

Morgan Stanley

December 28, 2010

VIA E-MAIL: rule-comments@sec.gov

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

Re: Assets Held as Collateral Under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act

Dear Ms. Murphy:

Morgan Stanley appreciates the opportunity to provide the Securities and Exchange Commission (the "*Commission*") with comments on certain provisions of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("*Dodd-Frank*") regarding the application of existing Commission Rules under the Securities Exchange Act of 1934 (the "*Exchange Act*") to assets held as collateral with respect to security-based swaps ("*SBS*"). This letter focuses on the way in which we believe certain aspects of such Rules should be applied, or modified, by the Commission in order to achieve the purposes of Dodd-Frank. This letter is focused on the treatment of collateral that is posted from the investor to the Swaps Dealer and does not address customer protection issues arising from collateral that is posted to a clearinghouse (in the case of a cleared SBS).

General Requirements

Section 763 of Dodd-Frank requires that all money, securities and property of any SBS customer received to margin, guarantee or secure an SBS ("*Margin Collateral*") (i) must be treated as belonging to the customer, (ii) must be separately accounted for, (iii) must not be commingled with the funds of the broker, dealer or security-based swaps dealer and (iv) must not be used to margin, secure or guarantee any trades or contracts of any customer or person other than the person for whom the Margin Collateral is held. With respect to uncleared SBS, these sections provide that a security-based swap dealer or major security-based swap participant ("*regulated SBS counterparty*") is required to notify its counterparty at the beginning of an SBS transaction that the counterparty has the right to require segregation of Margin Collateral. Such segregated Margin Collateral must be carried in an account at an independent third-party custodian and

designated as a segregated account for and on behalf of the counterparty. Section 763 makes clear that the segregation requirements applicable to uncleared SBS do not apply to variation margin payments.

Recommendations Regarding Cleared SBS

In our view, cleared SBS should receive treatment consistent with the treatment of exchange-traded options for purposes of both possession and control of securities and reserve formula calculations for cash under Rule 15c3-3 under the Exchange Act . With respect to margin required to be posted to OCC for options, the amount of collateral required by OCC in connection with the options becomes part of the debit in the Reserve Formula calculation. For clients holding put and call options issued by a registered clearing corporation and listed or traded on a registered national securities exchange or a registered securities association, the amount of the client's long positions that are required to be segregated is calculated by looking not only at the "debit" balance in the account, but also at the amount of margin required to be held by the broker relating to that customer by the rules of the exchange or the association authorized to trade the option. Applying a consistent system to cleared SBS would provide market participants with the clarity necessary to comply with the regulations promulgated under Dodd-Frank and provide the Commission a proven framework to draw from. Accordingly, cleared SBS should be required to be executed in a margin or portfolio margin account, and the segregation rules applicable to a cleared SBS should be determined by reference to the margin requirement applicable at the security-based swap dealer for such position. Under this approach, for example, if a client entered into a cleared SBS transaction for which the applicable rules required the security-based swap dealer to charge the client \$50 of Margin Collateral, then \$50 would be the amount considered as a debit in the Reserve Formula calculation and also would be added to the debit in the client's account for purposes of possession or control, thereby allowing the security-based swap dealer to rehypothecate collateral it receives from the client based on the \$50 amount.

Recommendations Regarding Uncleared SBS

Section 763 creates a client choice as to the segregation of initial Margin Collateral. The client has the ability to require segregation of the initial Margin Collateral or not. We believe that a new framework is needed for uncleared SBS to implement this client choice framework. This framework must also give effect to the fact that Section 763 does not require the segregation of variation margin; the treatment of variation margin is left up to the client and the regulated SBS counterparty.

To give effect to these two statutory principles—client choice with respect to initial margin, and freedom of contract with respect to variation margin—we believe that a new account type is needed. The current accounts offered by broker-dealers simply do not have the flexibility to address the structure contemplated by Section 763. Likewise, application of customer protection (Rule 15c3-3 under the Exchange Act for securities and SBS), net capital rules (Rule 15c3-1 under the Exchange Act), and the margin rules of self regulatory organizations would not, in our view, be consistent with the structure of Section 763. A new "security-based swap account" at broker-dealers, however, could be designed to meet the framework created by Section 763.

The new SBS accounts would work precisely as the language of Section 763 contemplates. With respect to the client choice portion of the framework, the regulated SBS counterparty would be required to segregate any initial Margin Collateral requested to be segregated by the counterparty. On the other hand, if the client does not request segregation of the initial Margin Collateral, the treatment of such Margin Collateral would be left to the contractual arrangements of the parties. This is precisely what Section 763 contemplates. Variation margin would be subject to the principle of freedom of contract; the parties would be permitted to contractually agree on whatever arrangements they deem are appropriate.

We believe that creating these new accounts outside of the existing margin, capital and customer protection rules is essential to give effect to the statutory framework for uncleared SBS. The framework contemplated by Section 763 with respect to uncleared SBS requires a new approach outside of the current regulatory framework.

We appreciate the opportunity to comment to the Commission on the segregation of assets held as Margin Collateral 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 Alan Thomas at 212-761-1643.

Very truly yours,



Alan Thomas
Managing Director