STATE STREET.

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February 1, 2011

Via: http://comments.cftc.gov

David A. Stawick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

Re: Protection of Collateral of Counterparties to Uncleared Swaps; Treatment of Securities in a Portfolio Margining Account in a Commodity Broker Bankruptcy – RIN: 3038-AD28

Dear Mr. Stawick:

State Street Corporation ("State Street")[1] welcomes the opportunity to comment on proposed new Part 23 of the Commission's regulations (the "Proposed Rules"), implementing Section 724(c) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), concerning the rights of counterparties of swap dealers ("SDs") and major swap participants ("MSPs") with respect to the segregation of collateral supplied for margining, guaranteeing, or securing uncleared swaps.

State Street strongly supports the goals of the Dodd-Frank Act and the Commission to provide swap market participants with increased certainty as to the legal position of margin provided by them to swap dealers and major swap participants. Congress' inclusion of an option for segregation of the initial collateral for uncleared swaps was an important element of its reform of the swap markets that was intended to provide additional protection to non-dealer participants. This protection would enable non-dealer participants to require that dealers provide a viable option for an independent custodian for such collateral. The Commission's release recognizes

[1]With $21.5 trillion in assets under custody and administration and $2.0 trillion in assets under management at December 31, 2010, State Street is a leading specialist in meeting the needs of institutional investors worldwide. Our customers include mutual funds, collective investment funds and other investment pools, corporate and public retirement plans, insurance companies, foundations, endowments and investment managers. Including the United States, we operate in 26 countries and more than 100 geographic markets worldwide.

this Congressional intent;[2] however, we believe that the Proposed Rules can be strengthened in important ways to provide non-dealer participants greater assurance that an independent segregated custodial account will be a real option available to them on acceptable terms. As proposed, the Proposed Rules may leave counterparties, other than a limited number with substantial market influence, little choice but to accept collateral segregation arrangements on terms they might not otherwise consider desirable or subject to credit risks they might not find appropriate. While the Rules as proposed would reflect the relative bargaining position of dealers and counterparties currently in the market, we believe that Congressional intent was to provide a more effective and broad-based right to market participants.

Selection of the independent custodian. In its release, the Commission noted that Proposed Rule 23.602(a)(1) does not require that initial margin be held with a custodian that is independent of any affiliate of an SD or MSP or the counterparty, "in order to permit parties to engage in swaps transactions with affiliates of their usual depositories." We strongly support this position. However, the language should also provide a counterparty an effective right to use an independent custodian when it engages in a transaction with an SD or an MSP that is not an affiliate of its depository.

If an SD or an MSP makes available to clients a segregation option only at one of its affiliates, clients would have little choice but to accept the affiliated segregated account, even though they may well consider that option to offer inferior credit protection, or to elect to forgo the trade with that dealer. If dealers generally only offered segregation with affiliated entities, non-dealer market participants would be effectively denied the "right" that Congress intended. It is, of course, possible for clients to negotiate more favorable custodial arrangements than the Proposed Rules specifically require, but that can be difficult (and may be made more difficult by the adoption of the new Rules), and the Congress could not have intended that only the largest counterparties with the strongest negotiating positions should be in a position to take advantage of the segregated account option.

An independent custodian provides important protections in derivatives transactions. Certainly it limits the ability of one party or the other to exert undue control of movements or property into or out of a collateral account. However in the minds of many of our clients, credit considerations are paramount, since the use of an independent custodian helps to ensure that financial distress affecting a party to a derivatives transaction will not likely have a significant effect on the credit position of the custodian. The bankruptcy of the Lehman Brothers entities have demonstrated the complexity of financial arrangements among dealers and their affiliates and the potential for such interconnections to financially undermine such affiliates. We believe that the Commission should consider revising the Proposed Rules to provide counterparty clients a greater role in the selection of the independent custodian. Specifically, we believe that the Commission should consider revising the Proposed Rules to provide that an SD's or MSP's counterparty has the right to designate the independent custodian, if that custodian is a U.S. bank (*see, e.g.*, the definition of "bank" in the Investment Company Act of 1940, as amended) and otherwise serves as a usual depository for assets of the counterparty.[3] Of course, the counterparty

[2] "Congress's description as a 'right' of what would otherwise be a simple matter for commercial negotiation suggests that this decision is an important one, with a certain degree of favor given to an affirmative election."

[3] In fact, this is currently the practice in the case of counterparties that are registered investment companies, which typically maintain both initial margin and variation margin in tri-party accounts for the benefit of dealers at their own bank custodians.

may choose a segregated account at an affiliate of the SD or MSP, but it would at least have the option to use its usual depository for the purpose.

Terms of custodial arrangement. It can be a difficult and time-consuming process for a client counterparty even today to negotiate terms of an agreement for the segregation of margin, and often it is only the largest clients who are able ultimately to put these agreements in place. Under the Proposed Rules, if the parties are unable for whatever reason to agree to such terms, the default position will, presumably, be that the margin will be held directly by the SD or MSP without segregation. We believe that the Commission should consider amending Section 602 so that these negotiations do not as a practical matter put the segregated account option out of reach of many client counterparties. We believe that it would be reasonable and in keeping with the Congress's expectations to require an SD or an MSP to agree to any tri-party segregated-account agreement proposed by the other party, if the agreement contains the terms required by Section 602 (and other terms appropriately protective of the independent custodian) and no additional material terms or other terms that would reasonably be considered to derogate in any material way from the protections offered by the required terms. In addition, we believe that the Commission should consider either developing, or encouraging industry trade groups to develop, standardized, even-handed segregated account provisions to which parties and the independent custodian might readily agree.

Pricing. Counterparties might be discouraged from taking advantage of segregated accounts if the costs of using segregated accounts are too high. We believe that the Commission should consider revising the Proposed Rules to provide that, although the pricing of the same transaction with and without a segregated account may differ, the pricing difference should be reflective of actual out-of-pocket costs expected to be incurred by the MD/MSP as a result of use of the segregated account, and that the nature and amounts of those costs should be fully disclosed. These steps would help to ensure a more open pricing negotiation between the parties and limit the risk that pricing differentials might be used generally to discourage use of separate accounts. The Commission should also consider making clear that an SD/MSP may not impose an additional cost based on credit risk where the custodian is a U.S. bank.

Conclusion. State Street strongly supports the segregation requirements of the Dodd-Frank Act and the Commission's efforts to implement those requirements. Enhancements to the Proposed Rules along the lines described above will make a counterparty's right to require segregation at an independent custodian more certain and provide the counterparty an effective choice between segregated and non-segregated collateral arrangements.

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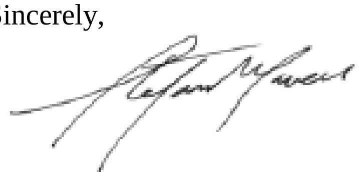
We would be happy to discuss the foregoing at your convenience.

Sincerely,



Stefan M. Gavell

cc: Jeffrey N. Carp, State Street Corporation, EVP and Chief Legal Officer
David C. Phelan, State Street Corporation, EVP and General Counsel