

FEDERAL RESERVE SYSTEM

Morgan Stanley  
New York, New York

Order Approving Retention of Shares of a Bank

Morgan Stanley (“Morgan”), a financial holding company within the meaning of the Bank Holding Company Act (“BHC Act”), has requested the Board’s approval under section 3 of the BHC Act<sup>1</sup> to retain up to 9.9 percent of the voting shares of Herald National Bank (“Herald”), both of New York, New York, a newly chartered national bank.<sup>2</sup>

Notice of the proposal, affording interested persons an opportunity to submit comments, has been published (73 Federal Register 66,246 (2008)). The time for filing comments has expired, and the Board has considered the proposal and all comments received in light of the factors set forth in section 3 of the BHC Act.<sup>3</sup>

Morgan, with total consolidated assets of approximately \$626 billion, engages in commercial and investment banking, securities underwriting and dealing, asset management, trading, and other activities in the United States and abroad.

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<sup>1</sup> 12 U.S.C. § 1842.

<sup>2</sup> Herald began operations on November 24, 2008, as Heritage Bank, National Association, until it was renamed on January 2, 2009. Morgan holds the shares of Herald through two subsidiary hedge funds: Frontpoint Financial Services Fund, L.P. and Frontpoint Financial Horizons Fund, L.P., both of Greenwich, Connecticut. Morgan acquired the shares in Herald’s public offering as a passive fund investment. No shareholder of Herald controls more than 10 percent of the bank’s voting shares, although SCJ, Inc., Irvine, California, and the Carpenter Funds it controls, have received approval under section 3 of the BHC Act to acquire up to 18 percent of Herald’s voting shares.

<sup>3</sup> A commenter objected to the Board’s waiver of public notice of Morgan’s application last September to become a bank holding company. In its order approving that application and Morgan’s election to become a financial holding company, the Board explained its rationale for waiving the public comment period. Morgan Stanley, 94 Federal Reserve Bulletin C103 (2008) (“Morgan FHC Order”).

Morgan controls Morgan Stanley Bank, National Association (“Morgan Bank”), Salt Lake City, Utah, which operates one branch in the state, with total consolidated assets of approximately \$66.2 billion and deposits of approximately \$54.1 billion. In addition, Morgan controls Morgan Stanley Trust (“MS Trust”), Jersey City, New Jersey, a federal savings association, with total consolidated assets of \$6.6 billion and deposits of \$5.8 billion.<sup>4</sup> Herald, which controls deposits of \$114.7 million, operates only in New York.<sup>5</sup>

#### Noncontrolling Investment

Morgan has stated that it does not intend to control or exercise a controlling influence over Herald and that its investment in Herald is a passive investment.<sup>6</sup> In this

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<sup>4</sup> Asset and deposit data are as of March 31, 2009. Morgan also controls Morgan Stanley Trust National Association (“MSTNA”), Wilmington, Delaware, a limited-purpose national bank that engages only in trust or fiduciary activities and is exempt from the definition of “bank” under the BHC Act pursuant to section 2(c)(2)(D) of the BHC Act (12 U.S.C. § 1841(c)(2)(D)).

<sup>5</sup> In acting on Morgan’s application last September, the Board determined that emergency conditions existed at the time that justified the Board’s expeditious action on the proposal. Morgan FHC Order. When Morgan’s application was approved on September 21, 2008, Herald was well advanced in its preparations to commence operations. In light of the emergency conditions when the Board approved Morgan’s application, the timing of Herald’s plans to commence operations, and Morgan’s status as a minority investor in Herald, Morgan has been permitted to retroactively file an application to retain the Herald shares.

<sup>6</sup> Although the acquisition of less than a controlling interest in a bank or bank holding company is not a normal acquisition for a bank holding company, the requirement in section 3(a)(3) of the BHC Act that the Board’s approval be obtained before a bank holding company acquires more than 5 percent of the voting shares of a bank suggests that Congress contemplated the acquisition by bank holding companies of between 5 and 25 percent of the voting shares of banks. See 12 U.S.C. § 1842(a)(3). On this basis, the Board previously has approved the acquisition by a bank holding company of less than a controlling interest in a bank or bank holding company. See, e.g., Mitsubishi UFG Financial Group, 95 Federal Reserve Bulletin B34 (2009) (acquisition of up to 24.9 percent of the voting shares of a bank holding company); Brookline Bancorp, MHC, 86 Federal Reserve Bulletin 52 (2000) (acquisition of up to 9.9 percent of the voting shares of a bank holding company); Mansura Bancshares, Inc., 79 Federal Reserve

light, Morgan has agreed to abide by certain commitments substantially similar to those on which the Board has previously relied in determining that an investing bank holding company would not be able to exercise a controlling influence over another bank holding company or bank for purposes of the BHC Act (“Passivity Commitments”).<sup>7</sup> For example, Morgan has committed not to exercise or attempt to exercise a controlling influence over the management or policies of Herald or any of its subsidiaries; not to seek or accept more than one representative on the board of directors of Herald; and not to have any other officer, employee, or agent interlocks with Herald or any of its subsidiaries. The Passivity Commitments also include certain restrictions on the business relationships of Morgan with Herald.

Based on these considerations and all the other facts of record, the Board has concluded that Morgan has not acquired control of, nor has the ability to exercise a controlling influence over, Herald through the acquisition of the bank’s voting shares. The Board notes that the BHC Act requires Morgan to file an application and receive the Board’s approval before it directly or indirectly acquires additional shares of Herald or attempts to exercise a controlling influence over Herald.<sup>8</sup>

#### Competitive Considerations

The Board has considered carefully the competitive effects of the proposal in light of all the facts of the record. Section 3 of the BHC Act prohibits the Board from approving a proposal that would result in a monopoly or would be in furtherance of any attempt to monopolize the business of banking in any relevant banking market. The BHC Act also prohibits the Board from approving a bank acquisition that would substantially lessen competition in any relevant banking market, unless the Board finds that the anticompetitive effects of the proposal clearly are outweighed in the public

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Bulletin 37 (1993) (acquisition of 9.7 percent of the voting shares of a bank holding company).

<sup>7</sup> These commitments are set forth in the appendix.

<sup>8</sup> 12 U.S.C. § 1842. See, e.g., Emigrant Bancorp, Inc., 82 Federal Reserve Bulletin 555 (1996).

interest by the probable effect of the proposal in meeting the convenience and needs of the community to be served.<sup>9</sup>

The Board has previously stated that one company need not acquire control of another company to lessen competition between them substantially.<sup>10</sup> The Board has found that noncontrolling interests in directly competing depository institutions may raise serious questions under the BHC Act and has stated that the specific facts of each case will determine whether the minority investment in a company would be anticompetitive.<sup>11</sup>

Morgan and Herald compete directly in the Metro New York banking market.<sup>12</sup> The Board has reviewed carefully the competitive effects of the proposal in the Metro New York banking market in light of all the facts of the record. In particular, the Board has considered the number of competitors that remain in the banking market, the relative shares of total deposits in depository institutions in the market (“market deposits”) controlled by Morgan and Herald,<sup>13</sup> and the concentration level of market

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<sup>9</sup> 12 U.S.C. § 1842(c)(1).

<sup>10</sup> See, e.g., SunTrust Banks, Inc., 76 Federal Reserve Bulletin 542 (1990).

<sup>11</sup> See, e.g., BOK Financial Corp., 81 Federal Reserve Bulletin 1052 (1995).

<sup>12</sup> The Metro New York banking market includes Bronx, Dutchess, Kings, Nassau, New York, Orange, Putnam, Queens, Richmond, Rockland, Suffolk, Sullivan, Ulster, and Westchester Counties in New York; Bergen, Essex, Hudson, Hunterdon, Mercer, Middlesex, Monmouth, Morris, Ocean, Passaic, Somerset, Sussex, Union, and Warren Counties and the northern portions of Mercer County in New Jersey; Monroe and Pike Counties in Pennsylvania; and Fairfield County and portions of Litchfield and New Haven Counties in Connecticut.

<sup>13</sup> Except for deposit data for Herald, which are based on its March 31, 2009, call report, deposit and market share data are based on data reported by insured depository institutions in the summary of deposits data as of June 30, 2008. The data are also based on calculations in which the deposits of thrift institutions are included at 50 percent. The Board previously has indicated that thrift institutions have become, or have the potential to become, significant competitors of commercial banks. See, e.g., Midwest Financial Group, Inc., 75 Federal Reserve Bulletin 386 (1989); National City Corporation, 70 Federal Reserve Bulletin 743 (1984). Thus, the Board

deposits and the increase in the level as measured by the Herfindahl-Hirschman Index (“HHI”) under the Department of Justice Merger Guidelines (“DOJ Guidelines”).<sup>14</sup>

Consummation of the acquisition was consistent with Board precedent and within the thresholds in the DOJ Guidelines in the Metro New York banking market. On consummation, the banking market remained moderately concentrated, and numerous competitors remained in the market.<sup>15</sup>

The DOJ also has reviewed the matter and has advised the Board that it does not believe that Morgan’s ownership interest in Herald is likely to have a significant adverse effect on competition in any relevant banking market. The appropriate banking agencies have been afforded an opportunity to comment and have not objected to the application.

Based on all the facts of record, the Board has concluded that approval of Morgan’s application would not have a significantly adverse effect on competition or on the concentration of resources in any relevant banking market. Accordingly, the Board has determined that competitive factors are consistent with approval.

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regularly has included thrift deposits in the market share calculation on a 50 percent weighted basis. See, e.g., First Hawaiian, Inc., 77 Federal Reserve Bulletin 52 (1991).

<sup>14</sup> Under the DOJ Guidelines, a market is considered unconcentrated if the post-merger HHI is under 1000, moderately concentrated if the post-merger HHI is between 1000 and 1800, and highly concentrated if the post-merger HHI exceeds 1800. The Department of Justice (“DOJ”) has informed the Board that a bank merger or acquisition generally will not be challenged (in the absence of other factors indicating anticompetitive effects) unless the post-merger HHI is at least 1800 and the merger increases the HHI by more than 200 points. The DOJ has stated that the higher-than-normal HHI thresholds for screening bank mergers and acquisitions for anticompetitive effects implicitly recognize the competitive effects of limited-purpose and other nondepository financial entities.

<sup>15</sup> Taking into account the deposits of Mitsubishi UFJ Financial Group, Inc. (“MUFG”), Tokyo, Japan, which controls approximately 21 percent of Morgan, the HHI would remain unchanged at 1357, with 284 insured depository institutions competing in the Metro New York banking market. The combined deposits of MUFG, Morgan, and Herald represent less than 1 percent of market deposits.

### Financial, Managerial, and 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 depository institutions involved and certain other supervisory factors. The Board has carefully considered these factors in light of all the facts of record, including confidential supervisory and examination information received from the relevant federal and state supervisors of the organizations involved, publicly reported and other financial information, information provided by Morgan, and public comments received on the application.

In evaluating the financial factors in expansion proposals by banking organizations, the Board reviews the financial condition of the organizations involved on both a parent-only and consolidated basis, as well as the financial condition of the subsidiary depository institutions and significant nonbanking operations. In this evaluation, the Board considers a variety of information, including capital adequacy, asset quality, and earnings performance. In assessing financial factors, the Board consistently has considered capital adequacy to be especially important. The Board also evaluates the financial condition of the applicant, including its capital position, asset quality, earnings prospects, and the impact of the proposed funding of the transaction.

The Board has carefully considered the financial factors in this case. Morgan, its subsidiary depository institutions, and Herald are well capitalized. Based on its review of the record, the Board also finds that Morgan had sufficient capital and other resources to effect the acquisition. The transaction was structured as a cash purchase using Morgan's existing resources.

The Board also has considered the managerial resources of the organizations involved.<sup>16</sup> The Board has reviewed the examination records of Morgan

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<sup>16</sup> A commenter expressed concern about Morgan's role in the auction-rate securities market. The Board considered the August 2008 settlement between Morgan and the Attorney General of the State of New York and pending litigation involving these matters. As part of its ongoing supervision of Morgan, the Board monitors the status of government investigations, consults as needed with relevant regulatory authorities, and periodically reviews Morgan's potential liability from material litigation.

and its subsidiary depository institutions, including assessments of their management, risk-management systems, and operations. In addition, the Board has considered its supervisory experiences and those of the other relevant banking supervisory agencies with the U.S. banking operations of Morgan and their records of compliance with applicable banking law, including anti-money laundering laws.

Based on all the facts of record, the Board has concluded that the financial and managerial resources and the future prospects of Morgan, Herald, and their subsidiaries are consistent with approval of this application, as are the other supervisory factors the Board must consider under section 3 of the BHC Act.

#### Convenience and Needs Considerations

In acting on a proposal under section 3 of the BHC Act, the Board also must consider the effects of the proposal on the convenience and needs of the communities to be served and take into account the records of the relevant insured depository institutions under the Community Reinvestment Act (“CRA”).<sup>17</sup> The CRA requires the federal financial supervisory agencies to encourage insured depository institutions to help meet the credit needs of the local communities in which they operate, consistent with their safe and sound operation, and requires the appropriate federal financial supervisory agency to take into account a relevant depository institution’s record of meeting the credit needs of its entire community, including low- and moderate-income neighborhoods, in evaluating expansionary proposals.<sup>18</sup>

The Board has considered carefully all the facts of record, including reports of examination of the CRA performance records of Morgan’s subsidiary insured depository institutions, data reported by Morgan under the Home Mortgage Disclosure Act (“HMDA”),<sup>19</sup> as well as other information provided by Morgan, confidential supervisory information, and public comment received on the proposal. A commenter

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<sup>17</sup> 12 U.S.C. § 2901 et seq.; 12 U.S.C. § 2903; 12 U.S.C. § 1842(c)(2).

<sup>18</sup> 12 U.S.C. § 2903.

<sup>19</sup> 12 U.S.C. §2801 et seq.

alleged, based on HMDA data, that Morgan has engaged in disparate treatment of minority individuals in home mortgage lending. The commenter also expressed concern over subprime lending by Morgan and by Saxon Mortgage, Inc. (“Saxon Mortgage”), a subsidiary Morgan acquired in 2006. Morgan represented that it currently does not directly or indirectly originate subprime loans and that it has no plans to engage in such lending.

A. CRA Performance Evaluations

As provided in the CRA, the Board has considered the convenience and needs factor in light of the evaluations by the appropriate federal supervisors of the CRA performance records of the insured depository institutions of Morgan. 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.<sup>20</sup>

Morgan Bank received an “outstanding” rating at its most recent CRA performance evaluation by the Federal Deposit Insurance Corporation (“FDIC”), as of January 30, 2006.<sup>21</sup> Herald has not yet been evaluated under the CRA by the Office of the Comptroller of the Currency (“OCC”).

B. HMDA and Fair Lending Record

The Board has carefully considered the fair lending records and HMDA data of Morgan in light of public comments received on the application. Those comments alleged, based on 2007 HMDA data, that in certain metropolitan statistical areas (MSAs), Saxon Mortgage disproportionately made higher-cost loans to African

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<sup>20</sup> 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 Interagency Questions and Answers Regarding Community Reinvestment, 74 Federal Register 498 at 527 (2009).

<sup>21</sup> Morgan Bank became a national bank on September 23, 2008, on its conversion from a Utah-chartered industrial bank. The 2006 evaluation was conducted before this conversion. MSTNA is not an insured depository institution, and MS Trust is a limited-purpose savings association not subject to the CRA. See 12 CFR 563e.11(c)(2).

American and Hispanic borrowers than to nonminority borrowers.<sup>22</sup> The Board's consideration of HMDA-related comments included a review of 2007 HMDA data reported by Saxon Mortgage and Morgan Stanley Credit Corporation ("MSCC"). Morgan acquired Saxon Capital, Inc. ("Saxon Capital"), the parent of Saxon Mortgage, in 2006 and MSCC in 1997. Morgan now originates residential mortgage loans only through MSCC, which currently originates only prime mortgage loans. Morgan services mortgage loans through Saxon Capital, including subprime loans originated by Morgan and others.

Although the HMDA data might reflect certain disparities in the rates of loan applications, originations, denials, or pricing among members of different racial or ethnic groups in certain local areas, they provide an insufficient basis by themselves on which to conclude whether or not Morgan is excluding or imposing higher costs on any racial or ethnic group on a prohibited basis. The Board recognizes that HMDA data alone, even with the recent addition of pricing information, provide only limited information about the covered loans.<sup>23</sup> HMDA data, therefore, have limitations that make them an inadequate basis, absent other information, for concluding that an institution has engaged in illegal lending discrimination.

The Board is nevertheless concerned when HMDA data for an institution indicate disparities in lending and believes that all lending institutions are obligated to ensure that their lending practices are based on criteria that ensure not only safe and

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<sup>22</sup> Beginning January 1, 2004, the HMDA data required to be reported by lenders were expanded to include pricing information for loans on which the annual percentage rate exceeds the yield for U.S. Treasury securities of comparable maturity by 3 or more percentage points for first-lien mortgages and by 5 or more percentage points for second-lien mortgages. 12 CFR 203.4.

<sup>23</sup> The data, for example, do not account for the possibility that an institution's outreach efforts may attract a larger proportion of marginally qualified applicants than other institutions attract and do not provide a basis for an independent assessment of whether an applicant who was denied credit was, in fact, creditworthy. In addition, credit history problems, excessive debt levels relative to income, and high loan amounts relative to the value of the real estate collateral (reasons most frequently cited for a credit denial or higher credit cost) are not available from HMDA data.

sound lending but also equal access to credit by creditworthy applicants regardless of their race or ethnicity. Moreover, the Board believes that all bank holding companies and their affiliates must conduct their mortgage lending operations without any abusive lending practices and in compliance with all consumer protection law.

Because of the limitations of HMDA data, the Board has considered these data carefully and taken into account other information, including examination reports that provide on-site evaluations of compliance by Morgan's subsidiary insured depository institutions with fair lending laws. The Board also has consulted with the FDIC and OCC, Morgan Bank's former and current primary federal supervisors, respectively. In addition, the Board has considered information provided by Morgan about its compliance risk-management systems.

The record of this application, including confidential supervisory information, indicates that Morgan has taken steps to ensure compliance with fair lending and other consumer protection laws and regulations.<sup>24</sup> As noted, Morgan currently originates residential mortgage loans only through MSCC and services subprime loans only through Saxon Capital. Morgan represented that MSCC and Saxon Capital have policies and procedures to help ensure compliance with fair lending and other consumer protection laws and regulations. For example, MSCC uses an automated underwriting and loan-pricing system that substantially limits discretionary criteria and, before denying

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<sup>24</sup> A commenter expressed concern about Morgan's alleged warehouse financing to subprime lenders and securitization of subprime loans. Morgan represented that it does not provide warehouse lending or custodian services for subprime lenders. To the extent it provides servicing activities for subprime loans, Morgan asserted that it conducts due diligence to promote compliance with fair lending laws. Morgan also has asserted that, to the extent it underwrites securities for or participates in commercial loans to subprime lenders, Morgan has no role in the lending or credit review practices of those lenders. In addition, Morgan has represented that, to the extent it underwrites securities for subprime lenders, its due diligence procedures seek to ensure that mortgage pools supporting securitizations do not include loans subject to the Home Ownership and Equity Protection Act of 1994 or loans with predatory lending features. As noted above, the Board will continue to require all bank holding companies and their affiliates to conduct their lending operations without any abusive lending practices and in compliance with all applicable laws.

a loan application, MSCC makes reasonable efforts to gather additional information that could appropriately qualify an applicant. MSCC employees do not have override authority in pricing loans, and their compensation is not based on loan pricing. Morgan has represented that Saxon Capital clearly discloses fees to consumers and monitors fees to ensure compliance with applicable law. In addition, MSCC and Saxon Capital provide training in fair lending and consumer protection law to employees involved in originating and servicing loans and maintain complaint resolution systems. MSCC's fair lending compliance procedures include reviews of loan origination and pricing data that use statistical and comparative file analyses.

C. Conclusion on Convenience and Needs and CRA Performance

The Board has carefully considered all the facts of record, including the evaluation of the CRA performance record of Morgan Bank, information provided by Morgan, comments received on the proposal, and confidential supervisory information. Morgan represented that its investment in Herald has helped provide consumers with additional choices for meeting their banking needs. Based on a review of the entire record, including the noncontrolling nature of the investment, the Board concludes that considerations relating to the convenience and needs factor and the CRA performance records of the relevant insured depository institutions are consistent with approval of the transaction.

Conclusion

Based on the foregoing and all the facts of record, the Board has determined that the application should be, and hereby is, approved.<sup>25</sup> In reaching its

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<sup>25</sup> The Board also has approved the retention of the indirect interest in Herald held by MUFG. MUFG, a financial holding company within the meaning of the BHC Act, currently controls approximately 21 percent of the voting shares of Morgan Stanley. The Board notes that MUFG provided no funding for Morgan's acquisition of the Herald shares, and Morgan's retention of those shares would not alter the current structure of MUFG's investment in Morgan. In addition, MUFG's U.S. subsidiary banks remain well capitalized. The Board previously has determined that the foreign banks controlled by MUFG are subject to comprehensive supervision on a consolidated basis by their home country supervisor, the Japanese Financial Services Agency ("FSA").

conclusion, the Board has considered all the facts of record in light of the factors that it is required to consider under the BHC Act and other applicable statutes.<sup>26</sup> The Board's approval is specifically conditioned on compliance by Morgan with the conditions imposed in this order and the commitments made to the Board in connection with the application.<sup>27</sup> For purposes of this action, the conditions and commitments are deemed

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The Board has determined that these banks continue to be subject to comprehensive supervision on a consolidated basis by the FSA. All other factors are consistent with approval of MUFG's retention of its indirect interest in Herald.

<sup>26</sup> A commenter requested an extension of the comment period on the application. Notice of the application was published in the Federal Register on November 7, 2008. Newspaper notices were published on October 31 and November 4 in the appropriate newspapers of record, and the comment period ended on December 4, 2008. Accordingly, interested persons had approximately 34 days to submit views. This period provided sufficient time to the commenter to prepare and submit its comments and, as noted above, the commenter provided a written submission, which the Board considered carefully in acting on the application. The Board also has accumulated a significant record in this case, including reports of examination, confidential supervisory information and public reports and information, in addition to public comments. Moreover, the Board is required under applicable law and its regulations to act on applications submitted under the BHC Act within specified time periods. Based on all the facts of record, the Board has concluded that the record in this case is sufficient to warrant action at this time and that no extension of the comment period is necessary.

<sup>27</sup> A commenter requested that the Board hold a public meeting or hearing on the proposal. Section 3 of the BHC Act does not require the Board to hold a public hearing on an application unless the appropriate supervisory authority for the bank to be acquired makes a written recommendation of denial of the application. The Board has not received such a recommendation from the OCC. Under its rules, the Board also may, in its discretion, hold a public meeting or hearing on an application to acquire a bank if necessary or appropriate to clarify material factual issues related to the application and to provide an opportunity for testimony. 12 CFR 225.16(e) and 262.25(d). The Board has considered carefully the commenter's request in light of all the facts of record. As noted, the commenter had ample opportunity to submit its views and, in fact, submitted written comments that the Board has considered carefully in acting on the proposal. The commenter's request fails to demonstrate why written comments do not present its views adequately or why a meeting or hearing otherwise would be necessary or appropriate. For these reasons, and based on all the facts of record, the Board has determined that a public meeting or hearing is not required or warranted in this case. Accordingly, the request for public meeting or hearing on the application is denied.

to be conditions imposed in writing by the Board in connection with its findings and decision herein and, as such, may be enforced in proceedings under applicable law.

By order of the Board of Governors,<sup>28</sup> effective June 26, 2009.

*(signed)*

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Robert deV. Frierson  
Deputy Secretary of the Board

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<sup>28</sup> Voting for this action: Chairman Bernanke and Governors Warsh, Duke, and Tarullo.  
Absent and not voting: Vice Chairman Kohn.

## Appendix

### Passivity Commitments

Morgan Stanley (“Morgan”), New York, New York, and its subsidiaries (collectively, “the Morgan Stanley Group”), will not, without the prior approval of the Board or its staff, directly or indirectly:

1. Exercise or attempt to exercise a controlling influence over the management or policies of Herald National Bank (“Herald”), New York, New York, or any of its subsidiaries;
2. Have or seek to have any representative of the Morgan Stanley Group serve on the board of directors of any subsidiary of Herald;
3. Have or seek to have more than one representative of the Morgan Stanley Group serve on the board of directors of Herald or permit any representative of the Morgan Stanley Group who serves on the board of directors of Herald to serve as (i) the chairman of the board of directors of Herald, (ii) the chairman of any committee of the board of directors of Herald, or (iii) a member of any committee of the board of directors of Herald if such representative occupies more than 25 percent of the seats on the committee;
4. Have or seek to have any employee or representative of Morgan Stanley Group serve as an officer, agent, or employee of Herald or any of its subsidiaries;
5. Take any action that would cause Herald or any of its subsidiaries to become a subsidiary of Morgan;
6. Own, control, or hold with power to vote securities that (when aggregated with securities that the officers and directors of the Morgan Stanley Group own, control, or hold with power to vote) represent 25 percent or more of any class of voting securities of Herald or any of its subsidiaries;
7. Own or control equity interests that would cause the combined voting and nonvoting equity interests of the Morgan Stanley Group and its officers and directors to equal or exceed 25 percent of the total equity capital of Herald or any of its subsidiaries;
8. Except in connection with the Morgan Stanley Group’s representation on the board of directors of Herald consistent with paragraph 3 above, propose a director or slate of directors in opposition to a nominee or slate of nominees proposed by the management or board of directors of Herald or any of its subsidiaries;
9. Enter into any agreement with Herald or any of its subsidiaries that substantially limits the discretion of Herald’s management over major policies and decisions, including, but not limited to, policies or decisions about employing and compensating executive officers; engaging in new business lines; raising additional debt or equity

capital; merging or consolidating with another firm; or acquiring, selling, leasing, transferring, or disposing of material assets, subsidiaries, or other entities;

10. Except in connection with the Morgan Stanley Group's representation on the board of directors of Herald consistent with paragraph 3 above, solicit or participate in soliciting proxies with respect to any matter presented to the shareholders of Herald or any of its subsidiaries;
11. Dispose or threaten to dispose (explicitly or implicitly) of equity interests of Herald or any of its subsidiaries in any manner as a condition or inducement of specific action or non-action by Herald or any of its subsidiaries; or
12. Enter into any banking or nonbanking transactions with Herald or any of its subsidiaries, except that:
  - (a) The Morgan Stanley Group may establish and maintain deposit accounts with Herald; *provided*, that the aggregate balance of all such deposit accounts does not exceed \$500,000 and that the accounts are maintained on substantially the same terms as those prevailing for comparable accounts of persons unaffiliated with Herald; and
  - (b) The Morgan Stanley Group and Herald may sell loan participations to each other, provided that: (i) the Morgan Stanley Group and Herald each are free to enter into similar transactions with other parties; (ii) the Morgan Stanley Group and Herald each use its own underwriting criteria to evaluate potential participations; (iii) any and all loan participation transactions between the Morgan Stanley Group and Herald are at market terms and on an arm's-length basis; (iv) the aggregate balance of all such loan participations purchased by Herald from the Morgan Stanley Group does not exceed the dollar amount equal to 5 percent of Herald's total loans and leases, net of unearned income; and (v) the aggregate balance of any such loan participations sold by Herald to the Morgan Stanley Group does not exceed the dollar amount equal to 5 percent of Herald's total loans and leases, net of unearned income.

The terms used in these commitments have the same meanings as those set forth in the Bank Holding Company Act of 1956, as amended, and the Board's Regulation Y.

Morgan understands that these commitments constitute conditions imposed in writing in connection with the Board's findings and decision on Morgan's application to retain up to 9.9 percent of the voting shares of Herald, pursuant to 12 U.S.C. § 1842, and, as such, may be enforced in proceedings under applicable law.