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Subcommittee on Securities, Insurance, and Investment
"Tri-Party Repo Market: The Remaining Challenges"
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Chairman Reed, Ranking Member Crapo, and Members of the Subcommittee, thank you for inviting me to appear before you today. My name is Thomas Wipf and I am a Managing Director at Morgan Stanley and responsible for the firm's Bank Resource Management including Secured Funding, Securities Lending and Counterparty Portfolio Management. Thank you again for the opportunity to discuss this very important issue in the markets for secured funding.

As an active member participant in the work of the Tri-Party Reform Committee ("Committee"), Morgan Stanley remains fully committed to accomplishing the goals laid out by the Committee within a timeline that is ambitious and acceptable to all stakeholders. Our firm views this work as a top priority and critical path in our own funding and liquidity strategy. As the Committee's recommendations continue to be processed, we have seen meaningful benefits and risk reduction on a market wide basis. Morgan Stanley agrees with the Financial Stability Oversight Council that more needs to be done and the delay in soundly eliminating intra-day credit risks is "unacceptable".

Secured funding is an important funding source and a foundational component of our centralized liability management strategy. We are committed to and have taken significant steps to put all the recommendations into practice at our firm. We have heard clearly from the secured funding investor community that the collateral management services provided by the clearing banks are an important element of their collateral valuation and risk management process.

The significant stability issues that appeared in 2008 provided the Committee, our regulators and all market participants (bank dealers, cash investors and the two clearing banks) with a road map for reform. Many long held assumptions around durability, settlement, credit exposure, agent versus principal relationships and contingency planning were proven wrong or overly optimistic during a period of significant stress in the broad funding markets. The major factors for the instability were the short tenor of funding particularly for less liquid assets; lack of transparency regarding collateral for investors; insufficient overcollateralization on less liquid assets; and uncertainty regarding credit counterparties during the period between trade maturity and settlement. Additionally, the overall reduction of counterparty risk as well as a heightened market wide aversion to counterparty risk contributed to the instability of the platform. We believe the Tri-Party Reform Committee identified these weaknesses and defined the issues requiring remediation. In implementing these recommendations, we see the remaining strategic issues falling into three categories:

-Complete clarity on the terms and limits for credit extension between the clearing banks and the bank dealers by asset class

-Full implementation of a transparent settlement process with a clear timeline that enables all market participants to understand and manage their settlement risk and

-Further building investor confidence and reducing intra-day risk by a meaningful and systematic reduction of collateral turnover between trade execution and maturity

Many of the challenges faced by the Committee were a result of mixing the issues. Credit extension, collateral management and settlements are separate and distinct issues that all impact the Tri-Party funding market. The extension of intra-day credit is a major focus issue for the bank dealers and the two clearing banks. While our investors are focused on the collateral management services provided by the clearing banks, the operational issues are relevant to all three parties to the transaction. Part of the challenge faced by the Committee was to separate these issues although there are certain co-dependencies among them. We believe that the work ahead will only be successful if the issues are treated individually going forward.

At Morgan Stanley, we have taken a number of steps to meaningfully reduce our daily settlement exposures ahead of the Committee's deadlines, most notably in the area of prudent liability and collateral management. Our firm has taken proactive steps to extend the maturity of our secured funding liabilities in a rules based governance process that requires minimum term of maturities consistent with the fundability characteristics of our assets. We additionally have imposed investor diversification and maturity limits to reduce our maturities with any investor in a given period and an overall limit on maturities during any given period. Our investors have focused on transparency of collateral, a reduction in collateral turnover during the period of the transaction and clarity on their credit exposure through execution, settlement and maturity. We have seen firsthand a marked increase in pre-trade collateral due diligence by secured funding investors.

We fully acknowledge there is considerable work remaining for the industry that requires senior leadership focus, commitment and investment by all participants in this market. We are committed to continuing to collaborate with investors, the two clearing banks and our regulators to complete the remaining workstreams and to advocate for a timeline that is acceptable to all stakeholders. Morgan Stanley's overarching goal in Tri-Party reform is investor confidence. The meaningful reduction in intra-day credit extension, transparency in collateral and advance rates combined with a more sound and durable operational platform are all positive steps toward this goal. Nevertheless, from our firm's perspective, we have prioritized our resource commitments in the context of the Tri-Party reform committee's agenda on initiatives designed to retain the confidence of our secured funding investors, the cash providers.

With lessons learned following the crisis, Morgan Stanley has worked over the past several years to add significant risk management enhancements to our secured funding model. As mentioned above, we have added significant term to the maturities in our secured funding liabilities and since a large portion of those liabilities come from investors who utilize the Tri-Party repo platform, our pro-forma and actual intra-day credit from our clearing banks has been meaningfully reduced. Since 2008 we have extended the weighted average maturity of our secured funding book from less than 30 days in 2008 to now well in excess of 120 days. This is now a disclosure metric in our public filings. Extending the maturity and limiting rollover risk are the most powerful tactical steps that can be taken by bank dealers immediately to reduce the intraday extension of credit. Since the credit extension takes place at the unwind of the trade, creating a longer and staggered maturity profile can yield significant risk reduction.

The Tri-Party Reform Committee has worked to identify the issues and put forth recommendations for the remediation of the gaps that became apparent in 2008. Many of those recommendations are now in practice or in scope on a clear timeline. Many of the enhancements to the settlement and confirmation processes have created increased stability and added clarity. It is clear, however, that the main and most important goal of reducing intra-day credit extension has not yet been achieved. It is also clear, however, that the responsibility for this cannot be solely assigned to the two clearing banks. We in the bank dealer community have to take the immediate and incremental steps available through our liability management practices to become a bigger part of the solution. There is no single operational solution or system development that can solve this issue completely. What is required is collaboration between the bank dealers and the two clearing banks to provide a set of strategic steps to begin a tactical but meaningful reduction of intraday credit extension in parallel to building operational and system enhancements. We believe that the status quo is unacceptable and by beginning this reduction through prudent liability management, we can reduce risk during the proposed build out by the clearing banks. At Morgan Stanley, we have seen considerable results achieved by working directly with our clearing banks to take significant tactical steps to reduce our reliance on intra-day credit.

Morgan Stanley is committed to taking the steps necessary to build investor confidence in this important funding channel. The markets' liquidity is provided by investors who seek to have transparency to their collateral, a clear understanding of the settlement process and the information they need in real time, to make appropriate risk decisions and to effectively manage their collateral and counterparty exposures.

We have worked with the Tri-party Committee and other industry groups to move this reform forward. Morgan Stanley is committed to achieving the entirety of goals laid out in the Committee's report and has invested and executed on changes to our processes well in advance of the scheduled timelines with the goal of meeting the needs of our investors. This work is a top priority of our firm and we will continue to work at both an industry and a firm level along with our regulators to add stability and durability to this funding platform.

Again, we are appreciative of the opportunity to discuss these important issues and look forward to providing this Committee with any level of detail and information that will be helpful as you deliberate on the path forward.