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VIA E-MAIL: rule-comments@sec.gov; dfadefinitions@cftc.gov

Ms. Elizabeth M. Murphy, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-0609.

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

Re: Implementation of Certain Provisions of Title VII of Dodd-Frank Wall Street Reform and Consumer Protection Act

Dear Ms. Murphy and Mr. Stawick:

Morgan Stanley welcomes the opportunity to provide the Securities and Exchange Commission (the "SEC") and the Commodity Futures Trading Commission (the "CFTC" and, together with the SEC, the "Commissions") with comments regarding the implementation of certain provisions of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act" or "Dodd-Frank") in anticipation of proposed rulemakings by the Commissions. This comment letter focuses on the phasing in of the clearing, execution and other requirements in Title VII of Dodd-Frank.

We appreciate the Commissions' willingness to consider our concerns regarding phasing in of the Title VII requirements. As further expressed below, our comments stem from our desire for the requirements of Dodd-Frank to be implemented in a way that allows the systemic benefits to be realized as quickly as possible, while simultaneously allowing for orderly, efficient and inclusive markets. We are concerned that, if the clearing, execution and other requirements of Dodd-Frank were simultaneously imposed on all market participants and all asset classes, the result could very well be severe market disruptions, and, at a minimum, would result in the exclusion of certain market participants and reduced liquidity. To avoid these consequences, we urge the Commissions to phase in the clearing, execution and other requirements product-by-product over time. The first portion of our letter will discuss the necessity of adopting a phase in approach while the second part will discuss the statutory basis for concluding the Commissions are permitted under Dodd-Frank to adopt such an approach.

Necessity of Phase In Approach. Requiring full compliance with the clearing and execution requirements of Title VII of Dodd-Frank across all markets on a single effective date, or even over a limited period of time, would in our view likely result in serious disruption in the OTC derivatives markets and the exclusion of certain market participants. In fact, we believe the market for certain asset classes or products may cease functioning, possibly for an extended period of time, before market participants are able to adapt to the new requirements and market structures. If the U.S. markets for certain products seize up, market participants may not be able to effect necessary hedging transactions and it is possible that a significant portion of such markets may move overseas, perhaps permanently. Simultaneous application of these requirements to all products and markets will not afford market participants, clearinghouses or SEFs a sufficient opportunity to identify and rectify the problems that will inevitably occur in the initial phases of the process or to implement necessary systems and compliance procedures.

The following analysis focuses on the potential issues that could arise from immediate implementation of clearing, execution and reporting requirements and provides some suggestions for phasing in such requirements. We note, however, that these three areas are highlighted as illustrative only and that the immediate implementation of other provisions of Title VII of Dodd-Frank could raise other concerns as well.

- ***Clearing.*** It currently appears that multiple clearinghouses will be established (or already exist) within and across different OTC derivatives asset classes. We are aware of approximately ten entities that are already in or attempting to enter the clearinghouse space. While we understand that an OTC derivative product will not be subject to mandatory clearing unless and until a clearinghouse is ready to clear the product (and the SEC and/or CFTC has approved that product or class of products for mandatory clearing), competitive pressures will likely push clearinghouses to rush to "land-grab" and to declare themselves ready to clear particular products as quickly as possible.

  If an OTC derivative product is subject to mandatory clearing, market participants will be required to connect to the clearinghouse(s) that are able to clear that product. How quickly and effectively market participants will be able to do that will likely vary depending on the type of participant and the particular market. Dealers will typically be able to establish connectivity more quickly than other market participants. Clearing between dealers is already occurring in several asset classes. Many dealers already have connectivity in place with other dealers and with major clearinghouses, whereas the vast majority of clients do not yet have the systems or processes, or the connectivity to dealers and clearinghouses, in place to enable them to clear OTC derivatives.

  For most market participants, establishing the right IT systems, adapting operational processes and entering into the necessary agreements will likely take a long period of time. Based on our experiences with similar documents, the Commissions should not underestimate how long it will likely take for completely new forms of agreements to be developed, reviewed and negotiated between dealers and other market participants. Much work on these issues is already underway, however there is a limit on how much the clearinghouses and dealers can do, and how much market participants will be willing to do, until there is certainty regarding the shape of final rules.

While dealers may be able to rapidly adjust to a clearing requirement for an OTC derivative product at a particular clearinghouse, not all market participants will be able to adapt as quickly. Particularly for smaller market participants or market participants that do not trade as frequently, it could take significant periods of time before connectivity is established. Market participants with greater resources to devote to IT connectivity, operations and document negotiation will likely be able to clear sooner, potentially disadvantaging participants without such resources.

Furthermore, dealers and clearing agencies will only be able to process a finite number of connections at one time, potentially creating a bottleneck that could disproportionately affect less active market participants.

As a result, if the Commissions impose clearing requirements for an OTC derivative product across an entire market as soon as a clearinghouse declares itself ready to clear that product, the practical effect will be to exclude some segment of the potential market participants for some period of time – a result that would both be detrimental to the markets generally and inconsistent with the goals of Dodd-Frank.

This concern is most acute as clearing requirements in general are imposed for the first time, but will also exist to some extent each time a clearinghouse submits an application to clear a new product. There are two potential ways to address this concern.

First, the Commissions, as part of the assessment of the clearinghouse's application to clear a particular product, could consider the breadth of dealer and other market participants' connectivity with that clearinghouse. Where the Commissions determine that appropriate connectivity is lacking, the Commissions could withhold approval until a sufficient portion of the relevant market participants had a realistic opportunity to connect, thereby allowing for a seamless transition to the clearing of that product without excluding certain market participants.

One downside to adopting such an approach now is that it may take significant periods of time before clearinghouses are established (at least in some asset classes), clearinghouse rules for members and customers implemented, and connectivity established and verified across any particular set of products, let alone all products in all asset classes. Indeed, until the Commissions adopt final (or at least near final) rules, clearinghouses will find it difficult to finalize their own member and customer rules, establish credibility and earn a reputation for clearing a particular type of product. Only a few of the largest and most sophisticated clients are currently attempting to establish clearing connectivity; many market participants will wait until they have a better handle on the clearing landscape and are able to assess the particular risks and rewards of a specific clearinghouse.

If the Commissions were to adopt the approach of waiting to impose OTC derivatives clearing until a sufficient portion of the market participants had a realistic opportunity to connect to the clearinghouses, it could result in no clearing obligation being imposed on any market participant for a significant period of time because the required connectivity simply does not exist at this point in time. While this approach would not be disruptive to the functioning of the OTC derivatives markets, it would also delay realization of the systemic benefits of Dodd-Frank's clearing requirements.[1]

Alternatively, the Commissions could adopt an approach that phases in the clearing requirements by different types of market participants and different types of asset classes. This approach would have the dual advantage of achieving the systemic benefits of clearing quickly for a meaningful segment of the relevant market, while permitting certain market participants time to continue trading in OTC derivative products while adapting to the new requirements. The lack of a mandatory clearing requirement would not prohibit a market participant that wanted to clear a particular product from clearing. Any market participant that was ready, willing and able to clear a particular product could voluntarily participate during the phase in period.

By phasing in clearing requirements across different asset classes, the Commissions would allow market participants to focus resources on achieving broad clearing within a particular asset class more quickly than would be achieved if resources were spread across multiple asset classes at once. This would also allow regulators and market participants to address issues more effectively and resolve problems that will inevitably arise in this nascent space as learning from one phase is applied to later phases.

With respect to asset classes, we would suggest the Commissions focus first on credit default swaps, then interest rate swaps, commodity swaps, foreign exchange swaps, and equity swaps, in that order. With respect to market participants, we would suggest the Commissions apply clearing requirements first to dealers and then to major swap participants. Other market participants could be phased in according to their relative size or market activities, with large or active market participants being subject to clearing requirements before smaller or less active participants.

- ***Execution.*** There will likely be many regulated exchanges and contract markets, and swap execution facilities and securities-based swap execution facilities (together, "SEFs", and together with regulated exchanges and contract markets, "trading platforms") created over the next few months and years, and the structures,

[1] We note that once clearing of OTC derivatives products for a particular asset class is mature (*i.e.*, market participants have established connectivity with multiple clearinghouses and many of the technology, operations and documentation issues have been identified and are understood), this approach may be optimal. In a mature clearing environment, we expect that it should not take as long for most market participants to establish connectivity with the relevant clearinghouses for a newly cleared product.

IT processes and documentation, among other aspects, will vary, perhaps significantly, from trading platform to trading platform. As with clearing, dealers will be able to connect and be prepared more quickly than most other participants, particularly smaller firms. However, even dealers will not be able to connect with every trading platform. Indeed, dealers and many market participants may find it prudent to wait to assess the trading, credit, documentation and other risks associated with a particular trading platform before deciding to join.

Before products are required to be executed on a trading platform, there must be a sufficient number of participants in order to provide the necessary liquidity, and the trading platform must make sure all participants are connected. Merely listing an OTC derivative product on a trading platform should not, in and of itself, be sufficient to justify imposing a requirement that the OTC derivative must be traded on a SEF or trading platform. However, even where there is meaningful trading in a product on the trading platform, the same issues discussed above with respect to clearing will exist. As not all types of market participants will be able to quickly establish the ability to execute on any particular trading platform, imposing such a requirement at the time the trading platform declares itself open for trading will necessarily result in some segment of the potential market participants being excluded from trading for some period of time – again, a result that would both be detrimental to the markets generally and inconsistent with the goals of Dodd-Frank.

Like clearing, as the trading platform space matures over time, these concerns will lessen – but at this phase of development, a sudden imposition of an execution requirement could result in a significant number of market participants being excluded from trading, with the effect disproportionately felt by the market participants with fewer resources.

The execution requirements could be phased in like the clearing requirements, but phase in could also be based on product liquidity. In other words, the Commissions could phase in the applicability of execution requirements based on the trading volumes of a product, permitting less liquid products more time to adapt to an execution requirement by allowing execution off of trading platforms for some period of time even where execution on a trading platform was available.

- ***Real Time Reporting.*** As OTC derivatives have never been publicly and comprehensively reported before, it will take some time to learn precisely what information to report and how to report it without adversely affecting liquidity. A phase in approach will allow the Commissions to learn what works best and is most useful to the market without disrupting liquidity. We note that in implementing the TRACE reporting system, the Financial Industry Regulatory Authority ("FINRA") phased in both the asset classes subject to reporting as well as the time limits. The reporting obligations started at 75 minutes and over the course of three years were reduced to the current 15 minute requirement. Allowing the industry to adapt to a broadening scope of bonds subject to reporting and an increasingly stringent time frame for reporting allowed market participants to work through issues and develop increasingly more effective compliance systems and practices.

In addition to phase in based on asset class and reporting times, reporting could also be phased in based on how a product trades. Reporting requirements could first apply to products that are cleared and executed on a trading platform; then to products that are cleared but not executed on a trading platform; and lastly to uncleared products.

Phase In Approach Successfully Applied by FRBNY. We understand the Commissions have spoken with the Federal Reserve Bank of New York ("FRBNY") regarding the approach taken by the FRBNY over the last several years with respect to OTC derivatives. We believe the FRBNY's incremental approach to imposing certain practices and requirements was the right model then and would also work well for the implementation of Dodd-Frank. As you are aware, the FRBNY began focusing on the back office practices for OTC derivatives in 2005. The FRBNY identified practices (such as backlogs of unexecuted trade confirmations) and set increasingly stringent goals for the major swap market dealers to meet. The FRBNY then turned to the clearing of credit default swaps. In a letter to the FRBNY dated September 8, 2009, fifteen major derivatives dealers committed to targets both for submitting new trades to clearinghouses and for clearing historical trades. The dealers committed to increase such target levels over time as their clearing capabilities and those of the clearinghouses improved, and to broaden the range of derivative products eligible for clearing in due course. In this context, the FRBNY set aggressive initial targets, monitored the industry's progress in reaching these targets, and moved the targets when appropriate.

The Dodd-Frank Act Permits a Phase In Approach. In our view, Dodd-Frank does not require application of the various requirements across all over-the-counter products on a single effective date or a limited range of effective dates. To the contrary, the statute permits and even contemplates that implementation of the requirements will be phased in over time, as appropriate and necessary to the continued operation of the markets. The Commissions are therefore permitted to structure the effective dates of their regulations in a manner that will preserve the ability of markets and market participants to continue their necessary hedging and trading activities.

This view is based primarily on the language of the statute itself. First, there is nothing in Dodd-Frank that requires effectiveness of the clearing, execution and related requirements on a single date or within a limited period. Accordingly, we do not believe that the CFTC and SEC are under any statutory mandate to require effectiveness on this basis. The only timing obligation of the Commissions is to adopt regulations within specified timeframes (in many cases, within one year of the effective date of Dodd-Frank), not to require full compliance by that date. Moreover, the relevant provisions in the Commissions' review of swaps and security-based swaps for clearing grant each Commission broad authority in making a determination to "require such terms and conditions to the requirements as the Commission determines to be appropriate." (Section 723(a)(3) and 763(a) of Dodd-Frank).

The language of Dodd-Frank supports and permits a phased approach to the effectiveness of these requirements. In particular, Section 723 of Dodd-Frank (with respect to the CFTC) and Section 763 (with respect to the SEC) state, as noted, that the CFTC and SEC, respectively, shall adopt regulations for clearing not later than one year from the date of enactment. Significantly, these provisions do not mandate that the regulations be effective on that date, nor that clearinghouses, exchanges, SEFs or market participants be in compliance with the regulations on that date. Therefore, we believe that the statute affords the Commissions considerable flexibility in determining the effective date or dates of the regulations and permits a phase in approach.

In addition, Section 723 of Dodd-Frank adds a new Section 2(h)(2) of the Commodity Exchange Act and Section 763 adds a new Section 3C of the Securities Exchange Act of 1934, which state that the CFTC and the SEC, respectively, shall determine on an on-going basis the products that are required to be cleared. This provision as well suggests that Congress contemplated a "phase in" approach and intended that it be made part of the rulemaking. Factors the Commissions are required to take into account in determining whether a swap, security-based swap, group, category, type or class of swaps or security based-swaps should be cleared are the "capacity, operational expertise and resources, and credit support infrastructure" in place to clear the contract and "[t]he effect on the mitigation of systemic risk, taking into account the size of the market for such contract and the resources of the [derivatives clearing organization] [clearing agency] available to clear the contract." A determination by the Commissions that a phasing in of clearing and other requirements is necessary or desirable would facilitate the establishment of back-office processes and systems to implement the clearing requirements and ameliorate systemic risk, in each case consistent with the intent of Dodd-Frank.

Further, Dodd-Frank clearly establishes the Commissions' authority to apply or disapply the Act's execution requirements for cleared swaps. Specifically, the execution requirement is subject to Section 5h(d)(1) of the CEA, which states that "[t]he [SEC] and the [CFTC] may promulgate rules defining the universe of swaps that can be executed on a swap execution facility. These rules shall take into account the price and nonprice requirements of the counterparties to a swap and the goal of this section as set forth in subsection (e)." We read this to permit the Commissions to undertake a separate determination with respect to whether the execution requirement is applicable to a particular swap or category of swaps, even if it has already been determined that the swap should be cleared. The goal of the section as set forth in subsection (e) is, in part, "to promote the trading of swaps on swap execution facilities." In our view, the phased in approach we have described would be the most effective way to successfully establish (and thereby promote) SEF trading, and therefore rules adopting such an approach would accomplish the section's goal and would be within this grant of authority to the Commissions.

Likewise, the broad general discretion granted to the Commissions under Dodd-Frank also supports this approach. As noted above, the determinations of the Commissions under Sections 2(h)(2) and 3C permit the Commissions to impose "such terms and conditions" as they deem "appropriate." This broad discretion is confirmed by Section 712(d)(2) of Dodd-Frank, which provides, that notwithstanding any other provision in Title VII, the Commissions shall adopt such rules regarding the definitions contained in the statute as the Commissions "determine are necessary and appropriate, in the public interest, and for the protection of investors." A phased approach as described herein clearly accomplishes those goals and is within the broad grants of authority to the Commissions.

The authority granted to the Commissions under Section 712(f)(4) also evidences the general legislative support for a phased approach. Under 712(f)(4), the Commissions are authorized to "exempt persons, agreements, contracts, or transactions from the provisions of this Act, under the terms contained in this Act". For the reasons discussed above, a phased approach, which could be applied as a temporary exemption for certain asset classes or types of market participants, would be consistent with the terms, purposes and objectives of Dodd-Frank, and thereby within the Commission's authority under Section 712(f).

As discussed above, a phase in approach is consistent with the approach the FRBNY took with respect to the clearing of credit default swaps. The role of the FRBNY in coordinating the establishment of a phased approach and target dates were undoubtedly well known to Congress at the time of the drafting and enactment of Dodd-Frank, and it is reasonable to assume that the provisions of the statute contemplating a similar approach reflected Congress's intent that the FRBNY's model be followed with respect to the Dodd-Frank requirements.

Conclusion. For the foregoing reasons, we believe that the Commissions are permitted by the Dodd-Frank Act to adopt a phase in approach to the imposition of clearing and other requirements mandated by Dodd-Frank. Indeed, given the market disruption that could result from the simultaneous application of these requirements across products and markets, and the potentially severe consequences to the markets and the larger economy, we believe that a phase in approach is both permitted and contemplated by Dodd-Frank, and desirable in order to maintain orderly, efficient, liquid and inclusive markets.

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We appreciate the opportunity to comment to the Commissions on the proposed rules, and would be pleased to discuss any questions either Commission may have with respect to this letter. Any questions about this letter may be directed to James Hill (212 761-2514) or Richard Ostrander (212 762-5346).

Very truly yours,

Mr. James Hill
Managing Director
Morgan Stanley