July 22, 2020

The Honorable Jerome Powell
Chair
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue N.W.
Washington, D.C. 20551

Dear Chair Powell:

Morgan Stanley has applied to the Federal Reserve Board to acquire E*Trade Financial Corporation. For the following reasons related to financial stability, competition, and general compliance failures, this application fails the relevant legal test and should therefore be rejected by the Fed.[1]

Rejecting this acquisition would also be consistent with the spirit of the request from nine economic justice organizations for the Fed to freeze merger and acquisition activity for organizations receiving support through the Fed's COVID-19 emergency lending programs.[2]

Financial Stability: Morgan Stanley is already a "Too Big to Fail" bank, and this merger would make it even bigger.

Leading up to the 2008 financial crisis, Morgan Stanley had been a standalone investment bank. It was forced to convert to a bank holding company in the depths of the financial crisis to access Fed supervision and the sweep of the Fed's safety net.[3] The bank received substantial taxpayer assistance, to the tune of $10 billion from the TARP bailout program and a peak of $135 billion borrowed through the Fed's emergency lending programs.[4] It was, by definition, a Too-Big-to-Fail (TBTF) bank. Twelve years later, Morgan Stanley is the sixth largest U.S.-based bank holding company, with $947 billion in total assets and nearly $1.2 trillion in total financial exposures.[5] It employs more than 60,000 people, operating across 47 jurisdictions worldwide

1 For an application of this nature, the Fed must consider whether "benefits to the public, such as greater convenience, increased competition, or gains in efficiency," would "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." *See* 12 U.S.C. § 1843(j)(2)(A).
2 *See* Press Release, Amer. Econ. Liberties Proj., "The Federal Reserve Must Not Finance a Merger Wave," May 7, 2020, https://www.economicliberties.us/press-release/the-federal-reserve-must-not-finance-a-merger-wave/.
3 *See* Bd. of Governors of the Fed. Reserve Sys., Order Approving Formation of Bank Holding Companies and Notice to Engage in Certain Nonbanking Activities, Sept. 21, 2008, https://www.federalreserve.gov/orders20080922a2.pdf. Although it was not legally a "bank," Morgan Stanley took deposits while being subject to lighter regulation as an "industrial loan company," a longstanding loophole in banking law that allows nonbank companies to own banks. *See id.*
4 *See* Congressional Oversight Panel for TARP, March Oversight Report: the Final Report of the Congressional Oversight Panel 36, Mar. 16, 2011, http://cybercemetery.unt.edu/archive/cop/20110401232213/http://cop.senate.gov/documents/cop-031611-report.pdf. Morgan Stanley also fell $1.8 billion short of its required capital buffer in the 2009 stress tests. *See* Board of Governors of the Federal Reserve System, The Supervisory Capital Assessment Program: Overview of Results 31, May 7, 2009, http://www.federalreserve.gov/bankinforeg/bcreg20090507a1.pdf.
5 *See* data from forms FR Y-9C and FR Y-15 as of Q1 2020.

through thousands of unique legal entities.[6] It has been identified by the international Financial Stability Board as a Global Systemically Important Bank,[7] meaning that it is a financial company whose "disorderly failure … would cause significant disruption to the wider financial system and economic activity."[8] In short, it is still a TBTF bank.

The balancing and tradeoffs required by the Fed's financial stability evaluation are not necessarily straightforward, nor have they been fully developed.[9] Former Federal Reserve Governor Daniel Tarullo has argued that there should be a "strong, though not irrebuttable, presumption of denial for any acquisition" by a global systemically important bank,[10] and that there is "little evidence that the size, complexity, and reach of some of today's [systemically important banks] are necessary in order to realize achievable economies of scale and scope."[11] In addition, the application presently under consideration would increase Morgan Stanley's systemic importance to levels that would exceed its importance prior to the 2008 financial crisis and bailouts,[12] a fact that should render this application unacceptable under the generally articulated financial stability test that the Fed has said it would apply to mergers and acquisitions in past cases.[13] Under either test, the Fed must deny this application on the basis of financial stability.

6 *See* FFIEC National Information Center data; *see also* Morgan Stanley, 2019 Resolution Plan, https://www.fdic.gov/regulations/reform/resplans/plans/morgan-165-1907.pdf.
7 *See* Fin. Stability Bd., 2018 List of Global Systemically Important Banks (G-SIBs), Nov. 2018, https://www.fsb.org/wp-content/uploads/P161118-1.pdf.
8 *See* Fin. Stability Bd., Reducing the Moral Hazard Posed by Systemically Important Financial Institutions 1 (Oct. 2010), https://www.fsb.org/wp-content/uploads/r_101111a.pdf.
9 *See* Daniel K. Tarullo, Member, Bd. of Governor of the Fed. Reserve Sys., "Financial Stability Regulation," Speech at the Distinguished Jurist Lecture, Univ. of Penn. L. Sch., 15-22 (Oct. 10, 2012), https://www.federalreserve.gov/newsevents/speech/files/tarullo20121010a.pdf; *see also* Jeremy C. Kress, *Modernizing Bank Merger Review*, 37 YALE J. ON REG. 435, 470 (2020)(the Fed's financial stability analysis "lacks clarity and analytical rigor."). For example, the Fed has approved mergers and acquisitions by large regional banks in recent years that appear on their face to increase risks in the banking system. *See* Bd. of Governors of the Fed. Reserve Sys., Order Approving Acquisition of a State Member Bank, Dec. 23, 2011 (approving the acquisition of RBC Bank by PNC Financial Services), https://www.federalreserve.gov/newsevents/pressreleases/files/order20111223.pdf; *see also* Bd. of Governors of the Fed. Reserve Sys., Order Approving the Acquisition of a Savings Association and Nonbanking Subsidiaries, Feb. 14, 2012 (approving the acquisition of ING Bank by Capital One Financial), https://www.federalreserve.gov/newsevents/pressreleases/files/order20120214.pdf; see also Bd. of Governors of the Fed. Reserve Sys., Order Approving the Merger of Bank Holding Companies, Nov. 19, 2019 (approving the merger of BB&T and SunTrust), https://www.federalreserve.gov/newsevents/pressreleases/files/orders20191119a1.pdf.
10 Tarullo, *supra* note 9, at 21; *see also* Daniel K. Tarullo, Member, Bd. of Governors of the Fed. Reserve Sys., "Regulating Systemically Important Financial Firms," at 6, Remarks at the Peter G. Peterson Inst. for Int'l Econ., 6 (June 3, 2011) (the regulation of systemically important banks "should discourage systemically consequential growth or mergers unless the benefits to society are clearly significant[.]"), https://www.federalreserve.gov/newsevents/speech/files/tarullo20110603a.pdf.
11 *Id.*
12 Its volatile, short-term funding makes up more than 80% of its assets adjusted for risk. *See* FR Y-15 data. While it may be argued that the E*Trade acquisition will expand Morgan Stanley's deposit base, the more significant expansion resulting from this acquisition would be to Morgan Stanley's wealth management activities that bring with them the risks associated with asset management. *See, e.g.*, Kenechukwu Anadu, et al, *The Shift From Active to Passive Investing: Potential Risks to Financial Stability?*, at 25-27, RPA Working Paper 18-04 (Aug. 27, 2018), available at SSRN: https://ssrn.com/abstract=3244467.
13 *See* Bd. of Governors of the Fed. Reserve Sys., Order Approving the Acquisition of a Savings Association and Nonbanking Subsidiaries, *supra* note 9, at 28 (the Fed "expects that it will generally find a significant adverse effect

Competition: Morgan Stanley has plans to build up a large position in wealth management, and it should not be allowed to do so.

The predominate purpose of this transaction is Morgan Stanley's acquisition of $3.1 trillion in wealth management assets. It is in a position to do so at a relative bargain due to the competitive price wars and consolidation of the two other biggest retail brokers, Charles Schwab and TD Ameritrade.[14] While traditional bank merger analysis has focused on measures that are in many ways outdated in the context of modern, large, and complex banking conglomerates,[15] the resulting implications for current and future asset management markets must be considered in this case.

Morgan Stanley has long pursued a growth strategy centered around its wealth management business.[16] Its wealth management division has grown substantially in recent years, due in part to another acquisition, when Morgan Stanley was allowed to purchase the Smith Barney brokerage from Citigroup.[17] Morgan Stanley has stated publicly that the company's goal is adding an additional one million clients through technology alone,[18] and competing with the largest wealth managers.[19] This acquisition would give it scale sufficient to capture even more market share. To be sure, the asset management industry is currently concentrated among a small group of giant companies.[20] The answer to this problem is not to anoint another member of this club; instead, the goal should be to increase competition by decreasing concentration.

Morgan Stanley has also been open about its desire to cross-sell individual products to customers of its corporate plan management business,[21] as well as to sell other products to customers that

if the failure of the resulting firm, or its inability to conduct regular-course-of-business transactions, would likely impair financial intermediation or financial market functioning so as to inflict material damage on the broader economy.").

14 *See* Liz Hoffman, *Morgan Stanley Is Buying E*Trade, Betting on Smaller Customers*, WALL ST. J., Feb. 20, 2020, https://www.wsj.com/articles/morgan-stanley-is-buying-e-trade-betting-on-littler-customers-11582201440.

15 *See* Kress, *supra* note 9, at 439.

16 *See* Justin Baer & Saabira Chaudhuri, *Gorman's Strategy Pays Off for Morgan Stanley*, WALL ST. J., Oct. 18, 2013 (noting "efforts by [CEO James] Gorman to transform the New York investment bank into a firm that relies less on trading and more on businesses like wealth management."), https://www.wsj.com/articles/morgan-stanley-swings-to-3rdquarter-profit-on-strong-wealth-management-results-1382096096; *see also* Liz Hoffman, *Morgan Stanley's Earnings Rise on Strength in Wealth Management*, WALL ST. J., Oct. 17, 2017 (describing the wealth management business as the "centerpiece of Mr. Gorman's effort to turn Morgan Stanley from Wall Street's problem child to a steadier firm prized by investors, largely by focusing on wealth and asset management."), https://www.wsj.com/articles/morgan-stanleys-earnings-rise-as-wealth-management-grows-1508238034.

17 *See id.* (Morgan Stanley's pre-tax wealth management profits grew from 9% to 25% from 2010 to 2017, and Morgan Stanley's wealth management account balance exceeded $1 trillion for the first time in 2017). Morgan Stanley has estimated that its pre-tax wealth income would exceed 57% as a result of the proposed acquisition.

18 *See* Telis Demos, *Morgan Stanley Raises the Bar*, WALL ST. J., Jan. 16, 2020 (stating that Morgan Stanley "believes it can add another million active clients in the future by extending its services to people who currently just touch the bank through corporate stock plans."), https://www.wsj.com/articles/morgan-stanley-raises-the-bar-11579198020.

19 *See* Hoffman, *supra* note 14 (quoting Morgan Stanley CEO James Gorman that "We'll take on Schwab. We'll take on Fidelity.").

20 *See* Lucian A. Bebchuck & Scott Hirst, *The Specter of the Giant Three*, 99 BOSTON U. L. REV. 721 (2019).

21 *See* Demos, *supra* note 17.

use its brokerage services.[22] These sorts of cross-selling practices should not be viewed solely as a benefit to customers, but there is ample evidence that cross-selling can also harm customers, including those of wealth management businesses.[23]

Other harms: Morgan Stanley's record of repeated legal violations that harm customers and investors, and investments that harm society show that it is already "too big to manage."

According to the organization *Good Jobs First*, since the financial crisis of 2008, Morgan Stanley has been the subject of 41 different action by Federal, state, and private parties from abuses ranging from sales of toxic securities, to investor protection violations, to antitrust violations.[24] Since 2000, it has paid out almost $10 billion in fines and penalties. In its most recent annual filing, Morgan Stanley reported four cases currently being litigated against the bank for securities violations.[25] This is not a financial institution that has demonstrated that it can effectively comply with the law at its current size – in short, it is "too big to manage"[26] – and it should therefore not be allowed to grow, risking more abuses and violations.

In addition, and notwithstanding its various corporate social responsibility statements, Morgan Stanley has provided nearly $92 billion in financing to fossil fuel companies since the signing of the Paris Climate Accords, the eleventh most of any banking organization worldwide.[27] It has also owned and traded significant amounts of oil and gas assets over the years through its status as a financial holding company authorized to engage in nonfinancial activities.[28] Though it has

[22] *See* Lisa Beilfuss, *Morgan Stanley Seeks to Manage More of Its Clients' Wealth*, WALL ST. J., July 30, 2018 ("The firm will pay advisers an extra percentage point in compensation if they put those relatively small clients into a plan under which they can see the customer's assets beyond what is held at Morgan Stanley. These plans are meant to accomplish certain financial goals for the client, and can help advisers bring in more of the client's wealth that isn't already held at the firm … Advisers also will make more by getting clients to do their everyday banking at Morgan Stanley … As part of its push to encourage more lending, the firm is near-doubling the reward for advisers who bring in more client debt."), https://www.wsj.com/articles/morgan-stanley-seeks-to-manage-more-of-its-clients-wealth-1532977551.

[23] *See, e.g.*, Emily Glazer, *Whistleblowers Detail Wells Fargo Wealth Management Woes*, WALL ST. J., July 27, 2018, https://www.wsj.com/articles/whistleblowers-detail-wells-fargo-wealth-management-woes-1532707096.

[24] *See* Good Jobs First, Violation Tracker, violationtracker.goodjobsfirst.org, *accessed* June 9, 2020.

[25] *See* Morgan Stanley, Inc., Dec. 2019 Form 10-K, at 125-26.

[26] *See* Jeremy C. Kress, *Solving Banking's 'Too Big to Manage' Problem*, 104 MINN. L. REV. 171, 173 (2019) (a bank is too big to manage when "its size prevents executives, board members, and shareholders from effectively overseeing the firm, leading to excessive risk-taking and misconduct.").

[27] *See* Rainforest Action Network, Banking on Climate Change, at 8 (2020), https://www.ran.org/wp-content/uploads/2020/03/Banking_on_Climate_Change__2020_vF.pdf.

[28] *See generally* PERMANENT SUBCOMM. ON INVESTIGATIONS, UNITED STATES SENATE, WALL STREET BANK INVOLVEMENT WITH PHYSICAL COMMODITIES 227-305 (Nov. 2014) (documenting that "Morgan Stanley once ran an empire of oil-related commodity activities, including trading, storing, transporting, and supplying oil products, including supplying jet fuel to airlines" as well as natural gas and crude oil), https://www.hsgac.senate.gov/imo/media/doc/REPORT-Wall%20Street%20Bank%20Involvement%20With%20Physical%20Commodities%20(12-5-14).pdf; *see id.*, at 230-31 (Morgan Stanley once owned physical commodity assets including the Heidmar Group, a marine transportation company; Wellbore Capital LLC, an oil and gas exploration company; Wentworth Holdings LLC, a shell company seeking to build natural gas compression facilities; and TransMontaigne Inc., which operated an oil storage and pipeline company).

scaled back some of these activities in recent years, it has also expanded them in other ways.[29] In addition to exacerbating the existential threat that is climate change, these activities have implications for financial risk and anticompetitive practices.

Conclusion: The Fed should reject this application.

In conclusion, the proposed acquisition would threaten financial stability by making a TBTF bank even bigger; increase the share of the wealth management industry controlled by such TBTF bank; and increase the size, scope, and scale of a Wall Street bank that already appears "too big to manage."

Banking regulators have not denied a merger application in approximately 17 years.[30] We know that increased corporation concentration is related to economic inequality.[31] Research is also beginning to show that inequality, financial stability and financial crises are related.[32] In a moment when the Fed is being scrutinized for its role in exacerbating inequality in its response to COVID-19,[33] we urge you to begin reversing the troubling trend of banking consolidation by denying this application.

Sincerely,

American Economic Liberties Project

Cc: The Honorable Richard Clarida, Vice Chair, Board of Governors of the Federal Reserve System
The Honorable Randal Quarles, Vice Chair, Board of Governors of the Federal Reserve System
The Honorable Lael Brainard, Member, Board of Governors of the Federal Reserve System
The Honorable Michelle Bowman, Member, Board of Governors of the Federal Reserve System

[29] *See* Morgan Stanley, 2019 Form 10-K, *supra* note 24, at 93-94, 96 (reporting trading physical commodities including oil and gas, with a 256% growth in physical commodities assets from 2018 to 2019).
[30] *See* Kress, *supra* note 9, at 439.
[31] *See, e.g.*, David Autor et al, "Concentrating on the Fall of the Labor Share," NBER Working Paper No. 23108 (Jan. 2017), https://www.nber.org/papers/w23108; *see also* Simcha Barkai, Declining Labor and Capital Shares (Nov. 19, 2019), J. OF FIN., *Forthcoming*. Available at SSRN: https://ssrn.com/abstract=3489965.
[32] *See* Pascal Paul, "Historical Patterns of Inequality and Productivity around Financial Crises," Federal Reserve Bank of San Francisco Working Paper 2017-23 (2020), https://doi.org/10.24148/wp2017-23.
[33] *See* Gene Ludwig & Sarah Bloom Raskin, *How the Fed's Rescue Program Is Worsening Inequality*, POLITICO, May 28, 2020, https://www.politico.com/news/agenda/2020/05/28/how-the-feds-rescue-program-is-worsening-inequality-287379.