Good morning. This is Celeste Mellet Brown, Head of Investor Relations at Morgan Stanley. Welcome to our Second 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 www.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.

I will now turn the call over to President and Chief Executive Officer, James Gorman.

James Gorman

Thank you, Celeste. Good morning, everybody. Before handing the call over to Ruth, I just want to make a few comments about our performance this quarter and importantly, how that balances our strategic direction. Speaking that we've just completed a Board meeting in Tokyo with our partners, MUFG, and I'm pleased I was able to make it back in time to join this call.

When I became CEO about 18 months ago, I had a list of 10 or so important steps that we felt needed to be achieved in order to restore Morgan Stanley to the strong financial position we have enjoyed so much by history. Chief among those were enhancing the already-strong performance and client focus of our Equities, Banking and Capital Markets businesses; improving share and performance in fixed income; successfully integrating MSSB while growing assets, revenues and margins; derisking Asset Management to focus on our core institutional and merchant banking activities and then growing from that base; selling or shutting down the pure proprietary businesses that we had pre-crisis; resolving legacy balance sheet issues; increasing our liquidity; and importantly, achieving an early conversion of the MUFG-preferred security with the 10% coupon.

Our progress has, at times, been uneven over the past 6 quarters, and the shifting regulatory landscape has made it challenging to anticipate required capital and liquidity levels. Our single-minded focus has been to drive forward against these goals and in so doing, shorten the list.

In a moment Ruth will walk through the segment results, but let me touch on a few key items. Equities, Banking, Capital Markets are in great shape. The results reflect it, and we have achieved several high-water marks this quarter. In fixed income, despite a very complicated challenging market, our teams delivered solid performance and we are improving client connectivity, and the results demonstrate it. In GWM, revenues, flows and assets were all strong. However, we remain very focused on expenses in this business. Margins must improve and do so soon.

Finally, the MUFG conversion has received relatively modest attention, but in our view, was a breakthrough from Morgan Stanley. By converting the security at the cost of 75 million shares or approximately $1.7 billion, we have permanently removed a $780 million annual drag on our earnings while simultaneously increasing Tier 1 common by approximately $8 billion.

Just as importantly, we have enhanced the alignment with our Japanese partner. The most recent evidence of which was taking our whole Board to Tokyo to meet with them. By them now applying equity accounting to our earnings, MUFG prospers when Morgan Stanley prospers. Thus, we have great incentives to combine our resources and client contacts to drive incremental results and leverage both balance sheets, including the joint commitment of $30 billion in our global lending joint venture since inception.

These are unquestionably challenging markets, but our focus is and must be on methodical and resolute forward progress, with an ever-increasing eye on those things which we do control, in particular driving greater penetration with our clients while leveraging our global platform, as well as stringent cost management, including the firm-wide expense reengineering program Ruth discussed extensively at the recent conference and will discuss, no doubt, more through the course of this call.

Let me turn it back to Ruth.

Ruth Porat

Thank you, and good morning.

Our firm-wide revenues for the second quarter were $9.3 billion, up 22% sequentially on a reported basis and up 7% when excluding DVA in each period and the MUMSS-related loss last quarter. Results also reflected gains related to monolines in the quarter versus losses in the first quarter of 2011.

Our noninterest expenses were $7.3 billion, up from $6.8 billion last quarter. The firm-wide compensation ratio was 50% compared to 57% in the first quarter. So excluding the impact of DVA and the MUMSS lost last quarter, the ratio was 52% in the second quarter versus 51% in the first quarter.

Non-compensation expenses were $2.7 billion, up 10% from last quarter. Non-compensation expenses this quarter included $130 million associated with our joint venture with Huaxin Securities in China as well as about $45 million in higher FDIC fees in Global Wealth Management that I alluded to last quarter.

Overall for the quarter, income from continuing operations applicable to Morgan Stanley was approximately $1.2 billion. Diluted earnings per share was a loss of $0.38 after preferred dividends. That is attributable to a noncash charge of approximately $1.7 billion related to the conversion of MUFG-preferred into common reflected in the preferred dividends line. This translated to a $1.02 per share negative impact to diluted earnings per share for the quarter. The charge was partially offset by savings of $196 million in preferred dividends due to the earlier-than-expected conversion. DVA positively impacted results by $244 million.

Period-end shares outstanding were 1.93 billion, while our diluted average shares outstanding were 1.46 billion. Excluding the charge, EPS would have been calculated on an if-converted basis because of the earnings level in the quarter. Diluted average shares outstanding underlying the if-converted method were $1.79 billion, which is what the calculation of the charge is based on in our press release.

We are very pleased to have closed the conversion, which puts the firm in a robust Tier 1 common position. Our partner, MUFG, now owns more than 22% of our shares outstanding. And pursuant to the conversion agreement, MUFG now holds 2 seats on Board, subject to conditions of the agreement.

In addition to MUFG converting its preferred, MUMSS has been working through a strategic risk management review and remediation program and has changed its leadership and process controls. As we previously announced, MUFG increased the capital in a joint venture during the quarter, $86 million of which accrues to Morgan Stanley equity and book value.

Book value at the end of the quarter was $30.17 per share, while tangible book value was $26.61 per share. The changes in book value and tangible book value reflect the benefit of net income earned in the quarter as well as the impact of the MUFG conversion.

Turning to the balance sheet. Total assets were $831 billion at June 30, which included $182 billion of liquidity or 22% of our assets and reflects our enhanced approach to secured funding including extending WAM, investor diversification and strong governance. Although our calculations are not final, we believe that our Tier 1 common ratio under Basel I will be approximately 14.6%, up from 11.7% in the first quarter, and our Tier 1 capital ratio will be approximately 16.8% versus 16.5% in the first quarter. Risk-weighted assets under Basel I are expected to be approximately $304 billion at June 30.

Now turning to our businesses in detail. First in Institutional Securities, revenues of $5.2 billion were up 44% from last quarter and included the positive impact of DVA. Noninterest expenses were $3.7 billion, up 17% from the first quarter. The compensation ratio was 43% in the quarter. Excluding the impact of DVA, the ratio was 45%. Non-compensation expenses increased over the first quarter, largely due to the expenses associated with our new China joint venture I mentioned previously. The business reported a pretax profit of $1.5 billion. NCI, or non-controlling interest, was $117 million for the quarter, primarily attributable to our joint venture with MUFG.

Turning to Investment Banking. Our activity remained robust with revenues of $1.5 billion, up 46% from the first quarter on higher revenues across the board, M&A, equity and fixed income underwriting, and up 66% from a year ago. We generated our highest M&A revenue quarter since 2007 and our strongest reported quarter ever for the firm in fixed income underwriting. At the end of the second quarter, according to Thomson Reuters, Morgan Stanley ranked first in global completed M&A, second in global announced M&A and second in both global equity and global IPOs. We led significant deals including 4 of the top 5 transactions in global completed M&A.

Notable transactions in banking included Marathon Oil's $15.2 billion spin-off of Marathon petroleum, the 22.4 billion merger of VimpelCom and Weather Investments in Italy, Glencore International's $10 billion IPO and Chrysler's $3.2 billion high-yield issuance. Advisory revenues of $533 million were up 38% sequentially, driven by a significant increase in America's revenues, partially offset by lower results in EMEA. Equity underwriting revenues were $419 million, up 47% over the first quarter.

Results were healthy across regions with particular strength in Europe, which saw increased activity in both IPOs and rights issues as well as higher Asian activity centered around large Hong Kong and China IPOs. Activity was also diversified across sectors with particular strength in technology, financials and materials. Fixed income underwriting revenues of $521 million increased 54% from last quarter. Results were driven by an increase in acquisition's enhanced activity in both the investment-grade and noninvestment-grade markets.

Equity sales and trading delivered its highest revenue since the financial crisis at $1.85 billion, including positive DVA of $52 million, driven by a focus on clients and continued share gains. Excluding DVA, we generated a sequential revenue increase of 4% with 40% growth from a year ago on market share gains in cash equities, client derivatives activity as well as continued strength in financing products, notwithstanding lower market volumes and an increasingly challenging environment for investors. Prime brokerage revenues were up significantly sequentially and double-digit year-over-year, while client balances continue to grow modestly.

Derivatives revenues were down from their highest results in the first quarter due to lower volatility levels, partially offset by higher client volume. Year-over-year, equity derivative revenues were up significantly.

Growth in our electronic trading businesses continued to outpace the market. And our ongoing commitment to sustaining a world-class research product, alongside our potent sales and trading business, continues to yield strong results in independent surveys. Our efforts to balance institutional equities performance across products and regions has resulted in greater earnings stability even in challenging markets, a primary objective for all of our major businesses.

Fixed income and commodities sales and trading revenues of $2.1 billion included positive DVA of $192 million. Fixed income markets during the quarter were difficult and especially so in commodities, which experienced very significant and material declines on lower client activity across the sector. In aggregate, our fixed income business outside of commodities and excluding MBA, evidence the ongoing progress we are making. For example, results of recent surveys from Greenwich Associates and Orion Consultants indicate that our market penetration across fixed income is growing, while our service levels continue to improve with clients. Of note, client volumes in FX increased from the first quarter, reflecting stronger activity in the Americas.

Our rates revenues for the first half of 2011 were higher than the same period last year, although the second quarter revenues were down from the very strong first quarter. Credit revenues reflected strength in structured credit although were lower than the first quarter, due primarily to the decline in securitized products after a notably strong first quarter.

Results in the fixed income business also included $471 million in gains related to monolines. We made changes to our hedging program related to monolines during the quarter, as we continue to actively manage this mark-to-market exposure. We will continue to evaluate this exposure and hedges as appropriate going forward. Other sales and trading negative revenues of $510 million primarily reflected the usual items, but in particular, losses on our loan book this quarter.

Turning to VAR. Averaged trading VAR increased to $145 million versus $121 million last quarter and compares to $139 million in the second quarter of last year. In Global Wealth Management, we continued to make progress on the integration, with attractive asset flows in the quarter even during a seasonally weak period. Revenues of $3.5 billion were up slightly from the prior quarter and up 13% versus the prior year.

Revenues in the Investment Banking line within GWM highlight the benefits of our solid issuance calendar. Trading and commissions were lower, reflecting reduced levels of retail engagement, with investor conviction declining throughout the quarter. Asset Management fees were up due to higher indices at the start of the quarter on higher assets under management.

The other revenue line includes gains related to sales out of our AFS portfolio among other items. Noninterest expenses were $3.2 billion, up 2% from last quarter. The compensation ratio of 62% in the quarter continues to be driven primarily by the formulaic grid payout and business mix. Non-compensation expenses were $1 billion, up from $964 million in the first quarter and primarily reflect the implementation of the new FDIC assessment, with approximately $45 million of incremental non-compensation expenses in the second quarter. This was driven by an increase in the assessment on Citi's depositories, but partially offset by a decline in the assessment on the Morgan Stanley depositories. Based on steps taken by Citi, we expect the assessment for the third quarter will return to approximately first quarter levels. Non-compensation expense includes integration costs of approximately $98 million.

Profit before tax was $322 million and the PBT margin was 9.3%, up about 250 basis points year-over-year. NCI for the quarter was $4 million, down from $74 million in the first quarter. Total client assets remained strong at over $1.7 trillion and well above prior-year levels on market appreciation and net asset inflows of $2.9 billion in the quarter, which represents a marked improvement from outflows in the second quarter last year.

Net fee-based asset flows were $9.7 billion, driving fee-based assets under management to a record-high $509 billion at quarter end, up 29% year-over-year. We see fee-based assets as valuable for our clients and the firm, because they enable us to leverage the power of the platform on behalf of clients and deliver a more stable revenue stream. Over the last 12 months, net fee-based asset flows were $45 billion. The number of FAs was 17,638, down just over 160 sequentially in line with our prior comments on FA headcount. Bank deposits were $110 billion, of which $56 billion are held by Morgan Stanley Bank.

Turning to Asset Management. We continue to make progress and take the appropriate steps in rebuilding our business, reflected in higher revenues and AUM over last quarter. In Traditional Asset Management, which includes our long-only liquidity and AIP fund-of-funds businesses, revenues increased 13% from the first quarter to $366 million and are up 44% versus the prior year. Results were up on higher average assets under management, driven by a positive market appreciation. Notably, these gains do not reflect much benefit from our significant inflows into the liquidity fund because, as is consistent with industry practice in a low interest-rate environment, we are waiving substantially all fees on these funds today. Keep in mind that liquidity funds tend to generate an attractive margin in a more normalized interest-rate environment.

In Real Estate Investing, revenues of $175 million were up on higher marks versus the prior quarter, approximately $95 million were related to investment gains from consolidated measure [ph] of funds. The majority of the gains were related to third-party investors and are reversed in the non-controlling interest line.

In Merchant Banking, revenues of $104 million included reduced investment gains in private equity driven by lower marks in the Asia Pacific region and the absence of a full quarter of revenues related to FrontPoint, but offset by gains in our infrastructure fund.

Compensation expense was $285 million in the quarter, up from $255 million in the first quarter, driven by a number of items, some of them one-time. Profit before tax was $165 million for a margin of 26%. NCI was $92 million, up sequentially reflecting gains in consolidated real estate funds as previously mentioned.

Total AUM increased 7% sequentially to $296 billion driven by net asset inflows of $15.7 billion and market appreciation. As of May 2011, over 73% of our long-term strategies continued to outperform their respective benchmarks on a 3-, 5- and 10-year basis.

Finally, turning to our outlook. Over the next several months, we would expect some relief in the markets due to policy makers in Europe and the U.S. avoiding the precipice. In addition, we hope to see the economy rebound modestly due to the absence of one-off events that impaired global growth, such as the tragic tsunami in Japan and the resulting supply chain disruptions as well as the impact of higher oil prices due to what is being called the [ph] spring. That being said, activity levels are seasonally slower in the summer months, which could be exacerbated by uncertainty in the market about policy, regulation and ultimately the outlook for growth.

On the positive side, there is ample liquidity ready to be deployed when the fog lifts. With $1 trillion of cash still on S&P 500 balance sheet, nearly 2x median levels and bank and client leverage at a very low level, activity could pick up significantly if there are real political breakthroughs. And we continue to chip away at opportunities to enhance the franchise, building capital and liquidity, further building share with clients and successfully addressing a number of items over the last year and a half, including reducing legacy positions which were drags on the business, exiting noncore businesses to enable us to redeploy capital to support our core business and as James indicated, optimizing our expense structure. What was once our "to-do" list is slowly getting closer to being our "done" list.

Thank you, and now James and I will take your questions.

Question-and-Answer Session

Operator

[Operator Instructions] The first question will come from Howard Chen with Crédit Suisse.

Howard Chen - Crédit Suisse AG

James, you noted you didn't believe you were garnering much attention for the MUFG conversion. I guess in that context, given your capital levels appear well above Basel targets, how are you prioritizing capital management here? I know you've mentioned in your past your desire to buy-in the first stake at Smith Barney, but given where the stock is trading below tangible book and you're checking these priorities off the list, does it make sense at all to you to shift focus here on maybe repurchasing shares?

James Gorman

Well, firstly, Howard, I think about this 2 chapters. The first chapter is to build ourselves into a fortress position, where we have the capital at the levels that we should have capital. That's been our focus, not just with the MUFG conversion in this quarter. Obviously, it's a mandatory conversion with the CIC last August and with the various accretive quarters that we've had in between. So game #1 was put ourselves in a position of strength so that we do have options. Clearly, with the stock trading where it is, we're not stupid. We evaluate those options on a continuous basis. We have, with Smith Barney, the ability to purchase the next 14% in May of 2012. So approximately 12 months from now is the first opportunity, but it is an open-ended option. We don't have to move at that date if, obviously, we felt that there was a better use of capital at that point in time. That's something that we constantly evaluate, Ruth and I and the management here talk about all the time. We do intend to run the Smith Barney business. But we built flexibility into the negotiation when we purchased this back in early '09 for exactly this kind of purpose. So Ruth may want to add on that broader capital planning, but we are focused on both long-term strategic intent and short-term optimization of our capital structure.

Howard Chen - Crédit Suisse AG

Okay. And shifting gears. We can see the progress in the Institutional Securities business. But with that, VAR trended higher while most of your peers went in the opposite direction. Is that simply a function of the rebuild of the sales and trading efforts or do you think there's other factors that impacted VAR? And should we expect that to continue?

Ruth Porat

No, I think you framed it well in your question. We have been on the view that we can increase market share by about 2% initially and continue to build from there. And really, what we're doing is building share back to levels where it was historically, back to where it was when Kenny was running the business previously, more in line with business, our other businesses. And so we're gaining traction with clients. I think we're seeing that. Third-party surveys are underscoring that. And with respect to VAR, we're basically running at levels we have historically. And I think notably, we ended the first quarter at VAR pretty close to these levels, saw strength continuing with clients throughout the quarter. It did come down at the end of the quarter. In fact, end-of-quarter VAR was 129, because we really saw clients starting to back away from the markets with the ongoing uncertainty, in particular, in Europe. But this is very much, I think, a continuation of building up the franchise.

Howard Chen - Crédit Suisse AG

Okay. And then just on Europe, Ruth, could you just update us on gross and net exposures related to peripheral Europe? And how you're thinking in managing risks specific to that region?

Ruth Porat

Absolutely. So EMEA, obviously, is an important market for us, and we've been focused on managing our exposures in the periphery for quite some time. The net funded exposure to the peripherals, Greece, Ireland, Portugal, Italy and Spain is about $2 billion. This includes exposure to sovereigns, corporates and financial institutions. It does exclude the benefit of any peripheral sovereign collateral and hedges purchased from peripheral banks against peripheral risk. And our gross exposure's about $5 billion. Both net and gross exposures exclude unfunded loans and any overnight deposits, and we'll have more details on all of this in the Q.

Operator

The next question will come from Glenn Schorr with Nomura.

Glenn Schorr - Nomura Securities Co. Ltd.

First of all, good for you for turning around the MBA hedge. But let's exclude last quarter's loss and this quarter's gain and let's exclude DVA. If you look at SIC [ph], I think it was down a little bit more quarter-on-quarter and year-on-year versus the peer group, obviously, better than Goldman but a little less than the peer group. I heard the opening comments about connectivity in some of the surveys. Just the thought process as we're going on 2 years in, in terms of revenue ramp relative to peers. And I say it relative to peers because, obviously, it's a tough market. So just the thought process on what to expect there as you continue to build out and are you done building out now?

Ruth Porat

So a couple of things. First, overall fixed income and commodities performance was very much affected, as I noted, by the activity in the commodities market. We have a strong team in commodities. It's historically been a very strong business for us, but was down meaningfully relative to last quarter and relative to prior periods. And as we've talked about in the past, our commodities business is really a mix of 2 businesses, structured solutions for clients and flows. And usually, that diversification helps us, but both were weak in the second quarter. And so we had the results was trading was lower. And the clients' side, the lack of trending volatility prevented consumers and producers to commit to hedging. So revenues, while positive, were down quite significantly quarter-over-quarter. And the lower levels in commodity really masked, we think, the relative progress across the balance of the fixed income franchise. So we're continuing to do what we've talked about in the past. We're focused on consistent progress. We said it would take some time to continue to build up our share in fixed income but are pleased with the progress we're making. And the hiring we did is, I think, a core part of it. We have the team in place, and they're continuing to focus on driving share.

James Gorman

I just want to add, Glenn, I just want to add something to that, and I've said this before. Leadership really matters in these businesses. And I think Kenny is doing a terrific job. We're fortunate to have somebody that experienced coming back into that role. And the team around him, we really have a team on the field now that can get this job done. But it takes some time. The SRM program we've built up, the connectivity that we're seeing through the surveys, the integration with TIPIC [ph] and the team in equities is very important, and it's a series of small steps.

Glenn Schorr - Nomura Securities Co. Ltd.

Well, I definitely appreciate that. It sounds like rates and FX were actually up quarter-on-quarter, given the beat down on commodities. So that is the progress, because I don't think the markets were.

Ruth Porat

Actually, the rates business is up first half over first half. It was down off of what was a very strong first quarter. But we're overall very pleased with the performance across our desks.

Glenn Schorr - Nomura Securities Co. Ltd.

Okay, I appreciate that. And then in Wealth Management, obviously, tough markets and low rates. You can only do so much. But can you update us specifically on the systems conversion side and where we're at in both what needs to get done? What's gotten done? And then what that can produce in cost saves?

Ruth Porat

We've talked for a very long time about the platform being completed built by the third quarter of 2011 and moving all of the Morgan Stanley financial advisors onto the platform by the end of the third quarter of '11. And here we are in the third quarter, and we're very much on track for that, so pleased with that. The next step is training the Smith Barney financial advisers, moving them on to the platform. That will begin at the end of this quarter and goes through mid-next year, and so very much on track with the integration. We're continuing to spend. It was, I think, $98 million integration spend this quarter. But to your question, one of the key elements to increasing profitability across Morgan Stanley Smith Barney is completion of the integration, and this is a very important milestone.

James Gorman

I just want to -- Glenn, on this, the way I think about it is every month that we go through this integration is a month that we're not spending in the future. In other words, we're one step closer. And at the same time, Greg Fleming, Jim Rosenthal and the team working on the integration with

Baricocoin [ph] are looking at beyond the Smith Barney piece which occurs, as Ruth said, early, middle part of next year. What else we really need to do to get ourselves faster to the finish line? So we've taken aggressive relook at the back end of some of the integration steps.

Operator

The next question will come from Mike Mayo with CLSA.

Michael Mayo - Credit Agricole Securities (USA) Inc.

Just wanted to follow up on the Wealth Management. So the margin was down linked quarter, but it would have gone up from 10% to 11% if not for the FDIC charge, is that correct?

Ruth Porat

The FDIC charge was incremental. We had number of ins and outs with the business. But as I indicated, the FDIC charge, we believe, is fully going away this quarter.

Michael Mayo - Credit Agricole Securities (USA) Inc.

All right. So all things considered, the margin in the third quarter should be 11%?

Ruth Porat

No, we also had the sale out, the incremental gain I noted in the other line, which was sale out of the AFS portfolio. So as I indicated, we had a number of ups and downs. And we're adding on top of that, real focus on expense management to continue to drive it forward, but I'm not going to put a number out there now.

Michael Mayo - Credit Agricole Securities (USA) Inc.

Okay. And then the net inflows to Wealth Management, it wasn't a whole lot relative to the $1.7 trillion of assets, at least compared to say, some of the pure-play brokers, the online players like Ameritrade, Schwab, even E*TRADE had higher inflows. Now you've turned it around, but when do you think we'll see more substantive inflows?

Ruth Porat

Well, you hit the right point, which is when we look year-over-year, we're very pleased with going from some meaningful outflow second quarter of last year to inflows this year. And we are continuing to see that kind of progress that's affecting our overall flows in the business. The other point I made is that we're quite focused on managed money, given what that does for our clients and for the business. And that's a helpful added boost to overall performance in Morgan Stanley Smith Barney.

Michael Mayo - Credit Agricole Securities (USA) Inc.

And then lastly, as it relates to expense control for Wealth Management or for the firm as a whole, I might have missed this, but what are your overall targets to improve any measure of expenses or efficiency?

Ruth Porat

We think of really the expense management as a 3-legged stool. There's the tactical expense management, which we continue to do, and as James just noted, was were very focused across our businesses. But in particular, Greg is really pushing hard within Morgan Stanley Smith Barney to help drive margin. There is the office of reengineering that we've spoken about previously, which is really stepping back from some of the more tactical, cost-cutting initiatives and looking at what broader changes we can make in the way we're addressing spend. For example, more meaningful looks at what we're doing in technology, where can things be outsourced more efficiently, what can we do on legal entity structure, a whole host of initiatives that we've identified, built-up, bottoms-up to the office of reengineering and established $1 billion run rate savings over 3 years coming from that leg of the stool. And then we're very focused on headcount. So as I indicated previously in the year, making sure that we're quite focused on reducing, in particular, underperformers. As I noted, our headcount was down amongst FAs in Morgan Stanley Smith Barney. We're having that same kind of discipline across the business. And obviously, that's not just compensation expense but every employee has a multiplier effect with them. They're in the building, they use data, there are a whole host of things that go along with it. So that kind of control over headcount, it's really those 3 that drive, will drive noncomp and comp control.

Michael Mayo - Credit Agricole Securities (USA) Inc.

All right.

James Gorman

Can I just go back to your question on flows? Because we're kind of an inflection point here in the industry. You're right in the observation against the online players. The full-service firms typically have much larger outflows in the second quarter because of tax season. But a more sort of strategic issue is what is the quality of the assets? And I've noticed at least one of our competitors has stopped reporting net new money. What really matters is the net new annuitized money and the revenue that you generate on annuitized assets versus transaction assets. So that will be an increasing part of the conversation going forward.

Operator

The next question will come from Michael Carrier with Deutsche Bank.

Michael Carrier - Deutsche Bank AG

Maybe on the trading side, and I guess particularly on equities but even on the fixed income side, when we look at rates, FX and credit. Year-over-year last -- or second quarter is pretty challenging as well. But when you look at since you made those investments, it's always hard, we all compare revenues across the businesses and across the peers. But in terms of market share, can you dig down and provide any detail on product levels in terms of where you've gone or where you come from? And then where you see additional opportunities?

Ruth Porat

Well, starting with equities. I think there's a lot of -- it's the best reported quarter since 2008. And that really was with broad strength and with the backdrop of anemic industry volumes. So the data we've looked at underscores that we're gaining share really across the globe. And I think it's really a testament to the great job the team is doing. But we saw improvement in our prime brokerage franchise. We continued to see strength, again, across products in a challenging market, but it really goes to the strength of the franchise. Our Delta One business, although revenues were lower in line with the decline on industry volumes, what we're seeing is share is up. And similarly, in our Derivatives business, we're seeing strong client flows. So it is, I think, is evidenced by the numbers. They speak for themselves. In terms of share, we're doing well across the board. And in fixed income, again, what we're seeing is greater activity, greater flow. The data that we've looked at goes more to some of the qualitative factors. We're having greater traction with clients. They're turning to us more. And again, I think what you'll see when everyone reports is it will be our best way to have a proxy for what overall is the share. We've targeted 2% market share growth. And the way we measure our progress is we look at the top 9 players globally and just take our revenues relative to the entire pool. And we look forward to the rest of our peers reporting, so we can try and quantify that answer.

Michael Carrier - Deutsche Bank AG

Okay. And then just as a follow-up, earlier this year, you discussed the reengineering or the cost initiatives over the next 3 years and targeting around $1 billion. And when I think about the industry, we're seeing quite a few banks, brokers kind of go down the same path. Some are taking a faster approach, like may be in the next 6 months, in the next 12 months. And so I guess when you look at the macro headwinds, the regulatory pressures, one is do you feel that's enough? And two is are there any businesses within Morgan Stanley that you feel like given the regulatory changes and the pressures, can be done better or can compete better on its own with other pure plays?

Ruth Porat

So strategically, we think the portfolio of businesses we have is a potent combination. And we have exited a number of businesses, and as you've seen over the last couple of years. And we're very focused on the kind of the symbiotic nature between what we're doing on the institutional origination and distribution side on the one hand and retail distribution on the other. And within Institutional Securities, the ability to deliver across products for our clients. So I would say on that, we're very pleased with the portfolio of businesses we have. And within our Investment Management business, we see opportunity for growth given the performance of across a lot of the funds and the power of this brand around the globe. So as it really goes to the second part of your question, or maybe it was the first part of your question, what else can we be doing with respect to our cost structure? We have 3 legs of the stool. We're very focused on each one of those legs, the tactical expense, the strategic through the office of reengineering and headcount, and making sure we're doing what we can to drive returns across the business. I would say, as an example, in sales and trading, when we announced our hiring program over a year and a half ago, we were very careful to point out that we were looking to hire to narrow the gap to our peers but not to close the gap to our peers. In fact, back then, we talked about having headcount that was maybe 20% to 25% lower than our peers, with the view that they would come down to us rather than us going fully up to them. And so what we're very pleased about is we have a strong cohesive team that's making progress on our market share goals. And I think that's part of the reason you're not hearing comments like that from us, because we never, we didn't close that gap fully.

Operator

The next question will come from Guy Moszkowski with Bank of America.

Guy Moszkowski - BofA Merrill Lynch

I was wondering, first of all, if you would have an estimate of your pro forma Basel III basis core Tier 1 ratio at the end of the second quarter?

Ruth Porat

So Tier 1 common would be around 6.5% to 7% under Basel III at the end of the second quarter, the range really being depending on the treatment of the MSSB NCI of $4.3 billion. And of course, that's looking at our balance sheet as of the second quarter. There's no benefit for any mitigation that -- past mitigation or anything that would roll off over time.

Guy Moszkowski - BofA Merrill Lynch

Got it. And are you still estimating about the same sort of RWA inflation and mitigation that you had talked about potentially in the past? No real change there?

Ruth Porat

No real change. We're comfortable with the prior guidance of about $480 billion risk-weighted assets by year-end 2012.

Guy Moszkowski - BofA Merrill Lynch

Okay, that's helpful. Back to GWM. I'm just trying to envision what we should really be looking for in terms of how the expense dollars might evolve. As you complete the systems integration, first, of the legacy Morgan Stanley folks and then the legacy Smith Barney people for the next 12 months, how will we see that really manifested in the P&L?

Ruth Porat

So the integration spend has been running at about 80 to 100 a quarter. And we will continue -- we've finished the technology platform this quarter and moved the Morgan Stanley FAs over, as I said. But we are continuing to spend as we go through the training of the Smith Barney FAs and running in parallel to ensure data quality, data integrity through kind of mid-next year. And so you really start seeing the benefit of the integration spend rolling off more towards the back half of next year.

Guy Moszkowski - BofA Merrill Lynch

Got it. And is all of that captured in the, I think you said $98 million type of numbers that you've been telling us each quarter? Is it integration or it's more than that?

Ruth Porat

Yes, that's the integration spend.

Guy Moszkowski - BofA Merrill Lynch

Okay. So that's what we should expect to see go away but not any other costs of supporting legacy systems that somehow aren't captured in that?

Ruth Porat

So to be clear, as I said, it starts rolling off because we continue to do -- we get the Smith Barney FAs moved on, on the second half of -- or at the end of the first half of next year. And then we have incremental work with the Morgan Stanley Private Wealth Management system, but it's rolling down through next year.

James Gorman

Got it. And then final...

James Rosenthal

There is another aspect to it, which we have not quantified but clearly is going to be a focus. Once you integrate the systems, you're putting 800 branches all on the same system. That means all the branch office infrastructure is now coordinated. So where we have capacity utilization issues, say you have 2 offices in one regional city a couple of miles from each other, we can't move those people yet. We can't consolidate the infrastructure. We can't get rid of dead real estate, because they're in different systems. They'd be moving to an office, they might be on the wrong system and all their clients' records, cost bases on accounts and some would be gone. So once the integration is done, we have a lot more flexibility as to how you manage across those 800 branches.

Guy Moszkowski - BofA Merrill Lynch

Right. Yes, I kind of thought there had to be more somehow. And does that include the fact that even at the branch level, you might have what that then will be sort of redundant systems and operations folks?

James Gorman

I mean again, we haven't quantified that. But that will be the work that gets done once you're all on one platform.

Guy Moszkowski - BofA Merrill Lynch

Got it. Final question that I have relates to the monolines, and how those positive revenues this quarter, negative last quarter related to the -- the actual underlying positions that those things were put in place to hedge, I mean I've had some discussions with clients this morning about should you back that out or add it back in the first quarter? And I guess to me, what's really relevant is to what extent did that revenue actually or positively to offset losses in what was clearly a very difficult, distressed mortgage-type environment. Can you give us a little color for how to think about the 470 in that context?

Ruth Porat

Sure. So we adjusted -- we obviously adjusted the hedges. If we had not adjusted the hedges, we would have had losses again this quarter. And so the risk management around this was an important part of the story and the outcome. I think more broadly within our Securitization business, if you're asking about mortgages, that is consistently a very strong business for us. We traded and risk managed well in what was a difficult market. We were off from a very strong first quarter that was driven by client demand, but still had good performance in that business and are really pleased with the work the team did in what was a challenging market.

Guy Moszkowski - BofA Merrill Lynch

Got it. And maybe just a little more color then on what kind of adjustments you made to the monoline hedge to get a better outcome?

Ruth Porat

So as we've said in the past, we constantly evaluate the position and adjust the hedges. And we'll continue look at the position and assess where we think it's best to be and where we kind of where we think the position of the markets will be.

Operator

The next question will come from William Tanona with UBS.

William Tanona -

One of your competitors earlier this week had mentioned that Europe and Asia were particularly weak. And if we look at your results, obviously, we saw that in Europe but did not see that in Asia. Asia was actually very, very strong for you guys. Can you give us some color and context around what drove that significant performance this quarter?

Ruth Porat

Well, overall, we have a very strong business in Asia across Sales and Trading, Banking. I think one of the points though to focus on quarter-over-quarter is we did have the loss in MUMMS, at our MUMSS joint venture last quarter. So when you normalize through that, we're basically in line. But I guess again, it goes -- the strength that we saw is because of cost of the businesses, Sales and Trading and Investment Banking. Europe was strong in our equity underwriting area, as I noted, large rights issues and IPOs. But fundamentally, it was a tougher market in Europe with the backdrop of the European sovereign crisis.

William Tanona -

Okay, that's helpful. And then I guess going back to equities. Obviously, a very strong quarter for you guys, and you guys were the only ones that were up quarter-over-quarter versus your peers. And I know you mentioned volatility, I know you mentioned prime brokerage, but can you give us any additional color as to what really helped to drive that?

Ruth Porat

I think the strength of it, as I've already noted, was that we had breadth across products and around the globe. And so that's an important part of the franchise. I'd say on our Prime Brokerage business, the revenues were up meaningfully versus the prior quarter. But as I noted, balances were up only modestly. And what we're really focused on within Prime Brokerage is the adjacencies across the equity franchise. So we think that's, again, this notion of connecting the dots across the business and the benefit of really leveraging what we have across Morgan Stanley, and you see that in these numbers because even in a market with lower industry volumes and cash equities, our business is continuing to do well.

Operator

Your final question will come from Roger Freeman with Barclays Capital.

Roger Freeman - Barclays Capital

I guess I wanted to come back -- a couple of issues have been brought up. First on capital. I guess when you reiterated, I guess, what you said in the past but if you are going to be at a roughly 10% Tier 1 common ratio under Basel III, wondering what -- how you think about what level you wanted -- would actually want to run at relative to the SIFI buffer assuming, let's say, you're 9%? Would you look to run at a buffer, 100 basis points or so, to that? And do you think it's important to be there immediately? Or other firms have suggested they might lag into it. And I ask that in the context of whatever decision you may want to make around the next Smith Barney purchase opportunity.

Ruth Porat

So it's obviously a topic that's in flux. But the way we think about it is we expect our to SIFI buffer will be around 2%, based on the guidance we've heard. We are hoping we get some final clarity resolution by year end. And our view is that although there are theoretical kind of phase-in through 2019 from everything we've seen so far, we think the market will expect us to be at those types of levels much sooner than the kind of 2019 Basel grid. And so we're looking to run closer to that number sooner. And our expectation is that with much higher capital levels, not only has the required percentage changed, but obviously, both the quality of capital and the calculation of risk-weighted assets is different, so it's meaningfully higher, which means that our buffer on that number appropriately could run at a lower level at about 50 or 100 basis points. I think we're still trying to assess what level's appropriate. But I think the added factor as we think about it, and very much to James' point, is we continue to operate in a very uncertain environment. The macro backdrop is uncertain. And we think that having this type of very strong capital position does give us some flexibility, which is important. Strong capital and strong liquidity really provide a kind of fortress foundation, and it give us the flexibility as we get greater clarity on what is the SIFI buffer, what is the phase-in to then assess what's the best next step and the most optimized views of that capital to drive returns.

Roger Freeman - Barclays Capital

Okay. And then as it relates to all of that and in Smith Barney. Is it, if you by the -- if you do buy the next 14% next year, does the impact to Tier 1 capital ratio under Basel III actually -- is it fair to say that's probably a bigger increase than what the cost of that piece would be? In other words, there is a revaluation of what's remaining that would drive RWA up as well?

Ruth Porat

No, I think what we're most focused on is -- what's an appropriate price is in the best interest of our shareholders, and that's really the factor that would drive what's the adjustment to book value. It's not really an RWA, kind of an RWA concept as much.

Roger Freeman - Barclays Capital

Okay, all right. And then I wanted to just ask separately on coming back to VAR. The increase, I guess, the rates and the credits were up about 25%

sequentially. And I just wanted to square that with the there's the commentary around client close being lower sequentially. Were there more concentrated positions you built around your risk book during the quarter?

Ruth Porat

So our VAR was, overall, in line with where we've been running it for the, as I noted, for kind of since fourth quarter '09. And similarly, in the credit rates line, you'll see the same kind of trend. I think what's notable is at the end of the first quarter, we were running with VAR above $134 million. And the average this quarter was up some from that but came down at the end of the quarter. And so our ending number was $129 million. Why? Because it was really towards the end of the quarter, really in June, we started seeing more concern amongst investors with the ongoing issues, in particular, in Europe. So we had good activity. And I think, our view very much across the franchise is that what clients expect of us is content with a point of view and that we put balance sheet and risk around that to facilitate trading where it makes sense. And I think in particular, in times like this, they're looking for a point of view and that's what our team is very much focused on. So the volumes that you saw coming off of the first quarter persisted for a good part of the second quarter, and then came down towards the end of the second quarter.

Roger Freeman - Barclays Capital

Okay. And then just last question. On commodities specifically, that VAR came down. I guess 2 questions. One, was commodities actually positive in the quarter? And secondly, was that a business that you pulled back on in terms of capital deployment or that was just not getting knocked around a lot?

Ruth Porat

Revenues were positive. And this was something where, again, it was business leaders' view based on activity they were seeing with clients, which was quite muted given the -- what was going on in the broad markets. Everyone basically stepped away from that market. So on the flow side, as I noted, given the dramatic swings that were going on, in particular in oil, energy, were strong. It really drove a lot of the activity to the sidelines. And similarly, there wasn't much on the hedging side given what was going on in the market. So this was very client-driven, less activity really stepping back from the market after what transpired throughout the quarter.

Celeste Brown

Thank you so much for joining us for our call, and we look forward to speaking to you again in October.