitments to ESDs, ESDs will lack certainty that executed trades will be accepted for clearing and will be forced to assume that they are taking the credit risk of a customer rather than a clearinghouse. ESDs would be obligated to address this credit risk by restricting the types, size and volume of trades that they are willing to execute with customers.[13] While the very largest customers may have long-standing relationships with ESDs, as well as credit and agreed documentation necessary to avoid major restrictions on their access to cleared swaps, other customers are likely to find their access to these products to be limited, given the fail risk and uncertainty they pose to ESDs. Aside from the indirect barriers to access the Proposed Prohibitions would create for particular customers, these barriers could also decrease liquidity in the market as a whole.

Similarly, even where ESDs are willing to transact with counterparties in the size, volumes and products customers desire, the credit risk posed by the potential for fails would necessitate time-intensive and expensive negotiation of documentation, as well as extensive credit diligence of each customer by the ESD prior to transacting. Because the negotiation and

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[13] Note also that the Proposed Prohibitions interfere with the ability of customers to address the "breakage" concerns of ESDs by negotiating separate clearing commitments with clearing firms with respect to trades executed at specified ESDs. Because the Proposed Prohibitions prohibit the clearing firm from knowing the identity of the executing counterparty, customers would be unable to translate such commitments into binding assurances to the ESDs that executed trades would be accepted for clearing by the clearing firm.

diligence costs will be passed on to customers, this will pose an additional barrier to entry into the swaps market and reduced liquidity. Indeed, the ability to avoid negotiating expensive documentation and credit terms with each counterparty is a primary driver of the development of derivatives prime brokerage services. Since documentation would need to be negotiated with each ESD, these transactions costs would likely burden competition as even customers that can bear these costs are likely to limit their execution relationships to the minimum number necessary.

III. It is Unlikely that Real Time Clearing and Limit Verification Can Be Developed Quickly Enough or with Sufficient Reliability to Eliminate the Need for Tri-party Clearing Commitments

The Proposed Rule would require clearing firms to accept or reject customer trades that are submitted for clearing "as quickly as would be technologically practicable if fully automated systems were used."[14] The Commission states that real-time clearing will largely mitigate so-called fail risk, and consequently suggests that imposing this standard largely eliminates the need for Tri-party Clearing Commitments, and indeed for any credit arrangements between ESDs and customers.[15]

Morgan Stanley supports the Commission's goal to develop real-time or near real-time clearing for swaps and agrees that robust, generally available systems for real-time limit verification and clearing would substantially mitigate systemic risk and risk to individual market participants. However, the challenges that will need to be overcome should not be underestimated. "Real-time clearing" in the sense alluded to in the Notice of Proposed Rulemaking would require much more than the ability of a single DCO to make clearing decisions throughout the day at automated speeds. It would require effectively reducing to zero the latency between the time an ESD agrees to execute a trade and the time it receives confirmation of clearing—regardless of the product, execution venue, DCO or clearing firm. It would require that the entire trade submission, validation, clearing and confirmation cycle be accomplished in real-time on a market-wide basis. To meet those requirements, various market participants would need to design, develop and implement complex systems and processes that do not exist today, and a very substantial build-out of infrastructure to coordinate those systems would be needed. At least at the present time, it is premature to assume that the systems and infrastructure necessary to provide this kind of "real-time clearing" can be developed quickly

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[14] Proposed Rules §§ 1.74 and 23.610. The Commission anticipates that this standard could require action in a matter of milliseconds depending upon the market or product. *See* 76 Fed. Reg. at 45733.

[15] In the section of the proposal titled Consideration of Costs and Benefits Under Section 15(a) of the CEA, the Commission states, "[a]s far as costs are concerned, the possibility of ''breakage'' remains for SDs and other counterparties. However, this concern is mitigated by the timelines required in the second section of this rule, which reduce the likelihood that a SD would have time to enter into other transactions before the one in view is accepted or rejected for clearing." *See* 76 Fed. Reg. at 45735.

enough and with sufficient reliability to eliminate the functional benefits of Tri-party Clearing Commitments and similar arrangements. This issue is exacerbated by the expected emergence of multiple DCOs and the proliferation of SEFs and related market fragmentation resulting from other provisions of the Dodd-Frank Act.

From the perspective of the clearing firm, prudent management of real-time clearing on a broad basis would require the development of qualitatively new risk tools. Given the policy of the Dodd-Frank Act to provide customer choice as to clearing venue[16] and the variety of products that could be subject to clearing, risk management will necessitate the use of automated systems with the capability to coordinate risk limits for the full scope of products that a customer could clear across multiple clearing venues. Because DCOs will likely clear somewhat different products within each swap category and use proprietary, rather than standardized margin models, risk filters and interfaces, clearing firms will require highly sophisticated systems to translate and coordinate limits across different platforms. These systems would effectively be required to be able to: (i) receive clearing information regarding new trades from a DCO wherever a customer clears; (ii) calculate the portfolio risk effects of introducing the new trade into the customer's portfolio; (iii) translate those effects into risk metrics for each of the other products that the customer might clear; (iv) increase/decrease the customer's clearing limits for each other swap product that the customer could trade using parameters recognized by each relevant DCO and trading venue; and (v) disseminate the updated limits to all relevant clearing and trading venues, all in real-time. Needless to say, these tools will take significant time and resources to develop, test and implement.

From a market standpoint, the provision of market-wide, real-time clearing will also demand the build-out of very substantial infrastructure to communicate and coordinate customer-specific risk-filter information among a large number of institutions. At a minimum, systems would need to be built to communicate and coordinate information at clearing members and multiple DCOs, and to disseminate real-time information at least to relevant DCMs and SEFs. SEFs and other trading venues will likely need to design and develop systems to integrate this information into their trade execution processes to prevent execution of trades that cannot be cleared. This infrastructure, particularly for SEFs, does not exist today. [17] In addition, clearing

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[16] *See* CEA § 2(h)(7)(E)).

[17] Morgan Stanley believes the Commission significantly overstates current readiness to implement real-time clearing by conflating automation of isolated systems and processes with automation of the clearing process for the market as a whole. *See* 76 Fed. Reg. at 45736 ("As far as costs are concerned, coordination among the DCOs, FCMs, SDs, and MSPs in order to design and implement a system to clear transactions "as quickly as technologically practical if fully automated systems were used" will likely require capital investment and personnel hours in some instances. The Commission believes, however, that DCOs and clearing members may already be using procedures that comply with the standard. To the extent that participants do not currently have automated systems, they may need to install or upgrade

firms will need to be able to trade and monitor customer limits at multiple DCOs and SEFs on an asset class by asset class basis. Moreover, the relevant infrastructure and participants would need to ensure the integrity of the relevant systems and the security of data directed through these systems. Because a customer's credit information is a crucial point of competition among counterparties of swaps, customers understandably will demand assurance that information provided through clearing systems is adequately safeguarded.

We believe the need for robust systems with adequate speed and coordination could necessitate the creation of new service providers and market institutions. Even at automated speeds, the number of systems that would potentially need to communicate information could create substantial latencies. A multiplicity of systems also increases the risk of critical system breakdowns. Therefore, a need may develop for new utilities that centralize and coordinate information flows. For example, the problem of managing and communicating risk filter information for clearing members, SEFs and DCOs could perhaps best be served by a market utility to centralize the warehousing of risk filters and communications across clearing members, SEFs and DCOs. This type of utility does not exist today and would require significant time and resources to develop.

Furthermore, even assuming the establishment and full dissemination of automated systems for processing customer risk limits and clearing information, Tri-party Clearing Commitments may still be desirable to mitigate risk in many instances. For example, customers who enter into swaps to hedge large commercial transactions that must occur at a specified time may need the ability to coordinate between ESDs and clearing firms in order to obtain pre-trade certainty that a swap can be executed and cleared at the specified time. Perhaps more importantly, it remains to be seen how fast even fully automated clearing can be made to operate on a market-wide basis, and clearing within seconds or minutes could still be too slow to eliminate fail risk in fast moving markets. Even if effectively real-time speeds are achievable during normal conditions, risk of delays due to system disruptions and other unexpected events will inevitably remain.

IV. ESD Anonymity Is Not Required to Prevent Abusive Behavior By Clearing Firms

The Commission does not provide, and we are not aware of, any empirical evidence for the proposition that Tri-party Clearing Commitments, clearing firm knowledge of the identity of ESDs or the allocation of sub-limits will be misused by clearing firms.[18] Nor does the Commission explain why or how disclosure of the identity of ESDs or the use of Tri-party Clearing Commitments will "force" a customer to execute swaps with an affiliate of the clearing

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existing systems to comply."). Notably, the Commission does not provide any estimate of the time or investments that would be required.

[18] The Commission suggests that the Proposed Prohibitions protect customers from the *potential* for "discriminatory practices" by clearing firms. 76 Fed. Reg. at 45735.

firm.[19] Morgan Stanley believes that the ability of clearing firms to communicate with ESDs is a necessary condition for the provision of clearing commitments to ESDs as a service to customers. Given the number of institutions that already compete for business in the clearing space, it is highly unlikely that a clearing firm would have sufficient power vis-à-vis its customers to force customers to use ESDs of the clearing firm's choosing.

A. Anti-Competitive Behavior Has Not Manifested Itself In The Listed Derivatives Market, Where Tri-lateral Arrangements Are Used Extensively

As the Commission is aware, market participants in the U.S. and abroad long have used tri-lateral give-up agreements to delineate their respective rights and obligations in connection with executing and clearing listed futures and options on futures contracts. The FIA / FOA sponsored International Uniform Brokerage Execution Services ("Give-Up") Agreement (the "**Futures Give-Up Agreement**") is a voluntary tri-lateral agreement between a customer, executing broker and clearing broker that is widely used in the industry.

Like the Tri-party Clearing Commitments currently used in the OTC derivatives markets, and contrary to the Proposed Prohibitions, the Futures Give-Up Agreement expressly provides, among other things, that the clearing broker may, "upon prior notice to Executing Broker and Customer, *place limits or conditions on the positions it will accept for give-up for Customer's account.*"[20] The Futures Give-Up Agreement also provides that the customer is liable to the executing broker for any losses if the clearing broker "does not, for any reason, accept a trade transmitted to it" by the executing broker.[21]

The Futures Give-Up Agreement has broad acceptance in the listed derivatives markets and has enhanced the risk management practices and procedures of clearing brokers, executing brokers and customers. The Commission does not address in the Proposed Rule why the use of tri-lateral give-up agreements is a sound risk management practice for listed derivatives, but is not appropriate for cleared swaps. Because the risks faced by executing brokers and clearing firms in connection with cleared futures and swap agreements are substantially similar, we believe that the Commission should permit market participants voluntarily to use them in both markets.[22]

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[19] The Commission merely notes that "[s]ome market participants have stated" that such abusive practices will result. *See* 76 Fed. Reg. at 45731-32 (citing Letter dated April 11, 2011 from Stuart J. Kaswell, Executive Vice President, Managing Director, and General Counsel, Managed Funds Association).

[20] Futures Give-Up Agreement (Customer Version 2008), paragraph 2 (emphasis added).

[21] *Id.* at paragraph 7.

[22] In the listed derivatives markets, clearing firms receive similar information regarding allocations of bunched orders that the Proposed Rule would prohibit for cleared swaps, and there is no evidence that

B. Anticompetitive Practice Rules Could Adequately Address Any Potential Abuses

While the Commission cites the "potential" for abusive practices by clearing firms as the basis for the Proposed Prohibitions, we believe the abuses, if found to exist, would be addressed more properly through the prohibitions on any actions that impose unreasonable restraints on trade or material anticompetitive burdens on trading provided under Section 4s(j)(6) of the CEA.[23] The Commission has ample powers to monitor for abuses of anti-competitive practices rules and bring enforcement actions for rule violations. Similar to the requirements that apply in the listed derivatives market,[24] the Commission's reporting and recordkeeping requirements will require dealers, clearing firms, and customers to report swap transactions to swap data repositories ("**SDRs**") and maintain an audit trail regarding all swap transactions.[25] The Commission will have direct access to information provided to SDRs and firms are required to provide the Commission, on request, any records created in connection with a cleared swap transaction.[26] Customers also have clear incentives to bring any abusive practices to the attention of the Commission. Thus, there is no reason to believe that the Commission's existing enforcement powers are insufficient to deter, detect and punish any potential abusive behavior by firms.

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such transparency has led to abusive practices. Commission Rule 1.35 and National Futures Association ("**NFA**") Compliance Rule 2-10 permit commodity trading advisors ("**CTAs**") to allocate bunched orders among executing dealers, provided allocations are made in a fair and equitable manner and no account or group of accounts consistently receives favorable or unfavorable treatment over time. 17 C.F.R. § 1.35 (records of cash commodity, futures, and option transactions); NFA Compliance Rule 2-10, *Allocation Of Bunched Orders For Multiple Accounts*, (June 9, 1997; revised September 15, 2003), NFA Interpretive Notice ¶ 9029. The Commission interprets Rule 1.35 to require that, at or before the time the order is placed, the account manager must provide the clearing firm with information that identifies the accounts included in the bunched order and specifies the number of contracts to be allotted to each account. There is no evidence that such transparency regarding order allocation results in abuse by clearing firms or executing counterparties, and, indeed, the NFA has indicated that the purpose of Rule 2-10 is to prevent "various forms of customer abuse."

[23] *See* proposed Rule § 23.607; 75 Fed. Reg. at 71401.

[24] *See* 17 C.F.R. § 1.35.

[25] *See Real-Time Public Reporting of Swap Transaction Data*, 75 Fed. Reg. 76139 (proposed Dec. 10, 2010); *Reporting, Recordkeeping, and Daily Trading Records Requirements for Swap Dealers and Major Swap Participants*, 75 Fed. Reg. 76666 (proposed Dec. 9, 2010); *Swap Data Recordkeeping and Reporting Requirements*, 75 Fed. Reg. 76573 (proposed Dec. 8, 2010). We note that certain aspects of these proposals present separate concerns that are outside of this scope of this letter. *See, e.g.*, Letter from Simon T.W. Greenshields dated February 7, 2011 in response to Real-Time Reporting of Swap Transaction Data (75 Fed. Reg. 76139).

[26] Proposed Rule 23.605(f).

V. The Use of Sub-limits Need Not Delay Clearing Of Swaps

The Commission notes that "the process of evaluating individual transactions against counterparty sub-limits could delay notification of acceptance or rejection for clearing" and that monitoring of sub-limits will require "matching processes that have the potential to be time-sensitive."[27] It is true that implementation of sub-limits would require the processing of additional information for cleared trades where sub-limits are used. However, there is no reason why processing could not be automated using the same systems and technology as those needed to satisfy the Commission's requirements for clearing in real-time. Therefore, the processing of sub-limits should not be assumed to cause delays in clearing to such a degree that it justifies eliminating the benefits offered by Tri-party Clearing Commitments. In the listed derivatives markets, clearing firms have an affirmative obligation to adopt and enforce written procedures that are reasonably designed to prevent customers from entering into trades that create undue financial risks for clearing members and their other customers.[28] This includes setting pre-execution limits for trades submitted via automated order-routing systems that automatically block orders attempting to create new or increase existing positions that exceed the applicable limits. We are unaware of any evidence that indicates that the obligation of clearing firms to enforce compliance with risk limits unreasonably delays the clearing of listed derivatives that comply with those limits.

VI. The Proposed Prohibitions Are Not Required By The Dodd-Frank Act

The Commission does not cite any specific instruction or authority in the Dodd-Frank Act to impose the Proposed Prohibitions. As support for the rulemaking, the Commission cites only certain "premises" and "tenets" regarding the role of central clearing in reducing systemic risk and the role of open access principles[29] in increasing transparency and efficiency in the OTC derivatives market and the Commission's general authority to adopt conflict of interest rules.[30] The Proposed Prohibitions are far broader than any authority provided by the Dodd-Frank Act, and indeed would interfere with freedom of contract. Though formally addressed to clearing firms, the Proposed Prohibitions would effectively prevent customers from voluntarily entering into arrangements with their clearing firms and ESDs which they may highly value.

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[27] 76 Fed. Reg. at 45735-36.

[28] NFA Compliance Rule 2-9; NFA Interpretive Notice ¶ 9046 (Dec. 12, 2006).

[29] Section 2(h)(1)(B) of the CEA requires DCOs to provide for non-discriminatory clearing of swaps executed bilaterally or through an unaffiliated DCM or SEF. Under the Commission's proposed core principles for DCOs, Core Principle C would obligate DCOs to establish rules that provide fair and open access to clearing. *See Risk Management Requirements for Derivatives Clearing Organizations*, 76 Fed. Reg. 3698, 3700 (Jan. 20, 2011).

[30] *See* 76 Fed. Reg. at 45731.

Further, the transactional arrangements prohibited by the Proposed Prohibitions would not, *ipso facto*, be inconsistent with principles of open access to clearing. As discussed above, the arrangements prohibited by the Proposed Prohibitions are specifically intended as a means of facilitating clearing firm, ESD, and customer risk management and the reduction of transaction costs, with a view to providing cleared swap customers with the services they demand. The Commission should not prohibit or limit market-based solutions in the market for cleared swaps in the absence of actual evidence that these practices result in discriminatory access to clearing.

VII. The Commission Should Clarify Certain Requirements Of The Proposed Rule If The Proposed Prohibitions Are Retained In Final Rules

For the reasons stated herein, Morgan Stanley respectfully requests that the Commission withdraw the Proposed Prohibitions, at least until market-wide systems for real-time clearing of swaps are fully operational and, then, only to the extent necessary to address problems not addressed by other regulations. The Proposed Prohibitions are based upon strong assumptions about how the market will function, and the abuses that will allegedly occur, once automated clearing is fully functional. It is premature to impose prohibitions on the risk management practices that are the subject of the Proposed Prohibitions unless and until abuses occur. At that time, the Commission will be better able to assess the scope and nature of the problems, determine whether additional regulatory measures are needed to address them, and if so, fashion measures tailored to avoid unduly burdening the functioning of the market.

However, should the Commission choose to retain the Proposed Prohibitions in final rules, Morgan Stanley respectfully requests that, at a minimum, certain fundamental provisions of the rule be clarified.

A. The Proposed Prohibition On Arrangements That Impair A Customer's Access To Execution Of Swaps On Terms That Have A "Reasonable Relationship To The Best Terms Available"

Proposed Rules §1.72(d) and §23.608(d) would prohibit arrangements that "impair a customer's access to execution of a trade on terms that have a reasonable relationship to the best terms available." While the intent of these rules appears to be simply to prohibit arrangements that would impair a customer's ability to execute swaps with an ESD of its choice, the inclusion of the reference to the "relationship to the best terms available" creates uncertainty. Given that swap terms can differ on a wide variety of dimensions, and that the reasons one swap or provider may be preferred over another may differ from customer to customer, a "best terms available" concept does not provide a meaningful metric. Additionally, in proposed Rule §23.608 (which applies to swap dealers and major swap participants that enter into swaps to be cleared by the customer's clearing firm) the intended meaning appears to be inapposite to the context as the customer has already chosen its ESD.

Assuming the Commission adopts its proposals to require non-disclosure of a customer's ESD to its clearing firm, we submit that this additional requirement is unnecessary as the

clearing firm will not participate in the customer's interactions with third-party ESDs. We therefore suggest that it be eliminated. Alternately, if it is retained in proposed Rule §1.72, the reference to the "relationship to the best terms available" should be replaced with a reference to execution with an ESD of the customer's choice.

B. The Requirement To Accept Swaps For Clearing "As Quickly As Would Be Technologically Practicable"

The Commission's prohibition on arrangements that prevent compliance with the requirement to accept swaps for clearing "as quickly as would be technologically practicable if fully automated systems were used" will create uncertainty in the market. The speed at which clearing can be accomplished using automated systems is not a constant. Rather, it depends on the work those systems are required to do. Nor is it obvious what tasks are appropriate to clearing in a prudent manner consistent with the risk management needs and objectives of the parties. The Commission's proposed standard, interpreted broadly, would, for example, potentially pick up credit filters, as they could slow down clearing compared to what is "technologically practicable" without them. We therefore request clarification that this requirement is intended to prohibit only those arrangements that prevent the use of automated systems that are available in the market to facilitate clearing.

C. The Commission Should Clarify That The Proposed Rule Does Not Apply To Listed Derivatives

It is unclear whether the Proposed Rule, as drafted, applies to listed derivatives as well as swaps submitted for clearing. As the language of the Proposed Rule does not appear to limit its application to swaps submitted for clearing, it could be interpreted as applicable to futures commission merchants that clear futures. As futures markets are already adequately regulated, the Commission should clarify that the rule applies only to arrangements between clearing firms, ESDs and customers with respect to swap transactions intended to be submitted to a DCO for clearing.

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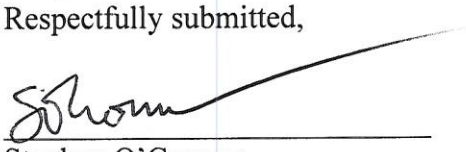
Morgan Stanley appreciates the opportunity to comment on the Proposed Rule and would be pleased to discuss any questions the Commission may have regarding the Proposed Rule or these comments.

Respectfully submitted,



Stephen O'Connor
Managing Director

cc: The Hon. Gary Gensler, Chairman
The Hon. Michael Dunn, Commissioner
The Hon. Jill E. Sommers, Commissioner
The Hon. Bart Chilton, Commissioner
The Hon. Scott O'Malia, Commissioner
Dan M. Berkovitz, General Counsel
John C. Lawton, Deputy Director and Chief Counsel
Christopher A. Hower, Attorney-Advisor