April 14, 2016

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

Dear Mr. Gorman:

On July 1, 2015, 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 (2015 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 2015 Plan taking into consideration section 165(d) of the Dodd-Frank Act, the Resolution Plan Rule, the letter that the Agencies provided to MS in August 2014 (the 2014 Letter) regarding MS's 2013 resolution plan submission, the communication the Agencies made to MS in February 2015 clarifying the 2014 Letter (the 2015 Communication), other guidance provided by the Agencies, and other supervisory information available to the Agencies.

In reviewing the 2015 Plan, the Agencies noted improvements over prior resolution plan submissions of MS. Nonetheless, the Agencies have identified shortcomings in the 2015 Plan.[1] The Agencies will review the plan due on July 1, 2017 (2017 Plan), to determine if MS has satisfactorily addressed the shortcomings identified in Section II below. 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.

In order for MS to allocate appropriate resources and staff to address the shortcomings identified in Section II below, the Agencies have jointly determined that the informational content of MS's 2016 annual resolution plan submission will be satisfied by submission of the following two items: a status report on MS's actions to address the shortcomings and a public section that explains, at a high level, the actions the firm plans to take to address the shortcomings. The Agencies have jointly extended the submission deadline for the 2016 annual resolution plan submission to October 1, 2016 (2016 Submission).

I. Background

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

[1] The Board determined that MS's 2015 Plan was not credible or would not facilitate an orderly resolution under the U.S. Bankruptcy Code, but this was not a joint determination by the Agencies as described in section 165(d)(4) of the Dodd-Frank Act.

of the company under Title 11, United States Code."[2] 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 information and guidance to assist MS's development of a resolution plan that satisfies the requirements of section 165(d) of the Dodd-Frank Act. This information and guidance included:

- The April 2013 joint guidance to 2012 plan filers, which addressed a number of resolution plan issues and detailed five significant obstacles to orderly resolution in bankruptcy (multiple competing insolvencies, global cooperation, operations and interconnections, counterparty actions, and liquidity and funding).[3]

- The 2014 Letter, which outlined a number of shortcomings in the 2013 resolution plan submission and specific issues to be addressed in the 2015 Plan. The 2014 Letter explicitly reminded MS that failure to make demonstrable progress in addressing those shortcomings and in taking the additional actions set forth in the 2014 Letter could result in a joint determination that MS's 2015 Plan is not credible or would not facilitate orderly resolution in bankruptcy.

- The 2015 Communication, which provided additional staff guidance in response to MS's December 2014 submission describing certain proposed elements of the 2015 Plan. Among other things, the 2015 Communication reminded firms to make conservative assumptions and provide substantial supporting analysis concerning certain of the proposed 2015 Plan elements.

Furthermore, since the release of the 2014 Letter, the Agencies have made staff available to answer questions related to the 2015 Plan.

---

[2] 12 U.S.C. § 5365(d)(4).

[3] *See* "Guidance for 2013 §165(d) Annual Resolution Plan Submissions by Domestic Covered Companies that Submitted Initial Resolution Plans in 2012" (2013 Guidance), issued jointly by the Agencies on April 15, 2013. The 2013 Guidance further noted that "this list of Obstacles is not exhaustive and does not preclude other Obstacles from being identified by the Agencies in the future, nor does it preclude Covered Companies from identifying and addressing other weaknesses or potential impediments to resolution."

In July 2015, the Agencies received the 2015 Plan and began their review. The Agencies reviewed MS's 2015 Plan to determine whether it 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 2015 Plan addressed each of the items identified in the 2014 Letter and the 2015 Communication, including whether the firm has made demonstrable progress to improve resolvability under the U.S. Bankruptcy Code based on the actions that the firm had completed by the July 2015 plan date against the firm's full-implementation schedule. Firms were expected to provide a timetable for completion of the remaining actions after the July 2015 plan date that included well-identified interim achievement benchmarks against which the Agencies could measure progress. Planned future actions are generally expected to be fully implemented by the date of the firm's 2017 Plan or earlier.[4]

Progress Made by MS

Over the past several years, MS has taken important steps to enhance the firm's resolvability and facilitate its orderly resolution in bankruptcy, including:

- MS has improved its funding structure and increased the level of firm-wide high-quality liquid assets (HQLA).
- In addition to improving its overall capital position, MS has complied with the clean holding company guidance from the 2014 Letter and 2015 Communication.
- MS has developed playbooks for how the firm would transfer the assets [redacted] and is implementing a shared services model whereby services are provided to subsidiaries through service entities that are operationally and financially separate from the [redacted]

[4] The 2015 Communication explicitly advised that remaining actions required by the Agencies in the 2014 Letter and the 2015 Communication to improve resolvability generally are expected to be completed no later than July 1, 2017.

- MS has developed triggers to escalate information to the board of directors. Additionally, the firm has [redacted] to facilitate the injection of resources into certain material entities as contemplated in its strategy.

- MS has developed a legal entity rationalization framework with specific criteria addressing the resolvability of the firm, has reduced the overall number of legal entities in its organizational structure, has separated its wealth management and investment management businesses from its institutional broker-dealer, and has simplified the ownership structure of its [redacted] operations.

- MS has revised and is making changes to its [redacted] to decrease financial interconnectedness within [redacted] and has adhered to the International Swaps and Derivatives Association 2015 Universal Resolution Stay Protocol.

II. Shortcomings

MS must address the shortcomings identified in this letter in its 2017 Plan. 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.

LIQUIDITY

Resolution Liquidity Adequacy and Positioning (RLAP): MS does not have an appropriate model and process for estimating and maintaining sufficient liquidity, at or readily available to, material entities[5] in resolution (RLAP model).[6] MS's funding model relies heavily on the firm's ability to shift substantial amounts of liquidity around the organization when experiencing stress, which makes MS's strategy potentially vulnerable to adverse actions by third parties, including ring-fencing.

---

[5] "Material entities" refer to the material entities identified in the 2015 Plan.

[6] "Model" refers to the set of calculations estimating the net liquidity surplus/deficit at each legal entity and for the firm in aggregate based on assumptions regarding available liquidity, e.g., HQLA, and third party and interaffiliate net outflows.

MS's Runway Liquidity Model and Resolution Contingency Funding Plan (R-CFP) does not take into account interaffiliate exposures and frictions, which may underestimate the vulnerability of certain entities to ring-fencing actions. Specifically, the 2015 Plan assumed that [redacted], regardless of the magnitude of interaffiliate liquidity dependencies or exposures. In a severe stress, however, local liquidity concerns could [redacted], resulting in material net liquidity deficits at certain entities. [redacted][7]

In addition, in MS's 2015 Plan, the parent company relies on approximately $[redacted] as available resources to assist in funding the recapitalization of, and providing liquidity support to, the firm's material operating entities. In a severe stress situation, however, those deposits may not be easily withdrawn.

The combination of the two factors above indicates the uncertainty about the adequacy and positioning of liquidity at certain material entities across the organization because, based on supervisory analysis, the estimated stand-alone liquidity deficits at material entities in stress are likely materially greater than the resources available to the parent to meet such needs.

To address this shortcoming, the 2017 Plan should indicate that the firm has developed and implemented an enhanced resolution liquidity model. Specifically, the enhanced model should measure the stand-alone liquidity position of each material entity—i.e., the HQLA at the

[7] Supervisory analysis is based on liquidity data submitted via form FR 2052a.

material entity less net outflows to third parties and affiliates—and ensure that liquidity is readily available to meet any deficits. The model should cover a period of at least 30 days and reflect the idiosyncratic liquidity profile and risk of MS. The model also should balance the reduction in frictions associated with holding liquidity directly at material entities with the flexibility provided by holding HQLA at the parent available to meet unanticipated outflows at material entities. Thus, the firm should not rely exclusively on either full pre-positioning or the parent. The model also should ensure that the parent holds sufficient HQLA (inclusive of deposits at the U.S. branch of the lead bank subsidiary) to cover the sum of all stand-alone material legal entity net liquidity deficits. The stand-alone net liquidity position of each material entity (HQLA less net outflows) should be measured using the firm's internal liquidity stress test assumptions and should treat interaffiliate exposures in the same manner as third party exposures. Finally, the firm should not assume that a net liquidity surplus at one material entity could be moved to meet net liquidity deficits at other material entities or to augment parent resources.

The Board considers this shortcoming regarding liquidity to be a deficiency in the 2015 Plan.

Resolution Liquidity Execution Need (RLEN): The Agencies found MS's 2015 Plan to have a shortcoming in its model and process for estimating the liquidity needed to fund its material entities during the resolution period. MS's R-CFP liquidity methodology is designed to estimate the liquidity needs of material entities to include estimates for [redacted], which includes intraday needs. The estimates, however, did not include a detailed breakout of interaffiliate flows and frictions that may impact liquidity needs. Additionally, supporting analysis demonstrating how the minimum operating liquidity level was determined was not provided. This lack of detail raises questions about the 2015 Plan's estimates of material entities' liquidity needs during the resolution period.

To address these shortcomings, the estimation of the liquidity needed in resolution contained in MS's 2017 Plan should include detailed support and analysis. In particular, the firm's estimation of resolution liquidity needs should include (A) detailed supporting analysis for how the firm determined the [redacted] of its material entities, and (B) for all material entities, a detailed breakout and analysis of interaffiliate flows and funding frictions and working capital needs to ensure that material entities could operate following the bankruptcy filing of the parent company in a manner consistent with regulatory requirements, market expectations, and MS's post-failure strategy. MS should continue developing its model and process for estimating the liquidity needed to fund its material entities during resolution, including by continuing its [redacted] efforts and addressing issues the firm has identified through its internal validation process.

DERIVATIVES AND TRADING ACTIVITIES

The Agencies also identified a shortcoming in the 2015 Plan regarding MS's trading activities. The 2015 Plan proposed a [redacted] pathway to wind down $[redacted] notional of derivatives in its trading entities, outside of bankruptcy, through novation and maturity. The 2015 Plan provided important details regarding how the firm would segment and package its derivatives positions, including explanations of the operational challenges and mechanics involved in novating large derivatives portfolios. Although the firm assumed [redacted], the firm did not estimate the costs or risks associated with this assumption. The 2015 Plan also did not provide sufficient detail on the residual $[redacted] notional portfolio.

To address this shortcoming, the 2017 Plan should estimate the hedging costs associated with actively winding down its trading portfolio and provide more detail regarding the residual portfolio, including its size, composition, complexity, and potential counterparties.

GOVERNANCE MECHANISMS

Playbooks and Triggers: In the 2015 Communication, the Agencies directed MS to identify the governance mechanisms in place or in development that would ensure execution of the required board actions at the appropriate time (as anticipated under MS's preferred strategy), including pre-action triggers and existing agreements for such actions. Such governance mechanisms are important to MS's resolution strategy because the 2015 Plan relies upon, among other things, the timely provision of financial resources from the parent to certain material operating entities. The Agencies identified a shortcoming regarding the governance mechanisms necessary to facilitate timely execution of the planned funding and recapitalizations of certain material entities.

MS's 2015 Plan included triggers to escalate information to the board of directors and to inject capital and liquidity (Support) prior to a bankruptcy filing into material entities, as contemplated under the firm's preferred strategy. However, the 2015 Plan did not include triggers that directly connect the provision of Support needed to execute the preferred strategy with the decision to file for bankruptcy. To address this shortcoming, MS should develop triggers to inform the timely execution of a bankruptcy filing and related pre-filing actions. These triggers should be based, at a minimum, on capital, liquidity, and market metrics and should incorporate the results of the firm's models for forecasting the liquidity and capital needed to operate following a bankruptcy filing. Additionally, the triggers and related actions under the proposed mechanism must be specific.

Pre-bankruptcy Parent Support: The 2015 Plan indicates that MS [redacted] a Support and Subordination Agreement (SSA) as a means of recapitalizing and funding certain subsidiaries prior to MS's bankruptcy filing. The Agencies identified a shortcoming in the 2015 Plan regarding MS's limited analysis of the range of potential legal challenges that could adversely affect MS's approach to providing Support.

To address this shortcoming, the 2017 Plan should further develop a detailed legal analysis of the potential state law and bankruptcy law challenges and mitigants to the planned provision of Support. Specifically, the analysis should identify any potential legal obstacles and explain how MS would seek to ensure the Support would be provided as planned.

The 2017 Plan also should include those mitigant(s) to potential challenges to the planned Support that MS considers most effective. In identifying appropriate mitigants, MS should consider the effectiveness of mitigants other than, or in addition to, the SSA or other contractually binding mechanisms, such as the pre-positioning of financial resources at material entities and the creation of an intermediate holding company.

The governance playbooks included in the 2017 Plan should incorporate any additional developments from MS's further analysis of potential legal challenges regarding Support, including any approach(es) or mitigant(s) concerning the provision of Support.

III. Conclusion

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

Very truly yours,

(Signed)

Robert deV. Frierson
Secretary of the Board
Board of Governors of the
Federal Reserve System

Very truly yours,

(Signed)

Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation