HEARING BEFORE THE SENATE PERMANENT SUBCOMMITTEE ON INVESTIGATIONS

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Chairman Levin, Ranking Member McCain, and Members of the Subcommittee, thank you for the opportunity to be here today on behalf of Morgan Stanley. My name is Simon Greenshields. Since 2008, I have served as the Global Co-Head of Commodities for Morgan Stanley, along with my Co-Head Colin Bryce. I am proud to have worked at Morgan Stanley for the last thirty-two years, where we have built and managed a leading commodities business that for decades has provided liquidity to markets and met the business needs of our clients and counterparties.

We appreciate the Subcommittee's interest in the role of financial institutions in the commodities marketplace. We share your commitment to ensuring that financial institutions effectively manage the risks of commodities businesses and participate in competitive markets that have appropriate safeguards against manipulation. Institutions must also be transparent with regulators and responsive to their concerns. At Morgan Stanley, prudent risk management and transparency with our regulators are among our core values. Morgan Stanley is also committed to mitigating the environmental risks that it may face as a firm, and it encourages its clients to do the same. We expect all of our employees to meet the high standards of conduct that we and our regulators demand. I am particularly proud of the team that we have assembled in Morgan Stanley's Commodities Division, who are among the most experienced and dedicated professionals in the industry.

The Subcommittee requested that I speak to a number of topics, each of which is addressed briefly below to the best of my ability. I also understand that a number of my colleagues at Morgan Stanley have prepared written submissions and visited with your staff on multiple occasions to provide additional details and information of interest. We have sought to cooperate fully with the Subcommittee's inquiry.

I. Overview of the Commodities Division

Since 1982, Morgan Stanley's Commodities Division has been active in the physical and financial commodities markets. Morgan Stanley's commodities business is designed to provide a broad spectrum of price risk management and physical supply services needed by commodities market participants. Morgan Stanley provides integrated services, including financing, credit risk management, and physical supply solutions, in a cost effective manner.

Among other things, Morgan Stanley facilitates private sector investment in, and development of, critically-needed domestic energy supplies. Energy developers, for instance, use Morgan Stanley's commodities services in order to manage proactively fuel costs and projected revenue streams. The ability to better manage commodity prices fosters confidence among potential lenders to extend credit—and lowers the cost of credit—which encourages energy developers to undertake necessary infrastructure improvements.

For example, during the past year Morgan Stanley's commodities business has helped renewable energy producers develop wind farms and harness solar power. By providing risk management services, Morgan Stanley facilitated the development of over 795 megawatts of new wind generation in Texas. In addition, Morgan Stanley helped to finance the development of over 20 megawatts of commercial and residential solar power projects throughout the United States.

Due to constantly changing supply and demand in the economy, commodities prices can fluctuate substantially. Moreover, the liquidity of commodities markets varies by commodity type, location, and time horizon. As an active participant in global commodities markets, Morgan Stanley has developed the expertise and judgment necessary to price risk effectively for physical transactions as well as swaps and futures. Clients and counterparties depend on the participation of large liquidity providers like Morgan Stanley to serve as a bridge between producers and end users of commodities that typically have different transaction goals in terms of price, quantity, location, and timing.

By owning some physical inventory, Morgan Stanley has been able to meet the demands of its clients whose businesses require that they transact in the physical market. These clients may not have the means to fulfill their physical supply requirements economically and efficiently, or they may not have the right infrastructure in the right locations, or they may have difficult-to-address seasonal or cyclical requirements. Ownership of physical commodities also facilitates participation in the derivatives market, where contracts may be settled by physical delivery. Our ability to participate in both the physical and derivative markets has enabled Morgan Stanley to provide clients with customized solutions to their price risk management and supply needs.

In light of changing market conditions and evolving regulatory expectations, we are seeking to focus our commodities business on its core strengths—providing clients with intermediation, risk management, and supply services. One outgrowth of our focus is our decision to sell our global physical oil merchanting business, discussed in more detail below. We understand that this is an area of interest for the Subcommittee and I look forward to answering your questions.

II. Risk Mitigation

Morgan Stanley is proud of its comprehensive approach to risk management, which has enabled the Firm to manage its commodities business prudently and effectively over the last three decades. Nevertheless, we recognize that past successes are no guarantee against future concerns, and we are always open to new ideas about how to better manage the risks inherent in our business activities.

Morgan Stanley's Commodities Division mitigates risk in a number of ways. For example, Morgan Stanley has protocols in both its business units and control groups to manage the risks associated with physical commodities activities. We also have a robust risk management framework through a Physical Operating Risk Steering Group ("Steering Group"), which monitors risk across various product groups. The Steering Group meets weekly and reports to my Co-Head and me. Its work includes assessing operational risk measures and standards, recommending operational risk policies, reviewing and evaluating significant physical operating risk developments, and monitoring physical operating risk procedures.

In addition to the Steering Group, the Firm's Operational Risk Department conducts monthly operational risk review meetings, which also include representatives from the Fixed Income and Commodities Non-Market Risk Team, Commodities Chief Operations Officers, Operations, Controllers, Compliance, Information Technology, Market Risk, Credit Risk, and Internal Audit. The meetings are used to discuss current operational risk issues. Moreover, proposals to undertake new business activities are vetted by the New Product Approval Committee, which includes a broad range of experts, including members of operational risk, compliance, legal, insurance, and corporate treasury. Projects that may expose the firm to reputational risk are submitted to the Franchise Risk Committee, which is comprised of members of senior management from relevant divisions of the Firm. Depending upon the nature of a proposed activity or investment, the proposal may be required to be reviewed by a number of additional committees as well as be subject to various policies and procedures.

We are also keenly focused on efforts to measure operational risk as part of the Firm's risk management framework. The Operational Risk Department uses an exposure-based model for internal risk management calculations relating to physical commodities activities of the Commodities Division. This model creates simulations to estimate hypothetical losses. Morgan Stanley uses these calculations to manage operational risk by, among other things, maintaining insurance in excess of simulated losses and taking a prudent approach to meeting its capital requirements. Morgan Stanley's Risk and Insurance Management Department is responsible for the placement and management of the Commodities Division's insurance program, working with insurance brokers to ensure that the business has appropriate insurance coverage. The Department analyzes and reviews the Commodities Division's exposure related to ownership of physical commodities and assesses potential liability and risk using internal information as well as industry information and data.

Morgan Stanley believes that appropriate safeguards for financial institutions' involvement in physical commodities markets can reduce risks and promote market efficiency and security. Whether a financial institution is engaging in complementary commodities activities, merchant banking commodities investments, or grandfathered commodities activities, the common element that should apply to all of these activities and investments is the obligation to conduct them in a safe and sound manner through a robust risk management framework. In this regard, Morgan Stanley agrees with the general proposition stated by Chairman Levin in response to the Advance Notice of Proposed Rulemaking issued by the Board of Governors of the Federal Reserve System earlier this year, namely that a rulemaking should establish requirements for strong prudential safeguards for all physical commodities activities, whether under complementary, merchant banking, or grandfather authority, to prevent undue risks and unsafe or unsound practices. Financial holding companies should also be required to maintain capital and insurance at levels informed by operational risk models that are subject to review by the Federal Reserve. Regardless of the authority under which a financial holding company conducts a physical commodities activity, it should be conducted in accordance with sound risk management principles and with adequate capital and insurance coverage. Morgan Stanley also supports the comment that the rulemaking should propose more detailed reporting obligations to ensure that the Federal Reserve is fully aware of all physical commodities activities undertaken by the financial holding company.

We recognize that risk can never be eliminated entirely, and that reputational risks in particular can be difficult to quantify. Our managers are expected to remain mindful of this, and are also expected to be fully transparent with our regulators, so that they can understand and be in a continuous dialogue with us about our risk profile. We believe that the staff of the Federal Reserve and our other regulators have a robust understanding of our business, and we very much value their direction and feedback. Ultimately, with respect to any business activity at Morgan Stanley, if we conclude that something involves risks that we do not fully understand or cannot appropriately mitigate, we will not undertake that activity.

III. Natural Gas and Oil Liquids Activity

Two wholesale commodities markets in which Morgan Stanley has been an active participant for many years, and in which the Subcommittee has expressed particular interest, are natural gas and oil liquids. In these sectors, Morgan Stanley's Commodities Division participates in the physical markets as well as the markets for associated futures and swaps.

A. Natural Gas

Morgan Stanley has been active in the wholesale natural gas market since 1989. In this market, we serve our clients' physical natural gas requirements and provide liquidity to the market.

Wentworth. Morgan Stanley recently formed Wentworth Gas Marketing LLC in order to provide natural gas to emerging Caribbean markets by leveraging a process that allows for more efficient shipping of compressed natural gas. The Wentworth business, which is not yet operational, is designed to deliver a cleaner and less expensive source of fuel to power generators and meet the needs of commercial end users for reliable natural gas supplies. The U.S. Department of Energy recently approved the Wentworth project. Although Morgan Stanley has created an initial structure and model for this project, we are actively exploring a sale of Wentworth to an unrelated party. While we believe Wentworth's business is well within the parameters of activity Morgan Stanley has traditionally engaged in and risk managed appropriately, our decision to transfer the business to others at this stage reflects Morgan Stanley's commitment to meeting evolving market conditions and regulatory expectations.

Southern Star. Morgan Stanley Infrastructure Partners LP ("MSIP"), which has an investment in Southern Star on behalf of the Firm and institutional investors, sits within Morgan Stanley's Investment Management Group ("MSIM"). Because MSIM is a separate business from Morgan Stanley's Institutional Securities Group, in which the Commodities Division operates, and is managed independently from the Commodities Division, I am not privy to information about MSIM's investment in Southern Star. In addition, Morgan Stanley has information barriers in place to prevent the transfer to the Commodities Division of material non-public information about MSIM's investments. I understand that others at Morgan Stanley have therefore been asked to provide you with requested information. Morgan Stanley believes that information barriers are an important safeguard to protect confidential information, and I appreciate the

Subcommittee's accommodation in seeking information on Southern Star from those outside of the Division I co-head.

B. Oil Liquids

Over the past twenty-five years, Morgan Stanley has built an oil liquids division that serves companies, municipalities, and other businesses seeking risk management services and market liquidity. Morgan Stanley has been active in the wholesale crude oil market since 1984 and the refined products market since 1985.

Morgan Stanley serves a number of important roles in the oil liquids markets. One way Morgan Stanley participates in these markets is by helping airlines manage the costs of jet fuel. For example, Morgan Stanley helped a leading U.S. airline in bankruptcy by entering into a long term contract to supply jet fuel and provide related logistical support. The contract helped the airline reduce its operating expenses because Morgan Stanley sold the airline jet fuel at a lower price than it was previously paying.

Recently, Morgan Stanley sold its ownership interest in TransMontaigne Inc., a U.S.-based oil storage, marketing, and transportation company, to NGL Energy Partners LP. Although Morgan Stanley has retained an interest in a TransMontaigne subsidiary that owns Olco Petroleum Group ULC, Olco no longer operates a refined oil sales business or gasoline stations. Morgan Stanley sold the majority of the Olco properties, and the remaining properties are non-operational and are being prepared for sale. Subject to obtaining regulatory approval, Morgan Stanley has also agreed to sell its global oil merchandizing business to Rosneft Oil Company, including its non-controlling stake in Heidmar Holdings LLC, which is the commercial pool manager of a fleet of independently owned commercial tankers. All of these activities are consistent with Morgan Stanley's forward looking business strategy of focusing our commodities business on its core strength.

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IV. The Role of Financial Institutions in Commodities Markets

Financial institutions play an important role in meeting the needs of U.S. businesses, such as airlines and energy producers, in critical industries that depend on the wholesale commodity markets.

Morgan Stanley is aware that there are differing views as to the scope of permitted commodity activities under the so-called "grandfather clause" in section 4(o) of the Bank Holding Company Act. The activities that we conduct under this authority are within the permitted scope of activities based upon either a broad or a more narrow reading of the grandfather clause. Nevertheless, in light of differing views, Morgan Stanley agrees with the Chairman's comment letter on the Advance Notice of Proposed Rulemaking that it would be helpful for regulators to formally clarify the scope of activities that are permissible under this authority through notice and comment rulemaking. Further clarification would provide greater certainty to market participants as to the scope of future activities that may be considered under this authority. Morgan Stanley also agrees with Chairman Levin that all grandfather clause activities should be subject to prudent safety and soundness constraints.

The public benefits of permitting financial institutions to engage in wholesale physical commodities activities are real and significant. Our clients and counterparties are cooperatives, cities, governments, and corporations, ranging from small businesses to global enterprises. Financial institutions like Morgan Stanley play a critical role in meeting the needs of producers, processors, and commercial users of commodities by helping them manage complex and long-term commodity price and physical supply risk.

We also note that different firms may approach the commodities market in unique ways based on their core strengths, and, therefore, we can only speak to the approach that we believe works best for Morgan Stanley and its clients. Broadly speaking, though, the historical role of U.S. financial institutions in the commodities markets has contributed to enhanced liquidity, more sources of financing, and stronger support for commodity-related projects, such as in the energy sector, while also promoting national economic stability and security.

Thank you for the opportunity to testify today. I am happy to answer any questions you have.