

FEDERAL RESERVE SYSTEM

Morgan Stanley
Morgan Stanley Capital Management LLC
Morgan Stanley Domestic Holdings, Inc.
New York, New York

Order Approving Formation of Bank Holding Companies and Notice to Engage in Certain Nonbanking Activities

Morgan Stanley (“Morgan”), Morgan Stanley Capital Management LLC, and Morgan Stanley Domestic Holdings, Inc. (collectively, “Applicants”) each has requested the Board’s approval under section 3 of the Bank Holding Company Act (“BHC Act”) (12 U.S.C. § 1842) to become a bank holding company on conversion of Morgan Stanley Bank, Salt Lake City, Utah (“MS Bank”), to a bank.¹ MS Bank currently operates as an industrial loan company that is exempt from the definition of “bank” under the BHC Act.² Morgan also has provided notice of its proposal to retain its foreign bank subsidiaries under section 4(c)(13) of the BHC Act.³ In addition, as part of its proposal to become a bank holding company, Morgan has requested the Board’s approval under sections 4(c)(8) and 4(j) of the BHC Act (12 U.S.C. § 1843(c)(8) and (j)) and section 225.24 of the Board’s Regulation Y (12 CFR 225.24) to retain its voting shares of MSTNA and MST.

¹ In addition to controlling MS Bank, Morgan also controls Morgan Stanley Trust National Association, Wilmington, Delaware (“MSTNA”), a limited-purpose national bank that engages solely in trust or fiduciary activities pursuant to section 2(c)(2)(D) of the BHC Act (12 U.S.C. § 1841(c)(2)(D)), and Morgan Stanley Trust, Jersey City, New Jersey (“MST”), a federal savings association. These subsidiaries are described in the appendix.

² 12 U.S.C. § 1841(c)(2)(H).

³ 12 U.S.C. § 1843(c)(13).

Morgan, with total consolidated assets of approximately \$1.0 trillion, engages in investment banking, securities underwriting and dealing, asset management, trading, and other activities both in the United States and overseas.⁴ Its principal subsidiaries include Morgan Stanley & Co., Incorporated, New York, New York, a broker-dealer registered with the Securities and Exchange Commission under the Securities Exchange Act of 1934 (15 U.S.C. § 78a et seq.).

MS Bank, with total consolidated assets of approximately \$38.5 billion has deposits of approximately \$30 billion. MS Bank engages primarily in financing and lending activities and taking deposits of the type that are permissible for an industrial loan company under the exception in section 2(c)(2)(H) of the BHC Act. MST, with total consolidated assets of approximately \$5.4 billion, has deposits of approximately \$4.8 billion. MST engages primarily in transfer agency and sub-accounting activities.

Factors Governing Board Review of Transaction

The BHC Act sets forth the factors that the Board must consider when reviewing the formation of a bank holding company or the acquisition of banks. These factors are the competitive effects of the proposal in the relevant geographic markets; the financial and managerial resources and future prospects of the companies and banks involved in the proposal; the convenience and needs of the community to be served, including the records of performance under the Community Reinvestment Act (12 U.S.C. § 2901 et seq.) (“CRA”) of the insured depository institutions involved in the transaction; and the availability of

⁴ Asset data for Morgan are as of May 31, 2008, and asset and deposit data for MS Bank and MST are as of June 30, 2008.

information needed to determine and enforce compliance with the BHC Act and other applicable federal banking laws.⁵

Section 3(b)(1) of the BHC Act⁶ requires that the Board provide notice of an application under section 3 to the appropriate federal or state supervisory authority for the bank to be acquired and provide the supervisor a period of time (normally 30 days) within which to submit views and recommendations on the proposal. Section 3(b)(1) also permits the Board to shorten or waive this notice period in certain circumstances.

The Board has notified the Commissioner of the Utah Department of Financial Institutions (“Commissioner”), the appropriate state supervisory authority for MS Bank, of the proposed transaction. The Commissioner has notified the Board that the Commissioner does not object to approval of the proposal.

In light of the unusual and exigent circumstances affecting the financial markets, and all other facts and circumstances, the Board has determined that emergency conditions exist that justify expeditious action on this proposal.⁷ For the same reasons, and in light of the fact that this transaction represents the conversion of an existing subsidiary of Applicants from one form of depository

⁵ In cases involving interstate bank acquisitions by bank holding companies, the Board also must consider the concentration of deposits in the nation and relevant individual states, as well as compliance with the other provisions of section 3(d) of the BHC Act. Because the proposed transaction does not involve an interstate bank acquisition by a bank holding company, the provisions of section 3(d) of the BHC Act do not apply in this case.

⁶ 12 U.S.C. § 1842(b)(1).

⁷ See 12 CFR 225.14(d)(4).

institution to another, the Board has waived public notice of the proposals involving retention of the depository institutions.⁸

Competitive Considerations

Section 3 of the BHC Act prohibits the Board from approving a proposal that would result in a monopoly. The BHC Act also prohibits the Board from approving a proposed bank acquisition that would substantially lessen competition in any relevant banking market unless the anticompetitive effects of the proposal are clearly outweighed in the public interest by the probable effect of the proposal in meeting the convenience and needs of the community to be served.⁹

The proposal involves the conversion of an existing, wholly owned industrial loan company subsidiary of Morgan into a bank with no resulting change in the ownership of Morgan, MS Bank, or any other depository institution controlled by Morgan. In addition, Morgan does not propose to acquire any additional bank or depository institution as part of this proposal. Based on all the facts of record, the Board concludes that consummation of the proposal would not result in any significantly adverse effects on competition or on the concentration of banking resources in any relevant banking market and that the competitive factors under section 3 of the BHC Act are consistent with approval of the proposal. The competitive effects of the proposed nonbanking activities are discussed below.

Financial, Managerial, and Other Supervisory Considerations

Section 3 of the BHC Act requires the Board to consider the financial and managerial resources and future prospects of the companies and banks involved in the proposal and certain other supervisory factors.¹⁰ The Board has

⁸ 12 CFR 225.16(b)(3).

⁹ 12 U.S.C. § 1842(c)(1).

¹⁰ 12 U.S.C. § 1842(c)(2) and (3).

carefully considered these factors in light of all facts of record, including supervisory information received from the relevant federal and state supervisors of the organizations involved in the proposal and other available financial information, including information provided by Morgan.

The Board consistently has considered capital adequacy to be an especially important aspect in analyzing financial factors. Morgan is adequately capitalized and all the Morgan entities that are subject to regulatory capital requirements currently exceed the relevant requirements. In addition, MS Bank and MST are currently well capitalized under applicable federal guidelines. MS Bank and MST also would be well capitalized on a pro forma basis on consummation of the proposal. Other financial factors are consistent with approval.

The Board also has carefully considered the managerial resources of Morgan in light of all the facts of record, including confidential supervisory information and information provided by Morgan. Based on all the facts of record, the Board concludes that considerations relating to the financial and managerial resources and future prospects of the organizations involved are consistent with approval, as are the other supervisory factors under the BHC Act.

Convenience and Needs Factor

The Board also has carefully considered the effect of the proposal on the convenience and needs of the communities to be served in light of all the facts of record. The Board has long held that consideration of the convenience and needs factor includes a review of the records of the relevant depository institutions under the CRA. As provided in the CRA, the Board evaluates the record of performance of an institution in light of examinations by the appropriate federal supervisors of the CRA performance records of the relevant institutions. An institution's most recent CRA performance evaluation is a particularly

important consideration in the applications process because it represents a detailed, on-site evaluation of the institution's overall record of performance under the CRA by its appropriate federal supervisor.¹¹

MS Bank received an "outstanding" rating under the CRA at its most recent performance evaluation by the Federal Deposit Insurance Corporation, as of January 30, 2006 (the "2006 Examination").¹² Consistent with the CRA regulations adopted by the federal banking agencies, MS Bank was evaluated under the community development test as a wholesale bank.¹³ The 2006 Examination indicated that MS Bank originated and funded new community development loans totaling \$7.7 million during the examination period (March 11, 2003, through January 30, 2006) and had more than \$14 million in unfunded community development loan commitments. The 2006 Examination also determined that MS Bank provided an outstanding level of community development investments. Morgan's conversion of MS Bank to a bank for purposes of the BHC Act purposes also will enhance the ability of the bank to meet the convenience and needs of its communities by permitting the bank to offer a wider array of deposit products.

Based on a review of the entire record, and for the reasons discussed above, the Board has concluded that considerations relating to convenience and

¹¹ The Interagency Questions and Answers Regarding Community Reinvestment provide that a CRA examination is an important and often controlling factor in the consideration of an institution's CRA record. See 64 Federal Register 23,641 (1999).

¹² MSTNA is not an insured depository institution, and MST is not subject to the CRA pursuant to regulations issued by the Office of Thrift Supervision. See 12 CFR 563e.11(c)(2).

¹³ See, e.g., 12 CFR 228.21(a)(2).

needs considerations and the CRA performance record of MS Bank are consistent with approval of the proposal.

Nonbanking Activities and Financial Holding Company Declarations

Morgan engages in a wide range of nonbanking activities that have been determined to be financial in nature, incidental to a financial activity, or complementary to a financial activity pursuant to section 4(k) of the BHC Act.¹⁴ These activities include, among other things, underwriting, dealing, and making a market in securities; providing financial, investment, or economic advisory services; acting as a placement agent in the private placement of securities; engaging in merchant banking activities; acting as principal in foreign exchange and in derivative contracts based on financial and nonfinancial assets; and making, acquiring, or brokering loans or other extensions of credit.¹⁵

Morgan has filed an election to become a financial holding company pursuant to sections 4(k) and (l) of the BHC Act and section 225.82 of the Board's Regulation Y. Section 4 of the BHC Act by its terms also provides any company that becomes a bank holding company two years to conform its existing nonbanking investments and activities to the requirements of section 4 of the BHC Act, with the possibility of three one-year extensions.¹⁶ Morgan must conform to the BHC Act any impermissible nonfinancial activities it may conduct within the time requirements of the Act.

Morgan also has filed notice under sections 4(c)(8) and 4(j) of the BHC Act to retain its ownership interests in MST and MSTNA and thereby operate a savings association and engage in trust company activities. The Board

¹⁴ See 12 U.S.C. § 1843(k).

¹⁵ See 12 U.S.C. § 1843(k)(4)(C), (E), and (H); 12 CFR 225.28(b)(1) and (8)(ii) and 225.171 et seq.

¹⁶ See 12 U.S.C. § 1843(a)(2).

determined by regulation before November 12, 1999, that such activities are so closely related to banking as to be a proper incident thereto for purposes of section 4(c)(8) of the BHC Act.¹⁷

To approve the notice, the Board also must determine that the acquisition of the nonbank subsidiaries and the performance of the proposed nonbanking activities by Morgan can reasonably be expected to produce benefits to the public that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interests, or unsound banking practices.¹⁸

The proposed transaction is expected to create a stronger and more diversified financial services organization and would provide the current and future customers of Morgan, MST, and MSTNA with improved financial products and services. In addition, there are public benefits to be derived from permitting capital markets to operate so that bank holding companies can make potentially profitable investments in nonbanking companies and from permitting banking organizations to allocate their resources in the manner they consider to be most efficient when such investments and actions are consistent, as in this case, with the relevant considerations under the BHC Act.

As part of its evaluation of the statutory factors, the Board considers the financial and managerial resources of the notificant, its subsidiaries, and any company to be acquired; the effect the transaction would have on such resources; and the management expertise, internal control and risk-management systems, and capital of the entity conducting the activity.¹⁹ For the reasons discussed above,

¹⁷ See 12 CFR 225.28(b)(4)(ii) and (5).

¹⁸ See 12 U.S.C. § 1843(j)(2)(A).

¹⁹ See 12 CFR 225.26.

and based on all the facts of record, the Board has concluded that financial and managerial considerations are consistent with approval of the notice.

The Board has carefully considered the competitive effects of Morgan's proposed retention of MST and MSTNA under section 4 of the BHC Act. The proposal would result in no loss of competition because it does not result in the acquisition of any entity and instead is tantamount to a corporate reorganization. For these reasons, and based on all the facts of record, the Board concludes that consummation of the proposal would have a de minimis effect on competition.

The Board also believes that the conduct of the proposed nonbanking activities within the framework established in this order, prior orders, and Regulation Y is not likely to result in adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interests, or unsound banking practices, that would not be outweighed by the public benefits of the proposal, such as increased customer convenience. Accordingly, based on all the facts of record, the Board has determined that the balance of public interest factors that the Board must consider under the standard of section 4(j) of the BHC Act is favorable and consistent with approval.

Morgan also has provided notice of its proposal to retain its foreign bank subsidiaries under section 4(c)(13) of the BHC Act. Based on the record, the Board has no objection to the retention of such subsidiaries.

Conclusion

Based on the foregoing, the Board has determined that the applications under section 3 and the notice under section 4(c)(8) of the BHC Act should be, and hereby are, approved. In reaching its conclusion, the Board has considered all the facts of record in light of the factors that the Board is required to consider under the BHC Act. The Board's approval is specifically conditioned on

compliance by Morgan with all the commitments made in connection with the applications and notice, including the commitments and conditions discussed in this order. The Board's approval of the nonbanking aspects of the proposal also is subject to all the conditions set forth in Regulation Y and to the Board's authority to require such modification or termination of the activities of a bank holding company or any of its subsidiaries as the Board finds necessary to ensure compliance with, and to prevent evasion of, the provisions of the BHC Act and the Board's regulations and orders issued thereunder. These commitments and conditions are deemed to be conditions imposed in writing by the Board in connection with its findings and decision and, as such, may be enforced in proceedings under applicable law.

Because the proposal does not involve the acquisition, merger, or consolidation of a bank, the post-consummation period in section 11 of the BHC Act does not apply.²⁰ Accordingly, the transaction may be consummated immediately and may not be consummated later than three months after the effective date of this order, unless such period is extended for good cause by the Board or by the Federal Reserve Bank of New York, acting pursuant to delegated authority.

By order of the Board of Governors,²¹ effective September 21, 2008.

(SIGNED)

Robert deV. Frierson
Deputy Secretary of the Board

²⁰ 12 U.S.C. § 1849(b)(1).

²¹ Voting for this action: Chairman Bernanke, Vice Chairman Kohn, and Governors Warsh, Kroszner, and Duke.

Appendix

Nonbanking Subsidiaries of Morgan Stanley

- (1) Morgan Stanley Trust, Jersey City, New Jersey, and thereby engage in operating a savings association in accordance with section 225.28(b)(4)(ii) of Regulation Y (12 CFR 225.28(b)(4)(ii)); and
- (2) Morgan Stanley Trust National Association, Wilmington, Delaware, and thereby engage in trust company functions in accordance with section 225.28(b)(5) of Regulation Y (12 CFR 225.28(b)(5)).