FEDERAL RESERVE BANK of NEW YORK

33 LIBERTY STREET, NEW YORK, NY 10045-0001

April 17, 2020

Luigi L. De Ghenghi, Esq.
Davis Polk & Wardwell LLP
450 Lexington Avenue
New York, New York 10017

Dear Mr. De Ghenghi:

In connection with (1) the notice by Morgan Stanley, New York, New York, to acquire E*TRADE Financial Corporation ("E*TRADE"), E*TRADE Bank, and E*TRADE Savings Bank, all of Arlington, Virginia, and thereby operate savings associations, pursuant to sections 4(c)(8) and (j) of the Bank Holding Company Act of 1956 ("BHC Act"); (2) the notice by Morgan Stanley to acquire E*TRADE pursuant to section 4(k)(6)(B)(ii) of the BHC Act; and (3) the notice by Morgan Stanley to acquire E*TRADE pursuant to section 163(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act, the following additional information is requested. Provide a response to each item below, including those in the confidential annex. Supporting documentation should be provided as appropriate.

To the extent the information requested below is not yet available, provide a date by which the requested information is expected to be made available to the Board of Governors of the Federal Reserve System ("Board").[1]

Financial and Supervisory

1. Please indicate if the current economic downturn resulting from the global pandemic has altered Morgan Stanley's proposed merger with E*TRADE in terms of any aspect of the merger agreement. In particular, given that the pandemic has impacted the respective stock prices of Morgan Stanley and E*TRADE, and otherwise has had an effect on other operational aspects, indicate if any changes are being contemplated to the stock exchange ratio or consummation timing.

2. In reference to the Treatment of Existing Indebtedness, discussed in section 8.12 of the Merger Agreement, please clarify the debt amount currently outstanding in E*TRADE's credit agreement with JPMorgan Chase Bank, N.A. Describe how E*TRADE would repay this debt and clarify whether this repayment is reflected in the pro forma financial statements.

[1] This is the Federal Reserve Bank of New York and Board staff's first additional information request for this application. Federal Reserve Bank of New York and Board staff anticipate the need for additional information requests as it continues to review the application.

3. Please describe how E*TRADE's margin loans have performed during the current economic downturn. Provide a summary of expected losses (e.g., total losses experienced, how many loans suffered greater than $100k in losses) or any material risk events.

4. With regard to the structure of the proposed transaction on page 11 of the notification, please indicate whether a decision has been made about the post-closing legal entity structure for the integration of E*TRADE legal entities with Morgan Stanley. If yes, indicate whether Morgan Stanley would be using push down accounting, and reflect any impact on pro forma and projected financial statements.

5. Please indicate whether the recent economic downturn would have any adverse impact on the combined enterprise-wide risk management and compliance programs, and discuss how Morgan Stanley plans to address such an impact. In this regard, also address whether Morgan Stanley is planning any changes to the overall integration plans.

6. Following consummation of the proposed merger, please describe changes, if any, to Morgan Stanley's enterprise-wide risk appetite and/or risk capacity. Your response should include, if applicable, anticipated changes to Morgan Stanley's risk management framework and/or total borrowing capacity, and to monitoring of operational and cybersecurity risks.

7. Page 3 of the notification notes that the proposed transaction is expected to add approximately $56 billion in low-cost deposits, which would provide significant funding benefits to Morgan Stanley and will enable it to reduce its reliance upon more expensive wholesale funding. Please confirm our understanding that the $56 billion in low-cost deposits includes the deposits that E*TRADE currently maintains through sweep deposit arrangements with third party financial institutions. If so, describe how the inclusion of sweep deposits in the total low-cost deposits would impact the FDIC insurance coverage that E*TRADE's sweep programs currently provide wherein customers have additional coverage of up to $1.25 million for individuals and $2.5 million for joint account holders. Further, please provide the combined firms' wholesale versus retail deposit profile.

8. Please provide the current status of other regulatory applications, particularly whether the OCC has made a decision to require a CIBCA notice with regard to Morgan Stanley's indirect acquisition of E*TRADE's bank subsidiaries.

Legal

9. Provide a pro forma shareholder list that identifies any shareholder or group of shareholders that would own or control, directly or indirectly, 5 percent or more of any class of voting securities, or 10 percent or more of the total equity, of Morgan Stanley

after consummation of the proposed transaction. In calculating the voting ownership, include any warrants, options, and other convertible instruments, and show all levels of voting ownership on both fully diluted and individually diluted bases. For purposes of calculating voting ownership on an individually diluted basis, any warrants, options, and other convertible instruments should be treated as having been exercised by individual holders (or commonly controlled entity groups or family groups), and by no other holders of the warrants, options, or convertible instruments. Aggregate the interests of any related shareholders, including, for example, shareholders that are acting in concert (pursuant to definitions and presumptions in 12 CFR 225.41) and shareholders that are commonly controlled or advised. Indicate whether any identified shareholder is a bank or bank holding company.

10. Pursuant to sections 2.03(i) and (ii) of the Agreement and Plan of Merger dated February 20, 2020, by and among Morgan Stanley, Moon-Eagle Merger Sub, Inc., and E*TRADE, included as Public Exhibit 1 ("Merger Agreement"), at the Effective Time, each share of E*TRADE Series A and Series B Preferred Stock outstanding immediately prior to the Effective Time will be converted into the right to receive one share of one of two newly created series of preferred stock of Morgan Stanley, each series having such rights, preferences, privileges, and voting powers, and limitations and restrictions, that, taken as a whole, would not be materially less favorable to the holders of shares of Series A and Series B Preferred Stock than the rights, preferences, privileges, and voting powers of those shares, respectively and taken as a whole.

    a. For each of the proposed newly created series of preferred stock, discuss whether the shares in the series would be "voting securities" for purposes of the Board's Regulation Y. In your discussion, describe the voting rights that would accrue to these shares. As a supplement to your discussion, provide copies of Annexes I and II, each as referred to in sections 2.03(i) and (ii) of the Merger Agreement.

    b. For each of the proposed newly created series of preferred stock, discuss in detail whether the shares in the series would qualify for inclusion as a component of Morgan Stanley's regulatory capital under 12 CFR 217.20.

11. Provide a copy of the Parent Disclosure Schedule and the Company Disclosure Schedule referenced in the Merger Agreement.

12. Clarify the BHC Act authority under which each of E*TRADE's non-depository institution subsidiaries would engage in activities upon consummation of the proposal. Indicate whether any activities of these entities would be impermissible for a financial holding company.

13. Provide the commitment in the Attachment.

14. Please provide more detail regarding the Morgan Stanley litigation matters listed: nos. 328, 372, 360, 286, and 264.

Competition

15. Identify all significant competitors of either Morgan Stanley or E*TRADE for brokerage products and services.
16. According to the Summary of Deposits (SOD), $179.8 billion deposits are booked at two branches of Morgan Stanley, and $42.7 billion deposits are booked at two branches of E*TRADE (as of June 2019).
    a. Separately for both Morgan Stanley and E*TRADE, provide the breakdown of aggregate deposits by the location of depositors (zip code), i.e., the aggregate deposit amount of depositors residing in each five-digit zip code.
    b. Separately for both Morgan Stanley and E*TRADE, provide the aggregate deposit amounts tied to any brokerage account by the location of depositors (zip code).
17. Separately for both Morgan Stanley and E*TRADE, provide the aggregate account value of all brokerage accounts by the location of customers (zip code).

Financial Stability

18. Provide a list of activities and products in which Morgan Stanley plans to initiate new operations, or expand existing operations, subsequent to the closing of the E*TRADE merger.

19. How would the combined entity use the deposit influx as a result of the Proposed Transaction to expand its lending and broker-dealer activities? How would this affect:
    a. Commercial lending (expected volume increase)
        i. Lending to SMEs (expected volume increase)
        ii. Syndicated funded commitments (expected volume increase)
        iii. Syndicated pipeline commitments (expected volume increase)
    b. Consumer lending (expected volume increase)
    c. Real estate (mortgage) lending (expected volume increase)
    d. Underwriting activities (expected volume increase)
    e. Broker-dealer activities (expected volume increase)?

20. What, if any, financial stability risks and vulnerabilities would increase as a result of the E*TRADE? What steps would Morgan Stanley or E*TRADE plan to take to mitigate these risks and vulnerabilities?

21. To the extent not already provided in the notifications, identify whether Morgan Stanley or E*TRADE are involved in each of the following activities, discuss the nature of this involvement, and provide a brief listing of other firms that engage in the same activity in the United States. For both Morgan Stanley and E*TRADE, provide measures of the scale of each activity specified, for both the most recent quarter and the most recently completed year. Measures should be stated both in U.S. dollars and as a share of overall U.S. activity; derivatives should be stated as notional dollar amounts. Responses may be confined to information maintained in the regular course of business.

    a. Short-term lending
        i. Reverse bilateral repurchase agreements (volume)
        ii. Reverse tri-party repurchase agreements (volume)
        iii. Fed funds (volume)
        iv. Tri-party repo dealing (volume)
    b. Commercial lending
        i. Syndicated lending (volume)
        ii. Syndicated pipeline commitments (volume)
        iii. Lending to small and medium-sized enterprises (volume)
        iv. Unfunded commitments (volume)
    c. Underwriting services
        i. Issuance of new equities (volume)
        ii. Corporate bonds (volume)
        iii. Commercial paper (volume)
        iv. Asset backed securities (volume)
        v. Other debt securities (volume)
    d. Total provisions of services in the following sectors.
        i. Prime brokerage (number of funds and fund sponsors, and total assets under management)
        ii. Securities lending (report value of securities lent as a custodian and securities lent from trading book)
        iii. Corporate trust
        iv. Correspondent banking
        v. Wealth management (total assets under management)
        vi. Insurance (by segment, including reinsurance)

22. Provide the dollar amounts for the ten largest types of Trading Securities and AFS Securities, for both Morgan Stanley and E*TRADE.

23. Provide the dollar amounts for the five largest categories of held-to-maturity securities for both Morgan Stanley and E*TRADE.

24. Provide a complete list of the assumptions used to arrive at the E*TRADE's estimates when completing the FR Y-15 form in Exhibit F.

25. Provide the five largest counterparties, rolled up to the parent company, and the corresponding amount of the following indicators for Morgan Stanley and E*TRADE, separately. For Morgan Stanley, provide information for both U.S. and worldwide operations, separately.
    a. Total exposure (as defined by Schedule A Line item 5 in FR Y-15)
    b. Total intra-financial system assets (as defined by Schedule B Line item 6 in FR Y-15)
    c. Total intra-financial system liabilities (as defined by Schedule B Line item 12 in FR Y-15)
    d. Total securities outstanding (as defined by Schedule B Line item 20 in FR Y-15)
    e. Payments activity (as defined by Schedule C Line item 2 in FR Y-15)
    f. Assets held as a custodian on behalf of customers (as defined by Schedule C Line item 3 in FR Y-15)
    g. Total underwriting activity (as defined by Schedule C Line item 6 in FR Y-15)
    h. Total notional amount of OTC derivatives (as defined by Schedule D Line item 3 in FR Y-15)
    i. Total adjusted trading and AFS securities (as defined by Schedule D Line item 9 in FR Y-15)
    j. Assets valued using Level 3 measurement inputs (as defined by Schedule D Line item 10 in FR Y-15)
    k. Foreign claims on an ultimate-risk basis (as defined by Schedule E Line item 1 in FR Y-15)
    l. Total cross-jurisdictional liabilities (as defined by Schedule E Line item 4 in FR Y-15)
    m. Total short-term wholesale funding (as defined by Schedule G Line item 5 in FR Y-15)

26. Provide the five largest counterparties, rolled up to the parent company, and the corresponding amounts of each component of intra-financial system assets and liabilities for Morgan Stanley and E*TRADE, reported in the most recent FR Y-15. For Morgan Stanley, provide information for both U.S. and worldwide operations, separately.

a. For intra-financial system assets:
   i. Funds deposited with or lent to other financial institution (M351)
   ii. Unused portion of committed lines extended to other financial institution (J458)
   iii. Holdings of securities issued by other financial institution (M352 + M353 + M354 + M345 + M356 – M357)
   iv. Net positive current exposure of securities financing transactions (SFTs) with other financial institution (M358)
   v. Over-the-counter (OTC) derivative contracts with other financial institutions that have a net positive fair value (M359 + M360)

b. For intra-financial system liabilities:
   i. Deposits due to other financial institutions (M363 + M364)
   ii. Borrowings obtained from other financial institutions (Y833)
   iii. Unused portion of committed lines obtained from other financial institutions (M365)
   iv. Net negative current exposure of SFTs with other financial institution (M366)
   v. OTC derivative contracts with other financial institutions that have a net negative fair value (M367 + M368)

27. Provide the current market exposure – gross, and net of collateral and other risk mitigants – for the five largest counterparties, rolled up to the parent company, of OTC derivatives of both Morgan Stanley's and E*TRADE's U.S. operations, as measured by

    a. Positive current exposure after netting arrangements.
    b. Negative current exposure after netting arrangements.

28. Describe the current clientele breakdown (including institutional and retail investors, and retirement plans) of Morgan Stanley and E*TRADE's online brokerage platform and their respective shares in terms of client assets, as of the most recent quarter for which data are available.

29. Provide the volume of total deposits, brokered deposits, and uninsured deposits for both Morgan Stanley and the E*TRADE banks both before and after the merger.

30. Provide details on sweeping activities conducted by Morgan Stanley and E*TRADE's broker-dealer subsidiary, including a breakdown of banks and other financial institutions into which the funds are swept.

Consumer Compliance and CRA

31. Describe the structure of the combined institution's consumer compliance program following the merger. In your response, please discuss:
    a. Which functions will be housed at the holding company level, and which will be housed at subsidiary banks;
    b. The experience level of staff responsible for managing the combined organization's compliance program, and general staffing plans;
    c. Internal audit plans for the compliance program;
    d. Third party oversight plans for the combined institution;
    e. Plans for outsourcing compliance functions to third party providers, including plans for overseeing those third party providers; and
    f. The governance structure overseeing the compliance program.
32. Describe the banks' plans for managing the combined institution's Community Reinvestment Act ("CRA") program to ensure continued satisfactory performance. In your response, please discuss:
    a. Which CRA program functions will be housed at the holding company level, and which will be housed at subsidiary banks;
    b. The experience level of key staff responsible for managing the combined organization's CRA program, and general staffing plans for the CRA program;
    c. The governance structure overseeing the CRA program; and
    d. Which of the current CRA lending, investment, and service initiatives of the E*TRADE subsidiary banks would be continued after the merger, and which would be discontinued.
33. If the applicant anticipates any changes to or expansion of products or services following this merger, describe any corresponding adjustments that would be made to combined institution's consumer compliance program as a result of such changes.

34. Please provide the consumer compliance risk assessments and corresponding testing results for E*TRADE's deposit regulations and Morgan Stanley's deposit and lending activities.

35. Please provide any consumer related complaints and MIS for the prior 12 months for both firms.

36. Please update us on your decision making regarding whether, and which, offices of E*TRADE subsidiaries will be closed at the completion of the transaction.

Please provide your response addressed to the undersigned within eight business days of the date of this letter. Any information for which confidential treatment is desired should be so labeled and separately bound in accordance with Section 261.15 of the Board's Rules Regarding Availability of Information.

If you have any questions regarding this matter, please contact Cecilia Caglio (202-452-3084) of the Board's Division of Research and Statistics; Surjeet Sidhu (202-728-5888) of the Board's Division of Supervision and Regulation; Ken Williams (202-452-3136) of the Board's Division of Consumer and Community Affairs; or Evans Muzere (202-536-7019), David Imhoff (202-452-2249), or Nate Balk (202-872-7517), all of the Board's Legal Division.

Sincerely,

Brian S. Steffey
Assistant Vice President
Bank Applications Function

Attachment

Confidential Annex

cc: Board of Governors