

MEMORANDUM

TO: File Number S7-04-21

FROM: Sheila Dombal Swartz
Senior Special Counsel
Office of Financial Responsibility, Division of Trading and Markets
U.S. Securities and Exchange Commission

DATE: May 14, 2021

RE: Meeting with Representatives of Morgan Stanley

On May 14, 2021, Commission staff met via telephone with Andrew Nash, Maria-Ines Raij, Yujing Yue, Henry Webb, Gareth James and Kieran O'Regan, representatives of Morgan Stanley, in connection with the proposed order for substituted compliance for security-based swap dealers and major security-based swap participants subject to regulation in the United Kingdom. Commission staff included Mark Wolfe, Carol McGee, Laura Compton, Pamela Carmody, James Curley, Michael Macchiaroli, Thomas McGowan, Randall Roy, Sheila Swartz, and Jonathan Balcom. The Morgan Stanley representatives discussed the proposed conditions for a positive substituted compliance determination with respect to Securities Exchange Act rule 18a-1.

Morgan Stanley



United Kingdom Substituted Compliance Order

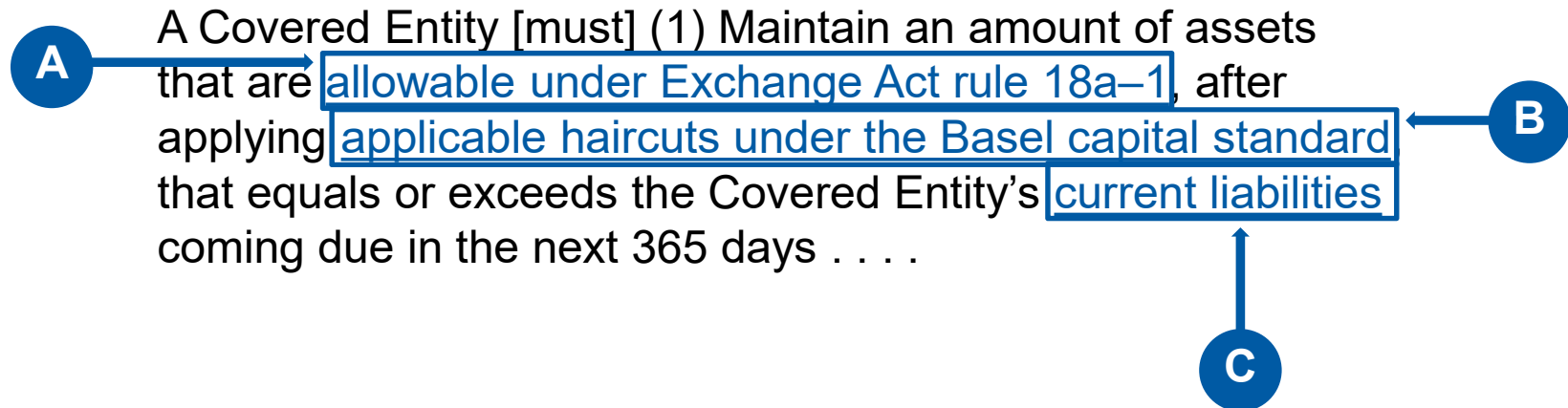
May 14, 2021

Executive Summary

- We strongly support the Commission's efforts to engage constructively with the FCA and PRA in developing a final substituted compliance order for the United Kingdom
 - Substituted compliance is an important, and necessary, component of a comprehensive and harmonious cross-jurisdictional regulatory framework for global markets
 - The SIFMA Letter provides a full technical summary of relevant standards
- We requested this meeting to provide Commission representatives with supplemental information that may be relevant for developing a final order, including with respect to:
 - UK capital and liquidity standards
 - Publicly disclosed financial metrics
 - UK regulatory reporting
 - Central bank access
- We respectfully request that the Commission, in a final order, recognize substituted compliance for UK SBSs' capital requirements by relying on existing UK standards

Draft Order

- Example 'Additional Conditions' for discussion



UK Capital and Liquidity Standards

UK regulatory standards are comprehensive and robust

	Capital	Leverage	Internal Capital Adequacy Assessment Process (“ICAAP”)	Supervisory Review and Evaluation Process (“SREP”)
Purpose	<ul style="list-style-type: none"> Ensure entity has sufficient capital to meet credit, market and operational risks 	<ul style="list-style-type: none"> Ensure entity has sufficient capital to withstand negative Balance Sheet shocks, and reduce risk of future deleveraging on the wider economy 	<ul style="list-style-type: none"> UK nonbank SBSBs’ internal Capital policies and models are evaluated and documented annually in an ICAAP 	<ul style="list-style-type: none"> The ICAAP is reviewed periodically by the PRA as part of the SREP and used to assess whether Capital risks are fully captured
Design	<ul style="list-style-type: none"> Capital / Risk-Weighted Assets (RWAs) 	<ul style="list-style-type: none"> Capital measure / Exposure measure 	<ul style="list-style-type: none"> Comprehensive documentation reviewed and evaluated by the PRA 	
Effectiveness	<ul style="list-style-type: none"> Effective now 		<ul style="list-style-type: none"> Effective now 	
Citation ¹	<ul style="list-style-type: none"> REGULATION (EU) No 575/2013 		<ul style="list-style-type: none"> PRA Supervisory Statement SS31/15 	
Related Link	<ul style="list-style-type: none"> https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A02013R0575-20230628&qid=1620384227407 		<ul style="list-style-type: none"> https://www.bankofengland.co.uk/prudential-regulation/publication/2013/the-internal-capital-adequacy-assessment-process-and-supervisory-review-ss 	
Disclosure (see slide 6)	<ul style="list-style-type: none"> 2020 Pillar 3 Disclosures 		<ul style="list-style-type: none"> N/A 	

¹ EU guidance referenced whilst UK reporting subject to a temporary transition period following the UK’s exit of the European Union (“Brexit”). See Bank of England, Consultation Paper CP5/21 Appendix 9: Draft PRA rule book (CRR) for proposed Basel aligned UK reporting requirements. <https://www.bankofengland.co.uk/prudential-regulation/publication/2021/february/implementation-of-basel-standards>

UK Capital and Liquidity Standards, cont.

	Liquidity Coverage Ratio (“LCR”)	Net Stable Funding Ratio (“NSFR”)	Internal Liquidity Adequacy Assessment Process (“ILAAP”)	Liquidity Supervisory Review and Evaluation Process (“LSREP”)
Purpose	<ul style="list-style-type: none"> Ensure entity has sufficient liquidity to meet 30-day stress scenario 	<ul style="list-style-type: none"> Ensure entity has stable funding to meet one-year funding requirements 	<ul style="list-style-type: none"> UK nonbank SBSs’ internal liquidity policies and models are evaluated and documented annually in an ILAAP 	<ul style="list-style-type: none"> The ILAAP is reviewed periodically by the PRA as part of the LSREP and used to assess whether liquidity risks are fully captured
Design	<ul style="list-style-type: none"> High Quality Liquid Assets (HQLAs) / Net Outflows 	<ul style="list-style-type: none"> Available Stable Funding (ASF) / Required Stable Funding (RSF) 	<ul style="list-style-type: none"> Comprehensive documentation reviewed and evaluated by the PRA 	
Effectiveness	<ul style="list-style-type: none"> Effective now 	<ul style="list-style-type: none"> Effective Jan. 1, 2022 	<ul style="list-style-type: none"> Effective now 	
Citation ¹	<ul style="list-style-type: none"> Article 4, Commission Delegated Regulation (EU) 2015/61 	<ul style="list-style-type: none"> Article 428b, REGULATION (EU) No 575/2013 	<ul style="list-style-type: none"> PRA Supervisory Statement SS24/15 	
Related Link	<ul style="list-style-type: none"> https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A02015R0061-20200430 	<ul style="list-style-type: none"> https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A02013R0575-20230628&qid=1620384227407 	<ul style="list-style-type: none"> https://www.bankofengland.co.uk/prudential-regulation/publication/2015/the-pras-approach-to-supervising-liquidity-and-funding-risks-ss 	
Disclosure (see slide 6)	<ul style="list-style-type: none"> 2020 Pillar 3 Disclosures 	<ul style="list-style-type: none"> Pillar 3 Disclosure from 31st March 2022 	<ul style="list-style-type: none"> N/A 	

¹ Refer to earlier slide re. use of European citations

Existing Financial Metrics can be used for Substituted Compliance

Publicly Disclosed

	Pillar 3	Audited Financial Statements
Effectiveness	<ul style="list-style-type: none"> Effective now 	<ul style="list-style-type: none"> Effective now
Citation ¹	<ul style="list-style-type: none"> Part Eight, REGULATION (EU) No 575/2013 	<ul style="list-style-type: none"> UK Companies Act 2006, S446 “Filing obligations of unquoted companies”
Related link	<ul style="list-style-type: none"> https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A02013R0575-20230628&qid=1620384227407 	<ul style="list-style-type: none"> https://www.legislation.gov.uk/ukpga/2006/46/part/15/chapter/10/crossheading/filing-obligations-of-different-descriptions-of-company
Disclosure	<ul style="list-style-type: none"> 2020 Pillar 3 Disclosures https://www.morganstanley.com/about-us-ir/pillar3/2020_Pillar_3_Disclosures_Morgan_Stanley_International_Limited.pdf 	<ul style="list-style-type: none"> MSIP Dec 2020 Accounts https://www.morganstanley.com/about-us-ir/pdf/MSIP_Group_Accounts_31_December_2020.pdf

Regulatory Reports

	COREP	FINREP
Effectiveness	<ul style="list-style-type: none"> Effective now 	
Citation ¹	<ul style="list-style-type: none"> Commission Implementing Regulation (EU) No 680/2014 	
Related link	<ul style="list-style-type: none"> https://www.eba.europa.eu/regulation-and-policy/supervisory-reporting/implementing-technical-standard-on-supervisory-reporting https://www.eba.europa.eu/regulation-and-policy/supervisory-reporting/its-on-supervisory-reporting-amendments-with-regards-to-corep-lcr 	<ul style="list-style-type: none"> https://www.eba.europa.eu/eba-publishes-final-draft-comprehensive-its-institutions%E2%80%99-pillar-3-disclosures-and-revised-final

¹ Refer to earlier slide re. use of European citations

Central bank access

- Subject to eligibility criteria, UK SBSBs also have access to Bank of England lending facilities, similar to U.S. bank SBSBs' Federal Reserve discount window access.
- UK SBSBs' central bank access includes:
 - a discount window facility (DWF)
 - an indexed long-term repo facility (ILTR)
 - a contingent term repo facility (CTRF), and
 - USD repo operations (URO)
- The Bank of England has published collateral schedules for these facilities, which distinguish across:
 - Level A collateral (high-quality highly liquid sovereign securities),
 - Level B collateral (high-quality liquid collateral, including other sovereign, supranational, mortgage and corporate bonds) and
 - Level C collateral (less liquid securitizations, own-name securities and portfolios of loans).
- In addition, at the Bank of England's discretion, certain equities may be posted as collateral.

Note: For more information, see: <https://www.bankofengland.co.uk/markets/bank-of-england-market-operations-guide/our-tools>

Conclusion

- We believe that, under a “holistic approach,” a final substituted compliance order should “ultimately focus on regulatory outcomes rather than a rule-by-rule comparison”
 - “Substituted compliance therefore should accept differences between regulatory regimes when those differences nevertheless accomplish comparable regulatory outcomes.”^[1]
- We recommend that the Commission recognize, for UK nonbank SBSDs, substituted compliance for capital, subject to SBSDs providing to the Commission:
 - Regulatory reporting in accordance with PRA/EBA standards; and
 - Pillar 3 disclosures for capital and liquidity.
- In the alternative, we recommend that the Commission provide substituted compliance for an interim three-year period on this basis
 - Development of new, Commission-specific balance sheet metrics will be difficult to develop and implement in the months before registration
 - UK regulatory standards protect the safety and soundness of UK SBSDs

¹ 78 Fed. Reg. 30,968, 30,975 (May 23, 2013).

Appendix I: Morgan Stanley International Limited Group P3 Disclosure

Content	Details
General Overview	<ul style="list-style-type: none"> • Overview and Key Metrics • Regulatory Frameworks • Risk Management • Basis of preparation and linkage to Financial Accounts
Capital Management / Resources	<ul style="list-style-type: none"> • Capital Management • Capital Resources • Total Loss-Absorbing Capacity
Capital Requirements	<ul style="list-style-type: none"> • Leverage • Capital Requirements and RWAs • Credit Risk • Counterparty Credit Risk • Securitisation • Market Risk • Operation Risk • Valuation Risk
Liquidity Requirements	<ul style="list-style-type: none"> • Liquidity Coverage Ratio • Asset Encumbrance • [Net Stable Funding Ratio – TBD]
Additional Information	<ul style="list-style-type: none"> • Board of Directors Knowledge, Skills and Expertise • MSI Group, MSIP & MSEHSE Group Capital Instruments & Eligible Liabilities • MSI Group, MSIP and MSEHSE Group Own Funds Disclosure Template • Countercyclical Capital Buffer (CCyB) • Additional Credit and Counterparty Credit Risk Tables • Morgan Stanley Investment Management Group • MSI Group Non-Statutory Financial Information • MSIM Group Non-Statutory Financial Information • CRR Reference Mapping

Appendix II: Morgan Stanley & Co. International PLC COREP

COREP Templates¹

Content	Details	Related Link
ANNEX 13 (NSFR)	<ul style="list-style-type: none"> NET STABLE FUNDING RATIO (NSFR) 	<ul style="list-style-type: none"> https://www.eba.europa.eu/regulation-and-policy/supervisory-reporting/implementing-technical-standards-on-supervisory-reporting-changes-related-to-crr2-and-backstop-regulation <p>Note. Link provides full suite of EBA ITS, subsequent updates noted below</p>
ANNEX 1 (Solvency)	<ul style="list-style-type: none"> CAPITAL ADEQUACY TRANSITIONAL PROVISIONS GROUP SOLVENCY CREDIT RISK OPERATIONAL RISK MARKET RISK 	<ul style="list-style-type: none"> https://www.eba.europa.eu/regulation-and-policy/supervisory-reporting/implementing-technical-standard-on-supervisory-reporting
ANNEX 18 (AMM)	<ul style="list-style-type: none"> CONCENTRATION OF FUNDING BY COUNTERPARTY / PRODUCT TYPE PRICES FOR VARIOUS LENGTHS OF FUNDING ROLL-OVER OF FUNDING 	
ANNEX 20 (CBC)	<ul style="list-style-type: none"> COUNTERBALANCING CAPACITY BY ISSUER 	
ANNEX 22 (Maturity ladder)	<ul style="list-style-type: none"> MATURITY LADDER TEMPLATE 	
ANNEX 16 (Asset Encumbrance)	<ul style="list-style-type: none"> ASSET ENCUMBRANCE 	<ul style="list-style-type: none"> https://www.eba.europa.eu/regulation-and-policy/supervisory-reporting/draft-implementing-technical-standard-on-supervisory-reporting-asset-encumbrance-
ANNEX 24 (LCR)	<ul style="list-style-type: none"> LIQUIDITY COVERAGE RATIO (LCR) 	<ul style="list-style-type: none"> https://www.eba.europa.eu/regulation-and-policy/supervisory-reporting/its-on-supervisory-reporting-amendments-with-regards-to-corep-lcr

¹ Refer to earlier slide re. use of European citations

Appendix III: Morgan Stanley & Co. International PLC FINREP

FINREP Templates¹

Content	Details	Related Link
Annex I (Annex 3 (FINREP))	<ul style="list-style-type: none"> • Balance Sheet Statement [Statement of Financial Position] • Statement of profit or loss • Breakdown of financial assets by instrument and by counterparty sector • Breakdown of non-trading Loans and advances by product • Breakdown of loans and advances other than held for trading to non-fin. corp. • Breakdown of financial liabilities • Loan commitments, financial guarantees and other commitments • Derivatives - Trading and economic hedges • Hedge accounting • Movements in allowances and provisions for credit losses • Collateral and guarantees received • Fair value hierarchy: financial instruments at fair value • Derecognition and financial liabilities associated with transferred fin. assets • Breakdown of selected statement of profit or loss items • Reconciliation between accounting and CRR scope of consolidation: B/Sht • Performing and non-performing exposures • Forborne exposures • Geographical breakdown • Tangible and intangible assets: assets subject to operating lease • Asset management, custody and other service functions • Off-balance sheet activities: interests in unconsolidated structured entities • Related parties • Group structure • Fair value • Tangible and intangible assets: carrying amount by measurement method • Provisions • Defined benefit plans and employee benefits • Breakdown of selected items of statement of profit or loss • Statement of changes in equity 	<ul style="list-style-type: none"> • https://www.eba.europa.eu/eba-publishes-final-draft-comprehensive-its-institutions%E2%80%99-pillar-3-disclosures-and-revised-final

¹ Refer to earlier slide re. use of European citations