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

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

May 24, 2012

Eric F. Grossman, Esq.
Chief Legal Officer
Morgan Stanley
1585 Broadway
New York, New York 10036

Dear Mr. Grossman:

This is in response to the notice by Morgan Stanley requesting the Board's prior approval of its proposed acquisition of additional shares of Morgan Stanley Smith Barney Holdings LLC ("MSSB"), a joint venture between Morgan Stanley and Citigroup Inc. ("Citigroup"), all of New York, New York. The notice is required under section 163(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act").[1]

Morgan Stanley is a financial holding company within the meaning of the Bank Holding Company Act ("BHC Act").[2] MSSB engages in the following activities under the BHC Act: (1) underwriting, dealing in, and making a market in securities pursuant to section 4(k)(4)(E);[3] (2) life insurance and annuity advisory activities pursuant to section 4(k)(4)(B);[4] and (3) other financial activities that are closely related to banking pursuant to section 4(k)(4)(F).[5]

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[1] Pub. L. No. 111-203, § 163(b), 124 Stat. 1376, 1422-23 (2010), codified at 12 U.S.C. § 5363(b).

[2] 12 U.S.C. § 1843(*l*).

[3] 12 U.S.C. § 1843(k)(4)(E).

[4] 12 U.S.C. § 1843(k)(4)(B).

[5] 12 U.S.C. § 1843(k)(4)(F). Those other activities include extending credit (12 CFR 225.28(b)(1)), trust company functions (12 CFR 225.28(b)(5)), financial and investment advisory activities (12 CFR 225.28(b)(6)), agency transactional services (12 CFR 225.28(b)(7)), and investing and trading activities in foreign exchange, forward contracts, options, and futures (12 CFR 225.28(b)(8)).

Morgan Stanley and Citigroup established MSSB as a joint venture in 2009 by combining Morgan Stanley's global wealth management group with various Citigroup business lines. Morgan Stanley currently owns 51 percent of MSSB and holds options to acquire Citigroup's 49 percent interest in MSSB in three one-year increments.[6] Morgan Stanley proposes to exercise the first of the options and acquire an additional 14 percent interest in MSSB from Citigroup.

Section 4(k) of the BHC Act generally permits financial holding companies to acquire shares of companies that conduct activities that are financial in nature without prior Board approval.[7] However, section 163(b) of the Dodd-Frank Act provides an exception to the general rule and requires prior Board approval before a bank holding company with assets of $50 billion or more may acquire shares of a company with assets of $10 billion or more that is engaged in activities under section 4(k) of the BHC Act. Morgan Stanley and MSSB exceed those asset thresholds.[8] Accordingly, Morgan Stanley's acquisition of an additional 14 percent interest in MSSB requires the Board's prior approval.[9]

Section 163(b) of the Dodd-Frank Act provides that the standards listed in section 4(j)(2) of the BHC Act shall apply to transactions subject to section 163.[10] Accordingly, the Board has considered whether the proposed

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[6] Morgan Stanley has options to acquire the following interests in MSSB: (1) 14 percent, exercisable beginning June 1, 2012; (2) 15 percent, exercisable beginning June 1, 2013; and (3) the remaining 20 percent, exercisable beginning June 1, 2014.

[7] 12 U.S.C. § 1843(k)(6).

[8] As of December 31, 2011, Morgan Stanley had total consolidated assets of $750 billion, and MSSB had total consolidated assets of $34.3 billion.

[9] Section 163(b)(2) of the Dodd-Frank Act provides an exemption to the prior notice requirement for the acquisition of shares that would qualify for the exemptions in sections 4(c) or 4(k)(4)(E) of the BHC Act. 12 U.S.C. § 5363(b)(4). Morgan Stanley's proposed acquisition of additional shares of MSSB is not eligible for the exemptions in section 4(c) of the BHC Act. In addition, because MSSB engages in activities other than underwriting, dealing in, or making a market in securities, the proposed transaction does not qualify for the exemption in section 4(k)(4)(E) of the BHC Act.

[10] 12 U.S.C. § 5363(b)(4).

acquisition can "reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interests, unsound banking practices, or risk to the stability of the United States banking or financial system."[11] In addition, as required by section 163(b)(4) of the Dodd-Frank Act, the Board has considered the extent to which the proposed acquisition "would result in greater or more concentrated risks to global or United States financial stability or the United States economy."[12] Under those standards, and as discussed more fully below, the Board has considered the financial and managerial resources of the companies involved, the effect of the proposal on competition in the relevant markets, the risk to global financial stability and the stability of the United States banking or financial system and economy, and the public benefits of the proposal.

Financial and Managerial Resources. In reviewing the financial resources of Morgan Stanley and MSSB, the Board has considered the financial condition of both organizations, including information about capital adequacy, asset quality, and earnings performance. The Board also has evaluated the pro forma financial condition of Morgan Stanley after consummation, including its projected capital position, asset quality, and earnings projections, and the impact of the proposed funding of the transaction. Morgan Stanley's regulatory capital ratios exceed the minimums required of well-capitalized bank holding companies and would continue to do so on consummation of the proposal. Consummation of the proposed transaction is also expected to enhance Morgan Stanley's earnings performance as a result of Morgan Stanley's right to receive an additional 14 percent of the revenues generated by MSSB. Based on its review of the record, the Board finds that Morgan Stanley has sufficient financial resources to effect the proposal.[13]

The Board also has considered the managerial resources of the organizations involved and, in particular, has reviewed the examination records of Morgan Stanley and its subsidiary depository institutions, including assessments of their management, risk-management systems, and operations. In addition, the Board has considered its supervisory experience with Morgan Stanley since it became a financial holding company in late 2008. Morgan Stanley currently has

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[11] 12 U.S.C. § 1843(j)(2).

[12] 12 U.S.C. § 5363(b)(4).

[13] Morgan Stanley proposes to fund the transaction with available cash resources.

operational control of MSSB, and MSSB is included in Morgan Stanley's consolidated financial statements. Under Morgan Stanley's operational control, MSSB has devoted significant resources to initiatives designed to integrate legacy business lines of Morgan Stanley and Citigroup, including the establishment of a new operating platform. Based on all the facts of record, the Board has concluded that considerations relating to the financial and managerial resources of the organizations involved in the proposal are consistent with approval.

Competitive Considerations. In addition, the Board has considered the competitive effects of Morgan Stanley's proposed acquisition of an additional 14 percent interest in MSSB. As noted above, Morgan Stanley currently owns 51 percent of MSSB. Morgan Stanley already is deemed to control MSSB for purposes of the BHC Act, and MSSB is included in Morgan Stanley's consolidated financial statements. Accordingly, based on all the facts of record, the Board has concluded that consummation of the proposed transaction would not have a significantly adverse effect on competition or on the concentration of resources in any relevant market and that competitive considerations are consistent with approval.

Financial Stability. The Board also has considered risk to the stability of the United States banking or financial system and the extent to which the proposed acquisition would result in greater or more concentrated risks to global or United States financial stability or the United States economy. In evaluating the effects of the proposed transaction on financial stability, the Board considers the size of the resulting firm; availability of substitute providers for any critical products and services offered by the resulting firm; interconnectedness of the resulting firm with the banking or financial system; extent to which the resulting firm contributes to the complexity of the financial system; and extent of the cross-border activities of the resulting firm. The Board has considered that Morgan Stanley already owns a 51 percent interest in MSSB and currently consolidates MSSB in its financial statements. The Board also has considered that the proposed transaction could increase Morgan Stanley's consolidated liabilities and deposits by a relatively small amount. The transaction would not increase Morgan Stanley's interconnectedness, complexity, or cross-border activities; nor would it affect the availability of substitute providers of Morgan Stanley or MSSB's products and services. Based on all the facts of record, the Board has determined that considerations relating to financial stability are consistent with approval.

Public Benefits. The Board has taken these and other considerations into account in reviewing the public benefits and possible adverse effects of the proposal. The transaction is expected to enhance Morgan Stanley's earnings performance as a result of Morgan Stanley's right to receive an additional 14 percent of the revenues generated by MSSB. In addition, Morgan Stanley has improved the operations of MSSB through integration initiatives, and the proposed transaction would provide additional incentive for Morgan Stanley to enhance MSSB's performance by further aligning Morgan Stanley's economic interests with its managerial control of MSSB. On the other hand, in light of Morgan Stanley's existing operational control and financial consolidation of MSSB, consummation of the proposal is not likely to result in significant adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interests, unsound banking practices, risk to the stability of the United States banking or financial system, or greater or more concentrated risks to global or United States financial stability or the United States economy. Accordingly, based on all the facts of record, the Board has determined that the balance of the public benefits it must consider is consistent with approval.

Based on all the facts of record, the Board has determined that the notice should be, and hereby is, approved. In making this determination, the Board has relied on all the information and representations provided by Morgan Stanley in connection with the notice, including the estimated purchase price of the transaction. This determination also is subject to the Board's authority to require modification or termination of the activities of a bank holding company or any of its subsidiaries as the Board finds necessary to ensure compliance with, or prevent evasion of, the provisions and purposes of the BHC Act and the Board's regulations and orders issued thereunder.

Please advise the Federal Reserve Bank of New York in writing when the transaction is consummated.

Sincerely yours,

Robert deV. Frierson

Robert deV. Frierson
Deputy Secretary of the Board

cc: Ivan J. Hurwitz, Vice President
Federal Reserve Bank of New York