



BOARD OF GOVERNORS  
OF THE  
**FEDERAL RESERVE SYSTEM**  
WASHINGTON, D. C. 20551

ADDRESS OFFICIAL CORRESPONDENCE  
TO THE BOARD

April 10, 2009

Mr. Fred Gonfiantini  
Managing Director  
Morgan Stanley  
1585 Broadway  
New York, NY 10036

Dear Mr. Gonfiantini:

This is in response to your letter dated March 31, 2009, regarding the regulatory capital treatment of the Board's Regulation T margin debits ("Reg. T margin loans")<sup>1</sup> of Morgan Stanley's registered U.S. broker-dealer, Morgan Stanley & Co., Incorporated ("MS & Co."), both of New York, New York. You request that Morgan Stanley be granted an exception to the Board's risk-based capital adequacy guidelines for bank holding companies ("Capital Guidelines"),<sup>2</sup> which require a 100 percent risk weight for Reg. T margin loans. Specifically, you have requested that Morgan Stanley be permitted to assign a 10 percent risk weight to its Reg. T margin loans, consistent with the treatment that the Board has approved for other bank holding companies.<sup>3</sup>

In the request, you contend that the risk-based capital requirement for such loans is excessive and represent that Morgan Stanley has a de minimis internal economic capital charge for credit risk on its Reg. T margin loans.

A margin account at a broker-dealer registered with the Securities and Exchange Commission ("SEC") is a leveraged account through which securities can be purchased, sold short, carried, or traded using a loan from the broker-dealer and a deposit of cash or securities by the customer. The amount of leverage

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<sup>1</sup> 12 CFR part 220.

<sup>2</sup> 12 CFR part 225, Appendix A.

<sup>3</sup> See Board letters to John C. Gerspach (Citigroup Inc.), June 15, 2007; Jeffrey D. Landau (The Bank of New York Mellon), December 17, 2007; and Alton E. Yother (Regions Financial Corporation), December 18, 2007.

available to a customer is limited by the Board's Regulation T, the margin-maintenance rules of the Financial Industry Regulatory Authority (NYSE Rule 431), and the lender's internal margin-maintenance requirements. Your request notes that Morgan Stanley generally applies internal margin-maintenance requirements that exceed those of the SEC or the NYSE. (MS & Co. is a member of the exchange).

As noted above, Reg. T margin loans held by U.S. bank holding companies currently are assigned to the 100 percent risk weight category under the Capital Guidelines, which results in a risk-based capital requirement of 8 percent. In contrast, foreign firms, including foreign banking organizations that own U.S. broker-dealers, as well as bank holding companies that own U.S. broker-dealers and that have already received the requested relief, are currently required to hold significantly less regulatory capital against Reg. T margin loans. The Board has broad authority to grant exemptions from the Capital Guidelines on a case-by-case basis.<sup>4</sup>

Based on all the facts of record, including the information provided in your request and other supervisory information, and subject to the conditions listed below, the director of the Division of Banking Supervision and Regulation, acting under delegated authority, has approved an exception to the Capital Guidelines that permits Morgan Stanley to apply a 10 percent risk weight to its Reg. T margin loans.

To qualify for the capital treatment outlined above, Morgan Stanley's Reg. T margin loans must meet the following conditions:

1. The securities collateral for the Reg. T margin loans is liquid and readily marketable;
2. The Reg. T margin loans and associated collateral are marked to market each business day;
3. The Reg. T margin loans are subject to initial margin requirements under Regulation T and daily margin-maintenance requirements under NYSE Rule 431 or NASD rule 2520; and

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<sup>4</sup> 12 CFR part 225, Appendix A, § III.A.

4. Morgan Stanley has a reasonable basis for concluding that it would be able to liquidate the collateral for the Reg. T margin loans without undue delay, even in the case of bankruptcy or insolvency of the borrower.

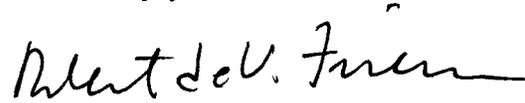
The capital treatment approved above for Morgan Stanley's Reg. T margin loans provides a more appropriate risk-based capital treatment for these transactions than their current treatment under the Capital Guidelines. The combination of initial margin requirements under Regulation T, ongoing margin-maintenance requirements under NYSE Rule 431, generally higher ongoing internal margin-maintenance requirements, Morgan Stanley's daily mark-to-market and margin-call policies, the presence of liquid and readily marketable collateral even in the case of insolvency or bankruptcy of the borrower, and the typical right to terminate such loans at any time makes them a low credit-risk product warranting a 10 percent risk weight.

This exception accommodates Morgan Stanley's broker-dealer activities in a risk-sensitive manner, helps remove a constraint on certain of Morgan Stanley's securities-based lending operations, and brings Morgan Stanley's risk-based capital requirement for Reg. T margin loans in accord with bank holding companies that are already permitted through Board exceptions to risk weighting these exposures at 10 percent. Morgan Stanley should be aware that the Board may in the future impose a regulatory capital treatment for Reg. T margin loans that differs from the treatment described in your request.

This determination is conditioned on Morgan Stanley's compliance with all the commitments and representations made to the Board in connection with the request. These commitments and representations are deemed to be conditions imposed in writing in connection with granting the request and, as such, may be enforced in proceedings under applicable law. Further, this determination is based on the specific facts and circumstances described in the request and in your discussions with Federal Reserve staff. Any material change in those facts and circumstances or any failure by Morgan Stanley to observe any of its commitments or representations may result in a different view or in a revocation of the regulatory capital treatment permitted under this determination.

Please contact Homer C. Hill, III, of the Federal Reserve Bank of New York at (212) 720-2164 if you have any questions.

Sincerely yours,

A handwritten signature in black ink, appearing to read "Robert deV. Frierson". The signature is fluid and cursive, with a prominent initial "R" and a long, sweeping underline.

Robert deV. Frierson  
Deputy Secretary of the Board

cc: Homer C. Hill, III  
Federal Reserve Bank of New York