

## FEDERAL RESERVE SYSTEM

China Investment Corporation  
Beijing, People's Republic of China

### Order Approving Acquisition of an Interest in a Bank Holding Company

China Investment Corporation (“CIC”), Beijing, People’s Republic of China, has requested the Board’s approval under section 3 of the Bank Holding Company Act of 1956, as amended (“BHC Act”),<sup>1</sup> to acquire indirectly up to 10 percent of the voting shares of Morgan Stanley, New York, New York.

Notice of the proposal, affording interested persons an opportunity to submit comments, has been published (75 Federal Register 45628 (August 3, 2010)). 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.

CIC is a sovereign wealth fund organized by the Chinese government for the purpose of investing its foreign exchange reserves. CIC controls Central SAFE Investments Limited (“Huijin”), also of Beijing, a Chinese government-owned investment company organized to invest in Chinese financial institutions. Huijin owns controlling interests in three Chinese banks that operate banking offices in the United States: Bank of China, China Construction Bank, and Industrial and Commercial Bank of China, all also of Beijing.<sup>2</sup> Under the International Banking Act, any foreign bank that operates a branch, agency, or commercial lending company in the United States, and any company that controls the foreign bank, is subject to the BHC Act as if the foreign bank

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<sup>1</sup> 12 U.S.C. § 1842.

<sup>2</sup> Bank of China operates two grandfathered insured federal branches in New York City and a limited federal branch in Los Angeles. Bank of China, in turn, controls a wholly owned subsidiary bank, Nanyang Commercial Bank, Limited, Hong Kong SAR, People’s Republic of China, that operates a federal branch in San Francisco. China Construction Bank operates a state branch and a representative office, and Industrial and Commercial Bank of China operates a state branch, all in New York City.

or company were a bank holding company.<sup>3</sup> As a result, CIC and Huijin are subject to the BHC Act as if they were bank holding companies<sup>4</sup> and are required to obtain prior Board approval to make a direct or indirect investment in 5 percent or more of the voting shares of a bank holding company or U.S. bank.<sup>5</sup>

In December 2007, CIC, primarily through a wholly owned nonbank subsidiary, invested in units consisting of trust preferred securities of Morgan Stanley and a stock purchase agreement to acquire voting common stock of Morgan Stanley by August 2010, subject to certain conditions.<sup>6</sup> In addition, CIC currently holds, through other subsidiaries, 2.49 percent of the voting common stock of Morgan Stanley. On consummation of the proposal, CIC would own and control up to 10 percent of Morgan Stanley's voting common stock. At the time of its initial investment in Morgan Stanley, CIC did not yet own the Chinese banks with U.S. branches and, therefore, was not subject to the BHC Act. In addition, Morgan Stanley, which became a bank holding company in September 2008, was not a bank holding company at the time it entered into

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<sup>3</sup> 12 U.S.C. § 3106.

<sup>4</sup> The Board previously provided certain exemptions to CIC and Huijin under section 4(c)(9) of the BHC Act, which authorizes the Board to grant to foreign companies exemptions from the nonbanking restrictions of the BHC Act where the exemptions would not be substantially at variance with the purposes of the act and would be in the public interest. See 12 U.S.C. § 1843(c)(9). The exemptions provided to CIC and Huijin do not extend to Bank of China, China Construction Bank, Industrial and Commercial Bank of China, or any other Chinese banking subsidiary of CIC or Huijin that operates a branch or agency in the United States. See Board letter dated August 5, 2008, to H. Rodgin Cohen.

<sup>5</sup> 12 U.S.C. § 1842(a)(3).

<sup>6</sup> The agreement provided that the trust preferred securities would either be remarketed in order to raise the funds necessary for CIC to purchase Morgan Stanley's voting common stock or directly redeemed in exchange for common stock of Morgan Stanley. The securities were converted directly into voting common stock of Morgan Stanley on August 17, 2010, and the portion of such shares that would have caused CIC to own more than 4.99 percent of Morgan Stanley's voting shares were transferred into a custody account. The shares in the custody account will be released on Board approval of this application and the expiration of the 15-day waiting period.

the stock purchase agreement with CIC. Therefore, the transaction in 2007 between CIC and Morgan Stanley did not require review or approval by the Board. Because Morgan Stanley is now a bank holding company and CIC is now subject to the BHC Act as if it were a bank holding company as a result of its acquisition of Huijin, CIC must receive prior Board approval under section 3(a)(3) of the BHC Act to own or control 5 percent or more of the voting shares of Morgan Stanley.<sup>7</sup>

Morgan Stanley, with total consolidated assets of approximately \$626 billion, engages in commercial and investment banking, securities underwriting and dealing, asset management, trading, and other activities both in the United States and abroad. Morgan Stanley 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 Stanley controls Morgan Stanley Private Bank, National Association (“MSPB”), Purchase, New York, with total consolidated assets of \$6.6 billion and deposits of \$5.8 billion.<sup>8</sup>

#### Noncontrolling Investment

CIC has stated that it does not propose to control or exercise a controlling influence over Morgan Stanley and that its indirect investment will be a passive investment.<sup>9</sup> CIC has agreed to abide by certain commitments substantially similar to

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<sup>7</sup> 12 U.S.C. § 1842(a)(3).

<sup>8</sup> In addition, Morgan Stanley holds a noncontrolling 9.9 percent interest in a bank holding company, Chinatrust Financial Holding Company, Ltd. (“Chinatrust”), Taipei, Taiwan, and a national bank, Herald National Bank (“Herald”), New York, New York. See Morgan Stanley, 95 Federal Reserve Bulletin B86 (2009), and Morgan Stanley, 95 Federal Reserve Bulletin B93 (2009).

<sup>9</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

those on which the Board has previously relied in determining that an investing 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”). For example, CIC has committed not to exercise or attempt to exercise a controlling influence over the management or policies of Morgan Stanley; not to seek or accept more than one representative on the board of directors of Morgan Stanley; and not to have any other director, officer, employee, or agent interlocks with Morgan Stanley. The Passivity Commitments also include certain restrictions on the business relationships between CIC and Morgan Stanley.

Based on these considerations and all the other facts of record, the Board has concluded that CIC would not acquire control of, or have the ability to exercise a controlling influence over, Morgan Stanley or any of its subsidiaries through the conversion of the trust preferred securities held by CIC in Morgan Stanley into voting common stock of Morgan Stanley. The Board notes that the BHC Act requires CIC to receive the Board’s approval before it directly or indirectly acquires additional shares of Morgan Stanley or attempts to exercise a controlling influence over Morgan Stanley or any of its subsidiaries.<sup>10</sup>

#### Competitive and Convenience and Needs Considerations

The Board has considered 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

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controlling interest in a bank or bank holding company. See, e.g., Mitsubishi UFG Financial Group, Inc., 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 Bulletin 37 (1993) (acquisition of 9.7 percent of the voting shares of a bank holding company).

<sup>10</sup> 12 U.S.C. § 1842. See, e.g., Emigrant Bancorp, Inc., 82 Federal Reserve Bulletin 555 (1996).

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 proposal that would substantially lessen competition in any relevant banking market, unless the anticompetitive effects of the proposal clearly are outweighed in the public interest by the probable effect of the proposal in meeting the convenience and needs of the community to be served.<sup>11</sup>

Several of the Chinese banks indirectly owned by CIC maintain branches that compete directly with a subsidiary bank of Morgan Stanley 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 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 relevant institutions,<sup>13</sup> and the concentration level of market deposits and the increase in the level as

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<sup>11</sup> 12 U.S.C. § 1842(c)(1).

<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> 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, 2009. 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 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).

measured by the Herfindahl-Hirschman Index (“HHI”) under the Department of Justice Bank Merger Competitive Review guidelines (“DOJ Bank Merger Guidelines”).<sup>14</sup>

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

The DOJ also has reviewed the matter and has advised the Board that it does not believe that CIC’s ownership interest in Morgan Stanley 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 consummation of the proposal would not have a significantly adverse effect on competition or on the concentration of banking resources in any relevant banking market and that competitive factors are consistent with approval of the proposal.

In addition, considerations relating to the convenience and needs of the communities to be served, including the records of performance of the institutions

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<sup>14</sup> Under the DOJ Bank Merger 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 would 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. Although the DOJ and the Federal Trade Commission recently issued revised Horizontal Merger Guidelines, the DOJ has confirmed that the DOJ Bank Merger Guidelines, which were issued in 1995, were not changed. Press Release, Department of Justice (August 19, 2010), available at [www.justice.gov/opa/pr/2010/August/10-at-938.html](http://www.justice.gov/opa/pr/2010/August/10-at-938.html).

<sup>15</sup> The HHI would remain unchanged at 1315 in the Metro New York banking market, which has 272 insured depository institution competitors. The combined deposits of the relevant institutions in the Metro New York banking market represent less than 1 percent of market deposits.

involved under the Community Reinvestment Act (“CRA”),<sup>16</sup> are consistent with approval of the application.<sup>17</sup> Morgan Bank received an “outstanding” rating at its most recent CRA performance evaluation by the FDIC, as of January 30, 2006.<sup>18</sup>

#### 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 depository institutions involved in the proposal, 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 regarding Morgan Stanley and its depository institution subsidiaries, publicly reported and other financial information, and information provided by CIC. With respect to the financial and managerial resources and future prospects of the companies and depository institutions involved in the proposal, Morgan Stanley’s subsidiary banks currently are well capitalized and would remain so on consummation of this proposal. In addition, the Board has considered the financial, managerial, and future prospects of CIC in light of the fact that CIC is a government-owned investment company organized to invest the foreign exchange reserves of the government.

Based on all the facts of record, the Board has concluded that considerations relating to the financial and managerial resources and future prospects

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<sup>16</sup> 12 U.S.C. § 2901 et seq.; 12 U.S.C. § 2903; 12 U.S.C. § 1842(c)(2).

<sup>17</sup> Bank of China has two grandfathered federal branches whose deposits are insured by the Federal Deposit Insurance Corporation (“FDIC”). The branches received a “satisfactory” rating at their most recent CRA performance evaluation by the FDIC, as of August 18, 2008.

<sup>18</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. MSPB became a national bank on July 1, 2010, on its conversion from a limited-purpose savings association not subject to the CRA. MSPB has not yet been evaluated under the CRA by the Office of the Comptroller of the Currency.

of the organizations involved in the proposal are consistent with approval, as are the other supervisory factors.<sup>19</sup>

#### Supervision or Regulation on a Consolidated Basis

In evaluating this application, the Board considered whether CIC is subject to comprehensive supervision or regulation on a consolidated basis by appropriate authorities in its home country. The system of comprehensive supervision or regulation may vary, depending on the nature of the acquiring company and the proposed investment. The Board believes that CIC may be found to be subject to an appropriate type and level of comprehensive regulation on a consolidated basis, given its unique nature and structure. CIC is an entity that is wholly owned by the government of China, was established to carry out the function of investing foreign exchange reserves, and is managed by officials who are selected by and report directly to the State Council of the People's Republic of China ("State Council"), which is the highest executive body in the Chinese government. The Chairman and Vice Chairman of CIC are appointed directly by the State Council and all other officer and director positions must be approved by the State Council. Each of the following Chinese government agencies is entitled to a seat on CIC's board of directors: the Ministry of Finance, the People's Bank of China ("PBOC"), the National Development and Reform Commission, the Ministry of Commerce, and the State Administration of Foreign Exchange. In addition, the Ministry of Finance of the People's Republic of China supervises CIC's finances and accounting,

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<sup>19</sup> Section 3 of the BHC Act also requires the Board to determine that an applicant has provided adequate assurances that it will make available to the Board such information on its operations and activities and those of its affiliates that the Board deems appropriate to determine and enforce compliance with the BHC Act. 12 U.S.C. § 1842(c)(3)(A). CIC has committed that, to the extent not prohibited by applicable law, it will make available to the Board such information on the operations of its affiliates that the Board deems necessary to determine and enforce compliance with the BHC Act, the International Banking Act, and other applicable federal laws. CIC also has committed to cooperate with the Board to obtain any waivers or exemptions that may be necessary to enable it or its affiliates to make such information available to the Board. Based on all facts of record, the Board has concluded that CIC has provided adequate assurances of access to any appropriate information the Board may request.

and China's National Audit Office conducts periodic external audits of CIC. This oversight by the State Council and by a number of agencies of the Chinese government, including the Ministry of Finance and the PBOC, allows for review of the worldwide investment strategy and portfolio of CIC. On this basis, appropriate authorities in China would appear to have full access to and oversight of CIC and its activities.

In considering this issue, the Board has taken into account that the proposed investment in Morgan Stanley would be a minority, noncontrolling interest. CIC has represented that it has no intention to control or exercise a controlling interest over Morgan Stanley and, as noted, has provided the Board with Passivity Commitments that help ensure that CIC cannot exercise control or a controlling influence. In addition, business relationships between CIC and Morgan Stanley are limited by the Passivity Commitments.

Based on all the facts of record, the Board has determined that CIC is subject to comprehensive supervision on a consolidated basis by its appropriate home country authorities for purposes of this application.<sup>20</sup>

### Conclusion

Based on the foregoing and all the facts of record, the Board has approved CIC's application to acquire up to 10 percent of the voting shares of Morgan Stanley pursuant to section 3(a)(3) of the BHC Act.<sup>21</sup> In reaching its 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.

The Board's approval is specifically conditioned on compliance by CIC with the conditions imposed in this order and the commitments made to the Board in

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<sup>20</sup> Neither Huijin nor any of the three Chinese banks with U.S. banking operations that are controlled by Huijin will be a direct or indirect investor in Morgan Stanley. In evaluating a proposal by Huijin or any of the Chinese banks owned by Huijin to acquire an insured depository institution in the United States, the Board would evaluate whether that entity is subject to consolidated comprehensive home country supervision.

<sup>21</sup> The Board also has approved the indirect acquisition by CIC of Morgan's interests in Chinatrust and Herald.

connection with the application. For purposes of this action, the conditions and commitments are deemed 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.

The proposal may not be consummated before the fifteenth calendar day after the effective date of this order, or later than three months after the effective date of this order, unless such period is extended for good cause by the Board or the Federal Reserve Bank of New York, acting pursuant to delegated authority.

By order of the Board of Governors,<sup>22</sup> August 31, 2010.

*(signed)*

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Robert deV. Frierson  
Deputy Secretary of the Board

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<sup>22</sup> Voting for this action: Chairman Bernanke and Governors Kohn, Warsh, Duke, and Tarullo.