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December 3, 2010

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: Use of the Term "Advisor" in Sections 731 and 764 of the 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 preliminary comments regarding the use of the term "advisor" in Sections 731 and 764 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.

As further expressed below, we believe the Commissions should interpret the term "advisor," as used in such sections, consistently with analogous provisions in the securities, commodities and common laws, and in a way that acknowledges the distinctions that have been drawn and sharpened over time by courts and regulators between activities of a fiduciary and those of a dealer.[1] Without clear guidance as to what activities give rise to "advisor" status under Sections 731 or 764 of Dodd-Frank, Special Entities (as defined below) and swap dealers[2] could misunderstand the roles and responsibilities each has. The greater the ambiguity over whether a swap dealer's activities give rise to "advisor" status, the greater the chilling effect will be on swap activity with Special Entities. Leveraging off the existing body of law and interpretations will provide the most clarity to market participants and allow for the most effective implementation of these provisions of Dodd-Frank.

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1 While Section 913 of Dodd-Frank calls for a study to assess those distinctions in the context of "retail customers," Special Entities are, by definition, not retail customers.

2 All references herein to the term "swap dealer" shall be deemed to include both a "swap dealer" as defined in Section 721(a)(21) of Dodd-Frank and a "security-based swap dealer" as defined in Section 761(a)(6) of Dodd-Frank.

Advisory Relationships Under the CEA, the Investment Advisers Act and Other Contexts

Section 731 of the Dodd-Frank Act amends the Commodity Exchange Act, as amended (the "CEA") by adding section 4s(h)(4)(B) which states that "[a]ny swap dealer that acts as an advisor to a Special Entity shall have a duty to act in the best interests of the Special Entity," and will be subject to certain other duties with respect to Special Entities.[3] Dodd-Frank also requires swap dealers that act as advisors to Special Entities to make "reasonable efforts to obtain such information as is necessary to make a reasonable determination that any swap recommended by the swap dealer is in the best interests of the Special Entity."[4] Dodd-Frank, however, does not define the term "advisor," nor does it establish any criteria for determining when a swap dealer is acting as an advisor and therefore would be subject to the heightened level of duties imposed under the Dodd-Frank Act.

Given the duty to act in the "best interests" of a Special Entity when acting as an "advisor," the term "advisor" for purposes of these provisions should be interpreted and applied in the same manner as the terms "investment adviser" and "commodity trading advisor" ("CTA") are interpreted under the Investment Advisers Act of 1940, as amended (the "Advisers Act") and the CEA, respectively, and as fiduciary relationships are interpreted under common law.

The CEA defines the term "commodity trading advisor" as a person who "for compensation or profit, engages in the business of advising others, either directly or through publications, writings, or electronic media, as to the value of or the advisability of trading in" instruments under the CFTC's jurisdiction, including futures and, subsequent to the effective date of Dodd-Frank, swaps.[5] The National Futures Association, the industry self-regulatory organization that is responsible for administering registrations under the CEA, pursuant to delegated authority from the CFTC, and for interpreting the applicability of the registration requirements, defines the role of a CTA to include primarily "exercising trading authority over a customer's account as well as giving advice based upon knowledge of or tailored to [a] customer's particular

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3 Section 764 of the Dodd-Frank Act amends the Securities Exchange Act of 1934, as amended (the "Exchange Act") in a substantially similar manner with respect to security-based swap dealers by adding section 15F(h)(4)(B). A "Special Entity" is defined as a federal agency, state, state agency, city, county, municipality, or other political subdivision, employee benefit and governmental plans as defined in Section 3 of the Employee Retirement Income Security Act of 1974 and endowments. CEA § 4s(h)(2)(C) and Exchange Act § 15F(h)(2)(C).

4 CEA § 4s(h)(4)(C); Exchange Act § 15F(h)(4)(C). Such information includes (i) the financial status of the Special Entity, (ii) the tax status of the Special Entity, (iii) the investment or financing objectives of the Special Entity, and (iv) any other information that the CFTC or SEC may prescribe by rule or regulation.

5 CEA § 1a(12).

commodity interest account, particular commodity interest trading activity, or other similar types of information."[6]

Similarly, the Advisers Act defines the term "investment adviser" to mean a person who, "for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities."[7] The SEC similarly examines whether a person "gives advice or makes recommendations or issues reports or analyses" about specific securities or categories of securities when determining whether a person is an investment adviser. [8]

Under both the CEA and the Advisers Act, advisory relationships typically are established by agreement between the advisor and the client where a client relies on the advisor to make trading decisions for the client or provide customized and specific trading recommendations, thereby forming a relationship of trust in and reliance upon the advisor by the client. This characterization is further underscored by the fact that each of the CEA and the Advisers Act recognizes that market professionals may from time to time provide information or input that might be characterized as advice, but that such information is provided in a manner that is incidental to the principal services being provided, and not in an advisory capacity.

Specifically, the CEA and the Advisers Act exclude from the definition of a commodity trading advisor and an investment adviser, respectively, various types of entities, such as banks, broker-dealers and futures commission merchants, among others, that are engaged in financial services businesses generally and that, in connection with the operation of these businesses, may from time to time (or even on a regular basis) incidentally provide information or input that might be characterized as advice with respect to their businesses. The definition of a CTA under the CEA expressly excludes any futures commission merchant "if the furnishing of such [advisory] services...is solely incidental to the conduct of [its] business." Similarly, the definition of "investment adviser" specifically excludes any "dealer whose performance of such [advisory] services is solely incidental to the conduct of his business as a...dealer and who receives no special compensation therefore."[9]

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6 National Futures Association, Registration, Commodity Trading Advisor (CTA), http://www.nfa.futures.org/nfa-registration/cta/index.html.

7 Advisers Act § 202(a)(11).

8 Applicability of the Investment Advisers Act to Financial Planners, Advisers Act Release No. 1092, 39 S.E.C. Docket 494 (Oct. 8, 1987).

9 CEA § 1a(12)(B)(iii) and § 1a(12)(C); Advisers Act § 202(a)(11)(C). In this regard, the CFTC should consider adopting an exemption from CTA registration for swap dealers whose advice in connection with swaps or futures is solely incidental to their business as a swap dealer. The same rationale underlying the exemption from CTA registration available to futures commission merchants should apply to swap dealers, and the same exemption should be available in this context as well. We also note that CFTC rules exempt from the definition of a CTA "a dealer, processor, broker or seller in a cash market transaction of any commodity (or product thereof)

These exclusions reflect the understanding of Congress and the Commissions that the typical interactions and communications between a client and a dealer should not result in treatment of the dealer as an advisor, even if the dealer on occasion engages in communications with the client that could be viewed as limited advice in some form. This characterization of an advisor is also consistent with the status of an advisor as a fiduciary under common law. For example, under New York law, a fiduciary relationship arises from the "assumption of control and responsibility and is founded upon trust reposed by one party in the integrity and fidelity of another."[10] Such relationships exist where one person "trusts in, and relies upon" another person.[11] In contrast, a fiduciary relationship does not exist in the normal course of an arm's-length transaction where one party acts as a principal in a transaction with a counterparty, even if information or input that might be characterized as advice may be rendered in a manner incidental to the dealings between the parties.[12]

Relationships Between Swap Dealers and Their Counterparties

The traditional activities of a swap dealer are distinct from those of an advisor or other fiduciary as the term has generally been understood under the CEA, the Advisers Act and common law. A swap dealer neither recommends that its counterparties enter into transactions nor, absent a separate advisory relationship, advises the counterparty on the "value of" the swaps or the "advisability of" entering into the transactions. A swap dealer's business consists of designing and entering into transactions to accommodate its counterparties' needs and desires for hedging or other types of transactions. In the typical relationship between a swap dealer and a counterparty, the swap dealer will routinely provide the counterparty with quotes and indicative terms for swaps that the counterparty seeks to enter into or that the swap dealer believes may be of interest to the counterparty. In the course of that interaction, the swap dealer may explain to the counterparty how and why the proposed transaction may be responsive to the counterparty's request or of interest to the counterparty. In connection with its swap dealing activities, a swap dealer may also discuss, among other things, market conditions and past performance of financial instruments underlying swaps with a counterparty, without becoming a fiduciary or advisor.[13] A swap dealer may provide similarly related

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[if]...the person's commodity trading advice is incidental to the conduct of its business." 17 C.F.R. § 4.14(a)(1). No similar exemption from registration under the Advisers Act is needed because the definition of an investment adviser does not include a person advising with respect to security-based swaps, and this definition was not amended by Dodd-Frank. The issue presented by the amendment to the definition of a CTA, therefore, does not arise under the Advisers Act.

10 *Beneficial Commercial Corp. v. Murray Glick Datsun*, 601 F. Supp. 770, 772 (S.D.N.Y. 1985); *see also Penato v. George*, 52 A.D. 2d 939, 942 (N.Y.A.D. 1976), *The Proctor & Gamble Company v. Bankers Trust Company*, 925 F. Supp. 1270, 1287 (S.D. Ohio 1996).

11 *Penato*, 52 A.D. 2d at 904-905.

12 *Beneficial Commercial Corp.*, 601 F. Supp. at 772, *see also The Proctor & Gamble Company*, 925 F. Supp. at 1289.

13 *Id.* at 1287. In this case, the court found that a dealer of swaps was not a CTA to its counterparty and no fiduciary relationship existed between the dealer and its counterparty even where the

services to its counterparty, such as the preparation of term sheets, provision of historical information and scenario analysis or modeling based on assumptions provided by the counterparty or on other agreed-upon assumptions, and should not be deemed a fiduciary or advisor as a result.

Discussions or ancillary services along these lines are solely incidental to the swap dealer's principal function, are informational in nature and do not involve representations to the counterparty that the transaction is appropriate or suitable for the counterparty, nor does the swap dealer recommend that the counterparty enter into the transaction. The counterparty, based on the judgment and independent assessment of its personnel and, where applicable, its third-party advisors, forms its own conclusions as to proposed transactions and terms. The counterparty may consider information provided by the swap dealer, but the evaluation of such information, and the decision to enter into the transaction – or not – is the responsibility of the counterparty.

That is not to say, however, that there are no checks on a swap dealer's business conduct. Even prior to Dodd-Frank, Morgan Stanley applied the equivalent of an institutional suitability standard to its swap businesses. Our policies and guidelines include provisions that, among other things, are designed to ensure that counterparties are independently capable of evaluating proposed transactions and are exercising independent judgment in evaluating the proposed transaction, or that they have retained professional advisors unaffiliated with Morgan Stanley to assist them in doing so. If a salesperson believes the client is unable to satisfy that standard, the transaction should not occur. While these policies and guidelines undoubtedly benefit counterparties, they do not establish a fiduciary duty to or similar relationship with counterparties.

Additional evidence of the scope of the typical relationship between a swap dealer and a counterparty is found in standard swaps documentation. Swap agreements typically include an express disclaimer stating that the swap dealer is not acting as an advisor or fiduciary of the counterparty and that the counterparty cannot rely on the swap dealer as such. These procedures and contractual provisions are designed to ensure that the swap dealer is not acting as an advisor, that the counterparty does not look to or rely on the swap dealer for advice or recommendations, and that the counterparty understands that the swap dealer is not acting as its advisor.

In contrast, an entity acting as an advisor with fiduciary duties typically does so pursuant to an agreement with the client, setting out the terms of the relationship and reflecting the obligations and expectations of the parties. While it is possible for a person to be acting in the capacity of an advisor in the absence of a written agreement to that effect, the fact that there is no such agreement is a strong indication that no advisory relationship exists and that any advice that may be rendered is incidental to another, separately documented, relationship.

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parties had conversations regarding "market conditions, past performance of Treasury notes and bonds, prognostications for the future, and the like." The court found the counterparty used its own independent knowledge of market conditions in forming its opinion about the direction of the swap market. *Id.*

Swap Dealers Will Not Want To Act As Both An Advisor and Principal

In our view, swap dealers will find it extraordinarily difficult to act as principal in a transaction where the swap dealer has a duty to act in the best interests of a counterparty. While it would likely be possible for a swap dealer to establish policies and procedures that would allow it to act in the best interests of the counterparty and trade as principal, such procedures would be complex and involve restrictions and practices which are unusual and in many situations could prove unworkable for a trading desk. Separate business lines may be established at affiliates of swap dealers to act as independent representatives or advisors for Special Entities, but we do not believe the traditional trading businesses of a swap dealer will be able to effectively operate under a duty to act in the best interest of its counterparty.

Therefore, given the compliance and administrative burden necessary to ensure a best interest duty is satisfied, and the potential liability for falling short, we believe most sales and trading desks will not engage in a transaction with a Special Entity if the desk cannot be reasonably certain that their traditional sales activities would not be viewed as giving rise to advisor status. In order to ensure that Special Entities have access to the swap markets and that swap dealers will be willing to act as principals with Special Entities, the Commissions should adopt rules to interpret the phrase "acts as an advisor" for purposes of Sections 731 and 764 of Dodd-Frank in a manner that leverages the existing, familiar and comprehensive rules for interpreting the terms CTA and investment adviser under the CEA and the Advisers Act, respectively. We further recommend that the Commissions clarify that a swap dealer providing traditional swap dealer services will not be deemed to be acting as an advisor for purposes of Sections 731 and 764 of the Dodd-Frank Act, unless the swap dealer has assumed fiduciary obligations under an agreement with the counterparty, or the course of dealing between the parties makes it clear that the counterparty is reasonably relying on the swap dealer as an advisor and reposing trust and confidence in the swap dealer. By doing so, the Commissions will ensure that only those swap dealers acting as advisors, based on the foregoing considerations, will be subject to the higher standards imposed under the Dodd-Frank Act.

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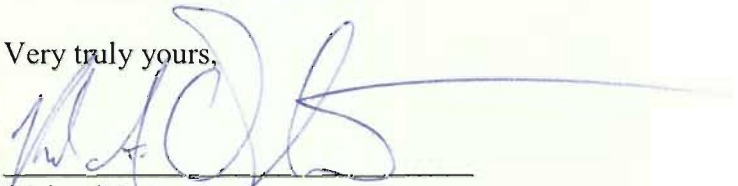
We appreciate the opportunity to provide preliminary comments to the Commissions on the use of the term "advisor" in Sections 731 and 764 of Title VII of Dodd-Frank in anticipation of proposed rulemakings by the Commissions. Any questions about this letter may be directed to Richard Ostrander (richard.ostrander@morganstanley.com; 212 762 5346).

Very truly yours,



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