Good morning. This is Celeste Brown, Head of Investor Relations at Morgan Stanley. Welcome to our fourth quarter earnings call. Today's presentation may include forward-looking statements, which reflect management's current estimates or beliefs and are subject to risks and uncertainties that may cause actual results to differ materially. The presentation may also include certain non-GAAP financial measures. Please see our SEC filings at 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 Chairman and Chief Executive Officer, James Gorman.

James P. Gorman

Thank you, Celeste. Good morning, everyone. As we say goodbye to 2011, we are happy to report that our prospects are much better going forward than they have at any point since I became CEO 2 years ago. Let me briefly review the year and share our outlook.

We know -- as you all know, we had a disappointing start to 2011 when we suffered a considerable loss in the Japanese joint venture. However, it proves to be a positive catalyst because it helped MUFG and ourselves reevaluate our partnership and determine that we should take steps to align the 2 companies more closely. The result was the creation of what I believe is one of the most exciting partnerships in the global financial services industry. The partnership bore abundant fruit in 2011, including the conversion of the preferred into common; the elimination of the preferred dividend, and now MUFG equity counts through our earnings; MUFG now has 2 board seats; the enhancement of a loan marketing agreement for the Americas; and we're continuing to look for other ways to expand this partnership around the world. All of these show our commitment to each other for decades to come in good times and in bad. Now taking you through this in detail, because I believe our deeper relationship is perhaps the most underappreciated of all the strategic moves that have taken place.

On the business front, we had terrific progress against our goals in 2011. In particular, look at equities. The growth in our share in equities, where we increased wallet significantly, with a more than 300 basis point increase in the first 9 months.

We grew share in Fixed Income. We also increased our wallet share in this business, as has been our focus, while deemphasizing certain parts of securitized products and other Basel III capital-intensive areas.

We grew our share in Investment Banking capital markets, where we achieved 100 basis point improvement in overall wallet share and significant positions in all of the rankings. We improved our margin and flows in Smith Barney.

While margin improved modestly for the year to 10%, net managed flows were the highest since the inception of the JV at $43 billion.

We are now moving to the final stages of integration of MSSB. Our technology platform will be fully integrated this summer.

We revitalized MSIM, which is evident in the flows in that business for the year and our momentum exiting the fourth quarter after several years of outflows.

Finally, we restored Research through its preeminent place in the industry, where we have seen improved Greenwich rankings and II rankings through the year.

On the organization front, we sought stability in management and a successful transition among our senior team. That has been done.

On the legacy front, we resolved the last major significant issue for us, MBIA, which was settled through the difficult decision to take a loss of $1.7 billion. But most importantly, in the process, we freed up approximately $5 billion of capital pro forma under Basel III.

We also continue to tightly risk-manage our exposure to the periphery, with exposures before hedges well below where we ended the third quarter. Ruth will review this with you in detail in a minute.

In addition, we've reshaped our balance sheet. Consistent with our commitment to you when I took this job, we exited 2011 with no outside risks and have fortified with a much stronger balance sheet.

With regards to compensation, 2011 represented a high-water mark for our deferrals due to the unusual aggregation of prior periods into this year. We are acutely aware of the impact of deferral decisions on future periods. But with the last year behind us, we will have more flexibility in the years to come.

Ruth will address the meaningful progress we made with respect to capital, funding and liquidity. But let me end with a few brief comments. First, this management team was determined to clear the decks of significant legacy issues and material exposures from 2008 and prior years. And we have done that. For the first time in 2 years, our to-do list is not our problem list, and we can focus our energies on enhancing our franchise. Second, this management team is determined to gain share in the businesses we have chosen to remain in, and we are doing that. In addition, we're assuming we come to acceptable terms, we would look to purchase the next 14% of MSSB.

Finally, this management team is resolute in its goal to generate acceptable and clean returns in quarters and years ahead. The recent decision to execute a reduction in force of 1,600 employees, as well as the ongoing reshaping of Fixed Income, are examples of important steps to achieving better performance on a sustainable basis.

We cannot control the accounting noise of DVA, the movement of counterparty spreads, the capital requirements imposed by our regulators or the evolving Dodd-Frank regulatory framework. However, there is a tremendous amount that we can and do control, and we will remain nimble, highly focused and disciplined in doing so. 2011 was a very difficult year for the markets and for the financial services. We are very glad to have it behind us. Although the markets remain fragile, Morgan Stanley is dramatically better positioned than it was just 12 months ago.

With that, I'll now turn over to Ruth to take you through our earnings in greater detail.

Ruth Porat

Good morning. As James said, we are particularly pleased this quarter with the steps we have taken to address legacy issues and position the firm for the future. Given the magnitude of the loss associated with the MBIA settlement, a $1.7 billion reduction to revenue and approximately $0.59 to EPS, to simplify comparisons to prior periods, I will provide reported numbers but then also provide certain amounts excluding the impact of the loss to help with comparability. Additionally, I will provide data with and without the impact of DVA.

Our firm-wide revenues for the fourth quarter were $5.7 billion, down 42% sequentially on a reported basis and down 15% when excluding DVA in both periods. DVA in the quarter was $216 million. Excluding the MBIA loss and DVA in both periods, revenues of $7.2 billion in the fourth quarter were up 12% over the third quarter. Our noninterest expenses were $6.2 billion, virtually unchanged from last quarter. The firm-wide compensation ratio was 67% in the quarter compared to 37% in the third quarter. Excluding the effect of DVA in both quarters and the MBIA loss this quarter, the ratio was 53% in the fourth quarter versus 57% in the third quarter. We expect to incur $150 million of severance expense due to the recently completed reduction in force that James mentioned.

Non-compensation expenses were $2.4 billion, down 6% from last quarter. Although we have historically experienced a seasonal increase in non-compensation expenses in the fourth quarter, firm-wide discipline resulted in the sequential and year-over-year declines.

Overall for the quarter, income from continuing operations applicable to Morgan Stanley was a loss of approximately $227 million. Net loss from continuing operations per diluted share was $0.14 after preferred dividends. DVA positively affected our results by approximately $0.06 per share. And as I mentioned, the MBIA loss negatively impacted our results by $0.59 per share. Period-end shares outstanding were 1.93 billion, while our diluted average shares outstanding were 1.85 billion. Book value at the end of the quarter was $31.42 per share and tangible book value was $27.95 per share.

Turning to the balance sheet. Total assets were $750 billion at December 31, down from $795 billion last quarter, reflecting lower client activity. The liquidity pool was $182 billion at the end of the quarter and has remained at or above those levels, even after paying down $2.5 billion of debt in early January. Although our calculations are not final, we believe that our Tier 1 common ratio under Basel I will be approximately 13% versus 13.1% in the third quarter, and our Tier 1 capital ratio will be approximately 16.6% versus 15.1% in the third quarter. Risk-weighted assets under Basel I are expected to be approximately $316 billion at December 31. The change in RWAs from last quarter reflects the impact of the MBIA settlement, our move away from RWA-intensive businesses and the reduction in the balance sheet.

You'll note that our Tier 1 common ratio under Basel I is down slightly from last quarter despite the significant reduction in our RWAs. This was driven by 2 adjustments to Tier 1 common. First, the dilutive impact of the MBIA transaction under Basel I, as we indicated when we announced the MBIA settlement. Second, a release by the Federal Reserve in December in which the regulatory definition of Tier 1 common capital was formalized to require the reduction of goodwill and nonservicing intangible assets associated with non-controlling interests. This means that we deduct $4.2 billion of goodwill associated with MSSB and NCI. There is no impact to our Basel III ratios from this change because our current and future estimates of Basel III capital reflect the deduction of NCI.

We continue to build our Tier 1 common ratio under Basel III, which was approximately 8% pro forma as of the end of the fourth quarter. Assuming full Basel III inflation of RWAs, no benefit from mitigation and unfavorable treatment of NCI. In addition, we expect to have a Tier 1 common ratio under Basel III of close to 10% at the end of 2012, reflecting passive mitigation driven by position rolloffs and consensus earnings.

Now turning to our businesses in detail. In Institutional Securities, reported revenues of $2.1 billion were down 68% from last quarter, including the $1.7 billion negative impact related to the MBIA loss that flowed through our Fixed Income business. Excluding the impact of DVA in both periods and the MBIA loss this quarter, revenues were up 20% sequentially. Noninterest expenses were $2.9 billion, down 4% from the third quarter. The compensation ratio was 75% in the quarter. Excluding the impact of DVA and the MBIA loss, the ratio was 43%. Non-compensation expenses declined 10%. The business reported a pretax loss of $779 million.

Turning to Investment Banking. Our results reflect our strong market positions against the backdrop of generally low market activity, resulting in revenues of $883 million, up slightly versus last quarter. At the end of the fourth quarter, according to Thomson Reuters, Morgan Stanley ranked #1 in global completed M&A, #2 in global announced M&A and #2 in both global equity and global IPOs. Notable transactions included Kinder Morgan's $39 billion acquisition of El Paso Corporation, Groupon's $805 million IPO and Amgen's $6 billion investment-grade debt offering.

Advisory revenues of $406 million were roughly flat to the third quarter as higher revenues in the Americas offset lower results in EMEA. Equity underwriting revenues were $189 million, down 21% versus the third quarter, driven in particular by lower activity in Europe.

Fixed income underwriting revenues of $288 million increased 36% from last quarter. Results primarily reflected a higher loan syndication activity and investment-grade bond revenues.

Equity sales and trading revenues of $1.3 billion included negative DVA of $23 million and were down 36% versus last quarter on a reported basis. Excluding DVA, revenues were down 5% sequentially and were up 8% from a year ago.

Although market volumes and liquidity declined in the fourth quarter with the Eurozone crisis weighing on client activity, our client revenues remained relatively resilient, and we successfully navigated the turmoil. The fourth quarter results capped a strong year overall for the equities business. Specifically, cash equities and electronic trading volumes, in particular, outperformed broader market volumes. After 3 sequential record quarters, derivatives were down in a seasonally weaker period. Prime brokerage revenues similarly reflected typical fourth quarter seasonality and lower market levels in the quarter. The number of clients remained unchanged from the prior quarter and up from the prior year.

Fixed Income and Commodities sales and trading negative revenues of $257 million included positive DVA of $239 million and the negative $1.7 billion impact from the MBIA loss. Revenues were down 107% on a reported basis. Excluding DVA in both periods and the MBIA loss this quarter, revenues were up 13% versus last quarter and up 52% versus a year ago. We continue to increase share in our focus areas and position the business for Basel III. The investment in our rates franchise maintained its momentum with revenues up modestly sequentially and up materially year-over-year. FX results were modestly lower than last quarter and up significantly year-over-year.

Our credit businesses recovered from a weak performance in Q3 but were still down materially versus the year ago. Commodities revenues were lower due to unseasonably mild Northern Hemisphere temperatures and slower global GDP growth. Results in the Fixed Income business were positively affected by the release of credit valuation adjustments due to the restructuring of certain peripheral exposures. The other sales and trading line reflects revenues of $83 million versus a loss in the third quarter.

Turning to VAR. Average VAR decreased from $130 million in the third quarter to $123 million this quarter using a 4-year data series. Period-end VAR declined from $143 million at the end of Q3 to $87 million at the end of Q4. Total trading VAR was down at period end in large part due to the MBIA settlement closing towards the end of the quarter. Related positions were captured in credit portfolio VAR. Our average aggregated VAR by primary risk category for the quarter was $66 million versus $93 million in the third quarter, reflecting reduced activity, particularly in credit products.

Global Wealth Management revenues of $3.3 billion were roughly flat to the prior quarter, in a period marked by low client volume and a headwind of lower market levels at the end of the third quarter. Specifically, Asset Management revenues were down 7% because fees are based on asset levels at the close of the prior quarter. GWM's Investment Banking-related fees were relatively flat to last quarter, in line with the firm's underwriting revenues. Trading revenues were up significantly versus Q3, primarily driven by markups in deferred compensation plans, although it is important to note that this increase was offset nearly 1-for-1 in the compensation expense line. Commissions were down 6% from last quarter, reflecting reduced levels of client activity. The other revenue line includes lower realized AFS gains compared to the prior quarter. Net interest was up 12% sequentially, attributable to the continued buildout of our lending business and performance of our investment portfolio. Noninterest expenses were $3 billion, up 4% from last quarter.

The compensation ratio of 64% in the quarter continues to be driven primarily by the formulaic payout grid but was elevated this quarter by the revenue mix, certain year-end adjustments and severance charges. Non-compensation expenses were $932 million, up from $896 million in the third quarter, reflecting seasonality and more normalized FDIC expenses, as I mentioned on our last earnings call. Integration costs were approximately $73 million in the quarter.

Profit before tax was $244 million, while the PDT margin was 8%, which reflected the revenue mix and the expense movement I mentioned. NCI for the quarter was $16 million, down from $52 million in the third quarter. Total client assets increased to $1.6 trillion due to market appreciation and net asset inflows of $6 billion in the quarter. Global fee-based asset flows were $4.9 billion. Fee-based assets under management grew to $496 billion at quarter end, up 6% year-over-year. Global fee-based asset inflows for the full year were $43 billion, the highest since the inception of the JV. We are focused on growing this portion of flows because they enable to us deliver the best of our content to clients while building stable fee revenue and are more relevant to the economics of the business.

Global representatives at quarter end were 17,156, down just over 130 sequentially. In preparing for the move of Smith Barney advisors onto the new platform, we reviewed and harmonized role definitions for Morgan Stanley and Smith Barney FAs, resulting in an increase of approximately 500 in the FA count as shown in our supplement as global representatives adjusted. Our disclosure going forward will provide the FA count using the new methodology. Turnover in our top 2 quintiles was at the lowest level since the fourth quarter of 2009. Bank deposits were $111 billion at the end of the quarter with approximately $56 billion held in Morgan Stanley Banks.

Turning to Asset Management. Revenues of $424 million were up from $205 million in the third quarter, due primarily to markups in the Merchant Banking and Real Estate funds this quarter versus sizable markdowns last quarter. In Traditional Asset Management, revenues of $290 million were flat to the third quarter. In Real Estate Investing, revenues of $111 million compared favorably to the prior quarter, which included markdowns on investments. Given the ownership structure of these funds, the majority of these revenues are passed to third-party investors in the non-controlling interest line. In Merchant Banking, revenues of $23 million were up from third quarter results, which included markdowns related to declines in global markets.

Compensation expense was $183 million in the quarter, up from $132 million in the third quarter, driven primarily by favorable markups in deferred compensation plans. Profit before taxes was $78 million. NCI was $44 million versus negative $18 million last quarter, again reflecting markups in funds versus markdowns in Q3. Total AUM increased $19 billion sequentially to $287 billion, driven by net asset inflows of $15 billion and market appreciation. Net asset inflows included $8 billion of net inflows into AIP funds, leveraging both the institutional sales force as well as the MSSB platform and $7 billion of net inflows into liquidity funds.

With respect to our exposures in the European periphery in France, we have provided updated and expanded disclosure in our earnings supplement. Specifically, we added a column for unfunded commitments, which are now included as a component of our exposure before hedges and our net exposure. Previously, we disclosed unfunded commitments in a footnote.

For the most part, the unfunded commitments and the exposures excluding the unfunded commitments are consistent with the prior quarter. The notable change is with respect to Italy. In December, we began to restructure certain derivative positions and amendments to those positions settled in January. As a result, our Italian exposure was higher at year end relative to the third quarter. However, as we highlight in the footnote to our exposure schedule, upon settlement in early January, the exposures declined materially. Thus, the data in the footnote most accurately reflect our positions post settlement. Following settlement of the restructuring and excluding the unfunded commitments, our comparable exposure to last quarter for the periphery are $4.3 billion before hedges and $2.3 billion net of hedges. For France, our comparable exposure the last quarter are $1.7 billion before hedges and less than $100 million net of hedges.

In conclusion, I will end where James started. We are focused on that which we can control. The markets continue to be affected by ongoing uncertainty in the Eurozone. However, the strategic steps that we took in 2010 and 2011 cleared out legacy positions and enabled us to focus our attention on building on the momentum we have across our businesses. Notably, these strategic steps have both a P&L benefit as well as a balance sheet benefit, reducing our funding needs. Our banking pipeline is healthy globally. Our equity business continues to distinguish itself. Our Fixed Income business is on its way to reestablishing itself as a market leader in the areas we have targeted, where we continue to focus on capital efficiency and balance sheet velocity. Our Wealth and Asset Management businesses begin 2012 well positioned to leverage 2011 flows, the highest in some time for both businesses. The steps we took also fortified our capital ratios, beginning in the first half of the year with the MUFG equity conversion and ending the year with the MBIA settlement, providing additional capacity to deliver for our clients.

Our strategic moves have resulted in diversification of our funding sources, allowing us significant degrees of freedom. Because of our increased funding diversification, our plain vanilla debt issuance should be meaningfully lower than last year as we benefit from efficiencies available from additional channels, such as we have $66 billion of wholly owned deposits across the firm, a benefit of our MSSB joint venture. Deposits are an attractive source of funding, not only for our loan book but increasingly for certain derivatives, which we are moving into the bank consistent with new regulations, including Dodd-Frank.

Our relationship with MUFG opened a new funding channel for the firm. We issued Uridashi bonds through our joint venture in Japan in the last 2 quarters. With our ongoing shift to more liquid flow businesses, we reduced the number of assets that require unsecured debt funding or what we refer to as cash funding per our asset liability management governance. And we have incremental flexibility in our liquidity pool because our rolling 12-month maturities will be $10 billion lower at the end of the first quarter versus the peak in September of 2011, thus lowering our funding needs by a portion of that amount.

Now in 2012, with legacy problems behind us, we are relentlessly focused on maximizing the return levers of our franchise. We have momentum in our businesses. We have and will continue to show discipline with lower noncomp expenses and have our peak compensation deferrals behind us.

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

Question-and-Answer Session

Operator

[Operator Instructions] And the first question will come from Guy Moszkowski with Bank of America Merrill Lynch.

[Technical Difficulty]

Operator

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

Howard Chen - Crédit Suisse AG, Research Division

James, your comments on capital management seemed more definitive on proceeding with the first phase of the buy-in, where previously it seemed you were a bit more open to kind of buying back the stock. Am I reading that correctly? And if so, what's driving that change in thinking?

James P. Gorman

Well, I think, listen, the first tranche is only 14%. It is a core plank in our overall corporate strategy, which we've made very clear. We're very happy with the business. I know the margins aren't where we'd all hope they'd be at this point. But the stability of the revenues, the stability of the asset flows and the stability of the managed money gives us great confidence in the business. And frankly, we're getting close to the end of the integration period. So in a tradeoff between sort of financial management being a short-term decision around buybacks versus a long-term strategic management bides [ph] us on the long-term strategic management, which is the first tranche of the purchase. Now all of that said, it's subject to price and it's subject to an appropriate price at fair market value. So if we felt that we couldn't come to appropriate terms, we wouldn't move ahead with it. We have no problem with that.

Howard Chen - Crédit Suisse AG, Research Division

Great. And what about both? Would it be a disappointing outcome if you had to choose between either doing the first phase or repurchasing the stock this year?

James P. Gorman

Listen, from my perspective, you'd take these things sequentially. I think that you have plenty of opportunities to move forward with buying back stock, raising dividends or buying the remainder of Smith Barney. And what we have tried to do, as a firm over the last couple of years, is be very steady and methodical and take one step at a time.

Howard Chen - Crédit Suisse AG, Research Division

Great. And then in equities, you both highlighted the share gains within the business over the recent year quarters. But could you just elaborate on what businesses and/or regions have been the primary contributors and how sustainable you believe those share gains to be?

Ruth Porat

So we've had actually strength globally and across the products, as I noted, and are pleased with the strength of the global team. I think that as we've gone through the year, you've heard it on both the banking side and the sales and trading side, given the ongoing overhang of issues in the Eurozone, that's been a more challenging market, but real breadth across -- around the globe.

Howard Chen - Crédit Suisse AG, Research Division

And then Ruth, quick one on the numbers on that $600 million crystallized CVA gain this quarter. Can you help quantify what losses to date were on those exposures prior to this quarter's gain?

Ruth Porat

I don't have that. But that is, as you characterized, it's a reversal of prior losses that have bled through the P&L.

Howard Chen - Crédit Suisse AG, Research Division

Okay, finally. And then I know it's early in the year, but could you just give a flavor for how businesses is progressing? One of your peers mentioned yesterday, business was about the same as the beginning of last year, and wanted to get your thoughts on that.

Ruth Porat

Well, with the caveat that it is -- 2 weeks is not a quarter, I would say that we ended the year feeling better about the state of the markets. There's a lot of cash on the sideline from clients. Our banking pipeline is very healthy. The equity new issue pipeline, in particular, has been on hold for quite some time, given the volatility in the market last year. The M&A pipeline is healthy. So with that very large caveat that 2 weeks is not a quarter, it's feeling a bit better. But I come back to that point, there's still uncertainty in the Eurozone, there's still issues in the macro environment. We're feeling better, but it's still early.

James P. Gorman

And I would just add to that on the broader economic front, that our view has been that the U.S. is a little better off than has generally been perceived, and that Europe is more likely than not to resolve itself, although over a period of a couple of years, not a couple of weeks, which was our sort of collective attention span in the fall. So against that macro outlook, it is -- we are as Ruth said.

Operator

The next question will come from Mike Mayo with CLSA.

Michael Mayo - CLSA Asia-Pacific Markets, Research Division

If you could elaborate a little bit more on MUFG. You commented on the funding. What's your intention in highlighting that so much at the top of today's call? Is it that they are there -- someone with deep pockets if you needed some extra help? Or am I just missing the point?

James P. Gorman

No, listen. How many times in the history of financial services have you seen a cross-border equity investment from one bank to another of this kind and the merger of different parts of their businesses, which we do with our securities business in Japan? And so number one, there is a strategic story here. Number two, the conversion obviously improved our capital and reduced a mandatory dividend that we were paying. And I just felt -- and maybe I'm the only one who felt this, but I felt that the world at large did not appreciate both the strategic and financial value of this transaction. And they are the second largest depository institution in the world. I think they have 70% more deposits than any U.S. institution. I may be incorrect on that, but I think I'm roughly correct. And I think because they're in Japan, they're just not just as well understood if frankly they're in our backyard. They're great partners and they have worked hard with us over the last several months to find ways to do business together. And I think that's a strategic imperative for us, to keep growing with them as partners in finding ways to do business around the world. And I just felt it was important to get that message out there.

Michael Mayo - CLSA Asia-Pacific Markets, Research Division

Right. And then one separate question. When you think about rightsizing the firm, the company has hired many employees in the past few years. And now you need to reduce employees, it's always very difficult in markets like this, but can you talk about the tradeoff between rightsizing for the current cycle and investing for the long-term?

Ruth Porat

So we were focused on -- have been focused on the pacing of the recovery. It continues to be slow. We, therefore, felt it was appropriate to reduce headcount. But that reduction is very consistent with what we've been describing strategically and it's quite targeted. So we've been judicious in investment areas, particularly within sales and trading. So for example, in rates, which has obviously been a focal area, and as I noted, up again this quarter, up year-over-year. We've continued to make key hires in research and trading to protect and support those growth areas. We've also been making, taking steps deemphasizing and reducing balance sheet and risk in areas that are inefficient under Basel III. So for example, within our sub-investment grade securitization through 2011, we were reducing risk, which not only freed up capital and liquidity but enabled us to make some headcount reductions. But we have a strong team there that's been proactive and repositioning the business. And now they are focused on those portions within securitization, the higher-quality credit quality tranches that actually are quite consistent with the new Basel III regime. So what we've tried to do is really strike that right balance between reducing headcount where we were could, while making sure we're well positioned for the recovery, which as James said, hopefully comes sooner rather than later.

Operator

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

Guy Moszkowski - BofA Merrill Lynch, Research Division

I wanted to ask you if you could elaborate a little bit on some of the headwinds that you had in 2011 from sort of multiple years of deferred comp. And if you can just give us a little bit more granularity on how that rolls off after 2011, in 2012 and beyond.

Ruth Porat

So in Institutional Securities, we did take comp down meaningfully per person this year. And as we said in the fourth quarter of last year call, we increased the deferral rate to 60% for 2011 versus 40% previously and made a number of other changes. This resulted in a higher comp expense in 2011, notwithstanding the decrease in comp per person, because 2011 was a transition year with an unusual aggregation of deferrals coming into 2011. But as James said, when we look at that deferral schedule going out from here and going most important into 2012, prior year deferrals normalize, and in fact, decline in 2012, and we do have more flexibility. So it's really about 2011 being that transition year.

Guy Moszkowski - BofA Merrill Lynch, Research Division

Right. Is there any more sort of quantification that you can provide us as we try to accurately reflect this in our model?

Ruth Porat

No, we're not doing that.

Guy Moszkowski - BofA Merrill Lynch, Research Division

Okay, fair enough. Wanted to ask about the Global Wealth Management and the divergence in the fourth quarter of the revenue versus the expense trend. I think you did cover it a little bit. But it was a pretty meaningful divergence, not for the full year but certainly for the fourth quarter. And yet I would hope that by now we would be starting to be able to see some of the benefit of the efficiency movements that you've made and being able to take advantage of the single platform.

Ruth Porat

Fair point. I mean, fundamentally we had consistent revenues, which underscored the stability of the business. But as James said, the margin wasn't quite where we want it. And there were a couple of factors affecting that. As we said on the third quarter call, revenues are meaningfully affected by the S&P close at the end of the year. You know that better than anyone. And the 9/30 S&P close was pretty depressed. That is used as the basis for setting Asset Management fees for the quarter. I think the good news, as we're sitting here today, is the S&P close at the end of the fourth quarter as of 12/31 was 11% higher than it was at the end of the third quarter. But that was a headwind for the fourth quarter. The other thing was there was a lighter equity issuance calendar. And again, that's market-related, and hopefully, we see some more activity coming out of that new equity pipeline, which does remain strong. The other factors, though, that were fourth quarter-specific affecting, in particular, the comp expense. One, we've been taking out -- reducing headcount of the lower performers. And so we had some severance costs in there. The other is that productivity of financial advisors has been increasing. And at higher productivity levels, they're entitled to a higher comp. And this year, that was a fourth quarter true-up. Last year, it was a fourth quarter true-down. And then the other factor I noted is market appreciation from the deferred compensation program, that's those that are invested in funds, generally flows through the revenue line and the comp expense line, so it becomes 0 margin revenue. And it was really a number of different factors. But you're right, and the focus of the team is very much focusing on expense across the board so that we can continue to drive the margin higher.

Guy Moszkowski - BofA Merrill Lynch, Research Division

I have one final question, which is just on the Investment Banking and trading opportunities that you might be seeing emerging from the problems that some of your European competitors are seeing and their need to shrink balance sheets maybe faster than some of the U.S. firms. Are you seeing significant revenue opportunity starting to develop there?

Ruth Porat

Well, we are focused on it across industries, given the strength of our banking franchise globally but in particular in Europe. So on the financial institutions side, the expectation is there will be more opportunities to help clients raise capital and restructure balance sheets. But I think the other factor to consider is it's not just within the state client base. It's really more broadly across industries. As we look at in 2008, European banks took share from U.S. banks. And that's obviously when this country was going through its capital rates focus and liquidity raise. And given that European banks are now going through similar issues, our view is that, that creates an even broader set of opportunities beyond just, say, again given the strength of our franchise, we do see this as an opportunity to gain share. On the sales and trading side, we're well positioned and hope to built off of the momentum that you've seen in some of the numbers through this year. And then on the balance sheet side, I think that, again going back to James' comments about the strength of our partnership with MUFG, it just further strengthens our ability to help clients in Europe as well.

James P. Gorman

And I think, Guy, as you -- in any industry restructuring, as the players between sort of 10 to 20 range exit, clearly that share is going to flow to those at the top. And a lot of our businesses were ranked 1, 2 or 3 in the key businesses we're in. So I think there's probably a little bit of a short-term impact, but I do think there's a longer-term change in industry structure that should play to our advantage.

Guy Moszkowski - BofA Merrill Lynch, Research Division

And is there any sign that some of those changes might be starting to improve market-making spreads pricing?

Ruth Porat

We haven't seen it yet.

Operator

The next question will come from Glenn Schorr with Nomura.

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

Two quick follow-ups on FICC and equities. First, in FICC in general, whether or not you want to include the CVA changes. If you back out DVA, CVA, MBIA, is the right starting point for the quarter for FICC on a clean basis, going forward, $600-ish million?

Ruth Porat

I'll let you judge how you want to look at it.

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

Excellent. I can read that. In equities, Ruth, your comments were very clear that cash and electronic was a better driver in the quarter, and PB and derivs sequentially were lower. I mean, something's going really right in cash and electronic. And I just don't know if you have any more you can tell us. Is it what you and James both just alluded to in Europe? Or is this just constant progress and getting a greater share of client wallet? Of course, it's a significant outperformance if it's cash and electronic.

Ruth Porat

It is real outperformance relative to the market volumes that we saw. With market volumes down, there was strength there. I would say that the strength of the team across products continues to be a real driver for the performance in the business. And you see it year-over-year, when you look at the sequential improvement, the strength that we had in derivatives goes back to a lot of the comments we've had on prior calls, which is that the team has been focused on really building adjacencies across its business, ensuring that we've built up what we did on the derivative side. You go back 2 years ago when we said we were going to build up equity derivatives. We had 3 sequential strong quarters there. And so it's really across products working together as well as they do and around the globe. So the benefit of the electronic platform is there's still delivery to clients, electronic invoice. It's working well, and it's really enabling us to stay as well connected to clients as possible.

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

Sounds like you feel it's sustainable as well. I appreciate that you are the only person I cover that actually expanded the European exposure disclosure. But what's the net-net? Meaning, I don't know if I heard the, "We feel very comfortable, we think their exposures are collateralized." And what's your net-net feeling on your Euro exposures?

Ruth Porat

We do feel -- I think you've summed it up well. We feel very comfortable with our exposures. We think that continuing to provide the transparency is helpful. And so we've expanded the disclosure this quarter, but we feel very comfortable with our exposures. We've got a strong business in Europe, and we remain present. But we like the way we've managed over the last several years here.

James P. Gorman

And I would say, Glenn, we were never quite in the camp of the hysteria that surrounded us last October about our European exposures. We're a little bewildered by it, to be honest, which led us to a very fulsome disclosure in the appendix last quarter, and it's been netted to with the unfunded commitments this quarter. And frankly, the position has been improved by reducing one of the larger concentrated positions.

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

And then lastly, is the overhang in Europe and uncertainty there, is that the major impetus to remove a cloud to get to a higher earnings level? I appreciate all the progress made, but I'm sure people are still looking for more in '12.

Ruth Porat

That is the primary overhang. This year -- the past year, 2011, has the dual complexity of all of the drama around the debt crisis and the downgrade for the U.S. But as James said, I think there are more signs of progress so far in the U.S., and that the ongoing uncertainty in the Eurozone continues to be a big cloud. There clearly also is some of the question marks around regulatory uncertainty. But if you were to rank them, I think the Eurozone and therefore, the issues that are holding back some clients from executing on transactions is a problem.

Operator

The next question will come from Roger Freeman with Barclays Capital.

Roger A. Freeman - Barclays Capital, Research Division

I guess, first, just -- you talked about some of the sort of resizing that you've done. And I guess, I'm curious. How much sort of the forward-looking -- and you said, too. You've kind of identified businesses you want to be in. But how confident are you around where the outstanding regulatory questions, rules around derivatives, Volcker, are going to land such that, that may still be subject to substantial revision going forward? Or do you think you kind of have a pretty good sense of positioning at this point?

James P. Gorman

Well, I think, as we've said for a while, the most important regulatory change are the capital requirements coming out of Basel III. And I think we have a reasonably good handle on where that is likely to end. The whole Volcker, Dodd-Frank discussions are obviously still very much ongoing, as witnessed by the hearings yesterday. And listen, we've obviously done an enormous amount of work internally quantifying the impact of different rule changes, what they would mean for our business and so on. Our base case is not an extreme shutting down of all market-making activity. And we think that the original concept of Volcker, which was to ensure that deposits were not used for highly liquid prop trading, should be honored, and then we'd move forward with that. So the regulatory front remains very much in dialogue. You've got governments around the world weighing in on the U.S. position to make sure that the various international bond markets aren't disproportionally affected. You've got inventory management by large institutions like ours to ensure that we can provide liquidity for our clients. So it remains fluid as you know it. But we run all sorts of scenarios against it.

Roger A. Freeman - Barclays Capital, Research Division

Okay, that's helpful. Then separately, other sales and trading, I was wondering if could give us a little more color on what drove the delta there. You mentioned hedge gains on owned debt. Did you repurchase some of your own debt during the quarter? And if so, how much? And is that an ongoing activity?

Ruth Porat

Well, you got a couple of questions in there. So the other sales and trading line is, as we've talked about in the past, is pretty difficult to model. I appreciate because it has a number of items in it, and it has amortizing hedges from debt we bought back in '08, '09. It has our long-term debt hedging program. It has our bank liquidity portfolio, loan book, our deferred compensation plan. And so sometimes the items all move in one direction and sometimes they're offsetting, and so therein lies the complexity. We did buy back some of our debt over the quarter. It was a small amount, and so that really didn't explain it. It was really just the various across-the-board items.

Roger A. Freeman - Barclays Capital, Research Division

Okay, got it. Then lastly, do you -- similar to what Goldman talked about yesterday on the relationship lending, both the CD backstops [ph], is that a big business for you? Are you considering potentially moving to hold the maturity? And tied to that, more broadly, are there other issues like this that maybe we put in an active mitigation bucket, that when we look forward to Basel III, helps you to even grow these ratios higher than what the past roll forward [ph] points to?

Ruth Porat

So with respect to lending an HFI, fundamentally, we are a mark-to-market shop. I think as it relates to the loan book, we obviously have a bank. We're the 15th largest U.S. depository by deposits. And so we're always considering what make sense in terms of capital and funding efficiency. I think notably in CCAR, mark-to-market loans were penalized substantially more than HFI loans. And our view is it's our responsibility to consider what makes sense for shareholders. So that is one consideration. And then the other question I think you're asking is with respect to what other repositioning under Basel III. And I think we have, as I noted, continued to focus on 2 things really within Fixed Income. One is share gains, the other is return on capital. And part of the return on capital driver is really having a forward lens to Basel III requirements and ensuring that we are positioning our businesses to be as capital-efficient under this Basel III regime. And so there should be continued benefit from active mitigation as we continue to rightsize some of the portions of businesses that are most affected by Basel III.

Operator

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

Michael Carrier - Deutsche Bank AG, Research Division

Ruth, maybe, one follow-up on the expenses. So you guys have kind of the efficiency initiative over the next, I think, 2 more years on the $1.4 billion side. And then you have some of this restructuring. So I guess, just some update on what's going on maybe in the first, second quarter on the cost side, given some of the more recent moves versus any change on that longer-term efficiency project for the $1.4 billion.

Ruth Porat

So on the office of reengineering, we remain confident with that $1.4 billion, that's a target by 2014. And we're also very comfortable with the run rate target for this year, which is $500 million. The key focus areas are the same as the ones we've discussed previously, the highest ones being location strategy, procurement programs and tech spending. And so that's very much on track. But I'd underscore the non-compensation expense this quarter, which as I said, was down relative to last quarter. And that's notable because the fourth quarter is typically our sequential high. And it really underscores what we're doing at the tactical level. So if you put kind of the office of reengineering in this bucket, a bigger, more strategic, however you want to define it, cost-cutting that takes longer to do because we're repositioning the way we do certain elements of the business, and put that to the side. We also have a tactical initiative, and we're pleased with our noncomps because it shows that on even across-the-board small items, we've taken a really diligent approach to ensure that we're doing all that we can to control costs. And that also persists as we move into this new year.

Michael Carrier - Deutsche Bank AG, Research Division

Okay, that's helpful. And then James, just on the Wealth Management business, so 2 things there. Just margins in the fourth quarter tend to be low, you guys mentioned, just given the seasonality of expenses and then given where markets were. As we head into this year and assuming rates don't change, like where do you think margins can get, assuming flat, slightly up markets? And then just in terms of the buy-in, based on what you guys have it marked and where Citi's got it marked, in terms of odds of getting that concluded or taking in that 14% stake, like if it's somewhere in between, like a middle ground, is that -- do you see enough value in that business to be purchasing it for some level of that's in that range?

James P. Gorman

Yes. I'll talk about the second question and Ruth can talk about where we're looking at the margins here. On the process, just recall it's a call option exercisable, I think, at May 31 or June 1. If the parties can't agree, we go to a third party, and it's at fair market value. I don't think there's going to be a whole lot of mystery, frankly, irrespective of whatever institution has it marked at is kind of irrelevant. It's a question of what is fair market value. And we're both mature, grown-up institutions, so I think we'll quickly figure out our fair market value. And if we can't, then we'll obviously go to a third party. So it's not a traditional M&A-type transaction in that the prices are already determined which is market value. So I'm not particularly focused on that element of it. And as we said earlier, if you look at the strategic rationale for this business, it's part of our long-term plan, and we obviously count the goodwill against that capital already in it. So the incremental cost, if you will, of doing this against the benefit is relatively small to say the least.

Ruth, I don't know if we have anything more to add on fourth quarter and where we're looking at this year?

Ruth Porat

Yes. And the only other thing to add, this is our call option. So similarly, our call option on whether it goes to arbitration. But with respect to margins, we're continuing to focus on the mid-teen margin target, and the levers that we've talked about remain very much the ones that Greg and his team continue to be focused on. So on the cost side, the lower integration expense having cracked the back on the major expenditures with the technology platform done in the third quarter of last year. But also given the environment, the team has raised the bar in expense management. And then similarly on the revenue side, a real focus on continuing growth of the managed account platform, as I mentioned, the ongoing growth in lending and a couple of other issues. And to be clear, that's not mid -- That's not 2012 guidance, that's kind of our mid-next year guidance.

Operator

The next question will come from Fiona Swaffield with Royal Bank of Canada.

Fiona Swaffield - RBC Capital Markets, LLC, Research Division

I just had a question on the risk-weighted assets under Basel I. I think you said $316 billion. Could you take us through kind of some quantification of the moving parts? And then I also think that you mentioned sub-investment-grade securitizations, having done some work on reducing. Would that then mean that the Basel III -- is that part of the $100 billion rolloffs? Or does that mean that the $480 billion, which I think will obviously has gone down post the MBIA, to maybe $430 billion, if you could confirm that? Does that mean that, that number could be coming down a bit? I wonder if you could help us on that.

Ruth Porat

So on Basel I, why the risk-weighted asset is lower there? They're lower in part as I noted because of MBIA and also the balance sheet's lower. And so our risk-weighted assets came down in line with where the balance sheet is. With respect to Basel III, what we're really focused on, given there have been a number of changes affecting -- in guidance affecting both numerator and denominator over the last 1.5 years, when we initially gave out guidance on RWA inflation and mitigation. And Basel 2.5 has moved from an NPR to 2.5, is kind of moving around. So as a result, what we thought is the most effective and useful is to give you where we are in Tier 1 common ratio. And our Tier 1 common under Basel III, we're comfortable that it's approaching 10% by year-end 2012. In the numerator, we are deducting the MSSB NCI and adding consensus earnings. And in denominator, you have RWA inflation and passive mitigation from here through the end of 2012. We'll continue to be focused on active mitigation, to your question. And so that remains incremental upside of any active mitigation, but focused on the overall ratio here.

Operator

The next question will come from Daniel Harris with Goldman Sachs.

Daniel F. Harris - Goldman Sachs Group Inc., Research Division

I was wondering if we can continue to focus on Global Wealth here for a second. So you mentioned that by the middle part of the year, the integration should be largely complete on the technology side. What happens then at that point with regards to the number of offices you have? And how do we think about that, assuming all else equal, with regards to your ability to take out non-compensation?

Ruth Porat

The offices -- we are continuing to look at where there are efficiencies in combining offices. Sometimes there are, sometimes there aren't because you have fully staffed active offices potentially within a similar area. So you can assume that across the board, we're continuing to look at where it makes sense to further consolidate or take or cut costs. And the team is being quite detailed about that. With respect to the technology spend and integration-related cost, the integration expense does come down. There is some software capitalization that then comes in, so you can't assume it's a cliff that drops off to 0. But it's come down meaningfully, and that's the real point there. And so we've hit the high point and it's rolling off. There are ongoing expenses that hit the P&L, and then the other expenses that the team can focus on include everything that you can imagine, all the details within the P&L, to do whatever we can to drive margin.

Daniel F. Harris - Goldman Sachs Group Inc., Research Division

And so the integration costs this quarter were roughly $70 million or so and you expect that, that should trend down a little but not get to 0?

Ruth Porat

The point is the integration expense comes down to 0. But I just wanted to make it clear that from a margin impact that there are offsets to that, namely I think, the one most relevant is software capitalization. And there's some other items that continue to flow through the P&L once we're steady-state.

Daniel F. Harris - Goldman Sachs Group Inc., Research Division

Okay. And then lastly on for me -- so thanks for the color earlier on into the very early 2 weeks of the year here. Obviously, a lot of us track activity levels, and they certainly seem weaker. But I wanted to focus in on one area that's more difficult, and that's credit. I think that, that's the one area where we look at that we can actually see some good results, if you're thinking about credit tightening and structured credit trading. Is that an area that's been something that's been better than we saw in the fourth quarter, which was down -- better in the first quarter that was down last year?

Ruth Porat

Well, again, it's very early, too early to say. I think that the marks that we -- the pain in credit in the third quarter was acute. And as I noted, it was modestly -- it was better this quarter but still not running at levels that are consistent with historic levels for that business. We have a very strong credit business broadly. And so there is upside as credit markets continue to heal. But I would say that, given that the major overhang, as both James and I said, is the Eurozone crisis and/or uncertainty in the Eurozone, it's too early to make a call on that.