Good morning. This is Celeste Brown, Head of Investor Relations at Morgan Stanley. Welcome to our first 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 reconciliation of such non-GAAP measures to the comparable GAAP figures and for a discussion of additional risks and uncertainties that may affect the future results of Morgan Stanley.

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

James Gorman

Thank you, Celeste. And good morning, everybody, and thank you for joining us. I'm going to take you through the major components of the quarter and our announcements this morning before turning the call over to Ruth to review the results in detail.

First, we made clear progress increasing client share, and this translated to financial performance. We've seen the benefits of our investment in hiring and leadership as we execute across our businesses. In Institutional Securities, our trading results demonstrated considerable improvement and reflect continued focus and discipline while we maintained at/or near the top of the league tables in global M&A and equity underwriting. Equity sales and trading had an outstanding quarter, its best since the financial crisis, as we continue to gain market share across our 3 major businesses. In fixed income and commodities sales and trading, we made important progress versus a year ago in interest rates, and all products were up sequentially.

In Global Wealth Management, we're pleased with our progress, and the MSSB integration remains on track. We delivered higher revenues. However, margins were lower as we indicated they would be on the last quarter's earnings call. In Asset Management, revenues were solid and asset flows gained some momentum.

Now secondly, in addition to improvements in our operating results, we had a significant benefit arising from the completed sale of Revel, which was a positive development.

Finally, as you're aware, we have a comprehensive strategic partnership with MUFG. In that partnership, we've set up two businesses in Japan that operate on a joint venture basis. One business is operated and risk managed by Morgan Stanley. The other is operated and risk managed by MUFG. MUFG has a 60% economic interest in each joint venture while ours is 40%. We were disappointed to announce that there was a significant trading loss in the business operated and risk managed by MUFG. Because of the economic structure, we will bear 40% of that loss, which drove a $0.26 per share impact this quarter.

Over the past weeks, the following things have occurred. MUFG will be injecting capital into the business that will partially offset the losses consistent with the shareholder agreement. MUFG, with the active input of Morgan Stanley, has taken a number of steps to address the issues that gave rise to the loss and to materially de-risk the business. Ruth is going to discuss each of these steps in the business in more detail. Notwithstanding the loss, we remain fully committed to our partnership with MUFG, which we regard as powerful and strategic. And we're constantly looking for ways to extend our relationship around the world.

On that note, we are particularly pleased to jointly announce today that MUFG will make a full conversion to our common shares of their $7.8 billion face value convertible preferred shares. This is a signature event for Morgan Stanley and reflects the strength of our ongoing partnership. The conversion will reduce annual preferred dividends by nearly $800 million, increase our earnings power and further enhance our capital ratios. Subsequent to the conversion, our capital position is unquestionably strong. It will increase our March 31 Tier 1 common ratio by 270 basis points on a pro forma basis.

We have made significant progress strategically repositioning the firm and moving towards a strong and durable institution while diligently focused on cleaning up some legacy issues. Although we've taken major steps to be in a position of operating strength, we understand that significantly more progress is expected, and it remains the focus of this management team. This is an institution that is extremely well positioned for the future, no matter the environment.

So now let me turn it over to Ruth to review our financial results in more detail, and then we'll be available for questions and answers.

Ruth Porat

Thank you, and good morning. Overall, for the quarter ended March 31, income from continuing operations applicable to Morgan Stanley was $966 million, with diluted earnings per share of $0.50 after preferred dividends. I will focus my discussion on 2 primary areas: first, the MUFG-related items, including the JV loss, the portfolio being managed by Morgan Stanley and the impact of the pending conversion; second, the operating improvements across our businesses globally.

With respect to the MUFG-related items, on the JV loss, our 40% economic ownership in MUMSS, the joint venture that MUFG operates, resulted in a negative equity pickup of $665 million (sic) [$655 million] or $425 million after-tax, which equates to $0.26 per share. The loss was associated with trading results and write-downs in its fixed income business, operating expenses and other costs. This loss is reflected within Institutional Securities in the other revenue line item.

As James indicated, MUFG is solely responsible for maintaining an appropriate level of regulatory capital at the MUMSS joint venture as part of the short shareholder agreement. Morgan Stanley is not required to add capital nor is our ownership in the joint venture diluted when MUFG injects capital. There was no capital injection in the first quarter, because MUFG had not completed its capital assessment by March 31. They have since concluded that they will contribute approximately $370 million of capital in April. This will partially mitigate the reduction in our book value by approximately $145 million and will be reflected in the second quarter. To the extent that there are additional losses in the MUMSS joint venture that affect regulatory capital, MUFG will be required to inject additional capital. Thus, the impact to Morgan Stanley could be partially mitigated from a book value perspective.

Following the loss, MUFG has embarked on a thorough and strategic risk management review and remediation program and is changing the leadership and process controls at MUMSS. MUFG is holding people accountable and moving forward to make necessary changes.

Given the restructuring and management changes under way at MUMSS, it was viewed as beneficial to transfer a portion of the portfolio that drove the losses to the Morgan Stanley-controlled joint venture in Japan, MSMS. We executed the transaction on an arm's length basis taking into consideration the size, liquidity and risk of the portfolio as well as the associated capital requirements. We will consolidate the full P&L associated with these positions in our fixed income results as we do all of MSMS. MUFG's 60% economic interest will continue to flow out of the noncontrolling interest line.

And finally with respect to the equity conversion we announced today, as James mentioned, MUFG will convert its $7.8 billion face value convertible preferred into our common stock, subject to regulatory approval and a shareholder vote. This will eliminate $784 million in annual preferred dividends. This security was not callable by its term other than when our stock hit its certain threshold. To effect an early conversion, we agreed on what we believe is fair consideration for foregone dividends, and we will be paying the premium via the issuance of an incremental 75 million shares of common stock.

As a result, we will be incurring a charge in the third quarter for this dividend based on our stock price at the time of conversion. Pro forma, based on yesterday's closing price, this would equate to approximately $2 billion. Total common shares outstanding will increase by approximately 385 million reflecting the conversion and the dividend payment. After the conversion, MUFG will own approximately 22.4% of Morgan Stanley. Pro forma, assuming the conversion occurred at March 31, our Tier 1 common ratio is estimated to increase by 270 basis points.

Now turning to our firm-wide results. We continue to make progress across our global platform. Our first quarter revenues were $7.6 billion, down 2% sequentially but up 5% when excluding DVA in each period, the MUFG-related loss this quarter and the CICC gain last quarter. Our noninterest expenses were $6.8 billion, up 2% from last quarter on higher compensation expenses, partially offset by a decline in noncompensation expenses. The firm-wide compensation ratio was 57%. Though excluding the impact of the MUFG-related losses and DVA, the ratio was 51%. Noncompensation expenses were $2.4 billion, down 5% from last quarter primarily due to lower professional services expenses, partially offset by higher brokerage and clearing.

We are focused on driving down our cost structure further through business reengineering. In February, we announced the creation of an office of reengineering and expense management under our COO and have commenced a 3-year program targeting $1 billion in annual run rate savings.

Results for the quarter also included a tax benefit of $447 million or $0.30 per share related to the completed sale of Revel. The benefit arose from the remeasurement of a deferred tax asset and the resulting release of a related valuation allowance. Excluding this discrete tax gain and the effect of the MUMSS loss, the quarterly effective tax rate from continuing operations would have been 28%. Book value at the end of the quarter was $31.45 per share while tangible book value was $26.97 per share.

Turning to the balance sheet. Total assets were $836 billion at March 31, up $28 billion sequentially driven by higher client demand. Although our calculations are not final, we believe our Tier 1 capital ratio under Basel I will be approximately 16.7% and our Tier 1 common ratio will be approximately

11.8%. Pro forma at March 31 for the pending conversion of MUFG's convertible preferred equity, our Tier 1 common ratio would be approximately 14.5%. Our Tier 1 capital ratio was affected by the change in the treatment of trust preferred securities, or TruPS, effective March 31. This capital is now limited to 15% of core capital and, therefore, approximately $4 billion of TruPS are now classified as Tier 2. This change does not impact our Tier 1 common ratio. Risk-weighted assets under Basel I are expected to be approximately $300 billion at March 31. We remained focused on RWA mitigation and optimization, and the decrease in RWAs versus December 31 came from a combination of business mix, analytics and collateral changes.

Now turning to our businesses. Institutional Securities revenues of $3.6 billion included the impact of the MUFG-related losses mentioned earlier and the negative impact from the tightening of credit spreads on firm-issued structured notes, commonly referred to as DVA, of approximately $189 million or $0.08 per share. Sequentially stronger trading results were driven by increased client flow but were partially offset by lower volumes in Investment Banking reflecting typical seasonal patterns. Noninterest expenses were $3.2 billion in the quarter, flat from the fourth quarter. The compensation ratio was 54% in the quarter. Excluding the impact of the MUFG-related losses and DVA, the ratio was 44%. The business reported a pretax profit of $397 million.

Investment Banking revenues were $1 billion, down from the fourth quarter on lower industry volumes but up nearly 15% from a year ago. This was our strongest first quarter in Investment Banking since 2007. For the quarter, Morgan Stanley ranked first, again, in global announced and completed M&A, and we were third in global equity. We led significant deals, including 3 of the top 5 transactions in global announced M&A. In the quarter, we advised on a number of significant transactions, including Deutsche Telekom's $39 billion sale of T-Mobile to AT&T, the $15.2 billion merger of ProLogis and AMB Property and HCA Holdings' $4.4 billion IPO. Advisory revenues of $385 million were down 20% sequentially driven by lower activity in the Americas.

Equity underwriting revenues were $285 million, significantly lower than the fourth quarter and reflected industry volumes that declined by nearly half following the record issuance level last quarter, particularly in Asia. Fixed-income underwriting revenues of $338 million declined 9% from last quarter as higher investment grade issuance was more than offset by lower loan syndication and municipal finance fees.

Equity sales and trading revenues of $1.7 billion included negative DVA of $30 million and represent our highest reported quarter since the financial crisis. Results were strong across our businesses and in each major geography driven by broad-based increases in client flows as we continue to make targeted investments. Of note, our European and Asian businesses were up significantly versus the fourth quarter. In addition, the U.S. equity research department improved its ranking to #3 in its 2011 Greenwich analyst and PM surveys, up from seventh and eighth, respectively, in 2010.

Cash equity revenues were up over 10% from the fourth quarter as a result of sustained market share gains, alongside client and geographic diversification, outperforming against a market backdrop of muted volumes in the U.S., volatility in Asia and growth in Europe. Derivatives outperformed in the quarter on expanded client footprint with sequentially higher client flows against the backdrop of elevated volatility arising from global macro events. Growth in our electronic businesses in cash equities and derivatives continued to outpace market volume. And prime brokerage recorded the highest level of client balances since the financial crisis as we continue to focus on innovation and client service.

Fixed income and commodities sales and trading revenues of $1.8 billion included negative DVA of $159 million. Results benefited from an increased client activity and better facilitation, with particular strength in Europe, while all product lines showed improvement from the fourth quarter. We continued to invest in the electronic trading platform for this business.

Interest Rate's revenues more than doubled from the previous quarter on strong client flows across all regions, particularly Asia, and included increased electronic share in Europe and more sustained activity in the U.S. We continued to make progress growing this business, where revenues were up 10% on a year-over-year basis, in particular, liquid flow rates were up over 50%.

Credit revenues increased meaningfully versus the fourth quarter with particular strength in securitized products. They were down from the prior year reflecting a quieter market in corporate credit.

FX revenues were also up on higher trading revenue versus the fourth quarter despite muted FX volatility during most of the quarter. We recorded our single largest electronic trading day in FX this quarter.

Commodities revenues were up significantly from the fourth quarter due to increased market volatility. Fixed income results continued to reflect a drag from the tightening of monoline credit spreads in CMBX indices with net losses of $318 million. Other sales and trading negative revenues of $458 million primarily reflected losses on economic hedges related to the firm's long-term debt and funding costs related to the higher amount of liquidity held by the firm's U.S. subsidiary bank.

Turning to VaR. Average trading VaR declined to $121 million from $132 million last quarter primarily driven by reductions in credit and foreign exchange.

Global Wealth Management revenues of $3.4 billion increased 3% sequentially as higher Asset Management fees and commissions were partially offset by lower Investment Banking revenues due to a quieter new issue calendar. Noninterest expenses were $3.1 billion, up 4% from last quarter on higher compensation expenses. The compensation ratio of 62% in the quarter continues to be driven primarily by the formulated grid payout. Integration costs were approximately $80 million. Profit before tax was $348 million, and the PBT margin was 10%.

Total client assets increased sequentially to $1.7 trillion on market appreciation and net asset inflows of $11.4 billion in the quarter. Net fee-based asset flows were $17.8 billion. As you consider the second quarter, note that client flows tend to be seasonally weak due to tax filings.

The number of FAs was 17,800, within our expected range, while turnover within our top 2 quintiles remained near historic lows. The decline in headcount was due to our focus on reducing low performing FAs, which could result in further reductions next quarter.

Deposits in our Bank Deposit Program were $112 billion, of which $54 billion is held by Morgan Stanley Bank. With respect to the second quarter, implementation of the new FDIC assessment rules may result in significantly higher FDIC charges related to the Citi depositories, which are part of the MSSB bank deposit sweep program, partially offset by lower FDIC charges related to the Morgan Stanley depositories in the same program. It is expected that Citi will take actions to mitigate most of the impact sometime during the third quarter. In addition, fed funds is half of what it was in the fourth quarter and well below where it was during the first 3 months this year. As you know, we have some sensitivity to rates, and the movement could pressure net interest margins.

Let me turn to Asset Management, where starting this year, we have organized this segment around 3 businesses. We have aligned our AUM and asset flow disclosure and provided the revenue breakout for these businesses in the supplement. The first is Traditional Asset Management, which includes our Long-Only, Liquidity and AIP fund of funds businesses, and where revenues declined 6% from the fourth quarter to $325 million.

The second is Real Estate Investing, where revenues of $118 million declined on lower investment gains. Approximately $42 million was related to investment gains from consolidated mezz rep funds. Given the ownership structure of these funds, the majority of the gains are passed to third-party investors in the noncontrolling interest line.

The third is Merchant Banking, which includes our private equity and infrastructure businesses and our hedge fund investments, where revenues of $183 million included lower investment gains in private equity and lower management fees as well as the absence of a full quarter of revenues related to FrontPoint. PBT was $127 million for a margin of 27 -- of 20%.

The Traditional Asset Management business reported strong margins in the quarter. Total AUM increased to $284 billion as market appreciation and net asset inflows of $1.4 billion were partly offset by the reduction in FrontPoint AUM. Inflows were driven by equity and liquidity assets. As of February 2011, over 74% of our long-term strategies continued to outperform their respective benchmarks on a 3-, 5- and 10-year basis.

Now turning to our outlook. We are cautiously optimistic about the operating environment with healthy liquidity and increased confidence providing tailwinds for our capital markets and advisory businesses. Risk assets have been resilient with markets absorbing and recovering from macro and geopolitical moves more quickly than in prior periods. However, concerns remain regarding the potential slowing pace of the U.S. growth, particularly at the impact of monetary fiscal stimulus wanes as well as ongoing stresses in Europe. These contradictory factors were evident in what we would characterize as moderate risk taking in the first quarter, but an improvement from the risk-on, risk-off environment of much of last year.

Beyond the operating environment, we are benefiting from the strategic moves and investments that we have made. First, we are pleased with the pending equity conversion that puts us in an even stronger capital position. And most notably, within our business segments, we saw ongoing progress in many areas in sales and trading. In fixed income, we continue to see the benefits of our investments to broaden our footprint. And in equities, our team globally was able to capture additional market share. We remain very focused on the disciplined execution of our strategy to continue enhancing our global footprint and growing our share of the market to deliver for clients and shareholders.

Thank you, and now we will take your questions.

Question-and-Answer Session

Operator

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

Howard Chen - Crédit Suisse AG

Congratulations on the announcement of the MUFG conversion. I think one of the overhangs I've certainly heard is you've got a lot of capital, but the quality of the capital was a bit challenged. So this certainly alleviates that. I think assuming you receive approval, Ruth, how does that change your capital management priorities in the context of both Basel I and Basel III?

Ruth Porat

That' s a very good and fair question, but a bit premature. We're delighted to be announcing this, this morning. As you said, it does meaningfully improve our Tier 1 common. Delighted to be up at 14.5% pro forma, but we still need to go through final regulatory approval and shareholder vote. I think, overall, it puts us in a very strong position with added flexibility, and we'll be back to you more on that in the future.

Howard Chen - Crédit Suisse AG

Okay, thanks. And then switching over to the results, you noted the monoline-related losses again this quarter. Could you just update us on where exposures stand at the end of the quarter? And what we should be looking at in terms of thinking about future losses and/or gains?

Ruth Porat

Certainly. So as we said before, this is a legacy exposure that will take time to work out. It's unfortunately not as straightforward as it may appear, because there are a number of factors in play and correlations are breaking down. So in addition to normal credit considerations, there's regulatory and litigation overlay. We're continuing to evaluate the market in all positions. So you're going to see more disclosure in our Q. As you would expect, we have adjusted some of our hedges, and that will be detailed in the Q.

Howard Chen - Crédit Suisse AG

Okay, thanks. And finally, you noted the RWAs were down during the quarter. Is that more environmental driven, or is that a function of getting ready for Basel III?

Ruth Porat

It's really our approach and focus on RWA mitigation and optimization. We've put more resources, people and analytics behind our RWA management. And as a result, it enabled us to identify opportunities to really optimize RWA. It's a combination of business mix change, analytics and changes in collateral. And we're focusing on Basel I now, but intend to use that same discipline focusing forward on 2.5 and III.

Howard Chen - Crédit Suisse AG

Okay, thanks. And just follow up to that, Ruth, I guess as you look to that RWA optimization, I mean, how do you think about the P&L ROA type of impact from mitigating those RWAs?

Ruth Porat

So what we talked about here, the reduction from $330 billion down to $300 billion did not have a P&L impact.

Howard Chen - Crédit Suisse AG

Great, thanks so much.

Ruth Porat

Thank you.

Operator

The next question will come from Glenn Schorr with Nomura.

Glenn Schorr - Nomura Securities Co. Ltd.

Ruth, if we could just do quickly, the pro forma tangible book and fully diluted share count post the conversion, I mean, the $25.63 range and 1.85 billion. Is that about right?

Ruth Porat

So the tangible book is around $25.78, book value, $29.36.

Glenn Schorr - Nomura Securities Co. Ltd.

And fully diluted, I just add the shares, nothing special there in the math?

Ruth Porat

Right, right.

Glenn Schorr - Nomura Securities Co. Ltd.

And then so what's interesting is your leverage is running 17.2x on common. This immediately takes it under 15. Just curious if you think about that as the right range, you knew this was coming versus is there an ability or any thought process on letting the balance sheet drift up a little now that you have a lot more common underneath it?

Ruth Porat

So this quarter, our balance sheet obviously did drift up, moved up from fourth quarter. It was lower at the end of the fourth quarter on, basically, client activity, and we took it up as we saw client activity. I think the real point here is that we're very pleased with the ongoing success we have in equities and fixed income, and that's really driven the demand for incremental balance sheet, which we've used. Clearly, this provides a very strong Tier 1 common base. But what was driving the balance sheet move fourth quarter over first quarter was client activity and executing on our strategy.

Glenn Schorr - Nomura Securities Co. Ltd.

Okay, so let's talk about that. I think you do deserve the credit for the progress there. Could we, inside of [indiscernible] talk about -- I know commodities is operating towards peak levels right now. I think that continues. But do you mind making a comment specifically on rates and FX, where a lot of the build has been? And what kind of contributors that was to the good results this quarter?

Ruth Porat

Certainly. So rates had very strong performance. It was up year-over-year and quarter-over-quarter in a choppy market. I think what you're really seeing is the results from the build that we've done, the strong leadership we have there, the additional talent added to our team globally. It really makes a difference. I think our point that we've talked about in the past is the need to build out the team to have greater presence with clients, which, in turn, would drive greater opportunity for client facilitation, and that was very much borne out this quarter. What you'll see in the 10-Q, when you look at our trading histogram is that it has moved over to the right. And again, another way of underscoring that with the addition of the team, greater presence of clients, greater client facilitation opportunities, that we're productive.

James Gorman

I would just add, Glenn, this is the first time that I have felt comfortable with the leadership across all of our fixed-income businesses. Moving Kenny deRegt, who ran fixed income 10-plus years ago, left the firm, came back to run risk and is now back running the business, his unique talent and mature, very capable trading executive. And under Kenny, the 4 or 5 players that he now has, really a world-class team. So leadership starts at the top. You've got to have that ability at the top. And the investment we made in hiring people, combined with the leadership at the top, I think is what started to move the needle.

Glenn Schorr - Nomura Securities Co. Ltd.

Excellent. All right, thanks, both of you.

Operator

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

Guy Moszkowski - BofA Merrill Lynch

I think it would be really helpful if maybe you could take us through a little bit more detail on how you achieved the reduction in the RWA even as the assets went up, because this mitigation thing is so important, I think, for us to understand.

Ruth Porat

It's really -- as I described, we built up the team that focusing on RWA optimization. And so the combination of business mix, as well as analytics, as well as looking at changes in collateral, has just yielded benefits, which one can candidly say, "It would have been nice to have had sooner," but we're pleased to have put the resources behind it to identify it. And these are Basel I improvements. I don't want to leave you with the notion that it necessarily rolls forward to Basel III. Some of them, we give up again in Basel II. And that's why I made the point that we're using the same approach to make sure that we're capturing all opportunities now in Basel I, but we're going to move this to 2.5 and III. So when I look to our Basel III guidance, it stays very much the same. I wouldn't want to leave you with the suggestion you can build off of that.

Guy Moszkowski - BofA Merrill Lynch

Got it. But it sounds like you are trying to identify opportunities to further this, even on a Basel I basis, and achieve more on a Basel III basis than maybe what you would have thought a few months ago you could do. Or is that not fair?

Ruth Porat

Well, no, that's very fair. The Basel III numbers that we talked about previously kind of inflation, passive mitigation, net up 140, $140 billion. We still think it's an appropriate way to look at it. We don't have any change to our earlier guidance of $480 billion of risk-weighted assets under Basel III. However, very much to your point, we intend to take the same focus apply it to 2.5 and III. And in addition, there are opportunities on active mitigation. But at this point, there are 2 steps, which is let's take this forward to 2.5 and III, see what else it yields and then see what we want to do beyond that.

Guy Moszkowski - BofA Merrill Lynch

Okay then, that's very helpful. Thank you. I was also hoping that maybe you could give us a little bit more color on the other sales and trading loss, which you refer to as being related to some of the economic hedges, I guess one on the corporation's balance sheet. I'm not sure that I understand it. And obviously, the losses are significant enough that it would be helpful to understand if those could -- if those are going to be mitigated ahead, or how we should model that.

Ruth Porat

Sure. So as we've discussed previously, this line item is volatile. And it unfortunately is difficult to model, because it includes a number of different items in it. So for example, we have amortizing hedges from debt we bought back in 2008 and 2009 in there, current long-term debt hedging program, our U.S. bank liquidity portfolio, leveraged loans and relationship lending. And so while we have negative in this line item, there are often also positive offsets. And that's what we had last quarter, we had some positive offsets. Unfortunately this quarter, the items all went the wrong way. And that's the negative. That's the drag.

Guy Moszkowski - BofA Merrill Lynch

Okay, thanks for that. And then the final question that I have is on equity, because obviously you've had a very, very successful result in the quarter. And I guess the question that we have to ask ourselves is how much of this is really sort of permanent, no, permanent is never the right word, but sustainable improvement from some of the footprint improvements that you've had and the like? And to what extent might you just have had a very favorable outcome from volatility-related equity derivatives trading? Can you help us with that at all, just so we don't overestimate what you might be able to achieve in the quarters ahead?

Ruth Porat

Yes, absolutely. We are very pleased with the performance. And I think you've hit the 2 issues. First and foremost, we have a terrific team around the globe. This is really -- the strength is broad based. It's across products.

It's across geographies, and it is about very strong team. Cash equities was very strong; derivatives as well; prime brokerage, as I noted. So I think it starts with the team and the stronger presence in front of clients that they're executing extremely well. We certainly also benefited, as you noted, from a constructive market. So for example, in derivatives, we certainly benefited from the market, but it was the team, with the backdrop of constructive market, they executed well against it.

Guy Moszkowski - BofA Merrill Lynch

Okay, thanks for that, and thanks for taking my questions.

Ruth Porat

Thank you.

Operator

The next question will come from Mike Mayo with CLSA.

Michael Mayo - Credit Agricole Securities (USA) Inc.

All my questions are on the MUFG conversion. I just wanted to clarify some, maybe some simple things. So you eliminate $784 million in dividends. That's a $0.53 pickup once you do that. Is that correct? So that's kind of in the bag?

Ruth Porat

I'm going to count on you doing the math right, the $784 million of dividends. Preferred dividends, to clarify.

Michael Mayo - Credit Agricole Securities (USA) Inc.

Right. So I'm just trying to understand how I would adjust my normalized estimates. So if my normalized number is $4, or $5 or $6, let's use $4 for the moment. So the increase in shares outstanding would be diluted by 1/4, which would take the $4 number down to $3. Then you'd add back that $0.53, and then normalized earnings power would be $3.53, not the $4. So it seems like normalized earnings would go down. And I want you to correct my logic. On the other hand, you have a mid-teen to ROE target. If you maintained that ROE target on a higher capital base, that would imply a higher normalized number. So if you could help me see my way through that.

Ruth Porat

So you've got a number of components to it. I'm going to address some of them, and then we'll just follow up on some of the math after the call. Because this conversion, we've been focused on getting the conversion done, and you're going into some of the numbers that I don't have in front of me. So you're right on the $784 million of preferred dividends. As I indicated, we're paying a premium with the incremental 75 million shares, so the total common shares up 385 million. As we look at it with respect to -- and so we'll come back to you on the earnings. What you're asking about ROE and really driving ROE on the strong capital base, we remain very comfortable with our mid-teens target over the cycle and come at it a number of different ways. Starts with our revenue mix and the right revenue mix globally. We think we're very well positioned for a changing regulatory environment, and we're executing across the businesses and geographies. And you see that, I think quite clearly, in the results here this quarter. So revenue upside in Institutional Securities, driving equities further based on the strengths that we've just talked about. And on fixed income, as we've talked about in the past, we're very focused on the initial closing the gap of 2% market share points, and the benefit that, that actually drives to the bottom line. Investment Banking is at a cyclical low given the strength of our Investment Banking franchise. We view that as a real positive. And obviously, there's a flow-through to other businesses from the new issue business that comes out of the Investment Banking franchise. There's the upside from GWM as we drive our PBT margin to the 20% target we've talked about in the past. The expense management program that we've talked about is incremental operating leverage. And then finally at some point, back to one of the prior questions, capital management's an added lift. So that's how we look to the ROE, and we'll come back to you on some of the builds.

Michael Mayo - Credit Agricole Securities (USA) Inc.

And then maybe -- you get $7.8 billion of additional common equity, if that's correct. So your tangible common would go up 19%, but your shares outstanding would go up by 25%. Am I doing the math correct, and if I am, why is so much more in the shares than the increase in the common?

Ruth Porat

We also have the incremental premium that we're paying, which is a deduct. So that, as I noted, will be a charge of about $2 billion based on yesterday's closing price.

Michael Mayo - Credit Agricole Securities (USA) Inc.

And when you gave the pro forma tangible book value of $25.78, does that include that $2 billion charge?

Ruth Porat

Yes, that's fully loaded.

Michael Mayo - Credit Agricole Securities (USA) Inc.

All right, thank you.

Operator

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

Roger Freeman - Barclays Capital

Just a couple more on MUFG. I guess, one, can you help us think about -- and you talked about the larger sort of strategic benefit of the relationship, and maybe just put into context some of the benefits that you've gotten out of that partnership so far? I'm just thinking of can we look at this in a some sort of cumulative context? And have there been any meaningful profits?

James Gorman

Firstly, on a pure financial basis, the investment that MUFG made during the financial crisis was obviously critical to repositioning us. The contribution to the various equity raises has also been critical, and we put in place a number of different business initiatives around the world. One of them was the formation of these double joint ventures in Japan. And while we have clearly had a stumble in the trading book on the fixed-income side of the business that they've been running, the long-term opportunity, the strategic opportunity in Japan giving us access to the retail market, which is a very large portion of the market there for distribution of our institutional product, and putting Morgan Stanley in a position to take Japanese corporates outside of Japan for their M&A and capital raising needs is a very compelling sort of strategic objective. Secondly, we have worked with MUFG and Bank of Tokyo subsidiary to bring them into a number of client relationships, where we're leveraging the combined balance sheet of both institutions. And I think the number -- I forget the exact number, but we're up over the 50 to 60 instances where we've done that. They did their first sub-investment grade deal with us. So there are number of opportunities for them to do that. Thirdly, as we look at various smaller emerging markets around the world, where they have a presence and capability, we might want to build the infrastructure. We're looking at ways where we can leverage their infrastructure. And then finally in the United States, they have operations here in both retail and commercial banking. So it's a very broad-based partnership. And again, obviously it's stumbled, but the evidence of the strength of the partnership, this truly moving investment here that they've made, and repositions us in lots of ways.

Roger Freeman - Barclays Capital

Okay, that's helpful. And then just thinking about the premium you're paying to convert to preferred early, kind of paying the next couple of years of the preferred dividend. And is it just the certainty of having the common equity contribution today as opposed to not sure whether the stock price is at the conversion point 2 years from now and there might still be a cost then? Have you had to negotiate something?

James Gorman

Yes, I'm going to let Ruth, she can take you through the mechanics. The bottom line here is, what we have spent the last couple of years doing is clearing up a number of uncertainties that impact our future, and this was frankly #1 on my list for this year. And we had a window of opportunity here to get this off the list, and obviously, we had to pay premium. We think it's a fair and balanced -- Ruth will take you through them.

Ruth Porat

So to that point, the security is not callable by its terms, which is customary for this type of security. And so we and they value the security with all relevant factors, share price, discount rate, volatility led to what we think is a fair outcome. And it really goes to James' point, which is this creates certainty which we believe really drives additional benefits for clients and all of our stakeholders.

James Gorman

And I just like to say, not to overstate this. But getting this done in this timeframe with all the Japanese partners are dealing with in Tokyo now is a measure of the strength of the partnership that they were willing to focus on this, that the CEO and board level and our board level, to get this done.

Roger Freeman - Barclays Capital

I appreciate that. Last question, in terms of your positioning sort of post-Dodd-Frank, Basel III sort of final clarity and how you might be thinking about any response to that from a resizing perspective. I think a lot of dealers have to kind of go through this process. My question for you is because you've been sort of in a rebuilding process, is it fair to assume that you kind of had some aspect of this outcome in mind and that your restaffing has been focused in businesses that likely have sort of brighter futures than others, and then ultimately there may be less of a headcount challenge for you than maybe some of your competitors?

Ruth Porat

I think you framed it well. The focus is very much, for us, a client-centric flow business, and that plays into much of the direction of much of the regulation. I think when you talk about some of the areas like derivatives, clearly there's a lot still to be done with respect to derivatives legislation. And we do want to -- we are focused on the need to ensure that U.S. institutions broadly aren't disadvantaged relative to global for other firms or European firms. But when you think about Morgan Stanley, I think there are ways that we are relatively advantaged versus peers. And we've talked about that in the past, the ability for us to move derivatives into the bank, the fact that the focus really is on client service and research support for our client, then it's giving us an opportunity here with our technology and connectivity leveraging off we're doing in, for example, foreign exchange and PB, to set ourselves up well for this new world. So we do feel that, in many ways, the market is going the direction that we're going. We still are somewhat smaller in fixed income on headcount, and so that very much, to your point, is beneficial given where the market's going.

Roger Freeman - Barclays Capital

Okay, thanks for the color.

Operator

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

Michael Carrier - Deutsche Bank AG

Ruth, last quarter, you gave some details on the Wealth Management business. Just in terms of some of the factors that can push the margin up over time, more environmental, and then there was also a portion that's more what Morgan Stanley can do in terms of consolidating platforms, realizing some of the additional synergies. So just wanted to focus on that portion. From a timing standpoint, are we still looking at -- I think you guys are saying like the beginning of 2012, but I just wanted to make sure like any update on the synergy, the consolidation on what you guys can control versus the environment?

Ruth Porat

So the 3 pillars, as I call it, that drive margin expansion, first, as you just referenced, completion of the integration and the synergies that come from having integrated the various platforms. We are moving the Morgan Stanley FAs onto this platform by the end of the third quarter where they'll be training up the Smith Barney FAs. They move on in the first half of 2012. So that's a very important part of this integration timeline. The second part and very important is building up the private banking business because that, as we've talked about in the past, is where we build our noncompensable revenues. And that, we are systematically building. We had 160 bankers at the end of the year. We have 178 at the end of the first quarter, which is ahead of our, what was our major target of 180, and we're looking to add about 30 a year. So this is a slow steady build to make sure we're providing the right client experience, the right risk management, the right -- full infrastructure around it. But that's an important part, and that will take time to build to the point where it really moves the needle. And then to your point, the third part, which we don't control but I did reference in the opening comments, is the backdrop, the 100 basis points movement in equity, the point on our PBT margin. And fed funds, we're focused on, because they're down from 19 basis points in the fourth quarter to 10 basis points here as we're going into the second quarter, second quarter to date. And every 50 basis points in fed funds is about 1 point on PBT margin. We look forward to that turning around.

Michael Carrier - Deutsche Bank AG

And then just to follow up on the ROE. You gave a few points, I think, on one of the last questions, just in terms of getting the ROE up over time. So I think you mentioned like 5 areas, so overall activity levels, which we'll see anyone can predict. You guys have the target in the Global Wealth Management business in terms of the improvement in the margin, so we can gauge that and size that opportunity. So I guess in terms of the 2 others or maybe 3 others, like the size of a trading opportunity in terms of punching at your weight or getting it to a level that's a better run rate. And then just on the cost side, I guess on those 2 areas when you look at the ROE and the impact of those businesses or those new initiatives have, is there any way to size that up? And not like next quarter or the quarter after but over the next year or 2 in terms of how much that can contribute?

Ruth Porat

Well, I'll give you a couple of data points to use to size it up and then look forward to reading how you write it up. But within the fixed income side, we're targeting an initial 2% wallet share growth, and that's steady, consistent. I think what you're seeing in the results this quarter give us confidence that you're seeing that borne out through the P&L, but that's a

2% upside. 2% market share upside is an important first metric that we are looking at in managing, too. And then with respect to the cost program, I mentioned the office of reengineering under our COO that was announced early this year. He is targeting and identified a $1 billion of run rate expenses to come out of the business. That is a 3-year reengineering effort. He has identified a number of different areas, but it does take time when you're doing substantive reengineering in that regard.

Michael Carrier - Deutsche Bank AG

Okay, thanks a lot.

Operator

Our final question will come from Jim Mitchell with Buckingham Research.

James Mitchell - Buckingham Research Group, Inc.

Just to follow up on the JV. I understand that this was an unusual quarter, but you were losing money in the JV over the prior 9 months, and understandably, it's got some strategic value. But how do we think about it -- how do you guys evaluate that longer term? Is there really value to be had there, particularly when you're giving up risk management? Is it sort of worth the effort?

James Gorman

Well, firstly, there are 2 businesses there. So the JV has 2 businesses, and one of them certainly has been making money. But secondly it's in its early stages. It was only formed in May. We have a lot of things that are going on in discussions about restructuring that particular business, which MUFG is going through and Ruth talked about. And we believe there are other potential synergies across both of those businesses for reducing the cost base in the infrastructure. So yes, from a cost perspective, we think it can be more efficient. From a risk management perspective, they're putting in place a number of changes at the leadership and the process level. And from a cost strategic perspective, to have access to the Japan retail market and have access to taking Japanese corporates globally is a major strategic move for us that we're frankly continue to be as excited as we were when we started. This is a stumble. We're disappointed with it. They're disappointed with it. They're putting in place the appropriate changes, but it's not something that's going to knock us off sort of 10-year vision for our business in Japan.

James Mitchell - Buckingham Research Group, Inc.

So you see a pretty reasonable path to profitability there is basically what you're saying.

James Gorman

Yes, in time. But as you know, obviously, the Japanese markets have been under pressure, and it's going to take some time to align the cost bases of the these businesses where we have combined in that market.

James Mitchell - Buckingham Research Group, Inc.

Okay, great. And, Ruth, on the risk-weighted assets, you still targeting $480 billion under Basel III. That's inclusive of the mitigation, right, of about $100 billion, I think, is the numbers. And then how do we think about -- you had mitigation on Basel I. Was, I guess I'll ask it again, was there any kind of mitigation related to Basel III yet? Or is that still to come and you still expect that to come?

Ruth Porat

So on Basel III, we're still guiding agents still, for now, look at $480 billion, net of passive mitigation. So as I said, we're not giving ourselves credit at this point for the Basel I RWA mitigation rolling through the Basel 2.5 and III, but we do intend to use that same focus as we look at 2.5 and III. So if you just hold to where we were previously, we'll continue to give you updates. That includes only passive mitigation. There are obviously other things that are quite logical like tariffs, and potentially, benefits from central clearing. But I think the other point is that in our prior guidance on Basel III, we were talking about 8% to 10% Tier 1 common by the end of 2012 with consensus earnings and the various other things we've talked about. The 10% number was contingent on the conversion of the MUFG convertible preferred, which we obviously now address today. So that's the only real update on that topic.

James Mitchell - Buckingham Research Group, Inc.

But none of the passive mitigation has come through yet?

Ruth Porat

No, on behalf of III, no.

James Mitchell - Buckingham Research Group, Inc.

Okay, thanks. And last itty-bitty question. Did you mention the dollar amount of the hedging loss for MBIA exposure or no?

Ruth Porat

The overall P&L impact was $318 million this quarter.