

Morgan Stanley

June 3, 2016

Robert de V. Frierson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551

Re: **Single-Counterparty Credit Limits for Large Banking Organizations, Docket No. R-1534, RIN No. 7100 AE-48.**

Ladies and Gentlemen:

Morgan Stanley appreciates the opportunity to provide comments to the Board of Governors of the Federal Reserve System (the "**Board**") in response to the Board's notice of proposed rulemaking to implement single-counterparty credit limits ("SCCL") for large U.S. banking organizations (the "**Proposed Rule**").¹

Morgan Stanley, a financial holding company supervised by the Board, provides its products and services to a large and diversified group of clients and customers around the world, including corporations, governments, financial institutions and individuals.

We support the adoption of a well-designed SCCL framework as a tool to prevent over-concentration of risk in financial markets. We adopt the recommendations made in the comment letter submitted by The Clearing House Association L.L.C., the American Bankers Association, The Financial Services Roundtable, the Securities Industry and Financial Markets Association, and the International Swaps and Derivatives Association (the "**Associations' Letter**") on the Proposed Rule.

Our comments in this letter focus on the treatment of joint ventures in the SCCL framework. Morgan Stanley operates in many markets—including in China, Japan and South Africa—through joint ventures, as do other institutions that would be subject to the Proposed Rule. Often this is because the law in a particular country limits the ownership interests that foreign investors may have in financial institutions in that country. Although the Proposed Rule does not discuss joint ventures, the expansive scope of the Proposed Rule would create many practical problems for normal course joint venture transactions, even where there are no underlying policy concerns with over-concentration of risk in financial markets. In this letter, we recommend modest approaches for tailoring the SCCL framework appropriately to accommodate joint venture structures, while still ensuring that credit limits are applied rigorously against all meaningful unaffiliated counterparty risks.

¹ 81 Fed. Reg. 14,328 (Mar. 16, 2016).

1. Summary of the issue

The Proposed Rule is grounded in two key definitions: "covered company" and "counterparty." Each covered company—generally speaking, a large U.S. bank holding company—must apply the SCCL framework to limit its credit exposures to any unaffiliated counterparty, which may include other financial institutions, corporate groups, and certain governmental entities.

When determining the scope of covered companies and counterparties, the Proposed Rule includes any other person in which the covered company or counterparty, respectively, owns, controls, or has power to vote 25 percent or more of a class of voting securities of such person.² As a result, in a joint venture structure, an entity may be deemed to be part of *both* the covered company and the covered company's unaffiliated counterparty, if each has at least a 25 percent voting interest in the entity.

By applying a 25 percent voting interest consolidation standard, the Proposed Rule creates three categories of problems for joint ventures. First, a joint venture entity may be simultaneously included in both the "covered company" and the "counterparty" consolidation groups. As a result, the covered company may be forced to treat its inter-affiliate exposures to such entity as exposures to an unaffiliated counterparty group, even where the covered company consolidates and risk manages the entity. Alternatively, when the joint venture partner consolidates and risk manages the entity, the covered company may nonetheless be required to treat the entity as part of its own covered company. In this scenario, the joint venture entity's inter-affiliate exposures to its own consolidating parent company, and potentially even the entity's exposures to the covered company's consolidated subsidiaries, would be deemed credit exposures of the covered company.

Second, the 25 percent voting interest standard requires that the covered company consolidate the external-facing credit exposures of a joint venture entity, even when the covered company has no operational control over the entity and no responsibility for supporting the capital of the entity.

Third, large U.S. bank holding companies that are covered companies under the rule would be required to treat the joint venture entity as simultaneously part of two separate counterparty consolidation groups, even when credit exposures to the joint venture entity have no bearing on credit risk to the non-consolidating joint venture partner.

2. Recommended solutions

The Proposed Rule does not discuss joint ventures, and we believe that the issues identified in Part 1 of this letter can be addressed through modest revisions to the SCCL framework that promote the Board's underlying policy concerns.

² See 12 C.F.R. § 252.171 (e)(2)(xi) (proposed) (definition of "counterparty"); 12 C.F.R. § 252.171(f) (proposed) (definition of "covered company," which incorporates the 25 percent voting interest standard through cross-references).

a. Financial reporting consolidation standard,

The most direct resolution of the joint venture issues would be to adopt financial reporting consolidation principles for determining the scope of the "covered company" and "counterparty." This approach would be consistent with the large exposure framework of the Basel Committee on Banking Supervision, and would align the SCCL framework with risk management considerations.³

b. Joint venture focus: comprehensive solution

Alternatively, if the Board elected to maintain the "covered company" and "counterparty" definitions in the Proposed Rule, a clarification could be added to address the issues raised by joint ventures. This approach would resolve all the concerns noted in Part I through standards that would require aggregation of a joint venture entity with its consolidating parent company. To avoid arbitrage concerns, the approach we are suggesting would apply only in cases where the joint venture entity is itself a regulated entity subject to effective supervision. Illustrative language demonstrating this approach is included in Part II.C of the Associations' Letter.

c. Joint venture focus: inter-affiliate solution

Finally, the Board could resolve the inter-affiliate issues in isolation and leave the remaining issues for resolution through case-by-case exemptive relief. This approach would address the most glaring operational problems created by the Proposed Rule while avoiding any significant structural changes to the SCCL framework. If the Board takes this approach, we respectfully request that it provide guidance in the final rulemaking describing the process for, and standards governing, exemptive relief requests submitted by covered companies pursuant to 12 C.F.R. § 252.77(c).

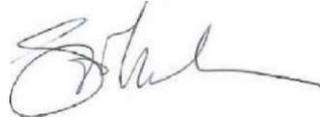
This approach could be implemented through a clarification that, for purposes of the SCCL framework, an "unaffiliated counterpart" excludes inter-affiliate exposures from or to a joint venture entity that is deemed to be part of the covered company or counterparty because of the 25 percent voting interest standard, as long as the covered company otherwise applies the SCCL framework to the non-inter-affiliate exposures of the entity. Illustrative language demonstrating this approach is included in Part II.C of the Associations' Letter.

³ See Basel Committee on Banking Supervision, *Supervisory framework for measuring and controlling large exposures* (April 2014), pp. 12, 22.

3. Conclusion

Morgan Stanley appreciates the opportunity to provide comments to the Agencies on the Proposed Rule. Please do not hesitate to contact us if you have any questions.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Soo-Mi Lee', with a long horizontal flourish extending to the right.

Soo-Mi Lee
Managing Director