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Morgan Stanley Bank, N.A.

By Electronic Mail **February 1, 2011**

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

RE: Docket No. R-1399, RIN 7100-AD59 (Regulation Z)

Dear Ms. Johnson:

Morgan Stanley Bank, N.A. (the "Bank" or "MS Bank"), Salt Lake City, Utah, submits this comment letter in response to the Proposed Rule published by the Board of Governors of the Federal Reserve System (the "Board") to amend the "large dollar loan" exemption in Regulation Z. *See* 75 Fed. Reg. 78636 (Dec. 16, 2010) (the "Proposed Rule"). The Bank has a significant interest in the Proposal's potential impact on Regulation Z's large dollar loan exemption because the Bank offers open-end credit accounts ("Accounts") collateralized by securities accounts held at an affiliated broker-dealer, and this program will be adversely impacted if the Proposal is adopted in its present form. We appreciate the opportunity to provide our comments on the Proposal.

MS Bank is a national bank wholly-owned by Morgan Stanley, a global financial services firm. Morgan Stanley holds significant market positions in the areas of institutional securities, global wealth management, and asset management. In June 2009, Morgan Stanley's Global Wealth Management Group and Citi's Smith Barney entered into a joint venture, creating the industry's leading wealth management business. Morgan Stanley Smith Barney offers 1,000 brokerage locations around the world, 18,000 financial advisors, and holds approximately $1.6 trillion in client assets.

The Proposed Rule seeks to implement recent amendments to Section 104(3) of the Truth in Lending Act ("TILA") by establishing higher dollar amount thresholds for exempt transactions, in accordance with Section 1100E of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Pub.L. 111-203, H.R. 4173) ("Dodd-Frank Act"). Effective July 21, 2011, the Dodd-Frank Act increases the general threshold amount from $25,000 to $50,000, and thereafter the exemption threshold is subject to indexing. The Proposed Rule changes the large dollar amount threshold from $25,000 to a proposed $50,000 level, and provides that the advance must be made at account opening in order for the large dollar threshold to apply. This new requirement is not supported by the terms of the Dodd-Frank Act. The Proposed Rule will also increase the administrative burden associated with providing uncommitted lines of credit to sophisticated clients. We respectfully request that the Board consider modifying the Proposed Rule to bring it closer in line with the purpose of the large dollar exemption.

MS Bank Accounts

MS Bank currently offers Accounts to customers who generally use such Accounts as an uncommitted line of credit that can be used when an immediate source of cash is necessary. For example, customers may use the credit facility for a large purchase rather than liquidating other assets, or for income tax payments. Secured by the customer's securities account, the Account gives the customer access to cash without liquidating a securities position (which might not be consistent with the consumer's investment strategy, or may have adverse tax or other implications). These customers are high-net worth individuals who are more sophisticated in financial matters. Customers open the Accounts with the understanding that they are "uncommitted lines" on which MS Bank reserves the right to not make advances. The funds from the Accounts are not accessible by credit card; rather, customers must receive advances by wire transfer or by checks. Customers are not allowed to use the Accounts to purchase, carry or trade margin securities, which ensures that the Accounts are not "purpose credit" under applicable margin credit regulations.

As mentioned above, the customers who obtain the Accounts from the Bank are generally high net worth individuals and the Accounts are high-dollar facilities, far different from the consumer accounts to which TILA and Regulation Z were intended to apply. The minimum credit line of the Accounts is $100,000, but the average line is more than $1 million. Customers generally seek to open Accounts in order to provide a readily available source of credit for cash flow needs and unexpected emergencies which may arise in the future, rather than to satisfy an immediate need for funds. As a result, almost thirty percent of the Accounts do not have any outstanding balance, and for those that do have an outstanding balance, the average amount is only a little more than half of the credit limit.

Summary of Comments

The Bank respectfully submits that an open-end credit plan that requires an initial advance in excess of the applicable threshold should be exempt from TILA even if the advance is not made at account opening. This approach would also serve the interests of consumers of such accounts, and would avoid unnecessary costs to creditors to change processes or change the nature of the products in order to comply with the amended rule. If, however, the Board adopts the requirement that the initial advance be at account opening, as the Proposal currently is drafted, the effective date should be delayed until December 31, 2012 to permit the Bank and similarly situated creditors of open-end credit accounts sufficient time to restructure their products or modify their current systems to become TILA-compliant.

Effect of the Proposal on MS Bank Accounts and Customers

Because all of the Bank's Accounts have been subject to a contractual requirement that the initial advance be greater than $25,000, the Bank has not been required to comply with TILA in the past. Under the Proposal, the requirement that the initial advance be made at account opening would require MS Bank to undertake the substantial effort to comply with the TILA and Regulation Z requirements, or to significantly alter the current product to meet the revised exemption. These effects are harmful to both consumers and MS Bank.

<u>The Proposal is not necessary to protect the sophisticated consumers of Accounts</u>.

As indicated in the statistics mentioned above, the majority of consumers do not use the Accounts as an immediate source of funds. The basis of the TILA exemption for loans in excess of the threshold amount is that the loans are considered sufficiently large that the borrowers who obtain them do not need TILA disclosures or other consumer protections. The sophistication of such customers is not dependent on whether the actual extension of credit is made at account opening or some time later, when the funds are actually required. Indeed, in our experience, the more sophisticated consumers are likely to recognize the benefit of obtaining in advance an open-end account on which funds can later be drawn. Moreover, it should be irrelevant if the customer does not obtain the initial advance until some point after the account is opened, since the only time that the consumer protections under TILA should be needed are when the customer obtains credit. In that regard, we note that the triggering point for TILA disclosures in connection with open-end credit is generally the first transaction on the plan (*i.e.*, the first extension of credit), not account opening. *See* Reg. Z, § 226.5(b)(1)(i). Should the customer eventually obtain funds from the Account, in that event the contract between MS Bank and the customer ensures that the initial advance will be in excess of the threshold amount -- thus satisfying purpose of the exemption and serving as a proxy for the customer's sophistication.

Requiring that the initial advance occur at account opening will have one of two effects: either customers will be forced to take an initial extension of credit that they do not want or need (in order to meet the exemption), or customers will be unable to obtain (in advance) credit lines on the terms that have historically been offered. Neither result is beneficial, as products like the Accounts are desired and sought after by customers in the relevant (albeit somewhat limited) target group.

We also respectfully note that the Dodd-Frank Act does not address whether a minimum initial advance must occur at account opening, rather than at some point during the life of the account. The statute merely changed the threshold amount that applies once the loan amount of an open-end credit plan is determined, which would happen at the time of the advance regardless of whether such advance was at the time of the account opening or at a later date. As a result, we do not believe that there is any need to add a new requirement that would not allow the first advance to occur at any time.

<u>A committed credit line does not satisfy the same needs.</u>

In addition to making an initial advance exceeding the threshold, the Official Staff Commentary provides that an account will also be deemed a loan in excess of the threshold amount if the creditor makes a firm commitment to lend greater than the threshold amount. However, requiring a firm commitment would not fit the needs of the customers who generally open Accounts, and it would change the economics of such Accounts.

A committed line is a fundamentally different loan product from an uncommitted line, and based on the number of committed lines versus uncommitted lines we currently provide, they are much less attractive to MS Bank customers. A credit agreement for a committed line usually is significantly more complicated and extensive than for an uncommitted line because it describes in detail the collateral conditions (*e.g.* eligibility and valuation) to the commitment to advance. Moreover, committed facilities typically incorporate obligor performance covenants, which we believe most MS Bank customers would find unacceptable and would be difficult to monitor from an MS Bank perspective given the substantial number of consumer-purpose loans involved. By contrast, uncommitted lines are typically opened using a standard agreement and do not require extensive processes for advances. Similarly, committed lines typically require advance notice of borrowing not needed in uncommitted lines. As a result, uncommitted lines tend to be less burdensome and complicated in almost every way that would affect customers.

In addition to the procedural complications, a committed line will generally be significantly more expensive for customers. Banks are required to maintain capital against the unfunded portion of committed lines, which is a substantial cost that is not present with the use of uncommitted lines. For credit plans with securities collateral, committed lines are also significantly more labor intensive and thus more expensive for customers. For the foregoing reasons, as well as increased administrative costs for committed lines, we believe that the lenders clearly would raise interest rates on uncommitted lines if they made them committed lines. Consumers with committed lines also would likely be charged "commitment fees" on the unused portion of a committed line, which are not imposed on uncommitted lines.

In our experience, many consumers intentionally choose the lower cost and the simpler uncommitted loan product over the complexity and expense of a committed line. In this regard, we note that on Accounts, which are structured as uncommitted lines with securities collateral, the Bank very rarely refuses a request for credit as long as there is sufficient collateral. Thus, in practice, we believe that a consumer receives little practical benefit from a formally committed line.[1] As a result, we believe the Proposal would have the unintended consequence of increasing prices for customers to the extent that they must use committed lines rather than uncommitted lines.

Delayed advances will not create uncertainty as to the exempt status of the Account.

The Proposal indicates that there could be uncertainty as to whether an account is exempt at account opening if no minimum initial advance is required at that time. However, these open-end accounts are subject to a contract between the Bank and the customer, which requires a minimum initial advance in excess of $25,000 currently (and will increase to $50,000). We believe that the Board can (and should) establish a bright-line rule that grants exempted status for all Accounts which are contractually limited to advances of at least the threshold amount, regardless of when the advance is actually made. This will provide certainty as to the status of the Accounts, without requiring customers to take what may be an unnecessary advance at account opening merely to qualify for the exemption. To the extent that the contract is modified to eliminate such a requirement (or if the creditor waives the requirement and permits an initial advance of less than the threshold amount), the exemption would not apply and the creditor would need to comply with TILA or Regulation Z.

It may be that future indexing creates some uncertainty, as the question could be raised whether the exemption should be based on the threshold at the time the account was opened or at the time the advance is actually made. We believe, however, that the Board can readily resolve this uncertainty in the Official Staff Commentary. In that regard, we believe that applying the exemption on the basis of the threshold amount at the time of the initial advance (if later than the account opening) would be acceptable.

Timing of the Compliance Requirements under the Proposal

Given the negative effects that the Proposal will have on customers, as detailed above, we strongly urge that the Board modify the Proposal to permit TILA exemption to be determined based on the first advance whenever it occurs, rather than just at account opening. However, if the Board does not change this requirement, MS Bank respectfully requests that the Board extend the timeline for compliance in order to permit the creation and implementation of TILA-compliant systems required under law.

TILA compliance by July 21, 2011 is not feasible for MS Bank.

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[1] Consumers who ask for a committed line typically do so because a third party requiring a loan facility, such as in connection with investment commitments, requires that facility to be committed so that the third party is not at risk that the consumer will not be able to access the credit line for necessary advances.

If the Proposal is enacted in its current form and MS Bank's Accounts no longer qualify under the exemption, MS Bank must develop the systems and procedures to comply with TILA requirements by July 21, 2011 – or else enact the negative changes to the account terms discussed above (namely, require an immediate initial advance or else extend a committed line). This timeline is not feasible for creditors that have not previously been subject to the statute, especially because the final rule will not likely be released any earlier than four short months before the mandatory compliance date. MS Bank, along with other banks affiliated with securities firms that offer credit plans with securities account collateral, does not offer consumer loan products that are subject to TILA.[2] As a result, MS Bank would have to create a completely new TILA-compliant system.

This is a difficult and time-consuming task for a variety of reasons, including concerns about changes that impact the core systems used for the related securities account products and the need to coordinate those systems with the systems used for the Accounts. We also would have to develop a new set of compliance procedures for requirements imposed under TILA which differ from our current systems. Initial disclosures, periodic statement disclosures, and change-in-terms disclosures would all be subject to very specific requirements – especially under the changes to Regulation Z that became effective on July 1, 2010 – and those requirements are very different from the types of disclosures given today. For example, periodic statements would need to show the calculation of interest and fees charged for the billing cycle and for year-to-date – disclosures not currently provided. Given the substantial nature of these tasks, we respectfully submit that a delayed effective date until December 31, 2012 would be appropriate. This delayed date would apply only to the change in the rule regarding when the initial advance must be taken; the increase of the threshold to $50,000 could be effective as proposed.

The Board has already recognized the need for a transition period, with respect to accounts opened prior to July 21, 2011, and we fully support that transition period and the Board's recognition that creditors who have previously relied on the exemptions under current Regulation Z will need time either to adopt TILA compliance procedures or amend products to meet the revised exception. We urge the Board to apply a transition period as well to accounts opened after July 21, 2011 – not with respect to the increase in the threshold to $50,000 but with respect to the requirement about the timing of the initial advance.

Conclusion

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[2] Or, to the extent the bank issues such products, it has entered into arrangements with third parties proficient in a particular area of lending, such as consumer credit card lending, to provide TILA compliance. We are not aware of vendors currently set up to provide TILA compliance for an open-end, securities collateralized line of credit such as the Accounts.

MS Bank appreciates the opportunity to provide our comments on the Proposed Rule. The Proposed Rule's requirement that an initial advance to occur at account openings will have a significant adverse impact on our ability to offer uncommitted lines of credit to sophisticated clients. Indeed, we believe that our suggested changes will benefit customers across the industry without undermining the intent of the Proposed Rule. Please do not hesitate to contact the undersigned at 212-762-3976 or Matthew Franks, legal counsel, at 914-225-5736 if we can provide any further information or if you have any questions.

Sincerely,

Susan E Carroll

Susan E. Carroll
Chief Operating Officer

cc: Paul Patton, Executive Director