MORGAN STANLEY
Form 10-Q
May 07, 2013

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES

EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2013

OR

¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES

EXCHANGE ACT OF 1934

Commission File Number 1-11758

(Exact Name of Registrant as specified in its charter)

Delaware	**1585 Broadway**	**36-3145972**	**(212) 761-4000**
(State or other jurisdiction of incorporation or organization)	**New York, NY 10036** (Address of principal executive offices, including zip code)	(I.R.S. Employer Identification No.)	(Registrant s telephone number, including area code)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the Registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the Registrant was required to submit and post such files). Yes x No ¨

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer x	Accelerated Filer ¨
Non-Accelerated Filer ¨	Smaller reporting company ¨

(Do not check if a smaller reporting company)
Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

As of April 30, 2013, there were 1,960,115,045 shares of the Registrant s Common Stock, par value $0.01 per share, outstanding.

Table of Contents

QUARTERLY REPORT ON FORM 10-Q

For the quarter ended March 31, 2013

i

Table of Contents

AVAILABLE INFORMATION

Morgan Stanley files annual, quarterly and current reports, proxy statements and other information with the Securities and Exchange Commission (the SEC). You may read and copy any document we file with the SEC at the SEC s public reference room at 100 F Street, NE, Washington, DC 20549. Please call the SEC at 1-800-SEC-0330 for information on the public reference room. The SEC maintains an internet site that contains annual, quarterly and current reports, proxy and information statements and other information that issuers (including Morgan Stanley) file electronically with the SEC. Morgan Stanley s electronic SEC filings are available to the public at the SEC s internet site, *www.sec.gov*.

Morgan Stanley s internet site is *www.morganstanley.com*. You can access Morgan Stanley s Investor Relations webpage at *www.morganstanley.com/about/ir*. Morgan Stanley makes available free of charge, on or through its Investor Relations webpage, its proxy statements, Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and any amendments to those reports filed or furnished pursuant to the Securities Exchange Act of 1934, as amended (the Exchange Act), as soon as reasonably practicable after such material is electronically filed with, or furnished to, the SEC. Morgan Stanley also makes available, through its Investor Relations webpage, via a link to the SEC s internet site, statements of beneficial ownership of Morgan Stanley s equity securities filed by its directors, officers, 10% or greater shareholders and others under Section 16 of the Exchange Act.

Morgan Stanley has a Corporate Governance webpage. You can access information about Morgan Stanley s corporate governance at *www.morganstanley.com/about/company/governance*. Morgan Stanley posts the following on its Corporate Governance webpage:

- Amended and Restated Certificate of Incorporation;
- Amended and Restated Bylaws;
- Charters for its Audit Committee; Operations and Technology Committee; Compensation, Management Development and Succession Committee; Nominating and Governance Committee; and Risk Committee;
- Corporate Governance Policies;
- Policy Regarding Communication with the Board of Directors;
- Policy Regarding Director Candidates Recommended by Shareholders;
- Policy Regarding Corporate Political Contributions;
- Policy Regarding Shareholder Rights Plan;
- Code of Ethics and Business Conduct;
- Code of Conduct; and

Integrity Hotline information.

Morgan Stanley s Code of Ethics and Business Conduct applies to all directors, officers and employees, including its Chief Executive Officer, Chief Financial Officer and Deputy Chief Financial Officer. Morgan Stanley will post any amendments to the Code of Ethics and Business Conduct and any waivers that are required to be disclosed by the rules of either the SEC or the New York Stock Exchange LLC (NYSE) on its internet site. You can request a copy of these documents, excluding exhibits, at no cost, by contacting Investor Relations, 1585 Broadway, New York, NY 10036 (212-761-4000). The information on Morgan Stanley s internet site is not incorporated by reference into this report.

Table of Contents

Part I Financial Information.

Item 1. Financial Statements.

MORGAN STANLEY

Condensed Consolidated Statements of Financial Condition

(dollars in millions, except share data)

(unaudited)

	March 31, 2013	December 31, 2012
Assets		
Cash and due from banks ($584 and $526 at March 31, 2013 and December 31, 2012, respectively, related to consolidated variable interest entities generally not available to the Company)	$ 17,773	$ 20,878
Interest bearing deposits with banks	25,129	26,026
Cash deposited with clearing organizations or segregated under federal and other regulations or requirements	31,313	30,970
Trading assets, at fair value (approximately $138,143 and $147,348 were pledged to various parties at March 31, 2013 and December 31, 2012, respectively; $3,343 and $3,490 related to consolidated variable interest entities, generally not available to the Company at March 31, 2013 and December 31, 2012, respectively)	267,236	267,603
Securities available for sale, at fair value	41,454	39,869
Securities received as collateral, at fair value	17,971	14,278
Federal funds sold and securities purchased under agreements to resell (includes $873 and $621 at fair value at March 31, 2013 and December 31, 2012, respectively)	140,415	134,412
Securities borrowed	135,727	121,701
Customer and other receivables	62,271	64,288
Loans (net of allowances of $129 and $106 at March 31, 2013 and December 31, 2012, respectively)	30,615	29,046
Other investments	4,940	4,999
Premises, equipment and software costs (net of accumulated depreciation of $5,750 and $5,525 at March 31, 2013 and December 31, 2012, respectively) ($222 and $224 at March 31, 2013 and December 31, 2012, respectively, related to consolidated variable interest entities, generally not available to the Company)	5,928	5,946
Goodwill	6,633	6,650
Intangible assets (net of accumulated amortization of $1,336 and $1,250 at March 31,2013 and December 31, 2012, respectively) (includes $8 and $7 at fair value at March 31, 2013 and December 31, 2012, respectively)	3,694	3,783
Other assets ($577 and $593 at March 31, 2013 and December 31, 2012, respectively, related to consolidated variable interest entities, generally not available to the Company)	10,284	10,511
Total assets	$ 801,383	$ 780,960
Liabilities		
Deposits (includes $1,442 and $1,485 at fair value at March 31, 2013 and December 31, 2012, respectively)	$ 80,623	$ 83,266
Commercial paper and other short-term borrowings (includes $1,262 and $725 at fair value at March 31, 2013 and December 31, 2012, respectively)	2,475	2,138
Trading liabilities, at fair value	132,472	120,122
Obligation to return securities received as collateral, at fair value	23,510	18,226
Securities sold under agreements to repurchase (includes $565 and $363 at fair value at March 31, 2013 and December 31, 2012, respectively)	119,270	122,674
Securities loaned	40,351	36,849
Other secured financings (includes $9,624 and $9,466 at fair value at March 31, 2013 and December 31, 2012, respectively) ($739 and $976 at March 31, 2013 and December 31, 2012, respectively, related to consolidated variable entities and are non-recourse to the Company)	16,294	15,727
Customer and other payables	137,127	127,722
Other liabilities and accrued expenses ($116 and $117 at March 31, 2013 and December 31, 2012, respectively related to consolidated variable interest entities and are non-recourse to the Company)	13,622	14,928
Long-term borrowings (includes $42,510 and $44,044 at fair value at March 31, 2013 and December 31, 2012, respectively)	165,142	169,571
	730,886	711,223

Commitments and contingent liabilities (see Note 12)		
Redeemable noncontrolling interests (see Notes 3 and 14)	4,425	4,309
Equity		
Morgan Stanley shareholders equity:		
Preferred stock	1,508	1,508
Common stock, $0.01 par value:		
Shares authorized: 3,500,000,000 at March 31, 2013 and December 31, 2012;		
Shares issued: 2,038,893,979 at December 31, 2012 and March 31,2013;		
Shares outstanding: 1,960,582,868 at March 31, 2013 and 1,974,042,123 at December 31, 2012	20	20
Additional Paid-in capital	23,661	23,426
Retained earnings	40,750	39,912
Employee stock trust	1,872	2,932
Accumulated other comprehensive loss	(694)	(516)
Common stock held in treasury, at cost, $0.01 par value; 78,311,111 shares at March 31, 2013 and 64,851,856 shares at December 31, 2012	(2,541)	(2,241)
Common stock issued to employee trust	(1,872)	(2,932)
Total Morgan Stanley shareholders equity	62,704	62,109
Nonredeemable noncontrolling interests	3,368	3,319
Total equity	66,072	65,428
Total liabilities, redeemable noncontrolling interests and equity	$ 801,383	$ 780,960

See Notes to Condensed Consolidated Financial Statements.

1

Table of Contents

MORGAN STANLEY

Condensed Consolidated Statements of Income

(dollars in millions, except share and per share data)

(unaudited)

	Three Months Ended March 31, 2013	Three Months Ended March 31, 2012
Revenues:		
Investment banking	$ 1,224	$ 1,063
Trading	2,694	2,402
Investments	338	85
Commissions and fees	1,168	1,177
Asset management, distribution and administration fees	2,346	2,152
Other	203	104
Total non-interest revenues	7,973	6,983
Interest income	1,398	1,542
Interest expense	1,213	1,601
Net interest	185	(59)
Net revenues	8,158	6,924
Non-interest expenses:		
Compensation and benefits	4,216	4,430
Occupancy and equipment	379	388
Brokerage, clearing and exchange fees	428	403
Information processing and communications	448	459
Marketing and business development	134	146
Professional services	440	412
Other	531	484
Total non-interest expenses	6,576	6,722
Income from continuing operations before income taxes	1,582	202
Provision for income taxes	332	54
Income from continuing operations	1,250	148
Discontinued operations:		
Gain (loss) from discontinued operations	(30)	28
Provision for (benefit from) income taxes	(11)	42
Net gain (loss) from discontinued operations	(19)	(14)
Net income	$ 1,231	$ 134
Net income applicable to redeemable noncontrolling interests	122	
Net income applicable to nonredeemable noncontrolling interests	147	228
Net income (loss) applicable to Morgan Stanley	$ 962	$ (94)

Earnings (loss) applicable to Morgan Stanley common shareholders	$	936	$	(119)
Amounts applicable to Morgan Stanley:				
Income (loss) from continuing operations	$	981	$	(79)
Net gain (loss) from discontinued operations		(19)		(15)
Net income (loss) applicable to Morgan Stanley	$	962	$	(94)
Earnings (loss) per basic common share:				
Income (loss) from continuing operations	$	0.50	$	(0.05)
Net gain (loss) from discontinued operations		(0.01)		(0.01)
Earnings (loss) per basic common share	$	0.49	$	(0.06)
Earnings (loss) per diluted common share:				
Income (loss) from continuing operations	$	0.49	$	(0.05)
Net gain (loss) from discontinued operations		(0.01)		(0.01)
Earnings (loss) per diluted common share	$	0.48	$	(0.06)
Dividends declared per common share	$	0.05	$	0.05
Average common shares outstanding:				
Basic		1,901,204,729		1,876,961,836
Diluted		1,940,264,085		1,876,961,836

See Notes to Condensed Consolidated Financial Statements.

Table of Contents

MORGAN STANLEY

Condensed Consolidated Statements of Comprehensive Income

(dollars in millions)

(unaudited)

	Three Months Ended March 31, 2013	Three Months Ended March 31, 2012
Net income	$ 1,231	$ 134
Other comprehensive income (loss), net of tax:		
Foreign currency translation adjustments(1)	$ (245)	$ 20
Amortization of cash flow hedges(2)	1	2
Change in net unrealized losses on securities available for sale(3)	(27)	(19)
Pension, postretirement and other related adjustments(4)	1	2
Total other comprehensive income (loss)	$ (270)	$ 5
Comprehensive income	$ 961	$ 139
Net income applicable to redeemable noncontrolling interests	122	
Net income applicable to nonredeemable noncontrolling interests	147	228
Other comprehensive income applicable to redeemable noncontrolling interests		
Other comprehensive income (loss) applicable to nonredeemable noncontrolling interests	(92)	(92)
Comprehensive income applicable to Morgan Stanley	$ 784	$ 3

(1) Amounts are net of provision for income taxes of $165 million and $4 million for the quarters ended March 31, 2013 and 2012, respectively.
(2) Amounts are net of provision for income taxes of $1 million and $1 million for the quarters ended March 31, 2013 and 2012, respectively.
(3) Amounts are net of provision for (benefit from) income taxes of $(19) million and $(13) million for the quarters ended March 31, 2013 and 2012, respectively.
(4) Amounts are net of provision for income taxes of $5 million and $2 million for the quarters ended March 31, 2013 and 2012, respectively.

See Notes to Condensed Consolidated Financial Statements.

Table of Contents

MORGAN STANLEY

Condensed Consolidated Statements of Cash Flows

(dollars in millions)

(unaudited)

	Three Months Ended March 31, 2013	Three Months Ended March 31, 2012
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 1,231	$ 134
Adjustments to reconcile net income to net cash provided by (used for) operating activities:		
(Income) loss on equity method investees	(64)	32
Compensation payable in common stock and options	265	372
Depreciation and amortization	360	375
Loss on business dispositions	5	
Gain on sale of securities available for sale	(3)	(1)
(Gain) loss on retirement of long-term debt		(14)
Impairment charges and other-than-temporary impairment charges	29	12
Provision for credit losses on lending activities	(39)	(2)
Changes in assets and liabilities:		
Cash deposited with clearing organizations or segregated under federal and other regulations or requirements	(343)	(698)
Trading assets, net of Trading liabilities	13,284	13,690
Securities borrowed	(14,026)	(14,536)
Securities loaned	3,502	3,969
Customer and other receivables and other assets	2,830	(5,179)
Customer and other payables and other liabilities	6,976	10,567
Federal funds sold and securities purchased under agreements to resell	(6,003)	(6,296)
Securities sold under agreements to repurchase	(3,404)	5,575
Net cash provided by operating activities	4,600	8,000
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from (payments for):		
Premises, equipment and software costs, net	(263)	(212)
Business dispositions, net of cash disposed	481	
Loans, net	(2,168)	(569)
Purchases of securities available for sale	(4,674)	(3,487)
Sales, maturities and redemptions of securities available for sale	3,380	1,003
Net cash used for investing activities	(3,244)	(3,265)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net proceeds from (payments for):		
Commercial paper and other short-term borrowings	337	(826)
Distributions related to noncontrolling interests	(8)	(7)
Derivatives financing activities	36	(169)
Other secured financings	501	(1,674)
Deposits	(2,643)	779
Net proceeds from:		
Excess tax benefits associated with stock-based awards	12	34
Issuance of long-term borrowings	10,046	5,320
Payments for:		
Long-term borrowings	(12,018)	(16,043)
Repurchases of common stock for employee tax withholding	(306)	(183)
Cash dividends	(119)	(112)

Net cash used for financing activities	(4,162)	(12,881)
Effect of exchange rate changes on cash and cash equivalents	(612)	93
Effect of cash and cash equivalents related to variable interest entities	(584)	(534)
Net decrease in cash and cash equivalents	(4,002)	(8,587)
Cash and cash equivalents, at beginning of period	46,904	47,312
Cash and cash equivalents, at end of period	$ 42,902	$ 38,725
Cash and cash equivalents include:		
Cash and due from banks	$ 17,773	$ 10,133
Interest bearing deposits with banks	25,129	28,592
Cash and cash equivalents, at end of period	$ 42,902	$ 38,725

SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION

Cash payments for interest were $728 million and $1,169 million for the quarters ended March 31, 2013 and 2012, respectively.

Cash payments for income taxes were $139 million and $145 million for the quarters ended March 31, 2013 and 2012, respectively.

See Notes to Condensed Consolidated Financial Statements.

Table of Contents

MORGAN STANLEY

Condensed Consolidated Statements of Changes in Total Equity

Three Months Ended March 31, 2013

(dollars in millions)

(unaudited)

	Preferred Stock	Common Stock	Additional Paid-in Capital	Retained Earnings	Employee Stock Trust	Accumulated Other Comprehensive Income (Loss)	Common Stock Held in Treasury at Cost	Common Stock Issued to Employee Trust	Non-redeemable Non-controlling Interests	Total Equity
BALANCE AT DECEMBER 31, 2012	$ 1,508	$ 20	$ 23,426	$ 39,912	$ 2,932	$ (516)	$ (2,241)	$ (2,932)	$ 3,319	$ 65,428
Net income applicable to Morgan Stanley				962						962
Net income applicable to nonredeemable noncontrolling interests									147	147
Dividends				(124)						(124)
Shares issued under employee plans and related tax effects			235		(1,060)		6	1,060		241
Repurchases of common stock							(306)			(306)
Foreign currency translation adjustments						(153)			(92)	(245)
Net change in cash flow hedges						1				1
Change in net unrealized losses on securities available for sale						(27)				(27)
Pension, postretirement and other related adjustments						1				1
Other net decreases									(6)	(6)
BALANCE AT MARCH 31, 2013	$ 1,508	$ 20	$ 23,661	$ 40,750	$ 1,872	$ (694)	$ (2,541)	$ (1,872)	$ 3,368	$ 66,072

See Notes to Condensed Consolidated Financial Statements.

5

Table of Contents

MORGAN STANLEY

Condensed Consolidated Statements of Changes in Total Equity (Continued)

Three Months Ended March 31, 2012

(dollars in millions)

(unaudited)

	Preferred Stock	Common Stock	Additional Paid-in Capital	Retained Earnings	Employee Stock Trust	Accumulated Other Comprehensive Income (Loss)	Common Stock Held in Treasury at Cost	Common Stock Issued to Employee Trust	Non-Redeemable Non-controlling Interests	Total Equity
BALANCE AT DECEMBER 31, 2011	$ 1,508	$ 20	$ 22,836	$ 40,341	$ 3,166	$ (157)	$ (2,499)	$ (3,166)	$ 8,029	$ 70,078
Net loss applicable to Morgan Stanley				(94)						(94)
Net income applicable to nonredeemable noncontrolling interests									228	228
Dividends				(129)						(129)
Shares issued under employee plans and related tax effects			94		86		490	(86)		584
Repurchases of common stock							(183)			(183)
Foreign currency translation adjustments						112			(92)	20
Net change in cash flow hedges						2				2
Change in net unrealized losses on securities available for sale						(19)				(19)
Pension, postretirement and other related adjustments						2				2
Other net increases									103	103
BALANCE AT MARCH 31, 2012	$ 1,508	$ 20	$ 22,930	$ 40,118	$ 3,252	$ (60)	$ (2,192)	$ (3,252)	$ 8,268	$ 70,592

See Notes to Condensed Consolidated Financial Statements.

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Introduction and Basis of Presentation.

The Company. Morgan Stanley, a financial holding company, is a global financial services firm that maintains significant market positions in each of its business segments Institutional Securities, Global Wealth Management Group and Asset Management. The Company, through its subsidiaries and affiliates, provides a wide variety of products and services to a large and diversified group of clients and customers, including corporations, governments, financial institutions and individuals. Unless the context otherwise requires, the terms Morgan Stanley or the Company mean Morgan Stanley (the Parent) together with its consolidated subsidiaries.

A summary of the activities of each of the Company s business segments is as follows:

Institutional Securities provides financial advisory and capital raising services, including advice on mergers and acquisitions, restructurings, real estate and project finance; corporate lending; sales, trading, financing and market-making activities in equity and fixed income securities and related products, including foreign exchange and commodities; and investment activities.

Global Wealth Management Group, which includes the Company s 65% interest in Morgan Stanley Smith Barney Holdings LLC (the Wealth Management Joint Venture or Wealth Management JV) (see Note 3), provides brokerage and investment advisory services to individual investors and small-to-medium sized businesses and institutions covering various investment alternatives; financial and wealth planning services; annuity and other insurance products; credit and other lending products; cash management services; retirement services; and trust and fiduciary services and engages in fixed income trading, which primarily facilitates clients trading or investments in such securities.

Asset Management provides a broad array of investment strategies that span the risk/return spectrum across geographies, asset classes and public and private markets to a diverse group of clients across the institutional and intermediary channels as well as high net worth clients.

Discontinued Operations.

Quilter. On April 2, 2012, the Company completed the sale of Quilter & Co. Ltd. (Quilter), its retail wealth management business in the United Kingdom (U.K.). The results of Quilter are reported as discontinued operations within the Global Wealth Management Group business segment for all periods presented.

Saxon. On October 24, 2011, the Company announced that it had reached an agreement to sell Saxon, a provider of servicing and subservicing of residential mortgage loans, to Ocwen Financial Corporation. The transaction, which was restructured as a sale of Saxon s assets during the first quarter of 2012, was substantially completed in the second quarter of 2012. The results of Saxon are reported as discontinued operations within the Institutional Securities business segment for all periods presented.

Prior period amounts have been recast for discontinued operations. See Note 21 for additional information on discontinued operations.

Basis of Financial Information. The condensed consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America (U.S.), which require the Company to make estimates and assumptions regarding the valuations of certain financial instruments, the valuation of goodwill and intangible assets, compensation, deferred tax assets, the outcome of litigation and tax matters, and other matters that affect the condensed consolidated financial statements and related disclosures. The Company believes that the estimates utilized in the preparation of the condensed consolidated financial statements are prudent and reasonable. Actual results could differ materially from these estimates.

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Intercompany balances and transactions have been eliminated.

In the quarter ended March 31, 2013, the Company renamed Principal transactions Trading revenues as Trading revenues and Principal transactions Investments revenues as Investments revenues in the condensed consolidated statements of income, and Financial instruments owned as Trading assets, Financial instruments sold, not yet purchased as Trading liabilities, Receivables as Customer and other receivables Payables as Customer and other payables in the condensed consolidated statements of financial condition.

The condensed consolidated financial statements should be read in conjunction with the Company s consolidated financial statements and notes thereto included in the Company s Annual Report on Form 10-K for the year ended December 31, 2012 (the Form 10-K). The condensed consolidated financial statements reflect all adjustments of a normal recurring nature that are, in the opinion of management, necessary for the fair presentation of the results for the interim period. The results of operations for interim periods are not necessarily indicative of results for the entire year.

Consolidation. The condensed consolidated financial statements include the accounts of the Company, its wholly owned subsidiaries and other entities in which the Company has a controlling financial interest, including certain variable interest entities (VIE) (see Note 7). For consolidated subsidiaries that are less than wholly owned, the third-party holdings of equity interests are referred to as noncontrolling interests. The portion of net income attributable to noncontrolling interests for such subsidiaries is presented as either Net income (loss) applicable to redeemable noncontrolling interests or Net income (loss) applicable to nonredeemable noncontrolling interests in the condensed consolidated statements of income. The portion of the shareholders equity of such subsidiaries that is redeemable is presented as Redeemable noncontrolling interests outside of the equity section in the condensed consolidated statements of financial condition. The portion of the shareholders equity of such subsidiaries that is nonredeemable is presented as Nonredeemable noncontrolling interests, a component of total equity, in the condensed consolidated statements of financial condition.

For entities where (1) the total equity investment at risk is sufficient to enable the entity to finance its activities without additional support and (2) the equity holders bear the economic residual risks and returns of the entity and have the power to direct the activities of the entity that most significantly affect its economic performance, the Company consolidates those entities it controls either through a majority voting interest or otherwise. For VIEs (*i.e.*, entities that do not meet these criteria), the Company consolidates those entities where the Company has the power to make the decisions that most significantly affect the economic performance of the VIE and has the obligation to absorb losses or the right to receive benefits that could potentially be significant to the VIE, except for certain VIEs that are money market funds, investment companies or are entities qualifying for accounting purposes as investment companies. Generally, the Company consolidates those entities when it absorbs a majority of the expected losses or a majority of the expected residual returns, or both, of the entities.

For investments in entities in which the Company does not have a controlling financial interest but has significant influence over operating and financial decisions, the Company generally applies the equity method of accounting with net gains and losses recorded within Other revenues. Where the Company has elected to measure certain eligible investments at fair value in accordance with the fair value option, net gains and losses are recorded within Investments revenues (see Note 4).

Equity and partnership interests held by entities qualifying for accounting purposes as investment companies are carried at fair value.

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Company s significant regulated U.S. and international subsidiaries include Morgan Stanley & Co. LLC (MS&Co.), Morgan Stanley Smith Barney LLC (MSSB LLC), Morgan Stanley & Co. International plc (MSIP), Morgan Stanley MUFG Securities Co., Ltd. (MSMS), Morgan Stanley Bank, N.A. and Morgan Stanley Private Bank, National Association.

Income Statement Presentation. The Company, through its subsidiaries and affiliates, provides a wide variety of products and services to a large and diversified group of clients and customers, including corporations, governments, financial institutions and individuals. In connection with the delivery of the various products and services to clients, the Company manages its revenues and related expenses in the aggregate. As such, when assessing the performance of its businesses, primarily in its Institutional Securities business segment, the Company considers its trading, investment banking, commissions and fees and interest income, along with the associated interest expense, as one integrated activity.

2. Significant Accounting Policies.

For a detailed discussion about the Company s significant accounting policies, see Note 2 to the consolidated financial statements for the year ended December 31, 2012 included in the Form 10-K.

During the quarter ended March 31, 2013, other than the following, no updates were made to the Company s significant accounting policies.

Condensed Consolidated Statements of Cash Flows.

For purposes of the condensed consolidated statements of cash flows, cash and cash equivalents consist of Cash and due from banks and Interest bearing deposits with banks, which are highly liquid investments with original maturities of three months or less, held for investment purposes, and readily convertible to known amounts of cash.

In the quarter ended March 31, 2012, the Company s significant non-cash activities included approximately $0.1 billion of net assets received from Citigroup, Inc. (Citi) related to Citi s required equity contribution in connection with the Morgan Stanley Wealth Management platform integration (see Notes 3 and 14).

During the third quarter of 2012, the Company identified that activities related to certain loans had been reported as cash flows from operating activities that should have been presented as investing activities. The Company corrected the previously presented cash flows for these loans and in doing so, the condensed consolidated statements of cash flows for the quarter ended March 31, 2012 has been adjusted to increase net cash flows from operating activities by $0.6 billion, with the corresponding decreases in net cash flows from investing activities. The Company has evaluated the effect of the incorrect presentation, both qualitatively and quantitatively, and concluded that it did not have a material impact on, nor require amendment of, any previously filed annual or quarterly consolidated financial statements.

Accounting Developments.

Disclosures about Offsetting Assets and Liabilities. In January 2013, the Financial Accounting Standards Board (the FASB) issued an accounting update that clarified the intended scope of the new balance sheet offsetting disclosures to derivatives, repurchase agreements, and securities lending transactions to the extent that they are either offset in the financial statements or subject to an enforceable master netting arrangement or similar agreement. These disclosure requirements became effective for the Company beginning on January 1, 2013. Since these amended principles require only additional disclosures concerning offsetting and related arrangements, adoption has not affected the Company s condensed consolidated statements of income or financial condition (see Notes 6 and 11).

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income. In February 2013, the FASB issued an accounting update that created new disclosure requirements requiring entities to report the effect of significant reclassifications out of accumulated other comprehensive income on the respective line items in net income if the amount being reclassified is required under U.S. generally accepted accounting principles (GAAP) to be reclassified in its entirety to net income. The disclosure requirements became effective for the Company beginning on January 1, 2013. Since these amended principles require only additional disclosures concerning amounts reclassified out of accumulated other comprehensive income, adoption has not affected the Company s condensed consolidated statements of comprehensive income or notes to the condensed consolidated financial statements (see Note 14).

3. Wealth Management Joint Venture.

On May 31, 2009, the Company and Citi consummated the combination of the Company s Global Wealth Management Group business segment and the businesses of Citi s Smith Barney in the U.S., Quilter Holdings Ltd. (see Note 21) in the U.K. and Smith Barney Australia (collectively, Smith Barney). The combined businesses operate as Morgan Stanley Wealth Management. Prior to September 2012, the Company owned 51% and Citi owned 49% of the Wealth Management JV.

In September 2012, the Company reached an agreement with Citi to purchase an additional 14% stake in the Wealth Management JV, and a transfer of approximately $5.4 billion of deposits at no premium from Citi. In addition, the agreement specifies that the Company must use reasonable best efforts to obtain the regulatory approvals required to purchase the remaining 35% stake in the Wealth Management JV by June 1, 2015 and, subject to receipt of such approvals, the Company must consummate such acquisition by that date at a purchase price of $4.725 billion (or a pro rata portion of such amount if less than 35% of the total outstanding stake is being purchased) and receive a transfer of deposits currently estimated to be $57 billion at no premium from Citi, no later than June 1, 2015.

The Company completed the purchase of the additional 14% stake in the Wealth Management JV from Citi on September 17, 2012 for $1.89 billion. The related $5.4 billion of deposits were transferred at no premium in October of 2012. At March 31, 2013, the Company held a 65% stake in the Wealth Management JV.

The change in the terms of the Wealth Management JV s agreement to acquire the remaining noncontrolling interest resulted in a reclassification of approximately $4.3 billion from nonredeemable noncontrolling interests to redeemable noncontrolling interests. At December 31, 2012 and March 31, 2013, the redeemable noncontrolling interest is not reflected as a liability at its redemption amount because it is not deemed probable that the noncontrolling interest will become redeemable due to the required regulatory approvals.

4. Fair Value Disclosures.

Fair Value Measurements.

A description of the valuation techniques applied to the Company s major categories of assets and liabilities measured at fair value on a recurring basis follows.

Trading Assets and Trading Liabilities.

U.S. Government and Agency Securities.

U.S. Treasury Securities. U.S. Treasury securities are valued using quoted market prices. Valuation adjustments are not applied. Accordingly, U.S. Treasury securities are generally categorized in Level 1 of the fair value hierarchy.

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

U.S. Agency Securities. U.S. agency securities are composed of three main categories consisting of agency-issued debt, agency mortgage pass-through pool securities and collateralized mortgage obligations. Non-callable agency-issued debt securities are generally valued using quoted market prices. Callable agency-issued debt securities are valued by benchmarking model-derived prices to quoted market prices and trade data for identical or comparable securities. The fair value of agency mortgage pass-through pool securities is model-driven based on spreads of the comparable To-be-announced (TBA) security. Collateralized mortgage obligations are valued using quoted market prices and trade data adjusted by subsequent changes in related indices for identical or comparable securities. Actively traded non-callable agency-issued debt securities are generally categorized in Level 1 of the fair value hierarchy. Callable agency-issued debt securities, agency mortgage pass-through pool securities and collateralized mortgage obligations are generally categorized in Level 2 of the fair value hierarchy.

Other Sovereign Government Obligations.

Foreign sovereign government obligations are valued using quoted prices in active markets when available. These bonds are generally categorized in Level 1 of the fair value hierarchy. If the market is less active or prices are dispersed, these bonds are categorized in Level 2 of the fair value hierarchy.

Corporate and Other Debt.

State and Municipal Securities. The fair value of state and municipal securities is determined using recently executed transactions, market price quotations and pricing models that factor in, where applicable, interest rates, bond or credit default swap spreads and volatility. These bonds are generally categorized in Level 2 of the fair value hierarchy.

Residential Mortgage-Backed Securities (RMBS), Commercial Mortgage-Backed Securities (CMBS) and other Asset-Backed Securities (ABS). RMBS, CMBS and other ABS may be valued based on price or spread data obtained from observed transactions or independent external parties such as vendors or brokers. When position-specific external price data are not observable, the fair value determination may require benchmarking to similar instruments and/or analyzing expected credit losses, default and recovery rates. In evaluating the fair value of each security, the Company considers security collateral-specific attributes, including payment priority, credit enhancement levels, type of collateral, delinquency rates and loss severity. In addition, for RMBS borrowers, Fair Isaac Corporation (FICO) scores and the level of documentation for the loan are also considered. Market standard models, such as Intex, Trepp or others, may be deployed to model the specific collateral composition and cash flow structure of each transaction. Key inputs to these models are market spreads, forecasted credit losses, default and prepayment rates for each asset category. Valuation levels of RMBS and CMBS indices are also used as an additional data point for benchmarking purposes or to price outright index positions.

RMBS, CMBS and other ABS are generally categorized in Level 2 of the fair value hierarchy. If external prices or significant spread inputs are unobservable or if the comparability assessment involves significant subjectivity related to property type differences, cash flows, performance and other inputs, then RMBS, CMBS and other ABS are categorized in Level 3 of the fair value hierarchy.

Corporate Bonds. The fair value of corporate bonds is determined using recently executed transactions, market price quotations (where observable), bond spreads or credit default swap spreads obtained from independent external parties such as vendors and brokers adjusted for any basis difference between cash and derivative instruments. The spread data used are for the same maturity as the bond. If the spread data do not reference the issuer, then data that reference a comparable issuer are used. When position-specific external price data are not observable, fair value is determined based on either benchmarking to similar

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

instruments or cash flow models with yield curves, bond or single-name credit default swap spreads and recovery rates as significant inputs. Corporate bonds are generally categorized in Level 2 of the fair value hierarchy; in instances where prices, spreads or any of the other aforementioned key inputs are unobservable, they are categorized in Level 3 of the fair value hierarchy.

Collateralized Debt Obligation (CDO). The Company holds cash CDOs that typically reference a tranche of an underlying synthetic portfolio of single name credit default swaps collateralized by corporate bonds (credit-linked notes) or cash portfolio of asset-backed securities (asset-backed CDOs). Credit correlation, a primary input used to determine the fair value of credit-linked notes, is usually unobservable and derived using a benchmarking technique. The other credit-linked note model inputs such as credit spreads, including collateral spreads, and interest rates are typically observable. Asset-backed CDOs are valued based on an evaluation of the market and model input parameters sourced from similar positions as indicated by primary and secondary market activity. Each asset-backed CDO position is evaluated independently taking into consideration available comparable market levels, underlying collateral performance and pricing, and deal structures, as well as liquidity. Cash CDOs are categorized in Level 2 of the fair value hierarchy when either the credit correlation input is insignificant or comparable market transactions are observable. In instances where the credit correlation input is deemed to be significant or comparable market transactions are unobservable, cash CDOs are categorized in Level 3 of the fair value hierarchy.

Corporate Loans and Lending Commitments. The fair value of corporate loans is determined using recently executed transactions, market price quotations (where observable), implied yields from comparable debt, and market observable credit default swap spread levels obtained from independent external parties such as vendors and brokers adjusted for any basis difference between cash and derivative instruments, along with proprietary valuation models and default recovery analysis where such transactions and quotations are unobservable. The fair value of contingent corporate lending commitments is determined by using executed transactions on comparable loans and the anticipated market price based on pricing indications from syndicate banks and customers. The valuation of loans and lending commitments also takes into account fee income that is considered an attribute of the contract. Corporate loans and lending commitments are categorized in Level 2 of the fair value hierarchy except in instances where prices or significant spread inputs are unobservable, in which case they are categorized in Level 3 of the fair value hierarchy.

Mortgage Loans. Mortgage loans are valued using observable prices based on transactional data or third-party pricing for identical or comparable instruments, when available. Where position-specific external prices are not observable, the Company estimates fair value based on benchmarking to prices and rates observed in the primary market for similar loan or borrower types or based on the present value of expected future cash flows using its best estimates of the key assumptions, including forecasted credit losses, prepayment rates, forward yield curves and discount rates commensurate with the risks involved or a methodology that utilizes the capital structure and credit spreads of recent comparable securitization transactions. Mortgage loans valued based on observable market data for identical or comparable instruments are categorized in Level 2 of the fair value hierarchy. Where observable prices are not available, due to the subjectivity involved in the comparability assessment related to mortgage loan vintage, geographical concentration, prepayment speed and projected loss assumptions, mortgage loans are categorized in Level 3 of the fair value hierarchy. Mortgage loans are presented within Loans and lending commitments in the fair value hierarchy table.

Auction Rate Securities (ARS). The Company primarily holds investments in Student Loan Auction Rate Securities (SLARS) and Municipal Auction Rate Securities (MARS) with interest rates that are reset through periodic auctions. SLARS are ABS backed by pools of student loans. MARS are municipal bonds often wrapped by municipal bond insurance. ARS were historically traded and valued as floating

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

rate notes, priced at par due to the auction mechanism. Beginning in fiscal 2008, uncertainties in the credit markets have resulted in auctions failing for certain types of ARS. Once the auctions failed, ARS could no longer be valued using observations of auction market prices. Accordingly, the fair value of ARS is determined using independent external market data where available and an internally developed methodology to discount for the lack of liquidity and non-performance risk.

Inputs that impact the valuation of SLARS are independent external market data, the underlying collateral types, level of seniority in the capital structure, amount of leverage in each structure, credit rating and liquidity considerations. Inputs that impact the valuation of MARS are recently executed transactions, the maximum rate, quality of underlying issuers/insurers and evidence of issuer calls/prepayment. ARS are generally categorized in Level 2 of the fair value hierarchy as the valuation technique relies on observable external data. SLARS and MARS are presented within Asset-backed securities and State and municipal securities, respectively, in the fair value hierarchy table.

Corporate Equities.

Exchange-Traded Equity Securities. Exchange-traded equity securities are generally valued based on quoted prices from the exchange. To the extent these securities are actively traded, valuation adjustments are not applied, and they are categorized in Level 1 of the fair value hierarchy; otherwise, they are categorized in Level 2 or Level 3 of the fair value hierarchy.

Unlisted Equity Securities. Unlisted equity securities are valued based on an assessment of each underlying security, considering rounds of financing and third-party transactions, discounted cash flow analyses and market-based information, including comparable company transactions, trading multiples and changes in market outlook, among other factors. These securities are generally categorized in Level 3 of the fair value hierarchy.

Fund Units. Listed fund units are generally marked to the exchange-traded price or net asset value (NAV) and are categorized in Level 1 of the fair value hierarchy if actively traded on an exchange or in Level 2 of the fair value hierarchy if trading is not active. Unlisted fund units are generally marked to NAV and categorized as Level 2; however, positions which are not redeemable at the measurement date or in the near future are categorized in Level 3 of the fair value hierarchy.

Derivative and Other Contracts.

Listed Derivative Contracts. Listed derivatives that are actively traded are valued based on quoted prices from the exchange and are categorized in Level 1 of the fair value hierarchy. Listed derivatives that are not actively traded are valued using the same approaches as those applied to over-the-counter (OTC) derivatives; they are generally categorized in Level 2 of the fair value hierarchy.

OTC Derivative Contracts. OTC derivative contracts include forward, swap and option contracts related to interest rates, foreign currencies, credit standing of reference entities, equity prices or commodity prices.

Depending on the product and the terms of the transaction, the fair value of OTC derivative products can be either observed or modeled using a series of techniques and model inputs from comparable benchmarks, including closed-form analytic formulas, such as the Black-Scholes option-pricing model, and simulation models or a combination thereof. Many pricing models do not entail material subjectivity because the methodologies employed do not necessitate significant judgment, and the pricing inputs are observed from actively quoted markets, as is the case for generic interest rate swaps, certain option contracts and certain credit default swaps. In the case of more established derivative products, the pricing

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

models used by the Company are widely accepted by the financial services industry. A substantial majority of OTC derivative products valued by the Company using pricing models fall into this category and are categorized in Level 2 of the fair value hierarchy.

Other derivative products, including complex products that have become illiquid, require more judgment in the implementation of the valuation technique applied due to the complexity of the valuation assumptions and the reduced observability of inputs. This includes certain types of interest rate derivatives with both volatility and correlation exposure and credit derivatives including credit default swaps on certain mortgage-backed or asset-backed securities, basket credit default swaps and CDO-squared positions (a CDO-squared position is a special purpose vehicle that issues interests, or tranches, that are backed by tranches issued by other CDOs) where direct trading activity or quotes are unobservable. These instruments involve significant unobservable inputs and are categorized in Level 3 of the fair value hierarchy.

Derivative interests in credit default swaps on certain mortgage-backed or asset-backed securities, for which observability of external price data is limited, are valued based on an evaluation of the market and model input parameters sourced from similar positions as indicated by primary and secondary market activity. Each position is evaluated independently taking into consideration available comparable market levels as well as cash-synthetic basis, or the underlying collateral performance and pricing, behavior of the tranche under various cumulative loss and prepayment scenarios, deal structures (*e.g*., non-amortizing reference obligations, call features, etc.) and liquidity. While these factors may be supported by historical and actual external observations, the determination of their value as it relates to specific positions nevertheless requires significant judgment.

For basket credit default swaps and CDO-squared positions, the correlation input between reference credits is unobservable for each specific swap or position and is benchmarked to standardized proxy baskets for which correlation data are available. The other model inputs such as credit spread, interest rates and recovery rates are observable. In instances where the correlation input is deemed to be significant, these instruments are categorized in Level 3 of the fair value hierarchy; otherwise, these instruments are categorized in Level 2 of the fair value hierarchy.

The Company trades various derivative structures with commodity underlyings. Depending on the type of structure, the model inputs generally include interest rate yield curves, commodity underlier price curves, implied volatility of the underlying commodities and, in some cases, the implied correlation between these inputs. The fair value of these products is determined using executed trades and broker and consensus data to provide values for the aforementioned inputs. Where these inputs are unobservable, relationships to observable commodities and data points, based on historic and/or implied observations, are employed as a technique to estimate the model input values. Commodity derivatives are generally categorized in Level 2 of the fair value hierarchy; in instances where significant inputs are unobservable, they are categorized in Level 3 of the fair value hierarchy.

For further information on derivative instruments and hedging activities, see Note 11.

Investments.

The Company s investments include direct investments in equity securities as well as investments in private equity funds, real estate funds and hedge funds, which include investments made in connection with certain employee deferred compensation plans. Direct investments are presented in the fair value hierarchy table as Principal investments and Other. Initially, the transaction price is generally considered by the Company as the exit price and is the Company s best estimate of fair value.

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

After initial recognition, in determining the fair value of non-exchange-traded internally and externally managed funds, the Company generally considers the NAV of the fund provided by the fund manager to be the best estimate of fair value. For non-exchange-traded investments either held directly or held within internally managed funds, fair value after initial recognition is based on an assessment of each underlying investment, considering rounds of financing and third-party transactions, discounted cash flow analyses and market-based information, including comparable company transactions, trading multiples and changes in market outlook, among other factors. Exchange-traded direct equity investments are generally valued based on quoted prices from the exchange.

Exchange-traded direct equity investments that are actively traded are categorized in Level 1 of the fair value hierarchy. Non-exchange-traded direct equity investments and investments in private equity and real estate funds are generally categorized in Level 3 of the fair value hierarchy. Investments in hedge funds that are redeemable at the measurement date or in the near future are categorized in Level 2 of the fair value hierarchy; otherwise, they are categorized in Level 3 of the fair value hierarchy.

Physical Commodities.

The Company trades various physical commodities, including crude oil and refined products, natural gas, base and precious metals, and agricultural products. Fair value for physical commodities is determined using observable inputs, including broker quotations and published indices. Physical commodities are categorized in Level 2 of the fair value hierarchy; in instances where significant inputs are unobservable, they are categorized in Level 3 of the fair value hierarchy.

Securities Available for Sale.

Securities available for sale are composed of U.S. government and agency securities (*e.g.*, U.S. Treasury securities, agency-issued debt, agency mortgage pass-through securities and collateralized mortgage obligations), CMBS, Federal Family Education Loan Program (FFELP) student loan asset-backed securities, auto loan asset-backed securities, corporate bonds and equity securities. Actively traded U.S. Treasury securities, non-callable agency-issued debt securities and equity securities are generally categorized in Level 1 of the fair value hierarchy. Callable agency-issued debt securities, agency mortgage pass-through securities, collateralized mortgage obligations, CMBS, FFELP student loan asset-backed securities, auto loan asset-backed securities and corporate bonds are generally categorized in Level 2 of the fair value hierarchy. For further information on securities available for sale, see Note 5.

Deposits.

Time Deposits. The fair value of certificates of deposit is determined using third-party quotations. These deposits are generally categorized in Level 2 of the fair value hierarchy.

Commercial Paper and Other Short-Term Borrowings/Long-Term Borrowings.

Structured Notes. The Company issues structured notes that have coupon or repayment terms linked to the performance of debt or equity securities, indices, currencies or commodities. Fair value of structured notes is determined using valuation models for the derivative and debt portions of the notes. These models incorporate observable inputs referencing identical or comparable securities, including prices to which the notes are linked, interest rate yield curves, option volatility and currency, commodity or equity prices. Independent, external and traded prices for the notes are considered as well. The impact of the Company s own credit spreads is also included based on the Company s observed secondary bond market spreads. Most structured notes are categorized in Level 2 of the fair value hierarchy.

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Securities Purchased under Agreements to Resell and Securities Sold under Agreements to Repurchase.

The fair value of a reverse repurchase agreement or repurchase agreement is computed using a standard cash flow discounting methodology. The inputs to the valuation include contractual cash flows and collateral funding spreads, which are estimated using various benchmarks, interest rate yield curves and option volatilities. In instances where the unobservable inputs are deemed significant, reverse repurchase agreements and repurchase agreements are categorized in Level 3 of the fair value hierarchy; otherwise, they are categorized in Level 2 of the fair value hierarchy.

The following fair value hierarchy tables present information about the Company s assets and liabilities measured at fair value on a recurring basis at March 31, 2013 and December 31, 2012.

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Assets and Liabilities Measured at Fair Value on a Recurring Basis at March 31, 2013.

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3) (dollars in millions)	Counterparty and Cash Collateral Netting	Balance at March 31, 2013
Assets at Fair Value					
Trading assets:					
U.S. government and agency securities:					
U.S. Treasury securities	$ 24,411	$	$	$	$ 24,411
U.S. agency securities	2,040	22,796			24,836
Total U.S. government and agency securities	26,451	22,796			49,247
Other sovereign government obligations	29,893	8,577	3		38,473
Corporate and other debt:					
State and municipal securities		2,228			2,228
Residential mortgage-backed securities		1,684	19		1,703
Commercial mortgage-backed securities		1,122	174		1,296
Asset-backed securities		1,040	11		1,051
Corporate bonds		18,453	888		19,341
Collateralized debt obligations		442	1,666		2,108
Loans and lending commitments		11,175	5,284		16,459
Other debt		9,104	1		9,105
Total corporate and other debt		45,248	8,043		53,291
Corporate equities(1)	74,280	923	270		75,473
Derivative and other contracts:					
Interest rate contracts	711	708,732	3,640		713,083
Credit contracts		58,131	4,134		62,265
Foreign exchange contracts	24	50,395	5		50,424
Equity contracts	965	42,508	1,044		44,517
Commodity contracts	3,674	15,559	2,332		21,565
Other		90			90
Netting(2)	(4,892)	(774,480)	(6,543)	(70,200)	(856,115)
Total derivative and other contracts	482	100,935	4,612	(70,200)	35,829
Investments:					
Private equity funds			2,291		2,291
Real estate funds		7	1,370		1,377
Hedge funds		370	545		915
Principal investments	20	2	2,855		2,877
Other	190	77	496		763
Total investments	210	456	7,557		8,223
Physical commodities		6,700			6,700
Total trading assets	131,316	185,635	20,485	(70,200)	267,236

Securities available for sale	14,049	27,405			41,454
Securities received as collateral	17,920	51			17,971
Federal funds sold and securities purchased under agreements to resell		873			873
Intangible assets(3)			8		8
Total assets measured at fair value	$ 163,285	$ 213,964	$ 20,493	$ (70,200)	$ 327,542
Liabilities at Fair Value					
Deposits	$	$ 1,442	$	$	$ 1,442
Commercial paper and other short-term borrowings		1,257	5		1,262
Trading liabilities:					
U.S. government and agency securities:					
U.S. Treasury securities	21,303				21,303
U.S. agency securities	1,765	96			1,861
Total U.S. government and agency securities	23,068	96			23,164
Other sovereign government obligations	26,928	3,325			30,253

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Counterparty and Cash Collateral Netting	Balance at March 31, 2013
			(dollars in millions)		
Corporate and other debt:					
State and municipal securities		47			47
Residential mortgage-backed securities			4		4
Asset-backed securities		1			1
Corporate bonds		6,979	424		7,403
Collateralized debt obligations		317			317
Unfunded lending commitments		252	25		277
Other debt		87	11		98
Total corporate and other debt		7,683	464		8,147
Corporate equities(1)	28,705	1,547	4		30,256
Derivative and other contracts:					
Interest rate contracts	747	681,975	3,662		686,384
Credit contracts		56,326	2,731		59,057
Foreign exchange contracts	3	51,466	240		51,709
Equity contracts	891	47,321	2,384		50,596
Commodity contracts	4,164	15,027	1,629		20,820
Other		30	3		33
Netting(2)	(4,892)	(774,480)	(6,543)	(42,032)	(827,947)
Total derivative and other contracts	913	77,665	4,106	(42,032)	40,652
Total trading liabilities	79,614	90,316	4,574	(42,032)	132,472
Obligation to return securities received as collateral	23,452	58			23,510
Securities sold under agreements to repurchase		410	155		565
Other secured financings		9,349	275		9,624
Long-term borrowings		39,726	2,784		42,510
Total liabilities measured at fair value	$ 103,066	$ 142,558	$ 7,793	$ (42,032)	$ 211,385

(1) The Company holds or sells short for trading purposes equity securities issued by entities in diverse industries and of varying size.
(2) For positions with the same counterparty that cross over the levels of the fair value hierarchy, both counterparty netting and cash collateral netting are included in the column titled Counterparty and Cash Collateral Netting. For contracts with the same counterparty, counterparty netting among positions classified within the same level is included within that level. For further information on derivative instruments and hedging activities, see Note 11.
(3) Amount represents mortgage servicing rights (MSR) accounted for at fair value. See Note 7 for further information on MSRs.

Transfers Between Level 1 and Level 2 During the Quarter Ended March 31, 2013.

For assets and liabilities that were transferred between Level 1 and Level 2 during the period, fair values are ascribed as if the assets or liabilities had been transferred as of the beginning of the period.

In the quarter ended March 31, 2013, there were no material transfers between Level 1 and Level 2.

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Assets and Liabilities Measured at Fair Value on a Recurring Basis at December 31, 2012.

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3) (dollars in millions)	Counterparty and Cash Collateral Netting	Balance at December 31, 2012
Assets at Fair Value					
Trading assets:					
U.S. government and agency securities:					
U.S. Treasury securities	$ 24,662	$ 14	$	$	$ 24,676
U.S. agency securities	1,451	27,888			29,339
Total U.S. government and agency securities	26,113	27,902			54,015
Other sovereign government obligations	37,669	5,487	6		43,162
Corporate and other debt:					
State and municipal securities		1,558			1,558
Residential mortgage-backed securities		1,439	45		1,484
Commercial mortgage-backed securities		1,347	232		1,579
Asset-backed securities		915	109		1,024
Corporate bonds		18,403	660		19,063
Collateralized debt obligations		685	1,951		2,636
Loans and lending commitments		12,617	4,694		17,311
Other debt		4,457	45		4,502
Total corporate and other debt		41,421	7,736		49,157
Corporate equities(1)	68,072	1,067	288		69,427
Derivative and other contracts:					
Interest rate contracts	446	819,581	3,774		823,801
Credit contracts		63,234	5,033		68,267
Foreign exchange contracts	34	52,729	31		52,794
Equity contracts	760	37,074	766		38,600
Commodity contracts	4,082	14,256	2,308		20,646
Other		143			143
Netting(2)	(4,740)	(883,733)	(6,947)	(72,634)	(968,054)
Total derivative and other contracts	582	103,284	4,965	(72,634)	36,197
Investments:					
Private equity funds			2,179		2,179
Real estate funds		6	1,370		1,376
Hedge funds		382	552		934
Principal investments	185	83	2,833		3,101
Other	199	71	486		756
Total investments	384	542	7,420		8,346
Physical commodities		7,299			7,299
Total trading assets	132,820	187,002	20,415	(72,634)	267,603
Securities available for sale	14,466	25,403			39,869

Securities received as collateral	14,232	46			14,278
Federal funds sold and securities purchased underagreements to resell		621			621
Intangible assets(3)			7		7
Total assets measured at fair value	$ 161,518	$ 213,072	$ 20,422	$ (72,634)	$ 322,378
Liabilities at Fair Value					
Deposits	$	$ 1,485	$	$	$ 1,485
Commercial paper and other short-term borrowings		706	19		725
Trading liabilities:					
U.S. government and agency securities:					
U.S. Treasury securities	20,098	21			20,119
U.S. agency securities	1,394	107			1,501
Total U.S. government and agency securities	21,492	128			21,620
Other sovereign government obligations	27,583	2,031			29,614

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Counterparty and Cash Collateral Netting	Balance at December 31, 2012
			(dollars in millions)		
Corporate and other debt:					
State and municipal securities		47			47
Residential mortgage-backed securities			4		4
Corporate bonds		3,942	177		4,119
Collateralized debt obligations		328			328
Unfunded lending commitments		305	46		351
Other debt		156	49		205
Total corporate and other debt		4,778	276		5,054
Corporate equities(1)	25,216	1,655	5		26,876
Derivative and other contracts:					
Interest rate contracts	533	789,715	3,856		794,104
Credit contracts		61,283	3,211		64,494
Foreign exchange contracts	2	56,021	390		56,413
Equity contracts	748	39,212	1,910		41,870
Commodity contracts	4,530	15,702	1,599		21,831
Other		54	7		61
Netting(2)	(4,740)	(883,733)	(6,947)	(46,395)	(941,815)
Total derivative and other contracts	1,073	78,254	4,026	(46,395)	36,958
Total trading liabilities	75,364	86,846	4,307	(46,395)	120,122
Obligation to return securities received as collateral	18,179	47			18,226
Securities sold under agreements to repurchase		212	151		363
Other secured financings		9,060	406		9,466
Long-term borrowings		41,255	2,789		44,044
Total liabilities measured at fair value	$ 93,543	$ 139,611	$ 7,672	$ (46,395)	$ 194,431

(1) The Company holds or sells short for trading purposes equity securities issued by entities in diverse industries and of varying size.
(2) For positions with the same counterparty that cross over the levels of the fair value hierarchy, both counterparty netting and cash collateral netting are included in the column titled Counterparty and Cash Collateral Netting. For contracts with the same counterparty, counterparty netting among positions classified within the same level is included within that level. For further information on derivative instruments and hedging activities, see Note 11.
(3) Amount represents MSRs accounted for at fair value. See Note 7 for further information on MSRs.

Transfers Between Level 1 and Level 2 During the Quarter Ended March 31, 2012.

Trading assets Derivative and other contracts and Trading liabilities Derivative and other contracts. During the quarter ended March 31, 2012, the Company reclassified approximately $1.1 billion of derivative assets and approximately $1.2 billion of derivative liabilities from Level 2 to Level 1 as these listed derivatives became actively traded and were valued based on quoted prices from the exchange. Also during the quarter ended March 31, 2012, the Company reclassified approximately $0.3 billion of derivative assets and approximately $0.4 billion of derivative liabilities from Level 1 to Level 2 as transactions in these contracts did not occur with sufficient frequency and volume to constitute an active market.

Level 3 Assets and Liabilities Measured at Fair Value on a Recurring Basis.

The following tables present additional information about Level 3 assets and liabilities measured at fair value on a recurring basis for the quarters ended March 31, 2013 and 2012, respectively. Level 3 instruments may be hedged with instruments classified in Level 1 and Level 2. As a result, the realized and unrealized gains (losses) for assets and liabilities within the Level 3 category presented in the tables below do not reflect the related

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

realized and unrealized gains (losses) on hedging instruments that have been classified by the Company within the Level 1 and/or Level 2 categories.

Additionally, both observable and unobservable inputs may be used to determine the fair value of positions that the Company has classified within the Level 3 category. As a result, the unrealized gains (losses) during the period for assets and liabilities within the Level 3 category presented in the tables below may include changes in fair value during the period that were attributable to both observable (*e.g.*, changes in market interest rates) and unobservable (*e.g.*, changes in unobservable long-dated volatilities) inputs.

For assets and liabilities that were transferred into Level 3 during the period, gains (losses) are presented as if the assets or liabilities had been transferred into Level 3 at the beginning of the period; similarly, for assets and liabilities that were transferred out of Level 3 during the period, gains (losses) are presented as if the assets or liabilities had been transferred out at the beginning of the period.

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Changes in Level 3 Assets and Liabilities Measured at Fair Value on a Recurring Basis for the Quarter Ended March 31, 2013.

	Beginning Balance at December 31, 2012	Total Realized and Unrealized Gains (Losses) (1)	Purchases	Sales	Issuances	Settlements	Net Transfers	Ending Balance at March 31, 2013	Unrealized Gains (Losses) for Level 3 Assets/ Liabilities Outstanding at March 31, 2013(2)
				(dollars in millions)					
Assets at Fair Value									
Trading assets:									
Other sovereign government obligations	$ 6	$	$ 1	$ (3)	$	$	$ (1)	$ 3	$
Corporate and other debt:									
Residential mortgage-backed securities	45	26	15	(42)			(25)	19	9
Commercial mortgage-backed securities	232	15	6	(80)			1	174	7
Asset-backed securities	109		1	(99)				11	
Corporate bonds	660	62	437	(247)		(12)	(12)	888	5
Collateralized debt obligations	1,951	191	314	(695)		(95)		1,666	63
Loans and lending commitments	4,694	20	944	(149)		(738)	513	5,284	1
Other debt	45	(8)	14	(49)			(1)	1	(1)
Total corporate and other debt	7,736	306	1,731	(1,361)		(845)	476	8,043	84
Corporate equities	288	(22)	85	(61)			(20)	270	5
Net derivative and other contracts(3):									
Interest rate contracts	(82)	(106)	1		(1)	192	(26)	(22)	18
Credit contracts	1,822	(452)	42		(15)	(4)	10	1,403	(418)
Foreign exchange contracts	(359)	8				109	7	(235)	(2)
Equity contracts	(1,144)	(140)	85	(1)	(93)	(76)	29	(1,340)	(125)
Commodity contracts	709	(10)	9		(4)	(8)	7	703	(30)
Other	(7)	(2)				6		(3)	(2)
Total net derivative and other contracts	939	(702)	137	(1)	(113)	219	27	506	(559)
Investments:									
Private equity funds	2,179	114	70	(72)				2,291	104
Real estate funds	1,370	80	3	(83)				1,370	90
Hedge funds	552	2	31	(34)			(6)	545	(3)
Principal investments	2,833	63	35	(85)			9	2,855	78
Other	486	17	11	(17)			(1)	496	16
Total investments	7,420	276	150	(291)			2	7,557	285
Intangible assets	7	4				(3)		8	2
Liabilities at Fair Value									
	$ 19	$	$	$	$ 1	$ (1)	$ (14)	$ 5	$

Commercial paper and other short-term borrowings									
Trading liabilities:									
Corporate and other debt:									
Residential mortgage-backed securities	4							4	
Corporate bonds	177		(131)	371			7	424	3
Unfunded lending commitments	46	21						25	20
Other debt	49	11	(37)	10				11	10
Total corporate and other debt	276	32	(168)	381			7	464	33
Corporate equities	5		(3)	1			1	4	1
Securities sold under agreements to repurchase	151	(4)						155	(4)
Other secured financings	406	12			13	(132)		275	5
Long-term borrowings	2,789	(17)			543	(188)	(377)	2,784	(17)

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(1) Total realized and unrealized gains (losses) are primarily included in Trading in the condensed consolidated statements of income except for $276 million related to Trading assets Investments, which is included in Investments revenues.
(2) Amounts represent unrealized gains (losses) for the quarter ended March 31, 2013 related to assets and liabilities still outstanding at March 31, 2013.
(3) Net derivative and other contracts represent Trading assets Derivative and other contracts net of Trading liabilities Derivative and other contracts. For further information on derivative instruments and hedging activities, see Note 11.

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Changes in Level 3 Assets and Liabilities Measured at Fair Value on a Recurring Basis for Quarter Ended March 31, 2012.

	Beginning Balance at December 31, 2011	Total Realized and Unrealized Gains (Losses)(1)	Purchases	Sales	Issuances	Settlements	Net Transfers	Ending Balance at March 31, 2012	Unrealized Gains (Losses) for Level 3 Assets/ Liabilities Outstanding at March 31, 2012(2)
					(dollars in millions)				
Assets at Fair Value									
Trading assets:									
U.S. agency securities	$ 8	$	$ 42	$ (26)	$	$	$ (1)	$ 23	$
Other sovereign government obligations	119	(1)	8	(118)				8	
Corporate and other debt:									
State and municipal securities							3	3	
Residential mortgage-backed securities	494	(21)	6	(245)			(191)	43	(18)
Commercial mortgage-backed securities	134	23	5	(21)		(1)	(13)	127	16
Asset-backed securities	31	1		(28)			(1)	3	1
Corporate bonds	675	45	426	(225)			(22)	899	39
Collateralized debt obligations	980	123	296	(161)			(73)	1,165	82
Loans and lending commitments	9,590	(20)	496	(1,018)		(421)	(30)	8,597	(35)
Other debt	128	2	27	(123)			23	57	
Total corporate and other debt	12,032	153	1,256	(1,821)		(422)	(304)	10,894	85
Corporate equities	417	(45)	901	(758)			39	554	(9)
Net derivative and other contracts(3):									
Interest rate contracts	420	170	6		(5)	(139)	(430)	22	179
Credit contracts	5,814	(1,381)	63		(10)	(47)	(58)	4,381	(1,786)
Foreign exchange contracts	43	(99)				162	(40)	66	(83)
Equity contracts	(1,234)	(99)	199	(58)	(50)	(250)	50	(1,442)	(161)
Commodity contracts	570	199	4		(4)	37	(3)	803	101
Other	(1,090)	58				269	740	(23)	56
Total net derivative and other contracts	4,523	(1,152)	272	(58)	(69)	32	259	3,807	(1,694)
Investments:									
Private equity funds	1,936	(7)	101	(36)				1,994	1
Real estate funds	1,213	52	87	(14)				1,338	5
Hedge funds	696	25	22	(33)			(87)	623	23
Principal investments	2,937	38	180	(65)			104	3,194	57
Other	501	(33)	34	(3)			28	527	(41)
Total investments	7,283	75	424	(151)			45	7,676	45
Physical commodities	46					(46)			
Intangible assets	133	(34)						99	(34)

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	Beginning Balance at December 31, 2011	Total Realized and Unrealized Gains (Losses) (1)	Purchases	Sales	Issuances	Settlements	Net Transfers	Ending Balance at March 31, 2012	Unrealized Gains (Losses) for Level 3 Assets/ Liabilities Outstanding at March 31, 2012(2)
					(dollars in millions)				
Liabilities at Fair Value									
Commercial paper and other short-term borrowings	$ 2	$	$	$	$ 13	$	$	$ 15	$
Trading liabilities:									
Other sovereign government obligations	8		(7)					1	
Corporate and other debt:									
Residential mortgage-backed securities	355		(294)					61	(61)
Corporate bonds	219	(59)	(186)	126			(25)	193	(74)
Unfunded lending commitments	85	25						60	25
Other debt	73	1				(55)	16	33	3
Total corporate and other debt	732	(33)	(480)	126		(55)	(9)	347	(107)
Corporate equities	1	(2)	(2)	10			(9)	2	
Securities sold under agreements to repurchase	340	1					(153)	186	3
Other secured financings	570	(44)			12	(32)		594	(44)
Long-term borrowings	1,603	(173)			262	(78)	183	2,143	(171)

(1) Total realized and unrealized gains (losses) are primarily included in Trading in the condensed consolidated statements of income except for $75 million related to Trading assets Investments, which is included in Investments revenues.

(2) Amounts represent unrealized gains (losses) for the quarter ended March 31, 2012 related to assets and liabilities still outstanding at March 31, 2012.

(3) Net derivative and other contracts represent Trading assets Derivative and other contracts net of Trading liabilities Derivative and other contracts. For further information on derivative instruments and hedging activities, see Note 11.

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Quantitative Information about and Sensitivity of Significant Unobservable Inputs Used in Recurring Level 3 Fair Value Measurements at March 31, 2013 and December 31, 2012.

The disclosures below provide information on the valuation techniques, significant unobservable inputs and their ranges and averages for each major category of assets and liabilities measured at fair value on a recurring basis with a significant Level 3 balance. The level of aggregation and breadth of products cause the range of inputs to be wide and not evenly distributed across the inventory. Further, the range of unobservable inputs may differ across firms in the financial services industry because of diversity in the types of products included in each firm s inventory. The disclosures below also include qualitative information on the sensitivity of the fair value measurements to changes in the significant unobservable inputs.

At March 31, 2013.

	Balance at March 31, 2013 (dollars in millions)	Valuation Technique(s)	Significant Unobservable Input(s) / Sensitivity of the Fair Value to Changes in the Unobservable Inputs	Range(1)	Averages(2)
Assets					
Trading assets:					
Corporate and other debt:					
Commercial mortgage-backed securities	$ 174	Comparable pricing	Comparable bond price /(A)	57 to 101 points	81 points
Corporate bonds	888	Comparable pricing	Comparable bond price / (A)	4 to 145 points	92 points
Collateralized debt obligations	1,666	Comparable pricing(6)	Comparable bond price / (A)	16 to 95 points	63 points
		Correlation model	Credit correlation / (B)	23 to 54 %	41%
Loans and lending commitments	5,284	Corporate loan model	Credit spread / (C)	44 to 1,045 basis points	245 basis points
		Comparable pricing	Comparable bond price / (A)	80 to 120 points	100 points
		Comparable pricing(6)	Comparable loan price / (A)	30 to 103 points	86 points
Corporate equities(3)	270	Net asset value(6)	Discount to net asset value / (C)	0 to 51 %	20%
		Comparable pricing	Comparable equity price / (A)	0 to 100 %	50%
		Comparable pricing	Comparable price / (A)	43 to 74 points	52 points
		Market approach	EBITDA multiple / (A)	8 to 10 times	9 times
Net derivative and other contracts:					
Interest rate contracts	(22)	Option model	Interest rate volatility concentration liquidity multiple / (C)(D)	0 to 10 times	0 times / 0 times (4)
			Comparable bond price / (A)(D)	5 to 98 points	52 points / 52 points (4)
			Interest rate - Foreign exchange correlation /(A)(D)	2 to 63 %	35% / 43%(4)
			Interest rate volatility skew / (A)(D)	9 to 117 %	53% / 48%(4)
			Interest rate quanto correlation / (A)(D)	-53 to 37 %	8% / -1%(4)
			Interest rate curve correlation / (A)(D)	42 to 98 %	78% / 82%(4)
			Inflation volatility / (A)(D)	60 to 83 %	70% / 66%(4)
Credit contracts	1,403	Comparable pricing	Cash synthetic basis / (C)(D)	1 to 10 points	3 points
			Comparable bond price / (C)(D)	0 to 83 points	27 points
		Correlation model(6)	Credit correlation / (B)	20 to 94 %	47%
Foreign exchange contracts(5)	(235)	Option model	Comparable bond price / (A)(D)	5 to 98 points	52 points / 52 points (4)
			Interest rate quanto correlation / (A)(D)	-53 to 37 %	8% / -1%(4)
			Interest rate - Credit spread correlation /(A)(D)	-59 to 60 %	-5% / -3%(4)
			Interest rate - Foreign exchange correlation /(A)(D)	2 to 63 %	35% / 43%(4)

			Interest rate volatility skew / (A)(D)	9 to 117 %	53% / 48%(4)
Equity contracts(5)	(1,340)	Option model	At the money volatility / (C)(D)	14 to 44 %	30%
			Volatility skew / (C)(D)	-2 to 0 %	-1%
			Equity - Equity correlation / (C)(D)	40 to 99 %	71%
			Equity - Foreign exchange correlation / (C)(D)	-60 to 38 %	-15%
			Equity - Interest rate correlation / (C)(D)	1 to 66 %	42% /40%(4)
Commodity contracts	703	Option model	Forward power price / (C)(D)	$18 to $110 per Megawatt hour	$42 per Megawatt hour
			Commodity volatility / (A)(D)	12 to 31 %	13%
			Cross commodity correlation / (C)(D)	43 to 97 %	91%
Investments(3):					