December 19, 2017

Mr. James P. Gorman
Chairman and Chief Executive Officer
Morgan Stanley
1585 Broadway
New York, New York 10036

Dear Mr. Gorman:

On July 1, 2017, the Board of Governors of the Federal Reserve System (Board) and the Federal Deposit Insurance Corporation (FDIC) (together, the Agencies) received the annual resolution plan submission (2017 Plan) of Morgan Stanley (MS) required by section 165(d) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), 12 U.S.C. § 5365(d), and the jointly issued implementing regulation, 12 CFR Part 243 and 12 CFR Part 381 (the Resolution Plan Rule). The Agencies have reviewed the 2017 Plan taking into consideration section 165(d) of the Dodd-Frank Act, the Resolution Plan Rule, the letter that the Agencies provided to MS on April 14, 2016 (the 2016 Letter) regarding MS's 2015 resolution plan submission (2015 Plan), the joint "*Guidance for 2017 Resolution Plan Submissions By Domestic Covered Companies that Submitted Resolution Plans in July 2015*" (the 2017 Plan Guidance), other guidance provided by the Agencies, and supervisory information available to the Agencies.

In reviewing the 2017 Plan, the Agencies noted meaningful improvements over prior resolution plan submissions of MS. Among other things, the Agencies reviewed the 2017 Plan with respect to the shortcomings in MS's 2015 Plan. Based upon their review of the 2017 Plan, the Agencies have jointly decided that the 2017 Plan satisfactorily addressed these shortcomings, as discussed in section I, below. Nonetheless, the Agencies have identified one shortcoming in the 2017 Plan, as discussed in section II, below. The Agencies will review the plan due on July 1, 2019 (2019 Plan) to determine if MS has satisfactorily addressed the shortcoming. If the Agencies jointly decide that this matter is not satisfactorily addressed in the 2019 Plan, the Agencies may determine jointly that the 2019 Plan is not credible or would not facilitate an orderly resolution under the U.S. Bankruptcy Code.

I. Background and Progress

Section 165(d) of the Dodd-Frank Act requires that each bank holding company with $50 billion or more in total consolidated assets and each designated nonbank financial company report to the Agencies the plan of such company for its rapid and orderly resolution in the event of material financial distress or failure. Under the statute, the Agencies may jointly determine, based on their review, that the plan is "not credible or would not facilitate an orderly resolution of the company under Title 11, United States Code."[1] The statute and the Resolution Plan Rule provide a process by which the deficiencies jointly identified by the Agencies in such a plan may be remedied.

In addition to the Resolution Plan Rule, the Agencies have provided supplemental written guidance to assist MS's development of a resolution plan that satisfies the requirements of

[1] 12 U.S.C. § 5365(d)(4).

section 165(d) of the Dodd-Frank Act.[2] The Agencies have also provided ongoing engagement with MS to facilitate the development of its 2017 Plan. The Agencies' staffs have met with MS frequently since April 2016 to answer questions related to the 2017 Plan.

In July 2017, the Agencies received the 2017 Plan and began their review to determine whether the 2017 Plan satisfies the requirements of section 165(d) of the Dodd-Frank Act and the Resolution Plan Rule. As part of their review, the Agencies assessed whether the 2017 Plan satisfactorily addressed each of the shortcomings identified in the 2016 Letter. The Agencies also assessed whether the 2017 Plan satisfactorily addressed each of the key vulnerabilities in resolution identified in the 2017 Plan Guidance. As noted in previous communications, actions to enhance resolvability generally were expected to be fully implemented no later than the date of the 2017 Plan.[3]

Progress Made by MS

Following receipt of the 2016 Letter, MS has taken important steps to enhance the firm's resolvability and facilitate its orderly resolution in bankruptcy. These steps include those taken

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[2] Most recently, this guidance has included:

- The 2016 Letter, which identified shortcomings in the 2015 Plan and stated that if the Agencies jointly decide that these matters are not satisfactorily addressed in the 2017 Plan, the Agencies may determine jointly that the 2017 Plan is not credible or would not facilitate an orderly resolution under the U.S. Bankruptcy Code.
- The 2017 Plan Guidance, which described the Agencies' expectations regarding the 2017 Plan and highlighted specific areas where additional detail should be provided and where certain capabilities or optionality should be developed to demonstrate that the firm has considered fully, and is able to mitigate, obstacles to implementation of the preferred strategy.
- Answers to common and firm-specific questions regarding the 2017 Plan Guidance.

[3] See the 2016 Letter.

to address the requirements of the Board's resolution-related rules regarding total loss-absorbing capacity, clean holding companies,[4] and stays of qualified financial contracts.[5]

MS has taken other significant steps. These include (i) improving its capital and liquidity capabilities by developing approaches to estimate stand-alone financial resource needs for each material entity; (ii) linking measures of estimated financial resource needs to available resources to inform the timely filing of the parent company's bankruptcy; (iii) developing a framework for the pre-positioning of capital and liquidity at material entities; (iv) entering into a contractually binding mechanism designed to provide capital and liquidity support to material entities; (v) creating a framework to govern escalation of information in support of timely decision-making; (vi) modifying its service contracts with key vendors to include provisions intended to ensure the continuation of services; (vii) identifying options for the sale of discrete businesses and assets under different market conditions and taking actions to make those options actionable; (viii) pre-positioning working capital in service-providing entities; (ix) developing playbooks to support continued access to payment, clearing, and settlement activities; (x) rationalizing its material service entity provider network to employ certain hub entities to enable the provision of shared services; and (xi) enhancing its separability analysis to support sales strategies for its wealth management and investment management businesses during resolution.

Finally, MS has adequately addressed the shortcomings identified in the 2016 letter. In response to the firm's liquidity shortcomings, MS developed a model that measures the stand-alone liquidity position of each material entity, and provided detailed analyses of the liquidity

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[4] See 12 CFR 252.60-.65. This rule generally requires MS to maintain capital and long-term debt outstanding to absorb potential losses following entry into bankruptcy and to not enter into certain financial arrangements that would create obstacles to an orderly resolution.

[5] See 12 CFR 252.81-.88. This rule generally requires MS and certain of its subsidiaries to amend their qualified financial contracts to stay the exercise of default rights that could undermine the firm's resolution strategy.

needs of each material operating entity. In response to the firm's governance mechanisms shortcomings, MS modified its trigger framework to incorporate metrics that would inform the timely execution of a bankruptcy filing and the provision of financial resources to certain material entities. The firm also included relevant legal analysis of the potential challenges and mitigants to its planned support of material entities before bankruptcy, developed mitigants (e.g., contractually binding mechanism) to those challenges, and incorporated these developments into its governance playbooks. In response to the derivatives shortcoming, MS provided estimates of hedging costs associated with winding down its trading portfolio and information concerning its residual portfolio (e.g., size, composition, complexity, and potential counterparties).

II. Shortcoming Regarding Legal Entity Rationalization Efforts

The Agencies identified a shortcoming in the 2017 Plan regarding the firm's development and implementation of criteria for a rational and less complex legal entity structure that supports the firm's preferred resolution strategy. The firm's legal entity structure, which contains 27 material entities, increases the inherent risk of misallocating resources and therefore raises questions about the firm's ability to execute its strategy across a range of scenarios.

In order to provide the firm with flexibility to meet the capital and liquidity needs of its material entities (MEs) across a range of scenarios, the firm holds a substantial amount of resources at its top-tier holding company (MS Parent). Under the firm's resolution strategy, the firm appropriately assumes that MEs would have limited ability to redistribute resources among themselves in a resolution scenario. Some liquidity and loss absorbing resources are pre-positioned at MEs, with MS Parent providing substantial support as needed before entering bankruptcy. MS Parent would provide such support pursuant to its estimates of the amount and timing of parent resources that would need to be downstreamed to each ME. As such, the flexibility provided by holding resources at MS Parent effectively ends when MS Parent enters bankruptcy, and the firm's successful resolution relies on the accuracy of such pre-bankruptcy estimates to determine the timing and amount of resources to be downstreamed in a particular scenario as it unfolds over months. The accuracy of these estimates is naturally limited, however, due to the absence of historical experiences to calibrate forecasts of losses and/or outflows throughout a single-point-of-entry resolution for a systemically-important financial institution.

The firm's large number of material entities (27) dictates the number of estimates that the firm needs to calculate in order to allocate MS Parent resources accurately to the firm's MEs in a timely manner. Projected pre-bankruptcy estimates could fall short of what one or more MEs need in resolution, including for purposes of stabilizing the firm. Given the natural limitations of estimates and the large number of estimates to be made, there is an increased risk that resources could be misallocated. The lack of a corresponding mitigant to this risk raises significant uncertainty about whether one or more MEs would have sufficient resources to support an orderly wind-down.

Moreover, MS Parent owns many of its MEs through multiple intermediate holding companies. Fourteen non-U.S. MEs are held through at least one intermediate holding company that is not wholly-owned by its direct parent. This complex ownership structure, considered in light of the risk of misallocating resources, further increases the uncertainty of whether sufficient support would be provided to MEs when needed.

The firm's legal entity rationalization (LER) criteria did not directly address the risk of misallocating resources across its 27 MEs, as described above.[6] Moreover, the implementation of the firm's LER criteria related to the complexity of its ownership structure for MEs did not adequately take into account the misallocation risk, which heightens the risk that material entities would not receive sufficient funds when needed. Rather, the firm provided explanations as to why the current structure may not interfere with its preferred resolution strategy.

To address this shortcoming, the firm's LER criteria and implementation efforts should include consideration of the risk of misallocating resources to MEs within its complex ownership structure and identify mitigants to that risk. Such mitigants could include reducing the complexity of the firm's structure or using a subsidiary of MS Parent to allocate funds to MEs during resolution on an as-needed basis.

If the Agencies jointly decide that this shortcoming is not satisfactorily addressed in the 2019 Plan, the Agencies may determine jointly that the 2019 Plan is not credible or would not facilitate an orderly resolution under the U.S. Bankruptcy Code.

III. Conclusion

In their review of the July 2017 resolution plans, the Agencies also identified four common areas where more work may need to be done to improve the resolvability of the firms: intra-group liquidity; internal loss absorbing capacity; derivatives; and payment, clearing, and settlement activities. Next year the Agencies intend to clarify improvements that should be reflected in the firms' next resolution plans, which are due on July 1, 2019. The Agencies are

[6] While the firm did enter into agreements to share the proceeds from sales of material entities that occur while the firm is in resolution, these sales would not occur immediately, which limits the ability of these agreements to mitigate the misallocation risk.

also considering ways to streamline the resolution plan submission process to allow more time for firms to make progress on resolvability before submitting plans to the Agencies.

The resolvability of firms will change as markets change and as firms' activities, structures, and risk profiles change. The Agencies expect firms to continue to address the resolution consequences of their day-to-day management decisions.

If you have any questions about the information communicated in this letter, please contact the Agencies.

Sincerely,

Ann E. Misback (Signed)

Ann E. Misback
Secretary of the Board
Board of Governors of the Federal
Reserve System

Sincerely,

Robert E. Feldman (Signed)

Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation