Good morning. This is Celeste Brown, Head of Investor Relations. Welcome to our Fourth Quarter Earnings Call. Today's presentation may include forward-looking statements, which reflect management's current estimates or beliefs and are subject to risks and uncertainties that may cause actual results to differ materially. The presentation may also include certain non-GAAP financial measures. Please see our SEC filings at morganstanley.com for a reconciliation of such non-GAAP measures to the comparable GAAP figures and for a discussion of additional risks and uncertainties that may affect the future results of Morgan Stanley. This presentation, which is copyrighted by Morgan Stanley and may not be duplicated or reproduced without our consent, is not an offer to buy or sell any security or instrument.

I'll now turn the call over to Chairman and Chief Executive Officer, James Gorman.

James Gorman

Good morning. Thank you, Celeste. As we begin another year, I wanted to update you on our thoughts on the state of Morgan Stanley and where we're headed as well as provide you with a list against which you can mark us to market through 2014.

Let's walk you through the list we laid out last January and then take you deeper into some of the strategic areas in which we've focused, in particular, those that would drive the greatest earnings in ROE upside for the firm. There are slides available on the website and then Ruth will take you through the quarterly review and together we will take questions at the end.

2013 was year of playing offense for Morgan Stanley. Outside of some of the legacy legal issues from the crisis period, our focus was moving the firm and our strategy forward and advancing down the path to meeting and beating our cost of equity. We achieved to advance a number of strategic objectives including the six to five in January of last year; specifically we acquired a 100% of the Wealth Management joint venture.

We achieved our Wealth Management margin goal through expense management and exceeded them through revenue growth. We made significant progress toward our RWA reduction goals of Fixed Income and Commodities and exceeded 2013 and our 2014 targets.

We are on track to meet our expense targets to 2014 excluding litigation. We are also on track to meet our long-term goals to growing earnings through Morgan Stanley specific growth opportunities. And finally we've made progress towards returns to meet and exceed the cost of capital, excluding litigation and we began our first buyback since 2008 in the middle of last year.

Like all of our peers we have litigation exposure which is laid out in extensive detail in our filings. In addition to the higher legal expenses we incurred in the first three quarters of 2013, we took a charge of $1.2 billion in the fourth quarter. Obviously we cannot predict the future. But we believe this move represent significant progress towards putting these matters behind us.

The steps we will outline for you today are a continuation of what we discussed a year-ago and consistent with the strategy that this management team put in place four years ago. We had six strategic focus areas and again you can follow along with the slides on our website.

We will achieve our goals in a prudent manner without taking outside risks and taking consideration the need of all of our stakeholders. Number one, continue to drive Wealth Management through margin goals and higher cost -- improved cost initiatives from revenue growth.

In mid 2013 we increased our margin targets to 20% to 22% by the end of 2015, driven by the upside from earning a 100% of the Wealth Management business. We reach the bottom of that range in the fourth quarter excluding the impairment driven by partial connection of the benefits of only a 100% as well as higher markets. Based on where the S&P closed 2013 and our expectation for deposit deployment, we are now raising our target for year-end 2015 to 22% to 25% even without the benefit of higher rates.

Second, Fixed Income and Commodities. We have a threefold plan to drive our returns to greater than our cost of equity in Fixed Income and Commodities. Number one; optimize the Commodities business by reducing our exposure of physical commodities. Number two, improve the efficiency in ROE of our other Fixed Income businesses through centralized or federalized management of resources. And number three continue to reduce risk weighted assets.

In regards to Commodities, we announced late last year that we are selling our global physical oil business. This will be done in two parts. The first is the transaction we announced for the Rosneft, which included the sale of our oil merchanting business. The second component is our intention to expose strategic options for our stake in TransMontaigne, which is a separate discrete entity that provides a wide variety of distribution and storage services for oil related products in North America. We believe we can generate an acceptable ROE with the remaining Commodities business, which is also more consistent with our client base across sales and trading.

Outside of Commodities we have philosophically changed the way we run Fixed Income from a highly segregated to a highly federalized model with a more strategic approach to resource allocation division wide and a particular focus on expenses, technology, capital and balance sheet. We have achieved normalized ROEs around or above that cost of capital in almost all product areas, except for rates. We are aligning our approach in rates to be more consistent with that of the rest of Fixed Income with the leadership team that has a heightened focus on balance sheet utilization and high velocity.

Finally, we have moved forward our Fixed Income and Commodities, RWA target by one year. Previously our target was to reach the 180 billion RWA level by the end of 2016. Now we expect to reach that level by the end of 2015.

Third area was expenses. Let me update you on where we are versus the targets we set out a year-ago. We said that assuming flat revenue our expenses will be down $1.6 billion by the end of 2014, which implied an expense ratio then of 79%. Of course our revenues grew in 2013 and we're on track to meet or beat the 79% expense ratio implied by the $1.6 billion target, assuming revenues in 2014 are higher or in line with 2013 and excluding litigation above 2012 levels. Because we expect revenue to continue to grow in 2014 and beyond, we will focus our discussion in the future on these ratios.

Our target expense ratio for 2014 and beyond is less than 79%, assuming flat or higher revenues and excluding legal expenses again above the 2012 levels. Marking the market 2013 our expenses were up for several reasons. First, we had expenses that are not likely to recur in 2014 including several write-offs in Wealth Management. Second, we along with the industry experienced elevated legal expenses. Adjusting for those two factors, our expense base in 2013 would have been $26.1 billion reflecting a 79% expense ratio.

Additionally, revenue grew 9% during the year and we thus experienced growth in activity relating expenses to those revenues including compensation, brokerage and clearing. Excluding activity-based expenses, our fully adjusted expense base in 2013 would have been $24.5 billion, more than half way through the reductions we discussed with you a year-ago.

Let me now turn to the fourth topic, which is Morgan Stanley specific growth opportunities and most notably in the bank. We spend a great deal of time in the last year introducing you to the upside associated with the bank. And in the deck you have on slide 11, we've laid out the upside very clearly.

Revenue growth in our bank will be driven by three tailwinds, including growth in the deposit base and associated assets, the optimization of these assets, moving cash into AFS and lending and finally upside from higher rates. The significant revenue growth will flow through Wealth Management and Institutional Services with exceptionally high incremental margins well above the margins we are generating today as we have already made the infrastructure investment.

By the end of 2015, we expect to have an asset base of approximately $160 billion. Based on current market rates and our expected asset mix at the end of 2015, the blended yield would be 1.8%. If we substitute the yields indicated by the forward curve on the same asset base, the average yield would then be 2.7%.

The fifth topic is of course the return of capital to shareholders. We intend to prudently increase our return of capital to shareholders over time subject to of course the regulatory approval, increasing both our share buyback program and our dividends reflecting greater percent of our revenue and earnings coming from more stable businesses. The key driver of increased return to shareholders over time are our increasingly consistent earnings, our strong capital ratios and finally our strategy that is consistent with the evolving regulatory requirements.

Finally, the sixth point which is of course our ROE returns. Our focus is to drive higher returns to shareholders through sustainably improving our ROE to levels equal to or in excess of our cost of equity even without a cyclical recovery. Assuming no improvement in the institution and retail market, normalized litigation expenses, execution of our bank strategy and expense initiatives, a strategic solution for physical commodities and centralized Fixed Income as well as Wealth Management margin improvement, we believe we can reach ROEs above 9% and ROTs of 10%. Then assuming excess capital will get us to or above 10% levels on ROE and 11% on ROT. Of course an improved operating environment would drive those numbers further.

I will now turn it over to Ruth, to walk you through the fourth quarter results. Thank you.

Ruth Porat

Good morning. I'll provide both GAAP results and results excluding the effect of DVA. We have provided reconciliations in the foot notes to the earnings release to reconcile these non-GAAP measures. The impact of DVA in the quarter was negative $368 million with $285 million in Fixed Income, sales and trading and $83 million in equity sales and trading. Excluding the impact of DVA, firm-wide revenues were $8.2 billion, up 1% versus the third quarter.

Earnings and earnings per share included $1.2 billion or $0.40 per share of legal expenses. The effective tax rate from containing operations for the fourth quarter reflects an overall benefit of $328 million including a discrete benefit of $192 million. Earnings from continuing operations applicable to Morgan Stanley common shareholders excluding DVA were approximately $384 million.

Earnings from continuing operations per diluted share excluding DVA were $0.20 after preferred dividends.

On a GAAP basis, including the impact of DVA, firm-wide revenues for the quarter were 7.8 billion. Earnings from continuing operations applicable to Morgan Stanley common shareholders were 144 million. GAAP results also included 1.2 billion or $0.40 per share of legal expenses. Reported earnings from continuing operations per diluted share were $0.07 after preferred dividends. Book value at the end of the quarter was $32.29 per share and tangible book value was $27.21 per share.

Turning to the balance sheet, our total assets were 832 billion at December 31. Deposits as of quarter end were 112 billion, up 8 billion versus 3Q. Our liquidity reserve at the end of the quarter was 202 billion compared with 198 billion at the end of the third quarter.

Turning to capital, although our calculations are not final, we believe that our Tier 1 common ratio under Basel I will be approximately 12.8% and our Tier 1 capital ratio will be approximately 15.7%.

Risk-weighted assets under Basel I are expected to be approximately 389 billion at December 31. Reflecting our best estimate of the final Federal Reserve rules, our pro forma Tier 1 common ratio under Basel III was 10.5% at December 31. Pro forma risk-weighted assets under Basel III are estimated to be 428 billion.

Our pro forma Tier 1 common ratio under Basel III was negatively affected by approximately 50 basis points due to an increase in our operational risk RWAs, which resulted from higher legal costs in the quarter. This was partially offset by earnings accretion and the ongoing reduction in Fixed Income RWAs.

We expect our pro forma supplementary leverage ratio to be approximately 4.2%. This estimate reflects the United States proposed regulatory rules for the numerator and the denominator and is subject to change is rules evolve. We continue to expect to exceed the required 5% level in 2015 including an assumption for increasing returns of capital to shareholders.

On Slide 14 of our strategy deck, we have outlined the drivers of our path to an SLR of greater than 5% in 2015. Forces within our control include exposure compression and RWA reductions, earnings accretion and other numerator drivers including DTA reductions, increased investment capacity, preferred issuance and other reduced numerator deductions, which in aggregate could drive approximately 180 basis points to 210 basis points of improvement in our ratio. Potential offsets include balance sheet growth and capital returns.

Turning to expenses, total expenses this quarter were 7.9 billion, up 20% versus the third quarter but up 1% excluding the legal item I noted. Compensation expense was essentially flat to the prior quarter. Non-compensation expense was 3.9 billion reflecting higher legal costs.

Let me now discuss our businesses in detail. In institutional securities, revenues excluding DVA were 3.7 billion, down 4% sequentially. Non-interest expense was 4.4 billion, up 34% versus the third quarter. Compensation was 1.6 billion for the fourth quarter, down 4% versus the third quarter, reflecting a 42% ratio excluding DVA.

Non-compensation expense of 2.9 billion reflects the elevated legal expenses due to settlements and additions to reserves related to legacy, residential, mortgage-backed securities matters associated with the credit crisis. The business reported a pre-tax loss of 745 million excluding the impact of DVA. Including the impact of DVA to pre-tax loss was 1.1 billion.

In investment banking, revenues of 1.4 billion were up 37% versus last quarter. Results were driven by increased revenues in all products; equity underwriting, advisory and Fixed Income underwriting. According to Thomson Reuters, Morgan Stanley ranked #3 in global announced and completed M&A, global IPOs and global equity at the end of the fourth quarter.

Notable transactions included in advisory, Morgan Stanley is a leader in cross-border activity with transactions including Portugal Telecom's 15.7 billion merger with Oi SA which represented the largest M&A announced deal for the quarter as well as Perrigo's 8.6 billion acquisition of Elan.

In equity underwriting, Morgan Stanley acted as the advisor to Crown Castle International as lead left book runner and stabilization agent on common and mandatory offering while also acting as lead left book runner on the 3.4 billion senior unsecured committed bridge facility.

In debt underwriting, event related financings included Morgan Stanley acting as lead left book runner on Devon Energy's 2.3 billion debt offering in support of the company's acquisition of GeoSouthern Energy's Eagle Ford assets.

Advisory revenues of 451 million were up 64% versus our third quarter results, driven by increased revenues across regions. Equity underwriting revenues of 416 million were up 76% versus the third quarter, also driven by increases across regions, in particular in Europe as well as a significant increase in IPO volumes.

Fixed Income underwriting revenues were 495 million, up 3% versus the third quarter driven by loan syndication fees partially offset by decreases in investment grade underwriting.

Equity sales and trading revenues, excluding DVA, were 1.5 billion, a decrease of 12% from last quarter. Results were strong for our fourth quarter with robust client activity across regions and products. Cash equity revenues increased driven by higher volumes in most major markets. Derivatives, revenues remained healthy although declined from a strong 3Q '13.

Prime brokerage revenues and balances were up in 4Q and were the highest since 2008. Fixed Income and Commodity sales and trading revenues excluding DVA were 694 million. Commodities revenues were meaningfully lower in a difficult market. Revenues outside of Commodities were up slightly sequentially, despite a larger sequential drag from CVA.

Revenues were driven by increases in credit, foreign exchange and securitized products partially offset by lower results and rates. Client volumes held up relatively well across businesses in the fourth quarter though remained subdued in line with the industry.

Investment revenues of 177 million were down versus the third quarter which included the sale of the insurance broker hub. Average trading bar for the fourth quarter was 51 million, essentially flat to the third quarter.

Turning to Wealth Management, revenues were 3.7 billion in the fourth quarter. Asset management revenues of 2 billion were up versus last quarter, reflecting the benefit of higher market levels at the beginning of the quarter and positive flows.

Transaction revenues increased 10% from last quarter consisting primarily of commissions of 576 million, which were up 14% versus the prior quarter, due to a pick up across products. Investment banking related fees of 206 million, up 11% versus the last quarter, reflecting an increase in equity underwriting activity, and trading revenues of 323 million, up 2% versus the third quarter reflecting higher deferred compensation plans.

Net interest revenue increased 7% to 528 million, driven primarily by higher revenues from our bank deposit program and continued growth in our lending product. Other revenue increased to 110 million from 75 million. Non-interest expense was 3 billion, up versus last quarter. The compensation ratio is 58%, flat versus the third quarter, non-compensation expense was 876 million, up 10% versus last quarter, due to an impairment charge as well as the typical seasonal increase in expenses.

The PVT margin was 19% and was 20% excluding the impairment charge. Profit before tax was 709 million. Total client assets were up versus the third quarter to 1.9 trillion. Global fee-based asset inflows were 12 billion. Fee-based assets under management increased to 697 billion at quarter end, representing 37% of AUM.

Global representative were 16,456, essentially flat to the third quarter. Bank deposits were 134 billion, up versus the third quarter, approximately 104 billion were held in Morgan Stanley banks.

Investment management, revenues of 842 million were up 2% from the third quarter. In traditional asset management, revenues of 430 million were up 17% from the third quarter, driven by higher market levels. In real estate investing, revenues of $160 million were down 31% driven by a decline in carry as last quarter we had a significant benefit from carry catch up. Merchant banking revenues were $252 million up 12% reflecting increased deferred compensation plans as well as higher investment gains from an IPL of an existing private equity investment. Expenses were $505 million down 4% from the third quarter. Profit before tax was $337 million up 12% sequentially. NCI was $46 million versus $64 million last quarter. Total assets under management increased to $373 billion driven by market depreciation.

As to our outlook, in investment banking the momentum evident in the fourth quarter persists as we enter 2014. In particular the M&A pipeline continues to build on the back of improving global economies. The drivers evident in 2013 remain in the cross border transaction, financial sponsors and activists. We expect further upside from one to pick up in corporate existing from sponsor, buyers as well as to the uptick in activity in EMEA after very muted levels for the last several years. The outlook for equity underwriting in 2014 remains healthy especially relative to the low volumes in EMEA and Asia experienced in 2013. Trading volumes and client activity across sales and trading are beginning to reflect confidence in global growth.

In Wealth Management our outlook for 2014 is similarly constructive given higher markets, lending growth and ongoing improvements in retail investor engagement. Our revised PBT margin targets helped to quantify the upside we see in this business. Finally we would expect return on equity to further benefit from an increasing capital returns upon completion of the CCAR process at the end of Q1.

Thank you for listening and James and I will now take your questions.

Question-and-Answer Session

Operator

(Operator Instructions) The first question will come from Glenn Schorr with ISI.

Glenn Schorr - ISI

Thank you. Within your plans for Fixed Income I was wondering if you could elaborate on how we get the ROE up in rates and isn't an ROE focus as opposed to a revenue focus? I'd appreciate that.

Ruth Porat

So the focus is an ROE focus as opposed to a revenue focus. And as we indicated we have a number of areas that are driving the overall ROE higher. First and foremost we talked about Commodities and the steps that we're taking in Commodities. We are selling two physical oil businesses there, the first one as we've talked about; we have announced the sale to Rosneft. In December we expect it to close in the second half of '14. The PBT in that business is essentially breakeven and it has about $4 billion risk weighted assets, so accretive to returns there. With respect to the second business TransMontaigne we'll share more when we have something to say on that. With respect to moving to centralize -- the move to centralized management we have a very systematic and clinical approach really to optimizing returns within each of our businesses. It's a focus on revenues, expenses and capital and we're continuing to balance those to drive returns and rates as we have in other businesses across the platform.

Glenn Schorr - ISI

Rates right now is still the biggest revenue piece of FICC I take it?

Ruth Porat

As I said we're really focused on the overall returns in the business and we're looking at within each of the product areas revenues, optimizing revenues, expenses and capital and so we've really driven returns within the FICC across products to levels on a normalized basis that are at or above cost to capital. We in fact made significant improvement in foreign exchange this year, this past year and are at this point operating with returns basically in line with our cost of capital when you look at RWA's on a normalized basis, so the next one to add here with the same approach is rates.

Glenn Schorr - ISI

Okay, cool. Speaking of RWA, hopefully I did the math right and I think Basel III RWA was up 3.5% almost quarter-on-quarter and I'm just curious because I know the overall focus is down in Fixed Income and down overall. Was there anything particular that drove that this quarter because I know the direction is going the other way?

Ruth Porat

So you're right. We have been reducing risk weighted assets within Fixed Income but the reason there's an addition here is a key component of the calculation is ops risk that captures litigation. And so with the higher reserve here in the fourth quarter that would change the overall calculation of the ops risk capital charge, so that's what you're seeing.

Glenn Schorr - ISI

A question on that Ruth is, if that happen in the quarter that you realized higher legal costs or is that a permanent addition that kind of sticks through the process until further notice?

Ruth Porat

So the way it works is, with the addition of a sizable data point within the overall distribution of data points you have to calculate ops risk. Once you add a more sizable data point as we did here, data in the tail would affect the overall calculation. Smaller pieces kind of in the belly of the distribution don't actually have an impact on the capital charge and once it is in the dataset it remains in the dataset until you see a change in the distribution, so it is in there for some time.

Glenn Schorr - ISI

Got you. I guess I mean if James is right on his comment of putting most of the stuff to bed, and maybe within a years time you start to get the benefit of that I know the CCAR process moves slow. Last one, Wealth Management loans and commitments were up another 10% this quarter or up almost 50% year-on-year, I guess there is the PLA component and all the securities based stuff and then the mortgage part. I don't know if you can share with us which one of those is growing and of the overall pie how important is it to

Wealth Management in general because I know it comes on a different comp grid.

Ruth Porat

So overall loan growth is important to Morgan Stanley across businesses; we're having deployments supporting growth in institutional securities as well as Wealth Management and in fact on the ROE walk it's the most important incremental driver to returns. But to your quarter with respect to Wealth Management what you're seeing is the benefit of the growing deposits that are asset optimization and then what that translates into. Growth is across both PLA or the securities based lending product and residential mortgage. There's more of it in PLA, although I would say in the mortgage side we've continued to see strong demand. Historically we were deliberately constraining production there because we were both focused on client experience and in fact applications were up in the quarter. But the bigger part of the growth has been PLA. And again what we're benefiting from here as we've talked about on prior calls is we're under-penetrated relative to our peers, this is very logical consistent product for them.

Glenn Schorr - ISI

Okay. Thanks Ruth.

Ruth Porat

Thank you.

Operator

The next question will come from Guy Moszkowski with Autonomous Research.

Guy Moszkowski - Autonomous Research

Good morning.

James Gorman

Good morning.

Guy Moszkowski - Autonomous Research

Just a quick question on the SLR first of all; did you have a chance to think about what the impact of the final BIS add-ons that were announced last weekend would be?

Ruth Porat

We have been working through that, it's a complex calculation in particular with respect to the net long CDS sold portion of it is as you know well. Our preliminary calculation is we are approaching 4% on that basis well above the 3% required.

Guy Moszkowski - Autonomous Research

Great, that's helpful. You talked about a number of drivers to get the SLR on the NPR basis up to the 5%. Can you talk a little bit about what the implications might be of some of those moves for revenue and I guess that's where maybe it gets into the overlap with what you're doing on the rate side?

Ruth Porat

Well the path to greater than 5% in 2015 and again that's including an assumption about increasing returns of capital as I just break them down into the numerator and denominator. In the numerator not only do we benefit from earnings accretion, but there is a multiplier effect because of certain deductions most notably DTA and the investment capacity deduction. The investment capacity is based on the size of Tier 1 capital so certainly as Tier 1 capital increases you have a larger basket smaller deduction of holding capital against certain items that fall into that basket amount like our joint venture in MUMSS at each end of the bucket. So when the bucket gets bigger there are fewer deductions. And then there are specific steps that we can take to focus, and that we are taking to focus on items that are captured in the investment bucket. So I would think of it, its earnings accretions and a multiplier impact on that for the reasons that I just described. And when it's being efficient with some of those numerator deductions that's not a -- that doesn't have an impact on revenue. Preferred obviously also adds to the numerator. You can do – so the dividends, you could say, would be the deduct, but it adds to the overall Tier 1 capital and as well to therefore the investment bucket. In the denominator, we continue to have a benefit from the RWA rundown and as we've talked about, that's in areas that are not accretive to revenue. And I'd say the other one that is important is compression. And I would put that in the bucket of just good hygiene. So we've invested quite a bit in central clearing, back loading into central clearing. It gives us great opportunity for compression. We're seeing more interest in that from banks on both sides of the Atlantic, and again that's just in the category of good hygiene. So I think that we're very comfortable with the implications of this, the various levers we have to move up to the greater than 5%.

Guy Moszkowski - Autonomous Research

So it doesn’t sound like you loaded into that a lot of the strategic changes that you might be making in rates? For example, maybe changing the way you look at repo or anything like that?

Ruth Porat

No. And the assumption on – that's embedded in this slide is consensus earnings, but I'd say that the other items that I enumerated are quite very important and no, there isn't enough change in the assumption on some of the other items.

Guy Moszkowski - Autonomous Research

Got it. Is there a new sort of breakeven level of thick revenues that you need to achieve to get to that ROE equal to your cost of equity, and when I say breakeven I mean specifically, a level of revenue that you would be given your cost base in order to get the whole FICC business to earning at cost of equity? I think in the past you've talked about 6 billion or so and I just wondered if its lower?

Ruth Porat

So let me answer that by pointing you back, for example, to Commodities. We've talked about the thing we are clinically focused on is driving returns higher in that business. And to your question you focused on one of the three levers, it's revenues, it's expenses and it's capital optimization. So as I indicated, with the business that is being sold throughout and after this point, it is essentially PVT breakeven from Morgan Stanley. It has about 4 billion of risk-weighted assets in it, so yes, there may be a diminution in revenues there but when you look at the cost structure running that type of business within BHC, it's more valuable in the hands of an investor or player. We have higher capital liquidity levels associated with the business and that's why we say what we're looking at is ROE. That is smart move for us, for the business, for our stakeholders, it's accretive to ROE although there are some revenues that go with it.

Guy Moszkowski - Autonomous Research

Got it, that's helpful. One of our big competitors took a large charge for FVA as they adopted that approach on their derivatives book. Is there – maybe you can tell us whether you currently do that or not and whether that's something that you're contemplating?

Ruth Porat

So that obviously refers to the potential implied financing costs around collateralized derivatives to the extent that those are observable. We do continue to evaluate it. There has been a lot of industry discussion around FBA. In our view, transparency has been lacking and today in our opinion there is not a basis to take the adjustment. From a risk management perspective, we do allocate capital and liquidity down to the product in debt level across our sales and trading businesses, so liquidity is allocated based on our liquidity funding model which models outflows in a stressed environment, and those are as I said allocated down to the product level. So from a risk management perspective, the businesses are being charged appropriately. That is different from seeing transparency in the marketplace.

Guy Moszkowski - Autonomous Research

Got it. Last one from me, you mentioned FX and having achieved some success there in terms of getting the returns to where you want it to be. I did notice that in the quarter, your FX bar is up a significant percentage of where it was before. Does that reflect changes in the business or just market volatility?

Ruth Porat

No, the FX flows up quarter-over-quarter and it just reflects plan activity.

Guy Moszkowski - Autonomous Research

Got it. Thank you very much.

Ruth Porat

Thank you.

Operator

Your next question is from Brennan Hawken with UBS.

Brennan Hawken - UBS

Good morning. So within ISG, was there a shift this year to less deferrals and would that maybe have put a little bit of upward pressure on your GAAP comp expense figure, just trying to maybe think about that even if we don't get specific numbers just from an area of perspective?

Ruth Porat

So the ISG comp ratio, I think you have this, is down from 45% to 42% this year. We did bring down the deferral rate as we indicated we would, so the deferral rate has come down. And when you think about our comp ratio on a go-forward basis, our view is that it will trend down to about that 40% range.

Brennan Hawken - UBS

Okay. But with deferrals coming out that would have put all else being equal even with the comp ratio coming down, some upward pressure on that ratio. Isn't that the right way to think about it?

Ruth Porat

Yes.

Brennan Hawken - UBS

Okay, great. And then thinking about a dividend that you guys sort of introduced in Slide 13, if you think back to 4Q trailing GAAP earnings when you guys submitted a CCAR which clearly includes some headwinds but in any event, we know that the Fed sort of looks at that. Very simplistically we just apply a 30% payout ratio to that, it would imply a $0.50 dividend per year. Any issue with the math on that? You think that people are thinking about it that way would be too aggressive?

Ruth Porat

Let me answer it this way. Our view is that the way to maximize return of capital over the longer term is to request steady consistent increases in capital returns in the interim as opposed to any type of discontinuous move. So given the ongoing accretion to capital and the higher ratios at Morgan Stanley, we think now it's the right time to increase the size of our share repurchase program and begin to increase the dividend. But I'd start it with our philosophy because I think it's an important way to frame how we think about legging in to any kind of change.

Brennan Hawken - UBS

Okay, that's helpful. And as we think about Wealth Management and you guys have had terrific momentum there clearly, and your outlook for improvement there and kind of with engagement continuing to improve, do you expect that that would increase the fee rates that you guys get on your managed assets? That had been under a little bit of pressure recently and it's sort of at lower levels. Does that reflect a lower level of engagement and does your expectation for increased engagement mean that that probably should, all else equal, have some upward pressure there?

Ruth Porat

No…

Brennan Hawken - UBS

Okay. I'm sorry, go ahead.

Ruth Porat

It's asset mix but no, that was an improvement.

Brennan Hawken - UBS

Okay. And then last one, you guys are looking for like a near doubling of the loan book as you laid out in the slide deck from now until 2015. How much of that doubling should we count on from Wealth Management versus institutional? And as we watch the disclosures that you guys gave in the supplement, is it mostly in the health or investment volumes that we should be watching?

Ruth Porat

I think you have a couple of questions in there. We've laid out the asset growth by product and I discussed it in a conference earlier in the year. The loan growth overall is supporting both, as I said, product and Wealth Management as well as institutional securities. So we talked already about mortgage and PLA within Wealth Management. In institutional securities, the product is similarly very consistent with our client franchise where we have strong domain expertise areas like commercial real estate, project finance, continuing to expand with our clients. It is primarily HFI. We've really migrated to HFI over the last several years and we see this as prudent, steady growth across a suite of products to support growth in those two businesses. We've laid out the products and the deck that James went though, so you can get a sense of the suite of products on both sides.

Brennan Hawken - UBS

Okay, thanks for the color, Ruth.

Ruth Porat

Thank you.

Operator

The next question will come from Mike Mayo with CLSA.

Mike Mayo - CLSA

Hi. I think you said the margin ROE targets do not reflect a change in interest rates, so what is Morgan Stanley sensitivity to higher interest rates, for example, or a 100 basis point increase in Fed funds?

Ruth Porat

We gave two targets and let me make sure we're very clear. When we focus on increasing the PVT margin in Wealth Management, we kept it on a basis consistent with the way we described it last year. So last year we had a Wealth Management target of 20% to 22%. We said we were holding rates and equity markets constant. And so as we hit our 20% PVT margin this quarter, excluding the impairments of 20% PBT margin. We took our guidance up for Wealth Management and that again is holding rates constant. We don't give ourselves the benefit of even the forward yield curve. It's holding rates where they are today and holding equity markets where they are today. If we now switch over to our ROE walk and look at the upside that comes from the bank with respect to the upside in the bank and the slides that looks at asset optimization and the yield on the various categories, in that we have embedded the forward yield curve and nothing more than the forward yield curve. So we try to give you a lot of the pieces with respect to asset growth and the mix and that assumption so that you can do all the sensitivities that you think are appropriate given your outlook on the market.

Mike Mayo - CLSA

So if you did have a 100 basis point increase in fed funds then we could assume a higher PBT for the Wealth Management business?

Ruth Porat

Yes, so rates obviously our benefit to the bank overall and to the Wealth Management business.

Mike Mayo - CLSA

You mentioned prime brokerage is back to that level since 2008, is it all the way back. I know the business was hurt during the crises and you trying to get customers back; are you back at a steady state or you're still gaining share?

Ruth Porat

We’re in a very strong business with PV and I would say that they has been a quite substantial change overall in prime brokerage over the last several years a restructuring of that business and the way the business is funded post to ’08 it's, so we’re in a strong position with balances, I think that’s reflecting the strength of it and the overall contribution of the franchise. So we feel very good about where we’re in the business, very important business to us and we’re – the team continues to deliver.

Mike Mayo - CLSA

In FICC compared to your peers, it looks like you underperformed and it's tough to breakout how much of that underperformance is due to the deliberate downsizing versus poor execution, I mean are you satisfied with the execution this quarter or not?

Ruth Porat

So a couple of parts to that question as well. As a reminder Fixed Income and Commodity is made up of the Fixed Income product and Commodities, two separate – two different businesses that on the one hand Commodities on the other, we were substantially weaker in Commodities down meaningfully quarter-over-quarter. The thick revenues excluding Commodities are up quarter-over-quarter not withstanding the bigger drag in CVA due to spread tightening. So in our securitized products area in credit and foreign exchange they were all up in the quarter. So to your second part of your question I feel good about the direction of those businesses, rates was down as with the market and our view is that we can continue to do to deliver more in that business which is why it was highlighted in James’s comments.

James Gorman

I would just add to that Mike. I wouldn’t draw a lot on percentage movements off of that number which is a fairly modest number to begin with to be perfectly frank. So I would focus more on the business mix as Ruth described, part of the business did well, parts of it didn’t. The new management has a plan to drive this higher and we come from where they plan.

Mike Mayo - CLSA

And then last question, Ameritrade last quarter said that the wire houses have made some moves which may get more difficult on the breakaway broker side, and I am not exactly sure what the online broker was referring to. But can you just address what you’re doing say to either retain customers or brokers or how the environments changed from several years ago say for example against online brokers or other competitors? Thanks.

Ruth Porat

Well attrition in our business you can see from the headcount numbers, it continue to be very low. It's actually down a bit this quarter from the very low levels that we've been talking about and we think that has a lot to do with the quality of the platform and when you look at our ongoing growth in assets you're reaching 1.9 trillion this quarter I think again the clients are speaking and FA's are speaking.

James Gorman

It's a different market segment.

Mike Mayo - CLSA

All right. Thanks.

Operator

Your next question will come from Michael Carrier with Bank of America.

Michael Carrier - Bank of America Merrill Lynch

Thanks. Maybe for James, just on the walk the ROE target, I guess I am just trying to figure out when I look at the pre tax margin being increased. The risk weighted asset reduction coming on sooner, expenses in line, the market up 30%, but the ROE target is still in that 9% to 10% plus range if we get a better environment too. I guess I am just trying to figure out it seems like it should be better I mean it seems like things have gone better than current expectations or what the expectations were a year ago. So anyways I am just trying to get a sense on, has some things gone the other way to keep the ROE target there or is it just being conservative.

James Gorman

Listen, this is a journey. Three years ago I think our ROE was close to 2%, two years ago it was about 5%; this year exited litigation is about 7%. You'll see on that chart Mike that we've got return target of 10 plus percent and then we talk about the additional upside, so you control your own conclusions from that. But I think we've said pretty consistently we were a kind of one step at a time management team. The one step is to get us to 10% and we'll do what that happy opportunity once we get there, so lets just play it out at a time.

Michael Carrier - Bank of America Merrill Lynch

Okay, thanks. And just as a follow up; based on giving more clarity around broker, I mean you guys have been probably more strategic in terms of moving forward in FICC, there maybe some other problems but, in any other areas in particularly investment management maybe unlike the merchant banking side are things fairly much set or should we be expecting much more to change in that part of the business based on what you know on the broker side as of now?

James Gorman

I don't expect material changes for the investment management business plus broker, I mean we had a lot more capital tied up in that business pre-crises. The bad news is we wrote a lot it off unfortunately, the good news is we now had much of those capital tied up in the business.

Michael Carrier - Bank of America Merrill Lynch

Okay, all right. Thanks a lot.

Operator

The next question will come from Devin Ryan with JMP Securities.

Devin Ryan - JMP Securities

Hi, good morning; thanks for taking my questions. So I just want to try to ask maybe the interest rate sensitivity question another way. I think the last formal update that we received was that a 100 basis point curve shift would increase net interest income by about $700 million. So is that still the firms view and if that's still in the range; can you give us any insight around how you're thinking about the viability side of the equation meaning how much of the benefit of the rate increase do you expect you have to pass along to customers?

Ruth Porat

So the rates have moved up a bit since we provided that guidance, and that's why we attempted in the material here and in the slide deck to break out the various component parts of it. You can apply whatever timeline you want to it and look at it at various points sometime, and so clearly in rising rate environment there would be some, be it mostly higher increase in deposit costs as well, but overall we have meaningful operating leverage from this. I think again one of the key points for us with respect to the bank is the cost structure of the bank. We don't have client acquisition cost because we’re talking about our embedded client base both on the Wealth Management side and on the institutional security side. We don’t have bricks and mortar. We have made the investments, fruitfully all of the investments that needed we continue to invest in the businesses of course in particular to continue to improve the customer experience. But as a result the incremental margin on this product is very high for Morgan Stanley, substantially higher than it is today and it's not just -- that we’ve clearly benefited from a rising rate environment and look forward to that whenever that may occur, but it's also the cost structure of that business that is very different.

Devin Ryan - JMP Securities

Okay, I appreciate that color. And then, just with respect to the litigation expense, how should we think about that moving forward. I know it's going to be lumpy, but can we think that maybe some of the outsized provision this quarter could reflect some pull forward from issues that maybe were thinking that were going to be addressed next year; just any other additional color there would be helpful.

Ruth Porat

Well as James said this reserve coupled with the reserves to date are appropriate based on what we now know and that being said litigation is the biggest headway for the industry, but this is obviously a substantial move.

James Gorman

The key on the litigation is, we wanted to make significant progress. It's estimable and probable and working with our legal team and finance and some that’s where we came out. So from what we see we made significant progress.

Devin Ryan - JMP Securities

Okay, great. And then, just lastly within the investment banking backlog; can you guys give anymore granularity around what you’re seeing and just kind of the businesses from a cyclical perspective kind of where you are today versus maybe what you think the upside maybe as we do get a cyclical recovery?

Ruth Porat

So the pipeline does remain strong. I think most gratifying is the pick up in M&A momentum coming from CO confidence that we’ve all been looking for, for quite some time now and it's really on the back of more data that supports the thesis of global economic growth. We are seeing more cross-border activity. We've talked about that on some prior calls. The Century deal that we announced early this week is yet another data point in that trend. We think that's an important one. I did comment that we're seeing more activity with corporate. I think last year much of it was much more about financial sponsor activity but now we're also seeing more corporate activity. And very valuable is increased participation from Europe as well, have pretty subdued there for quite some time. We feel good about where this is and if you look historically, M&A still at pretty low levels. Equity underwriting momentum continues industry wide and globally and I think with debt underwriting, it's less of forward calendar, but given debt related financings, expect some ongoing strength in that area as well.

Devin Ryan - JMP Securities

Great. Appreciate all the color.

Ruth Porat

Thank you.

Operator

The next question will come from Matt O'Connor with Deutsche Bank.

Matt O'Connor - Deutsche Bank

Good morning. As we think about the ROE progression from roughly 7% ex the litigations and the noise right now to the 9%, it seems like the improvement in PVT is worth about 1% to ROE. And then the FICC and the commodity is a big driver. Can you quantify how much ROE upside there is from that? And I understand there's been a lot of questions asked what the revenue opportunities, the expense opportunities and there's constant some moving pieces there. But from an ROE point of view if you get FICC and Commodities where you want it, how much of a driver is that to firm-wide ROE?

Ruth Porat

What I'd like to add to it because it's the most important incremental driver to ROE is the bank. I've commented on higher yield to asset optimization and the cost structure we have. We also have growing deposits and those are contractual. It's part of the acquisition from Citi that we're now getting in 1.75 billion of deposits per month to the middle of next year. So the result is a higher return on a larger base and given the cost structure, the incremental margin is substantial as I've already noted, so essentially just all drops to the bottom line. You start with that. I'll let you do your own forecasting and map on that plus the Wealth Management, higher profitability that we laid out here on this slide. And Fixed Income, yes, we are talking steps. We are moving it forward but we're not assuming a recovery in the FICC market, so that's not the biggest driver, not much there. And then we have more on the expense reduction program to come in, as James says, and finally the increasing returns of capital over time. So I just want to make sure you've got the full list. And again the importance of the bank is not to be understated.

James Gorman

I would just add at a sort of macro level if you think about it simplistically, comp to revenue ratios aren't going to change a whole lot, certainly going to be – we broke them down this year given revenues went up and we would expect them to come down as revenues go up. So that's kind of known. The firm is being managed very tightly from other non-comp expense basis. We have a comprehensive worldwide effort, as Ruth just referred to, making progress on that. And we're not going to take our foot off that. We're going to be driving those non-comps very aggressively. So it's really just the question what the revenues are. I think the clarity of our expense base is probably as high as it's been for a long time. And now, as we said with this substantial progress on the litigation behind us, it really is a revenue show right now.

Matt O'Connor - Deutsche Bank

And just a follow-up on the expenses, sorry if I missed it but of the 1.6 billion of savings, how much is in the run rate either for the full year 2013 or 4Q?

Ruth Porat

I'll refer you to the slides that James went through where we tried to break out the key components of it.

Matt O'Connor - Deutsche Bank

Okay, thank you.

Operator

The next question will come from Christian Bolu with Credit Suisse.

Christian Bolu - Credit Suisse

Good morning, James. Good morning, Ruth. Thank you for taking my questions. Just a follow-up on an earlier question on the 100% growth you expect in lend-in. Just be helpful to get some color on where you're seeing such robust loan demand? Is it completely new loan demand from your clients or is it your clients switching from existing lending providers to you? And what is it about your lending program that is driving such outsized growth relative to the industry?

Ruth Porat

If I break it down into the two sides of the business that are benefiting most from deposits. First, on the Wealth Management side; lending to clients where we have the deep relationship. Their assets are here at Morgan Stanley. And what we have talked about is we're underpenetrated relative to peers with lending product had not historically been a focus for our system. And over the last several years, we've been building up the number of bank advisors who sit with financial advisors providing the requisite support for their client base. So we're starting in a position where we're underpenetrated, have the client assets with us. This is product the clients want. It's simple products. For example, PLA our securities and base lending program enables clients to maintain their portfolio as is, but continued to invest as they wanted. So it's a very productive add on to the work that they're already doing with us. And again, given this is product that's significantly over-collateralized and as I've said with our existing client base, we've had virtually no credit losses to-date. It's mostly floating rate product and you're seeing growth – we're seeing nice growth in that. It's the bigger part of lending growth within Wealth Management and I'll refer you back to the conference I did earlier in the year where there's more detail on that one. In the mortgage side, we are continuing to see strong demand. To be fair, it's off of a low base but we were deliberately constraining production there, as I already noted, so continuing to see upside in that business. If you switch over to the institutional security side, we have historically been focused on relationship lending and event lending, if you were to expect, and what we're now adding our – well, I always characterize it like sleeves of product, all modestly sized that are consistent with the client franchise that we have. So this is business that otherwise we were not doing with our existing client franchise. This gives us the opportunity to continue to delve and that's what we've been doing in areas like commercial, real estate and project finance.

Christian Bolu - Credit Suisse

Great. Thanks for the detailed answer.

Ruth Porat

Thank you.

Christian Bolu - Credit Suisse

Just switching over the capital return, I can see that quantum of capital Morgan Stanley can return would be subject to regulatory approval. But as you consider the future's capital structure of Morgan Stanley, do you envisage being able to return more than a 100% of earnings to shareholders in the foreseeable future?

James Gorman

Listen, I think let's take one step at a time. We're in the CCAR process now. We had our first capital outlay last year which was the final acquisitions of Smith Barney. We had our first buyback last year since 2008 which was starting the $500 million tranche. We're participating in CCAR right now. We'll get the results of that in the first quarter. Let's just take our projections from then on.

Christian Bolu - Credit Suisse

Okay. Apologies if I missed this earlier on. But with regards to your 9% ROE target what Fixed Income revenue assumption are you making? Is it kind of 4.2 billion you did this year or is it more like fourth quarter's run rate? Just trying to get a sense of what's embedded in that 9% ROE target?

Ruth Porat

The main point, as I said, about the 9% ROE starting point for the firm is that within Fixed Income we are driving a return on capital that's in excess of our cost of capital. And as we indicated, with the steps in Commodities there is continued improvement in that ROE. In Fixed Income across a number of products we've already reached that type of return looking at RWAs or your capital on a normalized basis. We've added foreign exchange in 2013 notwithstanding what was challenging – more challenging foreign exchange market environment and we are looking to do the same with rate. So, it is very much if we are looking at what's the return for the overall firm, it is about achieving those types of returns for Fixed Income. But I'll repeat what I already said, which is, we are not assuming a recovery in the FICC market industry-wide in 2014. So, it is not much of a driver to the upside in our ROE.

Christian Bolu - Credit Suisse

Got it. And just lastly from me question on just regulation in the Wealth Management space. As one of the largest financial advisor networks in the country, just be curious for your thoughts around kind of potential amortization of whether there's differences between the SEC and FINRA regulated advisors and any potential implications for Morgan Stanley and its competitive positioning?

James Gorman

Boy, that's a pretty broad one. Honestly, we run the business and aspire to run it as well as anybody in the industry. We're constructively with the regulators. There are obviously some differences across FINRA and SEC but I'm not going to get into predicting harmonization impact on us. I would be very, very surprised if there are any material impacts on our business based upon any harmonization.

Christian Bolu - Credit Suisse

Great. Thank you.

Operator

The final question will come from Eric Wasserstrom with SunTrust Robinson.

Eric Wasserstrom - SunTrust Robinson

Thanks very much. Ruth, just to go back to Slide 14 for a moment. Obviously, the simple math is that looking at the potential numerator benefits gets you to 6 to 6.3. But I'm just curious about the box that you have in terms of potential offsets which foresights the balance sheet growth, I'm just trying to reconcile that with what James indicated the targets are on page 11. So does that -- does this outlook on ’14 embed this asset growth and driven by the deposit growth over the next two years?

Ruth Porat

So on the -- when we described or show the growth in assets for the bank to be clear, that’s looking at the asset side, so we have deposit growth, but we have equity supporting the bank. So that’s the -- that’s the asset side of the equation a bit higher than the deposit growth that we’re talking about. When we go to the potential offsets we’re looking at this ongoing, on boarding of deposits and yes it is built into our statements that it will be greater than 5% in 2015 with growing returns of capital. We manage overall the balance sheet to put – our balance sheet and capital behind growth areas within the firm, so we built in the capacity to have growth within the firm across our various businesses including the obvious deposit on boarding and so that’s one potential offset that has been incorporated into our outlook and the greater than 5% and then capital returns I think speaks to itself.

Eric Wasserstrom - SunTrust Robinson

Got it. And so does the same view get you to the SLR target on the bank level as well?

Ruth Porat

We are already at about 6% on the -- on our larger bank MSBNA and even higher than that on the other bank. We capitalized those banks to support the growth that we anticipate and so those are already in a strong position.

Eric Wasserstrom - SunTrust Robinson

Got it. And so just finally on this -- so as I think about the ROE targets and all of this going forward, is it fair to say that the governing issue at this stage is much more the compliance with SLR than CCAR capital?

Ruth Porat

Our view is that we have a very strong flight path to greater than 5% in 2015 and that incorporates returns of capital. And so that doesn’t serve as a constraint and so the CCAR process is -- it was obviously an annual process. We feel very good about what we have done over the last several years and last year with the consistency of the businesses that we have the ongoing accretion of capital, the ratios that we have, but we don’t view the SLR as a constraint on that because we built into our forward look return, increasing returns of capital.