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Morgan Stanley Bank

Member Federal Deposit Insurance Corporation

May 7, 2007

Mr. Robert Feldman
Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429

Re: Proposed Rule Part 354 – Industrial Bank Subsidiaries of Financial Companies; RIN No. 3064-AD15

Dear Mr. Feldman;

Morgan Stanley Bank submits these comments in response to the FDIC's February 5, 2007 request for public comments on the Corporation's proposed rules governing industrial banks operated by "financial companies."

Morgan Stanley Bank is an industrial bank chartered in the state of Utah. Our institution is controlled by Morgan Stanley, a financial services firm that is subject to holding company oversight as a "consolidated supervised entity" by the Securities and Exchange Commission, and as a thrift holding company by the Office of Thrift Supervision. Because the proposal focuses on industrial bank affiliations between industrial banks and nonfinancial companies that occur after the effective date of the rule, most of its provisions are not applicable to Morgan Stanley or its Bank, and we will not comment on them. The Securities Industry and Financial Markets Association intends to address in its comments issues affecting industrial bank ownership by financial services firms that occur in the future, and we urge the FDIC to consider those comments.

1. Absent a change in the law, the FDIC is not authorized to establish separate rules for "financial" and "non financial" industrial bank owners, or to require "financial" owners to engage solely in financial activities. Morgan Stanley Bank's letter to the FDIC in response to the earlier request for comments about industrial banks addressed this issue in detail. The fact that Congress is currently considering amendments to the FDI Act to

draw a distinction between financial and non-financial industrial bank owners (and to define "commercial" industrial bank owners) is clear evidence that the current law does not do this, or empower the Board to do so. The Board's moratorium on the approval of new charters for industrial banks with commercial owners was intended to provide an opportunity for Congress to clarify its intention with respect to these banks, and there are strong indications that legislation addressing industrial bank ownership and holding company supervision will be enacted in the current Congress. The FDIC should defer implementing a rule on industrial bank subsidiaries of financial companies until this legislation becomes law.

2. Industrial bank owners subject to oversight as "consolidated supervised entities" by the Securities and Exchange Commission should be treated in the same manner as those subject to oversight by federal bank supervisors. Specifically, the exemption in the proposed rule for financial companies that are supervised by the Federal Reserve Board or the Office of Thrift Supervision should also include companies supervised as consolidated supervised entities by the Securities and Exchange Commission. The reference in the rule to "Federal Consolidated Bank Supervision" should be revised wherever it appears to refer to "federal consolidated supervision."

The SEC's oversight regime for CSEs should be expressly recognized. As the FDIC is aware, firms regulated under the Securities and Exchange Commission's CSE regime control the bulk of the assets of the industrial bank industry. Like Federal Reserve and OTS oversight of bank and thrift holding companies, the SEC's oversight of consolidated supervised entities entails an enterprise-wide examination that allows supervisors to pinpoint activities that could weaken the holding company to the detriment of its regulated affiliates. Consolidated supervised entity oversight was discussed in depth in recent Congressional hearings by representatives of the Securities and Exchange Commission and the Securities Industry and Financial Markets Association[1] and we urge the FDIC to consider these presentations as part of its current rulemaking proceeding.

The FDIC should also take note of the approval by the Financial Services Committee of H.R. 698 on May 3, 2007. That legislation expressly recognizes CSE oversight and exempts industrial bank owners subject to such oversight from the requirement that industrial banks' owners register with the FDIC as "industrial bank holding companies." The co-sponsors of that legislation (Chairman Barney Frank and Rep. Paul Gillmor) have been among the most enthusiastic supporters of limiting "commercial" firms' ownership of industrial banks and ensuring that all industrial bank owners are subject to consolidated holding company supervision. The recognition of CSE oversight in their bill and the bipartisan support for that approach by the Financial Services Committee should be reflected in any regulatory regime for financial companies that control industrial banks.

3. The rule should not impose new requirements on industrial bank owners subject to federal consolidated supervision in the event of a change of control in which the

[1] Hearings before House Subcommittee on Financial Institutions on H.R. 698 (April 25, 2007).

acquiring company is subject to federal consolidated supervision. As currently drafted, new restrictions – including a requirement that the holding company engage "solely" in financial activities[2] - would be imposed in the event of a change in control. The expressed purpose for the proposed rule is to establish an enhanced regulatory oversight over industrial banks whose holding companies do not have a federal consolidated supervisor, and the rule would not apply to companies subject to such supervision. There is no need to change that rule for banks that undergo a change in control that does not result in the loss of holding company supervision.

The proposed rule defines "control" by reference to that term as used in the Change in Bank Control Act (12 U.S.C. 1817j) and federal regulations implementing it (12 C.F.R. 303.80). However, that statute's notification provisions are very broad. They cover not just transactions in which the ownership and operational control of a bank is transferred from one entity to another (e.g. where an industrial bank owned by a financial firm (or the firm itself) is sold to a commercial entity), but also transfers of small minority interests. This could include an acquisition of as little as 10% of a class of voting securities, a transaction that could occur when a mutual fund, in the open market, acquires 10% of a class of voting shares of an industrial bank owner. Such an interest does not give the owners of these securities operational control of the holding company or the bank or otherwise transform the nature of the holding company, and should not trigger changes in the regulatory requirements applicable to the bank or the activities permissible for the bank's owner.

Respectfully submitted,

Morgan Stanley Bank

By Susan E Carroll
Susan Carroll
President

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[2] The FDIC's proposed requirement that new owners of industrial banks engage exclusively in financial activities is inconsistent with current law, which imposes no such restriction, and even with the proposed limitation under consideration by Congress. H.R. 698 allows industrial bank owners to derive up to 15% of consolidated revenues from nonfinancial activities. Similarly, legislation approved by the House of Representatives in the 108th and 109th Congresses to limit the ability of industrial banks with "commercial" owners to offer interest-paying NOW accounts and to establish interstate branches covered only firms with commercial revenues in excess of 15%. The proposed ban on all commercial activities for industrial bank owners is more rigorous than the standard applicable to "financial holding companies" under the Bank Holding Company Act. In additional to "financial in nature" and activities "incidental" to financial activities, financial holding companies are authorized to engage in commercial activities that are "complementary" to a financial activity.