MEMORANDUM

TO: Public File - Notice of Public Rulemaking: Liquidity Coverage Ratio: Liquidity Risk Measurement, Standards, and Monitoring, (RIN 3064-AE04) ("Liquidity Coverage Ratio NPR")

FROM: Greg Feder, Counsel, Legal Division

DATE: May 21, 2014

SUBJECT: Meeting with Representatives from Morgan Stanley

On April 14, 2014, FDIC staff, together with staff of the Board of Governors of the Federal Reserve System and the Office of the Comptroller of the Currency, met with representatives of Morgan Stanley.

Representatives from Morgan Stanley presented their concerns and views with regard to certain provisions of the Liquidity Coverage Ratio NPR, which was issued in the Federal Register of November 29, 2013 (78 FR 71818), including the impact of the NPR on brokered sweep deposits and prime brokerage operations, as reflected in the attached materials.

The FDIC representatives at this meeting were:

- Kyle Hadley, Section Chief for Examination Support, Capital Markets/RMS
- Eric Schatten, Policy Analyst, Capital Markets/RMS
- Greg Feder, Counsel, Legal Division

Morgan Stanley's representatives in attendance at this meeting were:

- Penny Novick, Managing Director, Prime Brokerage
- Dan Park, Managing Director, Corporate Treasury
- Adeesh Setya, Managing Director, Corporate Treasury
- Erik Soderberg, Executive Director, Corporate Treasury
- Andrew Nash, Vice President, Legal

Materials from Morgan Stanley are attached.

Bank Deposit Program – LCR NPR Considerations

(Non- Confidential Version)

April 2014

Introduction to the Bank Deposit Program

- Bank Deposit Program (BDP) is the default cash sweep investment for excess cash held by clients in eligible brokerage accounts
- Cash is swept into omnibus accounts at the banks held in the name of the broker-dealer
- The balance in the omnibus account changes as a result of clients' daily net activity across all brokerage accounts
- Two Banks utilized to enhance available FDIC coverage for retail clients
- Deep and broad franchise relationships anchored through full-service investment advice
- Client deposit rate is based on relationship pricing: the greater the household assets at Morgan Stanley, the more favorable the rate
- As of December 31, 2013, the BDP balance of $103.6 Bn was divided between the firm's two U.S. banks as follows:
  - $83.2 Bn at Morgan Stanley Bank, N.A.
  - $20.4 Bn at Morgan Stanley Private Bank, N.A.

Bank Deposit Program – A Brief History

- Morgan Stanley launched the Bank Deposit Program (BDP) in late 2005 to offer retail brokerage clients the benefits of a deposit account and respond to competitive offerings from other brokerage firms
- On January 2009, Morgan Stanley and Citigroup announced a joint venture (Morgan Stanley Smith Barney, "MSSB") 51% owned by Morgan Stanley
- Full ownership of MSSB is largely contributing to deposit growth

LCR Considerations – Fully Insured Deposits

- The LCR NPR distinguishes between fully insured and partially insured deposits
- The LCR NPR proposes a 10% runoff rate for fully insured sweep deposits from affiliates
- Based on Morgan Stanley's experience these deposits should receive the same runoff treatment as stable retail deposits (3%) for the following reasons:
  - Morgan Stanley Banks' affiliate sweep deposits have demonstrated remarkable stability over a wide range of economic scenarios – typical of broad, deep, diversified and tenured retail franchise relationships
  - Experience in sustained idiosyncratic stress scenario from 2008 confirms stability
  - Insured sweep deposits are "right-way risk" in a crisis environment, as clients seek to de-risk by selling securities and increasing cash holdings
- Period of increased credit spread volatility in 2011 (Europe) and 2012 (Moody's downgrade) reconfirms stability assumption of deposits

Illustrative Internal Coverage Transactions

Loss of Client 1 Short:

1. Replaced by TSY funding for Issuer A and Issuer D Shorts

Funding Requirements

- Loss of Internal Coverage: $110

Mitigants to loss of internal coverage

Simulation of PB Client Leaving the Firm – Step 1 Loss of Internal Coverage

Starting Balance Sheet (No TSY Funding)

	Assets		Liabilities	
Issuer A	Client 2 Debit	55	Client 1 Short	55
	External Borrow	40	Client 3 Short	40
	Subtotal	**95**		**95**
Issuer B	Client 1 Debit	35	Client 2 Short	5
	Client 3 Debit	80	Repo	110
	Subtotal	**115**		**115**
Issuer C	Client 1 Debit	65	Client 3 Short	125
	Client 2 Debit	25		
	External Borrow	35		
	Subtotal	**125**		**125**
Issuer D	Client 4 Debit	120	Client 1 Short	55
			Client 2 Short	65
	Subtotal	**120**		**120**
	Grand Total	**455**		**455**

Step 1 – Loss of Client 1 Shorts

	Assets		Liabilities	
Issuer A	Client 2 Debit	55	~~**Client 1 Short**~~	~~**55**~~
	External Borrow	40	Client 3 Short	40
			TSY Funding	**55**
	Subtotal	**95**		**95**
Issuer B	Client 1 Debit	35	Client 2 Short	5
	Client 3 Debit	80	Repo	110
	Subtotal	**115**		**115**
Issuer C	Client 1 Debit	65	Client 3 Short	125
	Client 2 Debit	25		
	External Borrow	35		
	Subtotal	**125**		**125**
Issuer D	Client 4 Debit	120	~~**Client 1 Short**~~	~~**55**~~
			Client 2 Short	65
			TSY Funding	**55**
	Subtotal	**120**		**120**
	Grand Total	**455**		**455**

Illustrative Internal Coverage Transactions

Loss of Client 1 Margin Loans:

1. External borrows replace Client1 Issuer C long position
2. Existing repo capacity for Issuer B is used to fund Issuer D

Funding Requirements

- Loss of Internal Coverage: $110
- Freed-up secured financing: ($35)
- Net Outflow $75

Mitigants to loss of internal coverage

Simulation of PB Client Leaving the Firm – Step 2 Freed-up secured financing

Step 1 – Loss of Client 1 Shorts

	Assets		Liabilities	
Issuer A	Client 2 Debit	55	~~Client 1 Short~~	~~55~~
	External Borrow	40	Client 3 Short	40
			TSY Funding	**55**
	Subtotal	**95**		**95**
Issuer B	Client 1 Debit	35	Client 2 Short	5
	Client 3 Debit	80	Repo	110
	Subtotal	**115**		**115**
Issuer C	Client 1 Debit	65	Client 3 Short	125
	Client 2 Debit	25		
	External Borrow	35		
	Subtotal	**125**		**125**
Issuer D	Client 4 Debit	120	~~Client 1 Short~~	~~55~~
			Client 2 Short	65
			TSY Funding	**55**
	Subtotal	**120**		**120**
	Grand Total	**455**		**455**

Step 2 – Loss of Client 1 Margin

	Assets		Liabilities	
Issuer A	Client 2 Debit	55	~~Client 1 Short~~	~~55~~
	External Borrow	40	Client 3 Short	40
			TSY Funding	55
	Subtotal	**95**		**95**
Issuer B	2 ~~Client 1 Debit~~	~~35~~	Client 2 Short	5
	Client 3 Debit	80	Repo	75
	Subtotal	**80**		**80**
Issuer C	1 ~~Client 1 Debit~~	~~65~~	Client 3 Short	125
	Client 2 Debit	25		
	External Borrow	100		
	Subtotal	**125**		**125**
Issuer D	Client 4 Debit	120	~~Client 1 Short~~	~~55~~
			Client 2 Short	65
			Repo	**35**
			TSY Funding	**20**
	Subtotal	**120**		**120**
	Grand Total	**420**		**420**

Illustrative Internal Coverage Transactions

Use of Excess IC Capacity:

1. Return external borrows for Issuer A
2. Use Client 3 Issuer A shorts to fund the Client 2 margin, and reduce Treasury funding accordingly

Funding Requirement:

- Original loss of internal coverage - $110
- Actual funding requirement from TSY - $35
- **Client Cross Funding**:

  If the Firm loses shorts from more than one client, there is a high probability that the debit of one of the clients be funded by the shorts of the other; as a result, the loss of internal coverage is partially offset with the loss of debit

Mitigants to loss of internal coverage

Simulation of PB Client Leaving the Firm – Step 3 Excess Internal Coverage Capacity & Client Cross Funding

Step 2 – Loss of Client 1 Margin

	Assets		Liabilities	
Issuer A	Client 2 Debit	55	~~Client 1 Short~~	~~55~~
	External Borrow	40	Client 3 Short	40
			TSY Funding	55
	Subtotal	**95**		**95**
Issuer B	~~Client 1 Debit~~	~~35~~	Client 2 Short	5
	Client 3 Debit	80	Repo	75
	Subtotal	**80**		**80**
Issuer C	~~Client 1 Debit~~	~~65~~	Client 3 Short	125
	Client 2 Debit	25		
	External Borrow	100		
	Subtotal	**125**		**125**
Issuer D	Client 4 Debit	120	~~Client 1 Short~~	~~55~~
			Client 2 Short	65
			Repo	**35**
			TSY Funding	**20**
	Subtotal	**120**		**120**
	Grand Total	**420**		**420**

Step 3 – Use of Excess IC Capacity

	Assets		Liabilities	
Issuer A	Client 2 Debit	55	~~Client 1 Short~~	~~55~~
	1 ~~External Borrow~~	~~0~~	2 Client 3 Short	40
			TSY Funding	15
	Subtotal	**55**		**55**
Issuer B	~~Client 1 Debit~~	~~35~~	Client 2 Short	5
	Client 3 Debit	80	Repo	75
	Subtotal	**80**		**80**
Issuer C	~~Client 1 Debit~~	~~65~~	Client 3 Short	125
	Client 2 Debit	25		
	External Borrow	100		
	Subtotal	**125**		**125**
Issuer D	Client 4 Debit	120	~~Client 1 Short~~	~~55~~
			Client 2 Short	65
			Repo	35
			TSY Funding	20
	Subtotal	**120**		**120**
	Grand Total	**380**		**380**

Client Cross Funding