Scenario Design
Morgan Stanley Presentation to the FRB Model Symposium

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Guidelines for Establishing New Severely Adverse Scenarios

1. Risk Profile Changes
   - Reflect the changing composition of the Firm’s balance sheet, business mix and risk profile
     • Changes to business activities, including new or expanded businesses
     • Changes to risk profile, including material concentrations and key basis risks

2. External Environment Changes
   - Consider changes in the operating, market and macroeconomic environment
     • Relative changes and starting points for key market / macro drivers
     • Modified view around impact of certain operational risk events

3. Continued Process / Model Enhancements
   - Incorporate process improvements that better inform an understanding of key vulnerabilities and drivers of financial performance
     • Understanding of risk drivers and model enhancements
     • Impact of alternative scenarios
     • Sensitivity of models to key scenario features
     • Governance and review

Process

Design of Multiple Scenarios

Apply the above principles to both evaluate alternative scenario narratives and associated variable shocks and stress different combinations of the Firm’s risks
Macro Scenario Stress Testing ➔ Firm’s Capital Stress Testing

Day-to-Day Risk Management

Macro Scenario Stress Testing
- Adverse macroeconomic scenarios that incorporate regional and portfolio vulnerabilities across risk stripes
- Considerably more likely to occur than severely adverse scenarios

Product Stress Testing
- Instantaneous shocks
- Directional risks
- Non-linear risks
- Concentration and basis risks

Capital Adequacy Assessment and Capital Planning

Develop Candidate Scenario Narrative(s)
- Combine risk themes identified from multiple stress scenarios to develop plausible, severely adverse scenarios

Increase Scenario Severity and Broaden Risk Coverage
- Define theme; increase shock severity and stress additional risks
- Incorporate effects on earnings, balance sheet, risk-weighted assets and capital
- Add operational and idiosyncratic risk elements

Evaluate Scenarios for Capital Planning
- Assess scenarios based on relative risk capture, severity and impact to the Firm’s capital

Governance

Review and Challenge

Documentation of Scenario Narratives
Scenario includes necessary variables to capture Firm-specific risks identified in the Risk Inventory

Integrated stress tests estimate losses under varied severities
- Less severe scenarios provide practical day-to-day assessment of Firm-specific risks
- Utilization of stress testing to size emerging risks

Risk Appetite, expressed through multiple metrics including limits on stress losses, helps provide a constraint on risk-tasking activities

Capital adequacy assessed and capital targets set through BHC scenarios

Identifies unique risks that exist across risk types

Inventories where each of the unique risks exist across businesses

Scenario includes necessary variables to capture Firm-specific risks identified in the Risk Inventory