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 on 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 over the call to Chairman and Chief Executive Officer, James Gorman.

James P. Gorman

Thank you, Celeste. Good morning, everyone. Ruth and I will now address our performance during the quarter.

As you're all aware, tremendous political uncertainty in the second quarter was detrimental to the global capital markets, resulting in a very challenging environment for all aspects of our business. Weak demand flows and difficult conditions contributed to results in sales and trading. The environment for investment banking was likewise affected by the market backdrop. However, we maintained our top-tier rankings in announced M&A and global IPOs as well as a leading position in global equities. We continued to have momentum in equity capital markets and recently won several significant lead mandates that should enhance earnings once the fog of macro uncertainty lifts.

GWM evidenced revenue and profitability resilience in a very challenging environment for retail investors. Despite the macro pressures that weighed on both retail engagement and new issue activity, revenues were commensurate with the prior quarter while margins improved to 12%, reflecting the benefits of the cost focus in that business.

We also reached a major milestone for Morgan Stanley in the wealth management industry with the culmination of the MSSB integration. The integration was substantially completed on July 8, and we can now finally look forward to the benefits of a fully harmonized business with significant scale. Our Wealth Management business will considerably increase its value to our clients and financial advisors through superior functionality and to our shareholders through enhanced and stable earnings.

Performance in traditional asset management held up and flows were again strong.

Finally, our results evidenced continued comp and non-comp expense discipline across the firm with expenses down 17% year-over-year.

We remain resolute in our commitment to maximize firm value and continue to shape our business for its success. There are 6 specific areas that represent new or continued steps in this regard, and I would now like to touch on each one. First, we persist in our efforts to optimize our balance sheet and business mix to best serve our clients. As you know, we have a strong Basel III capital ratio. We have reduced our Fixed Income and Commodities risk-weighted assets significantly since 2009 and by 15% alone since the end of the third quarter 2011. The reduction in risk-weighted assets has been driven by active management, including resolving legacy issues such as MBIA as well as passive runoff of all positions. We continue to reshape our Fixed Income businesses away from more complex structured product businesses to high-velocity, flow-oriented products. We intend to shrink these risk-weighted assets more dramatically through a combination of passive mitigation and active business unit management. By the end of 2013, we expect to drive fixed income risk-weighted assets to levels at least 25% below those at the third quarter 2011 and 30% below by the end of 2014, subject to final rules and regulatory changes. And we will continue to look for ways to drive additional value in this business.

As I've said repeatedly, we're driving towards the right set of Fixed Income businesses for Morgan Stanley, those that makes sense to our client footprint and complement our strong equities and banking franchises.

Second initiative. As I've also said before, we believe the scale economics and extraordinarily -- are extraordinarily important in wealth management as they are the key drivers to returns. As a result, we're taking steps to unlock value in our wealth management businesses outside of North America, starting with the recently completed Quilter sale. Across non-Japan Asia, we will align Wealth Management with the Institutional Equities and Investment Banking units to realize inherent cost synergies and revenue synergies among those businesses. We also have plans to align our Latin American Wealth Management business with our U.S. efforts. In doing so, these advisors and clients will move to the integrated platform, which now supports U.S.-based clients and allows us to further leverage the U.S. scale, service spreads and sophistication.

And finally and importantly, in the European Wealth Management business, we're considering an array of strategic alternatives to enhance profitability. These moves should be incremental to the improvements we've already discussed in the past in GWM.

Thirdly, we will remain vigilant in regards to all expenses as we have demonstrated over the past several quarters. Non-compensation expenses should further decline in the coming 12 months as expenses from the MSSB integration run off and as we actively manage our expense base across the rest of the firm.

Fourthly, we are focused on headcount and expect to end 2012 approximately 7% lower across the firm than the end of 2011, driven by a combination of previously announced reductions in force as well as applying a very high bar for replacing natural attrition.

Fifthly, our partnership with MUFG deepens every day and across all our businesses. We continue to work with our joint venture partners to identify opportunities to work together around the world. For example, in the second quarter, we and our partners executed a joint bridge loan facility for a leading diversified retailer in Latin America. Morgan Stanley then went on to act as an active joint book runner for the same company's IPO.

Sixth and finally, we expect to complete the acquisition of the next 14% of MSSB in September.

As is plainly evident in our results, the market and our circumstances were challenging in the second quarter. While it is still early days, we are seeing some signs of improvement in the third quarter.

I'll now turn it over to Ruth to take you through our earnings in detail.

Ruth Porat

Good morning. I will provide both GAAP results and results excluding the effect of DVA. We have provided reconciliations in the footnotes to the earnings release to reconcile these non-GAAP measures.

DVA in the quarter was positive $350 million with $74 million in equity sales and trading and $276 million in Fixed Income sales and trading.

Excluding the impact of DVA, firm-wide revenues were $6.6 billion, down 26% sequentially. Noninterest expenses were $6 billion, down 11% versus the first quarter. Compensation expenses were $3.6 billion this quarter, down 18% sequentially, reflecting not only our view for the quarter but also our financial outlook for the year. Non-compensation expenses were $2.4

billion, up 3% from last quarter, reflecting seasonality, but were down 9% year-over-year. Earnings from continuing operations applicable to Morgan Stanley common shareholders were approximately $312 million. Earnings from continuing operations per diluted share were $0.16 after preferred dividends.

On a reported or GAAP basis, firm-wide revenues for the first quarter were $7 billion, roughly flat to last quarter. Earnings from continuing operations applicable to Morgan Stanley common shareholders were approximately $536 million. Reported earnings from continuing operations per diluted share were $0.28 after preferred dividends. Book value at the end of the quarter was $31.02 per share. Tangible book value was $27.70 per share.

Turning to the balance sheet on Page 4 of the supplement. Total assets were $754 billion at June 30, down from $781 billion last quarter, reflecting lower levels of client activity. Our liquidity reserve was $173 billion at the end of the quarter versus $179 billion last quarter. Our liquidity levels reflected an additional $6.5 billion reduction in debt outstanding in the quarter and $21 billion in the last 12 months, as well as $2.9 billion of collateral outflows associated with recent ratings actions. Deposits were up again this quarter to $68 billion from $66 billion. Although our calculations are not final, we believe that our Tier 1 common ratio under Basel I will be approximately 13.5% and our Tier 1 capital ratio will be approximately 17.1%. Risk-weighted assets under Basel I are expected to be approximately $317 billion at June 30. Subject to final rule-making but incorporating the recently codified Basel 2.5 guidance and our best estimate of the new Basel III NPR, our Tier 1 common ratio under Basel III was just under 8.5% as of the end of the second quarter, assuming full Basel III inflation of risk-weighted assets and 0 benefit from future mitigation. We expect that our Tier 1 common ratio under Basel III at the end of 2012 will be around 9%, reflecting continuing passive mitigation driven by position roll-off and consensus earnings with a modest benefit from the more active Fixed Income RWA management that James discussed.

Now turning to our businesses in detail. Unless otherwise noted, all discussion of income statement metrics and segment results will exclude DVA for the remainder of my remarks in order to differentiate revenues associated with our business from those associated with our borrowings that result solely from our credit spreads.

In Institutional Securities, revenues were $2.9 billion, down 42% sequentially. Noninterest expenses were $2.7 billion, down 18% versus the first quarter. The compensation ratio was 49%. Non-compensation expenses increased 6% from last quarter due to seasonality. The business reported a pretax profit of $158 million.

In Investment Banking, revenues of $884 million were up 4% versus last quarter. According to Thomson Reuters, Morgan Stanley ranked #1 in global IPOs, #2 in global announced M&A at the end of the second quarter. Notable transactions included, in equity underwriting, the $16 billion IPO for Facebook and the $3 billion IPO for Felda Global Ventures which are the 2 largest IPOs priced globally this year. In advisory, Anheuser-Busch InBev's $20 billion acquisition of Grupo Modelo SAB. And in debt underwriting, the $5 billion investment grade debt offering for GlaxoSmithKline capital.

Advisory revenues of $263 million were down 16% versus the first quarter, driven by lower fees across all regions. Equity underwriting revenues were $283 million, a 65% increase from the first quarter, reflecting stronger revenues in the Americas, partially offset by modest issuance levels in Europe. Fixed Income underwriting revenues of $338 million were down 8% versus last quarter, reflecting lower revenues from investment grade and high-yield issuance, partially offset by stronger loan syndication fees.

Equity sales and trading revenues were $1.14 billion, a decrease of 38% from last quarter. Results reflect challenging markets and lower industry-wide liquidity and volume. Despite lower volumes, our client franchise remains strong as evidenced by increased market share across most products. Prime brokerage revenues increased sequentially and at a faster rate than balance growth.

Fixed Income and Commodities sales and trading revenues were $770 million. Revenues were down 70% versus our strong first quarter results. Results in the quarter primarily reflect a challenging market and lower levels of client activity. Results also reflect meaningfully lower revenues from commodities after a strong first quarter that included a number of structured solutions for clients. Finally, results include period-specific items associated with the ratings action of approximately $225 million.

The other sales and trading line reflects negative revenues of $11 million compared with negative $286 million last quarter. Included in other sales and trading net revenue is the net positive impact of $76 million for adjustments related to certain derivative positions not qualifying as hedges of net investments in certain foreign subsidiaries.

Turning to VAR. Our average aggregated VAR by primary risk category for the quarter was $81 million versus $72 million in the first quarter and $135 million in the prior year. Period-end total VAR was $85 million at the end of the second quarter compared to $78 million at the end of the first quarter. Average total VAR was $91 million this quarter versus $84 million in the first quarter using a 4-year data series.

Turning to Global Wealth Management. Revenues of $3.3 billion were down 3% versus the prior quarter, driven primarily by lower retail activity. Asset management revenues were up 7%, benefiting from higher asset levels at the end of the first quarter. Transactional revenues declined 19% from last quarter, consisting primarily of commissions of $531 million, which decreased 16% from last quarter, reflecting low levels of client activity, Investment Banking-related fees of $223 million, which increased 9% versus last quarter, driven by particularly strong activity in closed-end funds and trading revenues of $222 million, which were down 40% versus the first quarter, reflecting markdowns in deferred compensation plans.

Noninterest expenses were $2.9 billion, down 4% from last quarter. The compensation ratio was 60% versus 62% in the first quarter. Non-compensation expenses were $918 million, flat to the last quarter. Expenses related to the integration were $79 million in the quarter and will decline from here.

Profit before tax was $393 million while the PBT margin was 12%, up from last quarter despite a decline in revenues, reflecting our expense control efforts in this business. The $61 million gain from discontinued operations after-tax includes a $108 million pretax gain from the previously announced sale of Quilter. NCI for the quarter was $81 million, up slightly from $74 million in the first quarter. NCI this quarter includes $8 million related to Quilter.

Total client assets decreased slightly to $1.7 trillion due to market depreciation. Global fee-based asset inflows were $4 billion. Fee-based assets under management declined to $526 billion at quarter end due to market depreciation but were up 6% year-over-year. Global representatives at quarter end were 16,934.

Bank deposits were $112 billion at the end of the quarter with approximately $58 billion held in Morgan Stanley banks. As James mentioned, we have reached a major milestone in this business. The integration was substantially completed 2 weeks ago when we moved the final wave of Smith Barney Financial Advisors onto the new platform. The final transition was executed on plan. In the 3 waves of legacy Smith Barney Financial Advisor and client migration that started in February, we transferred over $900 billion in assets, 7 years of transaction history comprised of approximately 2 billion documents and over 47 million client positions.

Additionally, the transition included significant training for employees moving onto the new platform, which enhances both the financial advisor and client experience.

Asset Management revenues of $456 million were down from $533 million in the first quarter, due primarily to lower valuations. In Traditional Asset Management, revenues of $337 million were flat compared to the first quarter. In Real Estate Investing, revenues of $122 million were down 16% versus last quarter. Due to the ownership structure of these funds, the majority of these revenues are passed to third-party investors in the noncontrolling interest line. In Merchant Banking, revenues were negative $3 million compared with positive $45 million in the first quarter, driven primarily by markdowns in Asia. Compensation expense was $214 million in the quarter, down from $218 million in the first quarter. Profit before tax was $43 million, down from $128 million last quarter. NCI was $23 million versus $65 million last quarter. And total AUM increased to $311 billion, driven by net inflows of $13 billion, partially offset by market depreciation.

In conclusion, results in the second quarter reflect a challenging market backdrop. We expect markets will continue to be affected by slow global growth and the challenges in the Eurozone. However, some of the more Morgan Stanley-specific issues are receding and we look forward to more business-as-usual performance. As James commented at the outset, we are further driving returns in our business through actions including ongoing emphasis on capital optimization, leveraging economies of scale and wealth management, driving further expense and headcount reduction and creating greater efficiencies in funding.

With respect to business trends in the near to medium term, we expect activity levels to remain highest in the Americas followed by Asia. We expect the challenges in Europe will continue to weigh on activity levels in the near term. However, we look forward to normalcy in Europe at some point given the strength of our franchise there. And when the discussion about outlook is more about economic growth and less about political risks, there's further operating leverage in the business. In Investment Banking, we continue to benefit from our leadership positions and have a healthy pipeline. In our trading businesses, we are becoming more effective by leveraging adjacencies across products and clients as well as investments in technology. In retail wealth management, we are pleased to have all of our financial advisors integrated on one platform.

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 Roger Freeman with Barclays.

Roger A. Freeman - Barclays Capital, Research Division

I guess -- thanks for your comments on what you think some of the sort of direct impact of the Moody's downgrade was. Have you seen -- was most of that, that you could quantify, before the actual downgrades or after and have you seen any change in behavior as the full impact of this has settled in?

Ruth Porat

So there are a couple of pieces to it. The portion that I quantified, the $225 million, came after the Moody's downgrade. So to be clear, it was associated with valuation allowances and contract adjustments. There are a couple of items we can't quantify. For example, our bankers spend a lot of time with clients and counter-parties throughout the period, addressing questions they may have had and that's time which otherwise would have been spent capturing new business. And as the quarter wore on with increasing speculation on rates, on the ratings outcome, some clients seemed to take a wait-and-see approach. So those are tougher to quantify but we certainly felt, in particular given the elongated deliberation process, that it did weigh towards the end of the quarter. Overall, with the ratings action on the sector finally resolved, we are seeing real relief and clients have reengaged. It's helpful to have that uncertainty addressed.

Roger A. Freeman - Barclays Capital, Research Division

Okay. And has there been any utilization of clients, particularly like pension funds, that are kind of more sensitive to transacting with the bank?

Ruth Porat

So if you're asking, has much gone into the derivative sub, there's not much of note. We have seen an acceleration of foreign exchange into the bank. We've seen -- we've been writing more new foreign exchange business in the bank.

Roger A. Freeman - Barclays Capital, Research Division

Okay. And then just last question on this topic. The collateral postings, it looks like you've posted a little less than half of what you're potentially obligated to. Is that just a function of the other half not having been called?

Ruth Porat

So we posted the $2.9 billion. Just to give you an update on the total collateral subject to call, it's actually a bit lower than in our first quarter Q.

We had an estimate of $6.8 billion in the first quarter. It's now ballpark around $6.3 billion. I think it's fair to say that we've been pleased with the pace of call, it's just been very measured, which, in our view, underscores that clients have comfort, real comfort, with the firm. Since the end of the quarter, in July, we've had another $800 million called. But again this pace does seem to be quite measured. We do expect more to be called going forward. Hard to forecast how much that is, but as we've talked about on prior calls, we are fully reserved for the full amount of potential collateral call and the sizing of our liquidity reserve.

Roger A. Freeman - Barclays Capital, Research Division

Right, okay. And just last question overall. The -- you talked about some of the -- some initiatives, streamlining within the units, focus on headcount. Any rough quantifications, maybe given current sort of run rates, what that -- what impact or benefit they're going to have to run rate expenses?

Ruth Porat

No.

Operator

The next question will come from Howard Chen with Crédit Suisse.

Howard Chen - Crédit Suisse AG, Research Division

James, on Fixed Income, the targets you mentioned at the beginning of the call appear like a meaningful strategic shift on the rebuild that, again, before you took the helm. The RWA targets are interesting, but it'd be really helpful to just hear exactly what and where you want the firm to be in the Fixed Income businesses today and how quickly you want to get there, and maybe what were some of the drivers of that thinking if, in fact, you agree with what I'm saying.

James P. Gorman

Sure, I'll let Ruth some of the targets on where we are and then I'll let you know where we're going to end up.

Ruth Porat

So the focus is continuing to be on fixed income optimization. As Colm and Kenny have talked about for quite some time, they focus on share capital efficiency and cost structure, and we're focused on ensuring that our footprint is consistent with what we need to do strategically. So we have a cohesive suite of products that is consistent with the strength we have across our platform, beginning with Investment Banking, what we're doing on the institutional equities side and a number of areas within Fixed Income. But there are certain businesses within the Fixed Income that may be nice to have, but they're not necessary and they're RWA-intensive and that's really what James was getting at in the reduction in risk-weighted assets that we're focused on driving. So down 15% from the third quarter to the second quarter, targeting being down 25% in aggregate by 2013 and we're really targeting active business unit management. So this essentially doubles the RWA reduction from the business. I think the other point is as we reduce more complex areas, it's not just the capital benefit, but there's a funding benefit and an expense benefit as well.

James P. Gorman

Yes, I'd just add I sort of see it as a couple of different chapters. The first was we had some legacy positions that, for the last couple of years we've had to deal with, and you have to deal with that artfully. You don't want to take unnecessary pain and we've worked our way out of those positions. I think the most significant, obviously, was the Republic of Italy and the MBIA exposures and so on. The second is that we've been building our footprint on the flow side of the business, which also has been a couple of years in the working. And the third is now adjusting the focus on particularly the heavier risk-weighted asset businesses, which we have been and increasingly have been more aggressive on and are reflective of the environment and the world as we see it going forward. We've consistently said that our focus is going to be on the flow, high-velocity, lighter risk-weighted asset businesses. And if anything, that focus has been -- the dial has been turned up on that.

Howard Chen - Crédit Suisse AG, Research Division

Okay, great. Understood, that's helpful. Just on the FID RWA reduction targets, I just want to confirm that's on Basel III basis. And then for starting point purposes, what's the FID RWA today on Basel III, Ruth?

Ruth Porat

That is on a Basel III basis and we -- what we've been doing is guiding to an overall Basel III ratio, not breaking out RWAs by business for the firm.

Howard Chen - Crédit Suisse AG, Research Division

Okay. The reason I asked, I guess, is if FID is the majority of the firm's RWA and let's just say it's $300 billion and you put 10% equity against that, that's $30 billion and that's larger than the market cap of the company today. I'm just curious, is there -- where are you, James and Ruth, in terms of more transformational thinking within the business because that just seems incorrect in my opinion.

Ruth Porat

Well I guess there are a couple of points in there. Our risk-weighted assets, obviously, are across the business, GWM, our MSIM business, in the lending business and smaller, obviously, in institutional equities. So we're trying to give you a sense of the decline in risk-weighted assets or more important strategically what we're driving within our Fixed Income business.

James P. Gorman

I would add to it, Howard. I understand exactly what you're saying. If all the risk-weighted assets and capital are tied up in that business, why wouldn't we be more aggressive? I think what Ruth is saying is it's not quite as simple as that. We have risk-weighted assets and capital tied up across the firm. That said, in the areas where it is most lumpy and has generated the least returns, we are being the most aggressive and will be increasingly so. It's a balancing act here of not throwing the baby out with the bath water. We have some great businesses within Fixed Income and we had obviously a very difficult quarter. There's no -- we're not going to hide from that in Fixed Income. It's a tough quarter and a disappointing quarter. But we have some great businesses within there and we need to manage that very, very carefully going forward, which is what we're doing.

Operator

The next question will come from Brennan Hawken with UBS.

Brennan Hawken - UBS Investment Bank, Research Division

So it was helpful to hear that the business is clearly impacted by the potential action from Moody's and given that clients have reengaged was hoping maybe you could help us think about how the quarter progressed, right? Things seem to have got drawn out by Moody's in June. And so was June particularly rough and was a lot of the impact focused in FICC? Can you help us think about just year-over-year how all of that look?

Ruth Porat

You're absolutely right. I think the elongation of the deliberation really just started to weigh on us, clients, counter-parties as it dragged on. And June, you just felt it was -- whether it was fatigue, waiting, it was -- we just certainly felt it weighing as we got towards the end of the quarter, and we're pleased that it finally was resolved. And I think it was exacerbated by the ongoing concerns about the Eurozone and just led to speculation about what the ratings outcome might be. And as I said, clients seemed to take this wait-and-see approach, but it got heavier as it ended. And finally, the third week in June finally resolved. So we have seen a real release, as I said, and it was primarily affecting the Fixed Income business. And so not only did you have the weight of kind of clients' wait-and-see plus our bankers focused on trying to ensure they had what they needed, but then the $225 million as we have the collateral at that last week or 1.5 weeks of the month come out.

Brennan Hawken - UBS Investment Bank, Research Division

Right. So if we -- I mean just looking at that sort of 9 95 [ph], assuming thats the sort of adjusted x DVA FICC for that 225, if we make assumptions that, okay, June was really weak and then we run rate that, it looks like x June, things were sort of closer to the back half of 2011. The reason I'm asking or trying to get at this is I'm trying to get at what the actual run rate really was in the quarter x this unusual onetime event, which now is -- as we all know is clearly behind you.

Ruth Porat

Right. Well, there were a couple of things. There was the macro backdrop and you've added obviously the 225 back appropriately. I think the other thing that I noted was our commodities was much weaker. It tends to be a lumpy business. We called it out on prior quarters because it's a mix of both flow and structured solutions for clients. We had a number of structured solutions for clients last quarter. We didn't have any this quarter. So the drag was exacerbated by the lower results there as well.

Brennan Hawken - UBS Investment Bank, Research Division

Okay. And then on equities, I noticed that VAR ticked up and the results were not so terrific. Were there any positional losses there, or is there any color in equities on that font?

Ruth Porat

No. Actually, VAR -- just to address that, VAR was up modestly versus last quarter. It was really more in the rates line. But I would say we're continuing to run at historically low levels. If I point you back to the same period last quarter and if you look at that line aggregation of primary risk category, so it takes out the noise from MBIA last year, we were at the $135 million of VAR last year, down to $81 million this past quarter. And so we're still running at low levels relative to the past prior years, and we think that's very prudent. That's the way we're running the business. So wanted just to make sure we were clear on that. And then with respect to equities, when you see the trading histogram for the firm overall, it moved a bit to the left, but we did not have trading losses there. We're profitable across the businesses it was just lower levels of activity.

Brennan Hawken - UBS Investment Bank, Research Division

Okay, okay. And then how about PB? Did you -- was there the similar themes to what you highlighted as far as the downgrade where there was a great deal of lost productivity and such in that business?

Ruth Porat

Actually in our prime brokerage business, revenues were up, clients were up and balances were up. And as I noted in my opening comments, revenues outpaced balance growth. So we felt very good about that business.

Brennan Hawken - UBS Investment Bank, Research Division

That's great. Okay, last one for me. If we could just get a feel for what net new assets were in the quarter and maybe if we could put in a request to reconsider disclosing that number. I know that you guys are focused on the fee-paying accounts, but just -- it'd be helpful just to get a sense of risk appetite among retail investors and the folks that are in the transactional business.

Ruth Porat

The reason we moved to disclosing managed money is that's the way Greg Fleming and the team are running the business and we think it gives you a better indication of the results in the business. So that's where we're managing it and that's why that's what we're disclosing.

Brennan Hawken - UBS Investment Bank, Research Division

Okay. Any chance to know what the net new assets were this quarter?

Ruth Porat

I don't have them with me.

Operator

The next question will come from Glenn Schorr with Nomura.

Glenn Schorr - Nomura Securities Co. Ltd., Research Division

A quick one on Commodities first. You mentioned twice the no-structured solutions in the quarter. Curious if you think that's a function of just flat out lower prices and less incentive to hedge on behalf of clients?

Ruth Porat

No, as I mentioned, it tends to be a lumpy business and this quarter there were fewer of them. We expect the forward quarters there will be some more. We're just not going to -- we don't forecast when they come. So at this point, no.

Glenn Schorr - Nomura Securities Co. Ltd., Research Division

Okay. And then I guess the broader question on FICC and apologize to both if I'm misinterpreting this. What I heard was the strategy is pretty similar to the past. You've put a lot of the legacy issues behind or if not all of them. The strategy sounds very similar. It's that you were going to run a much tighter ship on -- lower RWA and tighter on costs in FICC, which I think is what people do want. I just don't know if you had the same level of confidence in the ability to take share and grow revenues in that business. So somewhere in there is a question, I apologize.

Ruth Porat

No, there was a lot in there. Look, as I said Colm and Kenny have been focused on share capital efficiency and cost discipline. And we put in place tight governance around RWA management, so that we can drive down those RWA improvements that James articulated. And that's still with the notion, the key driving factor being what's the strategic suite of products that we need to have the strength in our core franchise. And so, again, what -- you'll see real rigor there and it's not about -- we look at the business not about how big it is, but about what's the returns in the business and are we placed and positioned where we want to be strategically. I think the other thing that we're doing is continuing to leverage not just client strength and market share positions across our franchise, but we're also leveraging what we're doing on the technology side. So there's a lot of talk about electronification in the market and we're benefiting from, for example, the leading MSET platform that we have on the equities side. And what that does is it helps both execution and analytics. So on the execution side, where we're focused -- and I've talked about this on a number of prior calls, markets with discontinuities and rapid throughput, very much in the foreign exchange market. I've talked about the increasing gains that we've had there. Derivatives also benefits. We're using or can use our MSET passport products to see what's in the SEF to place orders. And we've talked a lot about our commitment to central clearing and how we've invested there and you've seen some early wins with clients. And technology also, on the analytic side, helps improve service. So, for example, transaction cost analysis is something that we think is valuable. So what we're doing is providing clients with greater transparency and hopefully liquidity. But the main point here is we're leveraging a real asset we have on the institutional equities side to the benefit of where the Fixed Income market is going and we're rightsizing what we're doing on the Fixed Income side similarly to play off of the strengths we have within Institutional Securities.

Glenn Schorr - Nomura Securities Co. Ltd., Research Division

Okay. Last one, on comp. Obviously, comp ratios get amplified when revenues have a tough time, and this is a tough time. But it also makes me think that sometimes there's a certain floor and so let's maybe just stick with Institutional Securities. I hate using that word, but is there a certain level that comp can't really go below without something bigger happening? And maybe if you could comment on the impact of prior period deferreds.

Ruth Porat

So the way we look at comp is we look at it really again through all the levers we have to control to manage the compensation expense as efficiently as possible. We -- and so we accrue to an estimate for the full year. Obviously, we're only halfway through the year, and relatively strong quarters like last quarter we can accrue more dollars and it's at lower rates. But that shows really the operating leverage and a better environment. And then in tough quarters like this we reduce dollars and that underscores the cost discipline. But the way we think about is we want to drive returns, we want to ensure we can the pay people who are driving returns and we need to make sure that we're doing all that we can to use those compensation dollars most efficiently. That's why we talked about headcount reductions. That's why we established the Office of Re-engineering to do things like continue to drive location sourcing, moving people who don't need to be in centers like New York City to places like our Baltimore outsource location here in the States. So again, it's a number of levers that help us drive down what's that fixed cost component of it and how do we manage overall the compensation expense.

Glenn Schorr - Nomura Securities Co. Ltd., Research Division

Okay. Just one last important one is, your Basel III is better than everybody else for the most part. How will you use that to benefit you? In other words, you're going through the process with MSSB now. There's going to be a price whether you agree on it or it goes through arbitration. How do you balance accelerating the rest of MSSB or buying back stock if it has a tangible book? What's a better Basel III going to do for you?

Ruth Porat

We think what a better Basel III and strong capital ratios do for us now is underscore the strength of the franchise. What we've done with capital and what we've done with liquidity are both, as I've called them in the past, really a fortified foundation and that's a positive for the firm. We think that, over time, that will continue to give us greater flexibility with options to return capital to shareholders in -- with the kind of uncertainty in the macro environment. I think where we are today is very prudent and with the strategic opportunity in front of us, as you said, we have the immediate use of capital. But overall, accreting capital gives us degrees of flexibility.

Operator

The next question will come from Kian Abouhossein with JPMorgan.

Kian Abouhossein - JP Morgan Chase & Co, Research Division

Could you just briefly discuss NPR2. If that's on an internal basis or standardized basis? And within that risk-weighted asset Basel III, Basel 2.5 framework, can you also maybe give us a bit of an indication of how large your market risk-weighted assets are at this point considering the rules are finalized?

Ruth Porat

Sure. So there's a lot in that question as well. Why don't I start with, first, building up our spot in 2012 Basel III and then I'll go to the standardized approach and hopefully can get most of your questions in that. What we try to do is guide conservatively based on our best estimates of the rules as they continue to evolve. So at the end of the first quarter, we guided to a spot of 8% to 9% and obviously the Basel 2.5 rules weren't final at that point. And as I said then, the high end of the range assumed the international version of Basel 2.5 and the low end assumed our best assessment of the most likely worst case interpretation of Basel 2.5 NPR. And with 2.5 now done, codified, we ended up essentially in the midpoint of the range. But since then, the Basel III NPR rules were also introduced and we're focused on both the numerator and the denominator and that's what led us to our best estimate for spot, at the end of the second quarter was just under 8.5%. And as I said, that's full Basel III inflation, no mitigation. In other words, our second quarter earnings were more than offset by our assessment of the change in rules under Basel III NPR and that flows through as we roll forward to the end of 2012, approximately 9% by year-end 2012. And then, as it relates to your question about the standardized approach, I think there are 2 questions that keep coming up on standardized approach, one being about the Collins floor, and we are well above the minimum, which is obviously what the test is about. But I think, what you're really getting at is the impact on the correlation book under CRM model approval. So assuming we had model approval, our Tier 1 common ratio would be about 40 basis points higher assuming the book remains the same size it is as at the end of the second quarter. We are obviously working hard to get model approval, but we have not included the benefit of model approval in the numbers we've given you given the timing around -- even when you receive here our model approval, you have to wait a year to see the benefit. So to the extent -- I leave it to you whether you add that 40 basis points onto the guidance that I've given you, but we did not include the 40 basis points in our guidance.

Kian Abouhossein - JP Morgan Chase & Co, Research Division

That's very detailed. The second question is regarding CVA. You mentioned you have another $800 million of -- first of all, the $2.9 billion of collateral that you have to put up, can I put that in relation to the $225 million CVA charge and can I then use that to, very simplistically, say, okay, there's another $800 million that you've done on the third quarter, maybe that's even going up, i.e., it's something like $13 million -- for every $13 million of collateral you're putting up roughly $1 million of CVA. Should we assume basically further CVA impact in the third quarter? And what I'm doing, is that correct, $225 million where there's $2.9 billion?

Ruth Porat

Well, the most important point is that we're working to risk-mitigate any additional impact. And so I don't want to suggest there that you can do this straight-through extension. I think your proxy looking at the $225 million relative to the $2.9 billion, I'll leave that to you. But it's not all a valuation allowance. As we said it's a valuational -- it's primarily a valuation allowance. There were some contract adjustments, so it's a bit less than what you've looked at there.

Kian Abouhossein - JP Morgan Chase & Co, Research Division

And should you move to CCP some of the collateral? I assume you still have to put up CVA so far based on the proposal so far. So that shouldn't really help you. What I'm trying to understand is how could you mitigate this additional -- the additional charges?

Ruth Porat

Yes, we're working through a number of different execution paths there.

Kian Abouhossein - JP Morgan Chase & Co, Research Division

Okay. Lastly, on FICC. I hate to come back to that question of the risk-weighted asset reductions. The way I understand is you want to reduce capital-intensive businesses. These are normally your strong business, i.e., if I look on the Basel III and 2.5, that's commodities and credits, which historically was -- in FICC, have been your strong businesses. Can you talk a little bit about the revenue impact? And can you be maybe a little bit more specific also on the impact -- does it -- is it actually exiting certain business lines within these areas? Or is it maybe some geographical impact that we should be expecting from this?

Ruth Porat

We've highlighted in the past the areas that are heavy RWA and actually can be heavy funding requirements as well, but heavy RWA that aren't within that very tight strategic circle that I talked about, that James talked about. And they would really include structured credit and sub-investment grade securitization so we're still -- we have -- we're still active in various parts of the mortgage market. But there are parts of it -- some investment grade where we can reduce what we're doing, structure credit the same. I would say that commodities and credit, as you've indicated, are strong business is credit, being one of our strongest and very central to that strategic circle I talked about and similarly commodities has had strength over many years. So I'll point you back to prior comments consistently regarding the other areas.

Operator

The next question will come from Matt Burnell with Wells Fargo.

Matthew H. Burnell - Wells Fargo Securities, LLC, Research Division

The first question I have relates to the drop in corporate lending commitments. I'm just curious as to -- if you can provide some color as to what's going on there. Does that imply a substantially lower risk appetite, or was there a specific transaction that got done? Or could you provide some color on that?

Ruth Porat

No, we have continued lending. I think that what I'd point you to is our growth in HFI -- and I want to make sure you're looking at the entire picture, we have been increasing HFI balances. They're up meaningfully about 40% of our lending book now. I don't want to suggest that the rate of growth you've seen in the first half of the year is what you'll continue to see. We obviously moved to HFI. And I think that's Page 8 in the supplement. If you look at the 2 pieces combined, you'll see that we continue to be active there. And as James said, we're very pleased with what we're able to continue to do with our partner, MUFG, and there's a real power to the combination through our lending activities together.

Matthew H. Burnell - Wells Fargo Securities, LLC, Research Division

I would just like to follow up on the higher value at risk in terms of the interest rate and credit spread numbers. Is there -- was that due to volatility in the quarter, or was there something else going on there? Sorry for reiterating an earlier question, but...

Ruth Porat

No, that's fine. It's really just due to the mix of client activity and market volatility. But again, I'd point you to where it has run over the prior 3 years and it continues to be -- we continue to run it at lower levels.

Operator

The next question will come from Mike Mayo with CLSA.

Michael Mayo - CLSA Asia-Pacific Markets, Research Division

I'm just trying to reconcile 2 of your goals; one goal from, at least, last year, if not more recently, is to increase the market share in the Fixed Income trading business from 6% to 8% and reconcile that with the new target to reduce risk-weighted assets by 30% by the end of 2014. If those 2 goals collide, which one is more important?

Ruth Porat

Well, as I said, we're focused on share and capital efficiency and cost discipline, and we're continuing to drive share and share growth in areas that stay within that strategic circle. I keep coming back to that term for lack of a better one. But, for example, our rates business was up year-over-year. We've invested in it, it's a core part of the franchise. Corporate credit, as we have already talked about, is a key part of the business. So when we're looking and defining the businesses that are RWA-heavy, and in fact, it very much goes to the opportunities that we see in other areas, then it's about increased balance sheet velocity, which Colm and Kenny and all of us have talked about for quite some time that we're driving in our flow business. And so returns are most important. We're not going for size for size's sake, but we see that in the areas in which we're competing, we have opportunity for additional share growth and that's what we're driving, again leveraging the strength across Institutional Securities.

Michael Mayo - CLSA Asia-Pacific Markets, Research Division

So a little bit of an evolution, more toward returns as opposed to growth?

Ruth Porat

That's probably fair to say.

Michael Mayo - CLSA Asia-Pacific Markets, Research Division

And then I'm looking at Page 5 of the supplement. And you have $22 billion of your Tier 1 capital allocated to Institutional Securities. That's a little bit over 1/2 of the total firm. And my question is when it comes to trading businesses or Fixed Income trading businesses, are you reducing risk-weighted assets enough? I mean you're penalized by the regulators, you're penalized by the rating agencies, you're probably penalized by investors to some degree. And a lot of these securities will be traded electronically, if everything goes to plan. So why not reduce the risk-weighted assets more dramatically?

Ruth Porat

And that is what we're doing. As I said, we have governance around driving risk-weighted assets down. We're going to continue to drive them down while, again, balancing what we believe drives the greatest returns for all of our stakeholders going back to A, what's the strategic lens; and B, what else can we be doing leveraging technology and other strengths in the business. But we are very, I think, consistent with what you're asking, driving RWAs down and have a governance process around that to deliver lower RWAs where we don't -- where we feel it's most appropriate.

James P. Gorman

And I think, Mike, I mean what becomes dramatically if we're down 30% from the third quarter of '11 in risk-weighted assets by the end of '13, that's obviously a very significant shift. We've taken a lot of capital out of the merchant banking businesses and we'll continue doing that consistent with the Volcker Rule. All the prop businesses that we've exited, few little stakes that we have in different pieces that have been floating around, the strategic investments made every -- part of the last decade or so we've been slowly working our way out of, but we don't want to do it where we're taking unnecessarily damage -- unnecessarily damaging ourselves. So there is underneath this, if you aggregate the pieces, I would argue a pretty significant transformation. But we've also got to be mindful, as I think you pointed out earlier, we're balancing obviously revenues in some very strong businesses within Fixed Income and sales and trading with exiting on a prudent, sort of not patient, an aggressive timetable, but not a reckless timetable.

Michael Mayo - CLSA Asia-Pacific Markets, Research Division

And then last follow-up. So if Institutional Securities takes up 1/2 of your capital today, where do you think that might be 3 to 5 years from now, a fourth, a third?

James P. Gorman

I don't know you whether we want to wing that.

Michael Mayo - CLSA Asia-Pacific Markets, Research Division

But less?

James P. Gorman

Yes, obviously. The capital makes it look whole corporation's coming down. We hold a lot of capital at the parent level where, as Ruth pointed out under Basel III, we're, I guess, a tad below or somewhere below 8.5. We feel like on any comparative measure -- I mean it's one thing to have to go and raise capital and maybe have high returns in the short run versus having low returns and having the capital already in-house, and that's the position we're in. And over time, as we restructure, bring down the risk-weighted assets, obviously we'll get much more active on the capital management side, which is what something I know all shareholders, including us, are looking forward to doing.

Operator

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

Michael Carrier - Deutsche Bank AG, Research Division

First on the MSSB business. If the integration costs are going to start coming down in the next couple of quarters, does anything change on your margin outlook? And I guess, more importantly, you mentioned a lot of other things kind of outside the U.S. that you're working on, I mean using the U.S. as generating more efficiencies. So does anything change if we're still in this rate environment? Or do you still need rates and market as a tailwind to get to that longer-term 20%?

Ruth Porat

So the mid-teens margin by mid-next year is the -- we're still on track for that and that was predicated upon the integration being done and integration-related expenses coming off, so there's no news in that. The discussion we have -- are having regarding what we're doing with our International Wealth Management businesses are modestly additive to that mid-teens by mid-next year target. And as we look at the longer-term higher target it's still predicated on a lift from rates or equity markets. As we've talked about 50 basis points in said funds is 1 point on PBT margin, and at some point, rates will revert to the mean. So that is still additive. But that is how we build it up over time. Still very much on track and the International Wealth Management is modestly additive.

Michael Carrier - Deutsche Bank AG, Research Division

And then on the expenses. As part of that reengineering effort, the $1.4 billion, does that take into consideration everything that you're talking about on the fixed side in terms of reducing the risk-weighted assets, reducing the cost or would that be incremental? And then on top of that, just given the environment and given that $1.4 billion kind of target through 2014, has anything changed to force that up or anything more material?

Ruth Porat

So the Office of Re-engineering was set up quite some time ago to look at reengineering bigger parts of the business like what are we doing with technology structure and outsourcing or legal entity consolidation, things like that. We're very much on track for the $500 million run rate excess from this year and $1.4 billion that we talked about. What we've discussed today and the benefit of this incremental drive on non-comp expense is additive to the Office of Re-engineering. So I think a simple way to think about it is there's the Office of Re-engineering. There are the ongoing tactical expense initiatives that we've talked about and this adds -- the added drive on non-comp, comp-related items adds to our savings. And to be clear, in the Office of Re-engineering there is a component that's compensation and non-compensation related because we're fundamentally reengineering certain parts of the business. But the items that James went through this morning are additive.

James P. Gorman

And I think that, to be fair, the bar for incremental expenses for things that are not obviously investments driving really visible revenues is extremely high. We're -- like everybody else in the banking industry at the moment, there are a limited number of things you can control about the external environment. So we're controlling what we spend very carefully, and we'll continue to so.

Michael Carrier - Deutsche Bank AG, Research Division

Okay. And then last question, 2 items that are typically unforecastable. But the other sales and trading just x the adjustment this quarter expect to go back to that run rate loss? And then on the tax rate, same thing, a bit lower? A lot of moving pieces this quarter but expect it to go back to more -- a normal level?

Ruth Porat

Well, as you said, the other sales and trading is hard to forecast because there are a lot of different items in that line item. With respect of the tax rate, I can hopefully give you a little more guidance although the tax rate's obviously a function of geographic mix. But we would guide to still approximately 30% in the third quarter. But as I said it's a function of geographic mix and the second quarter was affected by the estimate of full year DVA, so that moves around as well. But best estimate at this point, for what it's worth, is 30%.

Operator

The final question will come from Douglas Sipkin with Susquehanna.

Douglas Sipkin - Susquehanna Financial Group, LLLP, Research Division

Just wanted to focus in a little bit more on the Global Wealth business. Looks like it's a little bit trickier quarter for some of the metrics. The brokerage headcount, and I guess, the percentage of assets with -- the percentage of brokers with wealthy clients. How much of this is sort of related to sort of this sort of being the final integration? Or I mean is there something else that maybe you guys can address, or was it really just sort of the all the uncertainty around the ratings and things like that? If you could address that, that'd be helpful.

Ruth Porat

Thank you. So we've talked over the last several quarters about focusing on the quality rather than the quantity of financial advisors. And the number is down this quarter, but again consistent with that strategic prioritization. Where we really focus is what's the retention of our top performers and the attrition in our top 2 quintiles is consistent with prior quarters, which we view as a positive, very much to your question about the impact of platform integration. Given the low attrition while going through platform integration we do view that as a real positive because human nature is people don't like change. The way the team is managing it is to do what they can to increase the productivity of financial advisors, and I think one very good example is the way they restructured the training programs. So we have reduced the number of trainees, incoming trainees, from 2,000 down to 1,250. And the view is that, that does quite a number of things for us. One, it raises the bar on the group that we bring into train. It allows us to do a much deeper job training them. We attach them to mentors and branches. And overall, we've seen a 30% increase in the success rate. So reduce the incoming number of people, not only is that helpful overall for the incoming people but -- and their productivity, but also non-compensation expenses benefit because we have fewer people coming in. But this is just an example of the types of things we're doing to focus on productivity and quality rather than the number. And in terms of the AUM for the $1 million-plus that you noted, what we see is kind of more seasonal pattern that anything. It's drifted down in the last several years in the second quarter as well.

Douglas Sipkin - Susquehanna Financial Group, LLLP, Research Division

Okay, great. And then could you guys provide any more specifics about guidance around integration charges for the remainder of the year? I know you guys mentioned it'd be coming down, but could you put any hard numbers do that in either Q3 or Q4 or just for the second half?

Ruth Porat

Well, historically they were running in the $80 million to $100 million area. It was $80 million in the second quarter. It does decline -- I'm not going to do a flag quantifying what that will be in the third or fourth quarter. But it comes down through the next several quarters for the obvious reason, done with integration. But we are running a number of things in parallel. So for example, data retention, we're continuing to keep people employed to ensure we're doing the right things with respect to data quality. We're also continuing training in the field. And we also have software capitalization kicking in. So we've got a number of additional items that's somewhat down.

James P. Gorman

I think just to add to that, that the mix, as Ruth said, is changing from building the technology to training the people to use it to capitalizing the software that it's based upon. So that's sort of a mix change. And I think the third quarter, obviously with the transaction we'll be doing with Citibank, will be a little messier as we get through that, but the outlook is clearly the mix change and the volume change.