STATEMENT OF

JAMES P. GORMAN

BEFORE THE

COMMITTEE ON FINANCIAL SERVICES
UNITED STATES HOUSE OF REPRESENTATIVES

CONCERNING

HOLDING MEGABANKS ACCOUNTABLE: A REVIEW OF GLOBALLY SYSTEMICALLY IMPORTANT BANKS 10 YEARS AFTER THE FINANCIAL CRISIS

PRESENTED ON

APRIL 10, 2019

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Chairwoman Waters, Ranking Member McHenry, and members of the committee, thank you for having us here today. This committee has an important responsibility to our nation: to ensure that we have a regulatory framework for the financial system that focuses on maintaining the safety and soundness of our financial institutions. I share your commitment to this goal.

We have significantly transformed Morgan Stanley over the last 10 years. We are now a safer and sounder financial institution focused on helping our clients finance economic growth, job creation, retirement security, college savings, and more.

First, we have transformed our business model. In 2008, we became a bank holding company, and we set out on a strategy to diversify the firm so that we would be less subject to market instability. Since 2008, we have more than doubled the size of our wealth management business, giving the firm a stable foundation of support, in any market environment. By building complementary franchises in Institutional Securities, Wealth Management and Investment Management, we reshaped Morgan Stanley over the last decade to derive a greater share of revenues from relatively stable businesses. In 2018, our wealth management and investment management businesses provided nearly half of our firm-wide revenues. Revenues from the sales and trading business, which is far more impacted by market swings, represented approximately a third of our total revenues last year, compared to more than half before the financial crisis.

Second, we have embraced the regulatory architecture set in place through the Dodd-Frank overhaul. I have compared the Dodd-Frank regime for monitoring the health of our financial institutions to the approach we take to our own health. First, just as you follow a day-to-day regimen of diet and exercise, the regulatory system requires banks to maintain robust levels of capital, liquidity and client protection. Per the Volcker rule, we don't take extraordinary risks with our own health, as our trading now is focused on making markets and executing trades for our clients, not on trading for our own profit and loss. Just as you watch your own diet, we have enhanced our risk management processes to ensure that we are managing risk appropriately. For example, we have put in place global risk protocols to identify and escalate employee conduct that could cause undue risk to the Firm, and we continuously evaluate our compensation programs to ensure that they do not encourage unnecessary or excessive risk-taking. We also have regulators on-site, watching day-to-day activities to monitor risk management protocols and compliance. Then, on a periodic basis, you go to the doctor for a thorough exam. And you prepare for the worst-case scenario by having a will in place. The financial system is similar: through the annual stress test process, regulators assess each bank's capital levels, requiring that they be high enough to sustain the institution through a period of stress. And every large banking organization is required to have a "living will" in place so that a failure would not undermine the wider financial system.

As a result of our strategic transformation and this new regulatory paradigm, Morgan Stanley is far safer, sounder and more resilient than we were before the financial crisis. I can say that I am very confident that Morgan Stanley is very well capitalized. Our capital has gone from \$34 billion in 2006 to \$72 billion at year-end. We have increased our liquidity from less than \$50 billion to approximately \$250 billion. Our leverage was over 30x pre-crisis and is approximately 12x today.

Finally, we have spent the last 10 years reinvigorating our culture of managing risk and putting clients first. A strong culture is the key to the long-term success of any financial institution. Long-term and enduring success lies in having a strong culture and talented employees who live our values. At Morgan Stanley, our culture guides our employees, and our values inform everything we do: we have a commitment to putting clients first, leading with exceptional ideas, doing the right thing, and giving back. These values honor both our history and our aspirations for the future.

In the end, a financial institution and its culture are only as strong as its people. We work to imbue our culture and values in our people, in many different ways. We hold annual mandatory culture conversations within each business unit, focused on topics such as escalating risk and putting the clients' interest ahead of the Firm's. Each year, every employee's year-end evaluation includes an assessment of how the employee has reflected and exemplified our culture. We have created a Culture, Values and Conduct committee of the Firm, co-chaired by our Chief Legal and Chief Human Resources Officers, which is responsible for ensuring that we are integrating our core values across our divisions and regions. Members of the committee work with their respective businesses to enhance our training, performance and compensation processes, and to continue developing a framework to measure and report back to our Board of Directors as appropriate. In addition to our other risk management processes, we have a Franchise Risk Committee, which reviews and can veto new business opportunities and transactions that may conflict with our values.

A diverse employee base and a talented leadership pipeline are critical to living our values and to delivering the best of the Firm to our clients. We are committed to an inclusive work environment where all employees can thrive. Our commitment to diversity is expressed as belonging as much as inclusion. All employees, irrespective of their race, gender or background, must feel that they belong at Morgan Stanley and that their values are recognized and respected. We are imbuing this sense of belonging in our culture – including through the annual performance review process, and as part of the onboarding of new employees into the Firm. We recognize that we have significant work to do to achieve our diversity goals, and that it requires efforts at every level of the Firm to deliver results over the long term. We have numerous initiatives aimed at providing our employees with opportunities for leadership roles and empowering them to achieve the visibility and recognition they deserve.

Our culture also includes a strong commitment to supporting the communities where we live and work. For example, we have supported the Morgan Stanley Children's Hospital since 1973. Our employees regularly give of their time and resources to volunteer organizations across the globe.

As a bank holding company, we have obligations under the Community Reinvestment Act (CRA), and we strive to maximize the impact of those resources. We focus our CRA initiatives around four themes: multifamily affordable housing, healthy communities, economic development, and expanding access to capital for Community Development Financial Institutions (CDFIs). We seek innovative opportunities to address the needs of a community holistically, to better knit together the resources that make a community work. Overall, in the last eight years we've made $18 billion in community development loans and investments and supported the creation of 99,000 affordable housing units. We have received an "outstanding" rating from the OCC on every CRA exam.

Our Firm strategy, combined with a strong culture, enables Morgan Stanley to play a vital role in supporting the US economy, our communities, and individual families, through the lens of responsible corporate citizenship. Let me give just a few examples. We work with new companies across economic sectors to take them public, so they can raise the capital they need to grow and create jobs. We underwrite green bonds for companies so they can raise the financing they need to make their plants more energy efficient and reduce their carbon footprint. We underwrite municipal bonds that enable cities across the country to renovate schools and build new parks. We help pension funds invest, so they can grow their assets and meet their obligations to retirees. We help college endowments invest and earn a return that allows them to increase scholarship funds for students in need of financial assistance. We work with individual families to plan for their financial futures, whether that is saving for college, preparing for retirement, or creating a legacy of philanthropic giving.

I am proud of the 60,000 employees of Morgan Stanley and the work they do every day to help our clients succeed. We are deeply committed to the ongoing strength of the Firm – both our financial strength and the strength of our culture – so that we can continue to fuel growth, innovation and prosperity.

Finally, in your letter dated April 1, 2019, you asked me to provide information on eight topics, including changes over the last 10 years. Information regarding these topics is included in the attached addendum.

Thank you again Chairwoman Waters, Ranking Member McHenry, and members of the committee. I look forward to your questions.

Addendum

1. Your bank's size and complexity.

Morgan Stanley employs over 60,000 employees in more than 500 offices worldwide. Our employees live and work in 41 countries. In 2018, we reported approximately $40 billion in net revenues and approximately $850 billion in total assets. While Morgan Stanley is a large, multi-faceted financial institution, we have taken significant steps in recent years to lessen our complexity and mitigate risks. Importantly, as described in my testimony, we have completely redesigned our business over the last 10 years to focus on three primary categories of services. Our focus on three complementary franchises allows us to effectively identify, manage and mitigate risk across our worldwide business. It also allows us to derive a significant amount of revenue from relatively stable businesses.

Our three primary categories of business are:

a. Institutional Securities, which provides investment banking, sales and trading, lending and other services to clients such as corporations, governments and financial institutions.

b. Wealth Management, which provides financial services and solutions to individual investors and small to medium-sized businesses and institutions. The services provided by Wealth Management include brokerage and investment advisory services; financial and wealth planning services; annuity and insurance products; securities-based lending, residential real estate loans and other lending products; and banking and retirement plan services.

c. Investment Management, which provides a wide range of investment strategies and products to a diverse group of institutional and intermediary clients.

Since the financial crisis, we have more than doubled the size of our wealth management business. By doing so, we have given the Firm a stable foundation of support in any market environment. Revenues from the sales and trading business, which is far more impacted by market swings, represented a third of our total revenues last year, compared to more than half in 2006.

As an example of risk mitigation, under Dodd-Frank, we are required to have a "living will" in place, so that if Morgan Stanley were to fail it would not undermine the wider financial system. As part of that resolution planning, we have taken significant steps such as rationalizing our legal entity structure to make the structure less complex and ensure that the structure supports our resolution strategy.

2. **The number and location of your bank's branches.**

Morgan Stanley does not provide retail banking services and thus does not have any retail branches. As noted above, Morgan Stanley employs over 60,000 employees in more than 500 offices worldwide.

3. **Enforcement actions, including any consent orders and settlements, against your bank and the number of consumers or investors harmed by your bank's actions.**

Like other large financial institutions, we have been subject to various enforcement actions over the last 10 years. Information concerning those enforcement actions is publicly available. Many of those enforcement actions, including the largest, related to activities that occurred prior to the financial crisis. Following the financial crisis, we substantially discontinued the businesses that were the subject of our largest enforcement actions. The following is a list of the enforcement actions where Morgan Stanley has paid in excess of $50 million between January 1, 2008 and the present:

- U.S. Department of Justice Civil Division, February 19, 2016, $2.6 billion – business discontinued in 2007.

- U.S. Securities and Exchange Commission, July 24, 2014, $275 million – business discontinued in 2007.

- New York Attorney General's Office, February 19, 2016, $150 million and $400 million consumer relief – business discontinued in 2007.

- Federal Reserve Board, April 2, 2012 and January 12, 2018, $124 million – business discontinued in 2012.

- Commonwealth of Massachusetts Attorney General's Office, June 24, 2010, $103 million – business discontinued in 2007.

4. **Your bank's capital market activities, including with respect to securities and derivatives, as well as any custodial banking activities.**

Morgan Stanley is a major participant in the global capital markets. We serve our clients by providing liquidity and capital through services such as originating, structuring, and executing public and private placement of a variety of securities, including both debt and equity products. We help our clients – such as schools, hospitals, governments and local and global corporations – raise capital and manage their financial positions so that they can remain stable, grow and provide employment opportunities.

We recognize that, as a financial institution, our ability to leverage the financial markets has a significant impact on our society. Thus, if we identify a potentially significant environmental or social risk associated with a transaction, the transaction is escalated to senior management and our Franchise Risk Committee. The Franchise Risk Committee can veto new business opportunities and transactions that may conflict with our values.

We also seek opportunities to make a positive impact through our business. For example, we proactively work to help scale low-carbon sources of energy and other sustainability strategies. We are continuing to shift our lending and capital-raising efforts toward cleaner and renewable sources of energy and to reduce the proportion of our energy financing for coal mining and coal-fired power generation. In 2015, we issued a $500 million green bond, to help fund the development of renewable energy and energy efficiency.

Moreover, we recognize that access to capital is clearly unequal across segments of the U.S. population. Through initiatives like our Multicultural Innovation Lab, which we launched in 2017, we identify women- and multicultural-led businesses with real growth potential, make an equity investment ourselves and then use our network to open doors for these innovators, putting them in front of potential investors to whom they might otherwise not have access.

At the same time, we have made significant changes to our own trading over the past decade. As discussed in my testimony, we have embraced the Volcker Rule and our trading now focuses on making markets and executing trades for our clients, not on trading for our own profit and loss. We do not take risks that could jeopardize the stability of our Firm.

The derivatives markets, and our derivatives trading, have also undergone significant de-risking as a result of the reforms implemented under Dodd-Frank. These reforms include margin and central clearing requirements as well as extensive reporting on derivatives transactions to regulators.

Custody services are a minimal aspect of Morgan Stanley's business. We provide custody services out of our Private Bank for prime brokerage clients who choose to utilize these services.

5. **The extent your bank utilizes forced arbitration clauses in its contracts with consumers, employees, investors and contractors**.

We believe that arbitration provides an opportunity for all sides to receive a fair hearing through a process that is generally more efficient and less costly than litigation. We ensure that information about our arbitration agreements is clearly disclosed and readily available to both prospective employees and customers before they enter into a relationship with us. In addition, our United States broker-dealers are FINRA member firms. For many years, FINRA has required that licensed employees arbitrate most non-statutory employment disputes with member firms.

When we made changes to our employee arbitration program in 2015, we provided our employees with detailed information on the program and gave them the opportunity to opt out. New Morgan Stanley hires are also provided an opportunity to opt out of our employee arbitration program.

6. **Your compensation and clawback policies, including how these policies are designed to promote accountability of company executives and how the compensation of the CEO and other C-suite executives compares to the median compensation of an employee at your bank.**

Morgan Stanley has a robust pay-for-performance philosophy and practice, and is committed to responsible and effective compensation programs. The Compensation Management Development and Successions ("CMDS") Committee of the Board of Directors, which is comprised entirely of independent directors, continuously evaluates Morgan Stanley's executive compensation to ensure that our approach is consistent with best practices in corporate governance, risk management and regulatory principles.

We have made significant changes to our executive compensation program in the past decade to better balance risk with rewards. These changes include: (i) enhancements to the long-term incentive program design by balancing fixed and variable pay, increasing deferrals, increasing the use of equity and performance-based awards and applying clawback provisions; (ii) strengthened processes and controls to integrate risk management into our compensation determinations; and (iii) increased board engagement in senior management compensation determinations.

Our compensation program, which has continuously evolved over the past 10 years, is designed around the following four key objectives.

1. We compensate for sustainable performance. Since 2009, we have moved the focus of our executive compensation program away from annual incentive awards and toward an emphasis on both variable annual incentives and performance-vested long-term incentives. Moreover, Morgan Stanley now conditions the vesting and payment of long-term incentives on future performance, which is measured against specified financial targets that align with long-term business strategy.

2. We align executive compensation with shareholders' interests. This objective is met by delivering a significant portion of incentive compensation in deferred awards that are subject to cancellation and clawback over a multi-year period. Over the past 10 years, we have significantly reduced the portion of incentive compensation paid in cash. As discussed in more detail below, we have also expanded our clawback provisions. Moreover, the deferred award structure ties a significant portion of executive compensation directly to Morgan Stanley's stock price and encourages ownership by requiring executives to retain shares.

3. We offer competitive pay levels to support Morgan Stanley's objectives of continuing to attract and retain the most qualified employees in a highly competitive global environment for talent. We structure incentive awards to include vesting, deferred payment and cancellation provisions that retain employees and protect the Company's and shareholders' interests.

4. In light of regulatory guidance, we have changed our approach to compensation to better balance employee conduct, such as risk taking, with rewards. We structure compensation arrangements to discourage unnecessary or excessive risk taking that could have a material adverse effect on Morgan Stanley. Over the past decade, we have integrated risk management more directly into our compensation determinations. In addition, there is no automatic vesting and no excise tax protection for deferred compensation upon a change-in-control. Morgan Stanley annually evaluates our compensation programs from a risk perspective and reviews our findings with the CMDS Committee and an independent compensation consultant.

Morgan Stanley's commitment to our performance-based approach is further demonstrated by our four-part CEO pay framework:

1. The Board of Directors sets annual performance priorities at the beginning of the year to guide its assessment of Firm and executive performance. The priorities include both financial and non-financial performance metrics for the Firm and its business segments.

2. At the beginning of each year, the CMDS Committee also establishes the target CEO compensation range. The range is informed by a number of factors, including prior year CEO compensation at peer financial firms.

3. At year-end, the CMDS Committee assesses Company and executive performance, including progress in achieving Morgan Stanley's strategic objectives and annual performance priorities, and the CEO's overall leadership.

4. The CMDS Committee then determines CEO compensation at year-end, based on its assessment of performance and discussion with the Board of Directors.

With respect to other Named Executive Officers ("NEOs"), the CMDS Committee evaluates both Firm and individual performance. As with CEO compensation, the CMDS Committee and the Board set performance priorities at the beginning of the year. The performance priorities are based on an assessment made at the beginning of the year in light of the market environment and Morgan Stanley's strategic objectives. The CMDS Committee then considers progress against the performance priorities in making executive compensation determinations at year-end. For 2018, the CMDS Committee reviewed performance priorities in the following areas:

- Financial performance, including return on equity
- Shareholder return
- Capital and liquidity strength
- Capital expense efficiency ratio
- Business performance for each primary business unit
- Firm risk management and controls
- Major infrastructure initiatives

- Standing with regulators
- Talent development, including diversity
- Board assessment of Firm culture, leadership, strategy and reputation.

With respect to clawback policies and procedures, in 2008, Morgan Stanley was the first major U.S. bank to enact a clawback provision that exceeded TARP requirements for a portion of year-end compensation. This clawback provision was further enhanced in 2009 to explicitly cover situations where there is (i) a substantial loss on a trading position or other holding or (ii) any loss on a trading position where an employee operated outside the risk parameters applicable to the trading position or other holding if, in either case, such position was a factor in that employee's compensation determination. This provision applied to deferred cash-based awards made to NEOs.

In 2011, we expanded our clawback provisions to apply to all long-term incentive compensation and enhanced our processes for preventing, investigating and addressing circumstances (such as poor risk outcomes, significant losses and improper employee behavior) that could require clawback or cancellation of previously awarded compensation, as well as adjustments to current year compensation.

Today, deferred incentive compensation awards generally are subject to clawback for, among other things, failure to comply with Morgan Stanley's compliance, ethics or risk management standards, termination for cause and misuse of proprietary or confidential information. Additionally, these awards are subject to clawback if an individual causes the need for a restatement of Morgan Stanley's consolidated financial results, violates Morgan Stanley's global risk management principles, policies or standards or violates an internal risk and control policy involving a subsequent loss. Managers may be held responsible for misconduct by their employees.

Throughout the year, employee conduct matters that are escalated through the Company's Global Conduct Risk Program are reviewed to determine whether they present situations that could require clawback or cancellation of previously awarded compensation, as well as downward adjustments to current year compensation. Clawbacks of previously awarded compensation are reviewed quarterly with the Employee Discipline Oversight Committee (a committee of senior management currently composed of the Chief Financial Officer, Chief Legal Officer, Chief Risk Officer, Chief Human Resources Officer, and Chief Compliance Officer) and reported to the CMDS Committee.

Regarding risk management, beginning in 2009, the CMDS Committee worked with Morgan Stanley's Chief Risk Officer and the CMDS Committee's independent consultant to evaluate whether Morgan Stanley's compensation arrangements encourage unnecessary or excessive risk-taking and whether risks arising from Morgan Stanley's compensation arrangements are reasonably likely to have a material adverse effect on Morgan Stanley. The Chief Risk Officer continues to evaluate any new incentive arrangements for the NEOs.

Moreover, the Global Incentive Compensation Discretion Policy adopted by the CMDS Committee sets forth standards for managers on the use of discretion when making annual compensation decisions and considerations for assessing risk management and outcomes. Further, the Company's control functions conduct a semi-annual review of employee conduct with respect to risk and control matters, and are asked to identify inappropriate behavior that may not be captured through other Company processes. The results of the reviews are reflected in performance feedback and considered in compensation decisions.

As disclosed in our most recent proxy statement, in 2018 the ratio between the CEO's total annual compensation and the median annual total compensation of all other employees was 198 to 1. In 2017, the ratio between the CEO's total annual compensation and the median annual total compensation of all other employees was 192 to 1.

7. The diversity of the directors of your board and C-suite executives, the policies and practices implemented at your institution to promote diversity and inclusion among your workforce, and the policies to promote the use of diverse contractors, including diverse asset managers, brokers and underwriters, by your institution.

Achieving greater diversity throughout the Firm is a key priority for me and my management team, and we are working hard to achieve our diversity goals. While I am proud of the gains that we have made over the past 10 years, there is still work to be done.

First, establishing diverse leadership is essential to bringing greater diversity to the Firm as a whole. For that reason, diversity at the board level is a significant priority. Four members of our 13-person Board of Directors are women. We have one African-American director as well. In 2008, we had two women directors and one African-American director. We continue to seek out diverse director candidates when we have openings on our Board.

Diversity in senior management is also critical to achieving our Firm-wide diversity goals. Today, we have three women on our 17-person Operating Committee, an increase from one woman in 2008. Of the 48 members of our Management Committee, 10 are women, three are African-American and two are Hispanic. In 2008, three members of the Management Committee were women and we did not have any African-American or Hispanic members. Moreover, every senior manager is required to have a succession plan for his or her senior team members, and part of that plan must include developing a diverse candidate pipeline.

We have also put in place a series of programs that are helping to expand diversity within our company. While we have more work to do, we are seeing results. In 2009, 16% of our financial advisors were female. That number now stands at 18%. In 2009, 3% of our financial advisor population was African-American or Hispanic and that number has grown to 7%. We have seen similar improvements in the diversity of our financial advisor trainee hires. In 2010, the first full year after our merger with Smith

Barney, 20% of our hires were female. That number has grown to 29% in 2018. In 2010, 8% of our trainee hires were African-American or Hispanic. In 2018, that number grew to 18%.

Our initiatives include innovative programs that are designed to recruit, retain and develop women for more senior roles in the firm. For example, in 2018, we held our first-ever conference gathering our women Managing Directors from around the globe, to continue their leadership development and engage them in helping us strengthen our diversity efforts.

As another example, our Return to Work program is designed for individuals who have left the workforce, whether to care for family or for other reasons. We offer a 12-week paid internship to assist them in updating their skills and rejoining the industry. Since the program was launched in 2014, it has placed over 100 individuals in roles across the Firm.

Recruiting is another essential component of establishing a diverse workforce, and our early insights program is a key element of our diversity recruiting efforts. Students visit our New York headquarters to learn about our businesses, network with employees and participate in the first stage of the Summer Analyst recruiting process.

Our Richard B. Fisher Scholarship Program has helped over 400 diverse undergraduate and graduate students gain access to the financial services sector.

It will take these and other initiatives, as well as the attention of every manager across the firm, to increase diversity at Morgan Stanley. We recognize that a more diverse workforce will enable us to better recognize and serve the needs of our wide variety of clients, and we are committed to that work.

8. Your bank's approach to cybersecurity and protecting consumer data.

Cybersecurity is also a top priority for Morgan Stanley. Our long-standing commitment to safeguard client information is essential to our goal to be the leading choice for financial services. Protecting the confidentiality and security of client information has always been an integral part of how we conduct our business worldwide. Today, like our peers and firms in many other industries, we must be extraordinarily vigilant on a constant basis, and we defend against numerous attacks every day.

To that end, Morgan Stanley employs multiple layers of security controls and practices to protect the personal information of its clients and employees, its proprietary data, its networks and other assets. We have in place physical, technical and procedural safeguards for personal information. We protect personal information from unauthorized access and use, instituting security measures – such as computer safeguards, secured files and buildings – that comply with cybersecurity laws and regulations in the United States and other countries in which we operate.

We maintain and enforce policies and security controls to ensure that our personnel properly handle customer information. We also require third parties who perform services on our behalf to adhere to appropriate security standards. We routinely gather intelligence on the threat environment and partner with vendors, peers in the industry, law enforcement and other government agencies to monitor cyber risks and emerging trends, and to enhance the robustness and effectiveness of our cyber defenses.

Cybersecurity risk is overseen by the Board as well as the Operations and Technology Committee. The Operations and Technology Committee has primary responsibility for oversight of information and cybersecurity operations. It receives reports at quarterly meetings from senior officers in the Information and Technology Department and the Firm Risk Management Department. The quarterly reports include information such as security, fraud and cybersecurity risk, as well as the steps that management has taken to monitor and control such risk. The reports also provide updates on Morgan Stanley's cybersecurity program, the external threat environment and Morgan Stanley's programs to address and mitigate the risks associated with the evolving cybersecurity threat environment.

The Operations and Technology Committee also receives an annual independent assessment of key aspects of the Company's cybersecurity program from an external party and holds joint meetings with the Audit Committee and Risk Committee. The Chair of the Operations and Technology Committee regularly reports to the full Board on cybersecurity risks. Senior management also discusses cybersecurity developments with the Chairs of the Operations and Technology Committee and the Risk Committee between Board and committee meetings, as necessary. Moreover, the Board or a relevant Board committee reviews and approves our cybersecurity policies at least annually.