Good morning. This is Celeste Brown, Head of Investor Relations at Morgan Stanley. Welcome to our Third Quarter Earnings Call.

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

James P. Gorman

Thank you, Celeste. Good morning, everyone. I'm pleased to be able to talk to you about our performance in these turbulent markets. Our businesses demonstrated resilience with strength across a number of our institutional areas, complemented by stability among retail investors and ongoing performance in MSSB. I'm also happy that we will be finally able to address some of the concerns and misinformation that have weighed on the stock of late.

While it was tempting to address some of the issues as they arose, frankly, our view is that addressing every rumor is counterproductive. When Ruth walks you through the numbers, it should be apparent that the biggest challenge we face of late is subdued client activity. In fact, overall, we were modestly profitable in the quarter.

Our firm and our system have derisked, both strategically and financially, which provides the type of stability needed in all times but particularly in challenging markets. Clearly, we're in a very dynamic environment and our journey is not done. But the U.S. financial system in general and Morgan Stanley in particular has made far more progress than it is being given credit.

On the topic of the financial system, a few quick words. The regulatory landscape continues to evolve. We're managing our business with an eye towards Basel III and the SIFI buffer. We're already above the 7% Basel III base requirement for Tier 1 common and are confident about our ability to reach required levels in the appropriate time horizon.

On the liquidity front, while we are significantly above proposed LCR ratios, we believe the regulators are doing the right thing for the system and the economy by taking another look at the calibration for those requirements.

In regards to Volcker, it's far too early to determine the impact on our business model and the industry. We understand the regulators are trying to strike the right balance of preventing prop trading by depositor institutions, but at the same time allowing for market making in liquid markets.

As we have repeatedly said, we have, over the past 3 years, taken the steps Volcker was designed to address. We have shut down our pure prop trading desk, we've spun our front point, we have announced plans to spin off PDT and we have meaningfully reduced the capital levels we intend to invest in support of the merchant bank.

It is critical that the Volcker Rule does not restrict activities necessary for market making in liquid markets. We and the rest of the industry have an opportunity now to weigh in on these issues during the upcoming comment period.

Let's turn to the environment. Market conditions are challenging. We're constantly reassessing whether we are experiencing something that is secular or cyclical and under what conditions we would act to shrink or change businesses, product lines, our overall balance sheet and our level of risk-weighted assets.

I want to be very clear about something. We will continue to make whatever decisions are necessary if we indeed determine we are experiencing a secular change. We're not myopically focused on SIs, only on the returns we generate for shareholders. We will optimize our business mix and our balance sheet to generate returns that you should expect from us.

We're all very focused on expenses. Ruth will walk you through an update of our cost-cutting program, and I want to briefly address compensation as it's clearly an important lever to drive returns.

We will be balanced and remain focused on protecting our important franchises and paying those employees who are delivering differential value. At the same time, we're fully cognizant of the challenging environment and the need to deliver acceptable returns for our shareholders. That is the balance we intend to find at year end.

If you take away one thought from my comments today, it should be this. We will make the necessary business decisions that need to be made to ensure that all the changes that have taken place at Morgan Stanley since the financial crisis, including reduced leverage, the shift in our business mix towards more stable revenue streams, the MUFG conversion and strategic alliance, the more than doubled liquidity and the elimination or spin off of our prop trading businesses, among others, all of these deliver the long-term shareholder value and performance investors expect.

We're delighted with our ongoing partnership with MUFG and I particularly want to thank them for their support in the past period. We look forward to many opportunities to strengthen our relationship in the months, years and decades to come.

Finally, it would be remiss of me not to acknowledge the incredible hard work and resilience of our employees, the steadfastness of our clients during this particularly challenging 6 weeks.

Thank you. And now let me turn it over to Ruth.

Ruth Porat

Thank you, and good morning. I will address 2 broad areas. First, our results for the third quarter. Second, I will review our exposures in key geographic markets as well as the steps we have taken to ensure we have ample liquidity and funding now and in the future. Both topics exemplify the steps we have taken during the last 2 years to ensure we have prudently risk managed the firm, given the ongoing weakness in the global economy.

Our firm-wide revenues for the third quarter were $9.9 billion, up 7% sequentially on a reported basis and down 28% when excluding DVA in each period. Revenues were $6.5 billion excluding DVA. Given the impact of DVA this quarter on our results, I will provide reported numbers but then also provide certain amounts, excluding DVA, to help with comparability quarter-over-quarter.

Our noninterest expenses were $6.2 billion, down 15% from $7.3 billion last quarter. The firm-wide compensation ratio was 37% compared to 50% in the second quarter. Though excluding the effect of DVA, the ratio was 57% in the third quarter versus 52% in the second quarter. Non-compensation expenses were $2.5 billion, down 5% from last quarter. Non-compensation expenses this quarter included approximately $100 million associated with the U.K. bank levy.

Overall, for the quarter, income from continuing operations applicable to Morgan Stanley was approximately $2.2 billion. Diluted earnings per share from continuing operations were $1.14 after preferred dividends. DVA positively affected our results by $3.4 billion or approximately $1.12 per share. Period-end shares outstanding were 1.93 billion, while our diluted average shares outstanding were 1.87 billion. Book value at the end of the quarter was $31.29 per share, while tangible book value was $27.79 per share, both up 4% from last quarter.

Turning to the balance sheet. Total assets were $795 billion at September 30, down from $831 billion last quarter, reflecting lower levels of client activity and our own tight risk management. This included $180 billion of liquidity or 23% of our assets.

Although our calculations are not final, we believe that our Tier 1 common ratio under Basel I will be approximately 13.1% versus 14.6% in the second quarter, and our Tier 1 capital ratio will be approximately 15.1% versus 16.8% in Q2.

Risk-weighted assets under Basel I are expected to be approximately $350 billion at September 30. The increase in our RWAs is not reflective of an increase in risk taking but rather a change in a regulatory reporting interpretation. Previously, we applied a capital treatment for OTC derivatives collateral that reduced our overall RWAs based on regulatory reporting guidance received from the Federal Reserve.

This month, we were advised by the Fed that based on their further review concerning the application of pre-existing regulatory policy, we should adjust our capital treatment for OTC derivatives collateral. In all circumstances, our calculations have been done consistent with Federal Reserve guidance. Neither the original capital treatment nor the revision carry through the Basel III. And as such, our previously provided estimates for our Tier 1 common ratio under Basel III currently, and by the end of 2012, are not affected.

We remain very comfortable under Basel III. We were over 7% as of the end of the third quarter, assuming full Basel III inflation of risk-weighted assets, no benefit from mitigation and unfavorable treatment of NCI. In addition, we continue to remain comfortable at the high end of the 8% to 10% range we have discussed with you for the end of 2012, reflecting passive mitigation driven by position roll-off.

Now turning to our businesses in detail. First, in Institutional Securities, revenues of $6.4 billion were up 24% from last quarter, including the positive effect of DVA. Excluding the impact of DVA, revenues were down 39% sequentially.

Noninterest expenses were $3 billion, down 19% from the second quarter. The compensation ratio was 24% in the quarter. Excluding the impact of DVA, the ratio was 51%. Non-compensation expenses included approximately $90 million related to the U.K. bank levy.

The business reported a pretax profit of $3.4 billion. NCI, noncontrolling interest, was $60 million for the quarter, primarily attributable to the JV with MUFG that we managed.

Turning to investment banking. Our activities flowed mid-lower market volumes due to increased market volatility and heightened concerns about global growth with revenues of $864 million, down 41% from the second quarter on lower revenues in each major category.

At the end of the third 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, increasing our rank in global equities. Notable transactions included Texas Instruments' $7 billion acquisition of National Semiconductor; Capital One's $2 billion follow-on equity offering; and Temasek's $3.6 billion sale of equity stakes in both Bank of China and China Construction Bank. Advisory revenues of $413 million were down 23% sequentially, driven by decreased revenues in the Americas, offsetting higher results in EMEA.

Equity underwriting revenues were $239 million, down 43% over the second quarter, driven particularly by lower activity in Europe. Fixed income underwriting revenues of $212 million decreased 59% from last quarter, results primarily reflected lower high-yield issuance and loan syndication activity.

Equity sales and trading revenues of $2 billion included positive DVA of $620 million and were up 6% versus last quarter and 112% from last year. Excluding DVA, revenues declined 26% sequentially but were up 20% from a year ago.

In the third quarter, the market was characterized by high volatility, high trading volumes and a generally challenging environment for our clients. Against this backdrop, our client flows outpaced a strong second quarter and were up double digit year-on-year. We gained share in cash markets globally versus last year.

Significant growth in our derivatives and electronic trading client revenues partially offset seasonality in our European business and the effects of a relatively difficult trading environment.

Prime brokerage revenues were down modestly on a sequential basis driven by deleveraging and lower markets, although the number of clients was up. Year-over-year, revenues and balances were both up double digits.

It was recently announced that we took the top spot on the inaugural II All-America Sales Team survey. Additionally, we moved from sixth to third on a commission-weighted basis in the 2011 II All-America Research survey.

Fixed income and commodities sales and trading revenues at $3.9 billion included positive DVA of $2.8 billion. Excluding DVA, revenues were down 43% versus last quarter and 17% versus a year ago. In aggregate, our fixed income business delivered in a number of our focused areas against the backdrop of a very challenging environment. The commitment to our rate franchise is yielding positive results with revenues up both sequentially and year-over-year, driven by greater client activity.

We continue to see increased share in FX products on higher volume. Our commodities business turned in a strong performance on improve client flow. The relative weakness was in credit and mortgage revenues, 2 areas of historic strength for us. Lower results versus last quarter and last year reflect wider spreads arising from illiquidity and challenging market condition. Results in the fixed income business also included $284 million in losses related to monolines.

Surveys from Greenwich Associates indicate that we gained more fixed income volume shares than any other dealer over the last year, ranking fourth overall with 6.6 market share versus 4.9 last year, with improvements across geographies and products. The other sales and trading line reflects negative revenues of $443 million.

Turning to VAR. Average VAR decreased from $145 million in the second quarter to $130 million this quarter. As I pointed out previously, we report VAR based on a 4-year data series, which includes the 2007 and 2008 crisis period. To provide better transparency on the components of VAR, in our supplement this quarter, we have separately set out credit portfolio VAR to provide VAR both including and excluding Credit Portfolio VAR, which reflects counterparty spread volatility as well as our relationship lending portfolio and hedges.

We believe this presents a clearer view of the components driving our VAR that are isolating the risk decisions we are making to date at the trading level. As you can see in the supplement, our average aggregated VAR by primary risk category for the quarter was $93 million versus $135 million in the second quarter.

The Global Wealth Management segment demonstrated revenue stability in the face of challenging market conditions, one of the benefits of MSSB that we have highlighted previously. In a seasonally slow period, revenues of $3.3 billion were down 6% from the prior quarter, but up 5% versus the prior year. Asset Management revenues are primarily driven by asset levels at the beginning of the period and were thus roughly flat with second quarter levels and well above the year ago period. The other revenue line decreased on pure gains from sales from our investment portfolio. GWM's investment banking-related fees fell 26% sequentially as new issue underwriting volumes fell during the quarter. Trading and commissions were lower versus the second quarter, reflecting the market's impact on investments related to the firm deferred compensation and co-investment plan, though commissions were up substantially versus the third quarter of last year.

Noninterest expenses were $2.9 billion, down 8% from last quarter. The compensation ratio of 61% in the quarter continued to be driven primarily by the formulaic grid payout and business mix. Non-compensation expenses were $896 million down from $1 billion in the second quarter. The FDIC assessment included in expenses was approximately $30 million lower than our expectation this quarter, all associated with the FDIC assessment related to Citi's depositories. FDIC fees should normalize in the fourth quarter.

Integration costs were approximately $90 million in the quarter. Profit before tax was $362 million and the PBT margin was 11%. NCI for the quarter was $52 million, up from $4 million in the second quarter. Total client assets moved slightly lower to $1.6 trillion due to lower market levels, despite the highest net asset inflow since the JV's inception at $15.5 billion in the quarter. Net fee-based asset flows were $10.1 billion, contributing to the growth in fee-based assets under management to $465 billion at quarter end, up 6% year-over-year.

Year-to-date, net fee-based asset inflows were $37.6 billion, an important factor in the stability of our revenue stream. FA's at quarter end were 17,291, down just over 300 sequentially, in line with our prior comments on FA headcount. Turnover in our top 2 quintiles was the lowest since the inception of the joint venture. Bank deposits were roughly flat with last quarter at $109 billion.

Turning to Asset Management. We continue to make progress and take the appropriate steps in rebuilding our business and saw strong performance versus benchmarks in the traditional side of the business. Results were lower, primarily on markdowns in merchant banking and real estate funds due to declines in global markets. In Traditional Asset Management, revenues decreased 20% from the second quarter to $292 million, driven by lower average AUM as well as a reduction in principal transactions due to markdowns on investments associated with deferred compensation plan. In Real Estate Investing, revenues of $61 million were lower on markdowns this quarter.

Given the ownership structure of these funds, the majority of the markdowns are passed to third-party investors in the noncontrolling interest line.

In Merchant Banking, negative revenues of $138 million compared to positive revenues of $104 million in the previous quarter, driven by markdowns in private equity, particularly in the Asia Pacific region. Compensation expense was $133 million in the quarter, down from $285 million in the second quarter, driven by lower deferred comp plan expenses. Losses before taxes were $117 million. NCI was negative $18 million versus positive $92 million last quarter, reflecting the markdowns in consolidated real estate funds versus markups in 2Q.

Total AUM decreased 9% sequentially to $268 billion, driven by market depreciation and net asset outflows of $5.8 billion. As of August 2011, over 76% of our long-term strategies continued to outperform their respective benchmarks on a 3-, 5- and 10-year basis.

In addition to operating results, we have made progress in our office of reengineering, and we are thus taking up the expected savings from our 3-year program. We previously expected slightly more than $1 billion in aggregate run rate savings during the next 3 years, but now expect that figure to grow to $1.4 billion, net of cost to implement the savings with the possibility for further upside as we continue to make progress.

These savings come from initiatives that address headcount compensation and non-compensation expenses, most notably with technology costs, procurement efficiency and location strategy.

Now turning to my second topic, prudent management of the franchise. First, we have been focused on carefully managing risk in both peripheral and core Europe for the last 2 years. As you can see on Page 13 of our supplement, we've summarized our exposure for the peripherals and France. The schedule captures exposure to sovereign, financials, corporate and clearinghouses.

Starting at the far right, we have provided our net funded exposure. We have then identified all hedges to get you to exposure consistent with the way we described it last quarter. We then provided you with the 4 components of our exposure. First, the CDS adjustment, which refers to credit protection purchased from the region on the region or from France on France. Second, we included funded lending. Third, net counterparty exposure, which includes repose and securities lending, which are both by definition a matchbook, and OTC derivative, which are subject to any master netting agreements as well as cash collateral. Fourth, is net inventory, which reflects netting of our short and long and single name positions. Our exposure excludes deposits and unfunded loans.

To be clear, for the periphery, our net exposure is $2.1 billion, and excluding the benefit of hedges is $5.7 billion. This approach is consistent with the approach we reviewed last quarter.

I'd also like to bring your attention to Italy, which as you can see in the exhibit, represents about 85% of our exposure to the region and is predominantly to the sovereign. Using the same approach with France, at September 30, net exposure was less than 0, and excluding hedges, the total was $1.5 billion. Approximately $1 billion of that amount includes our guarantee fund contribution and initial margin at a clearinghouse. Excluding the clearinghouse amount, we get to approximately $500 million.

Let me turn to what is being called FFIEC data. As many of you know and have written about, FFIEC Regulatory data present notional amounts outstanding in a country rather than providing a real measure of risk. In essence, the FFIEC data are reported on some combination of notional and growth asset basis and do not reflect the liability side of the balance sheet, and thus do not reflect offset for short positions or collateral. For example, reversed repo positions are reported growth with no deduction of collateral. In some cases, OTC derivatives are presented on a notional basis. And in addition, they are presented without the netting of collateral or without the benefit of offsetting trades that may have occurred in a different jurisdiction.

In certain countries, the FFIEC data are particularly not reflective of risk exposure because the data include all volumes that go through a central clearinghouse that is located in that country. It does capture transactions taking place outside of a country.

I'll share with you a couple of items in our June data for France so you can get a sense for how it differs from what we would consider risk. 20% to 25% of the FFIEC amount is a gross up of derivatives between fair value and notional. Approximately 55% of the amount reflects reverse repos through a French subsidiary of LCH Clearnet where we clear our reverse repos as well as other cash and collateral.

Let me now address what we are doing to risk manage liquidity and funding. You've heard us say how focused we have been since the autumn of 2008 on diversifying the entirety of our funding mix, staying ahead of maturities and extending WAM to enhance durability and optimize funding requirements. With respect to funding, we raised $7.5 billion in the third quarter and $30.5 billion of unsecured funding year-to-date, thereby prefunding much of our upcoming requirements.

We plan to access the vanilla debt markets only on an opportunistic basis for the following reasons. Our balance sheet is down from an average of $875 billion in Q2 to $849 billion in Q3, and we are focused on both sides and composition. In addition, as I have often discussed, we have significantly increased our liquidity pool over the last several years, in particular, in relation to the size of our balance sheet building a valuable buffer. Our liquidity averaged $138 billion in 2008, which we increased to $154 billion in 2009 and $159 billion in 2010.

Since the start of this year, we have further grown the reserve from about $170 billion to $180 billion at the end of the third quarter. The liquidity reserve remains strong, notwithstanding the fact that during the third quarter, we opportunistically bought back approximately $2 billion of our own debt in the open market in addition to retiring $4 billion of our maturities.

The larger liquidity reserve enhances our funding flexibility during ongoing market volatility. In addition, as I discussed at a recent conference, a key input in the sizing of the liquidity reserve is our rolling forward 12-month maturity. We reached the high point last month, and the rolling forward 12-month maturities will decline by approximately $10 billion in the first quarter of 2012, providing us with the ability to use some of the liquidity reserve while maintaining the same liquidity position versus our maturities.

The 2 examples I've given, exposures and liquidity management, are consistent with the very deliberate, prudent approach to managing the firm that we have repeatedly discussed and is evidenced by our leverage down from 32x in 3Q '07 to 13x at the end of the quarter; balance sheet, down from $1.1 trillion to $795 billion; and capital, substantially enhanced, in particular with the conversion of MUFGs preferred into common, cementing our decades-long relationship.

Let me close by turning to our outlook. Like everyone else, we remain concerned about growth prospects in both the U.S. and Europe, particularly because the path to growth depends heavily on choices made by policymakers and their ability to execute. Our pipelines remain healthy, but the ability to execute transactions is clearly affected by volatility in markets. With the move we have made during the last several years with respect to our business mix, capital and liquidity, we are confident in our foundation and our focus on optimally allocating resources to enhance returns firm-wide and best deliver for shareholders and clients.

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

Question-and-Answer Session

Operator

[Operator Instructions] The first question will come from Guy Moszkowski with Bank of America.

Guy Moszkowski - BofA Merrill Lynch, Research Division

I had a question for you about debt repurchases that I think you did during the quarter, maybe you can give us a sense for amounts, timing, how you think about that repurchase activity as part of your kind of long-term capital management plans. Then I have a couple of follow-ups.

Ruth Porat

So as I noted, the amount, we did buy debt throughout the quarter. In particular, as spreads widened, we bought debt towards the end of the quarter. We thought it was a profitable, smart move to make. Just for your reference, the debt buyback is reflected in the other revenues line, just so you know where to find it. And I think our view is, again, it's about prudently managing the liquidity portfolio. So we were early focused on those maturities that, in particular, are caught in that 12-month period of time, but as spreads widened it's just a wise prudent move to make, not just continuing to act appropriately as a market maker but the right answer for our shareholders. And so I think we'll continue to monitor it and do what's in the best interest depending on where the market is.

Guy Moszkowski - BofA Merrill Lynch, Research Division

Is it ever possible to include in that debt repurchase significant amounts of the structured products that give rise to the DVA? Or have you thought about anything else you could try to do to do some -- put on some hedges or something now to try to lock in some of these very significant gains?

Ruth Porat

Well, 2 parts to your question. One, we do buyback structured notes. That's reflected in the overall debt repurchase number that I gave you. And with respect to hedging, we don't hedge DVA, the noncash item, and we don't hedge to manage an accounting result. Our view is it's not worth the expense and we really run the business based on economics. But we do, as a regular matter, buy some of it back throughout the year.

Guy Moszkowski - BofA Merrill Lynch, Research Division

Okay, that's fair. Maybe you can -- I don't know if you've got the numbers that you'll use in the Q for the monoline CBA in terms of the gross counterparty exposure, the CBA adjustments and the counterparty hedges there. If you have those at this point, they would be useful.

Ruth Porat

So the monoline number is $284 million. I think I gave that. And that obviously, CBA is included in monolines, but there's more in that number as well.

Guy Moszkowski - BofA Merrill Lynch, Research Division

Okay. Maybe I'll just follow up with you off-line just to sort of see if we can update the 10-Q disclosures without having to wait for those to come out. And then I guess the final question I have is on GWM. You talked about the fact that you had $90 million of the restructuring costs still in there and yet it certainly looks like you're capturing some significant reductions in costs, especially on the non-personnel side, relative to what we've seen. Are we starting to see some benefit from moving on to the new systems and being able to stop supporting some of the legacy stuff? Or is that something else going on?

Ruth Porat

We are pleased with the progress on the integration, having completed the platform, moved to Morgan Stanley FAs onto the platform and the success we have with it and benefits has been another way. We're able to move the Smith Barney FAs on to that platform earlier next year than we have previously anticipated, which is helpful. Part of the margin benefit this quarter, as I noted, came from the lower FDIC fee than we had previously expected coming from the Citi side. But very much to your question, Greg Fleming is very focused on expense -- disciplined expense management. And that is a core part of what he's continuing to focus on with the team. It's reflected in a number of different ways, but one example that I gave was the reduction in FAs. And what he's focused on is reducing the lower-productivity FAs, and that brings with it some incremental cost savings as well. So yes, the core part is expense discipline.

Guy Moszkowski - BofA Merrill Lynch, Research Division

And let me ask a capital management question finally, that kind of ties in with MSSB as well. Obviously, you have approval from the Fed to purchase Citi's remaining stake in the JV. And your current capital ratios are all certainly very strong in all the relevant measures, but your stock is so cheap. I just wonder what's your strategic attachment to moving forward with the MSSB timetable for repurchase relative to using some of your excess capital and liquidity just buying the shares here.

James P. Gorman

Guy, it's James. The strategic intent is pretty clear. We want to intend to own this business. But timing of executing on that is flexible. And we built in that flexibility when we negotiated the initial deal with Citigroup. Whereas you may recall, it's in 3 stages beginning in May of 2012. And it is an open-ended call option where we have the right at that point to exercise the first, next May, first 14% but not the obligation to do it at that point in time. We're obviously aware of where the stock is trading right now. It certainly feels a little better than it did 2 weeks ago, but it's not where we think it should be. And it's something that we'll take into consideration. But May is a long way off, and we've got to be careful not to mix long-term strategy with short-term tactical optimization.

Guy Moszkowski - BofA Merrill Lynch, Research Division

So it sounds like you'll make game time calls as necessary.

James P. Gorman

Absolutely.

Operator

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

Howard Chen - Crédit Suisse AG, Research Division

All of what you say on funding, risk exposures, liquidity makes a lot of sense. But whether it's a result of market rumors or not, I guess the reality of the situation is the CBS spreads widened during the quarter. So other than DVA and the opportunity to buy back debt, I mean, how exactly does that widening impact to -- what all you have to do on a day-to-day basis and in the client-facing business?

Ruth Porat

When CDS in particular widened, it's clearly frustrating when we look at what we were seeing in the number of liquidity, the exposures. What it did result in is a lot of what I think it's fair to characterize as very productive conversations with clients. We're able to talk about the changes we made that James really opened with the business mix, the approach to liquidity, funding, capital. How we fund the firm, fundamentally different than it was years ago. And that was, I think, quite productive. I made comments with respect to how we think about funding the business. Our view is that we've seen a bit of moderation here in spreads. And hopefully, with the incremental information, that will be helpful as well. But we're certainly thinking about all options and have a lot of flexibility.

Howard Chen - Crédit Suisse AG, Research Division

Okay, great. And just a follow-up to that, can you specifically discuss what, if any, movements you had in the prime brokerage balances during the quarter and maybe how much additional collateral you may have had to post in some of the over-the-counter transactions, again, if you see any meaningful changes in there.

Ruth Porat

Well, the simple answer is we didn't see any meaningful changes. In the third quarter, as I noted, PB was one of the better performing businesses in equities, that we did see an increase in the number of clients. And as we moved into the fourth quarter, we had some balances move out. We had some move in. Where they were moved, they were more likely partial than more than that, and the business remains very strong. It really did benefit from the changes over the last several years, the focus on relationship management, the focus on really working with clients across the platform, this topic of benefiting from adjacencies and institutional equities. So we really didn't see a meaningful change. A lot more conversations but not substance change.

Howard Chen - Crédit Suisse AG, Research Division

Okay. And then just returning to the monoline exposure, James. You've done a good job of leading the charge to clean up legacy issues of the firm and noted your desire to kind of achieve acceptable returns over time. So I'm just curious what's the feasibility and appetite to effectively remove this overhang once and for all, free up the risk capital, lessen the volatility in the earnings stream, is that doable?

James P. Gorman

I think you've got to play this out over time. I think we've managed -- Kenny and the team have managed the exposure much more aggressively over the last 12 months. And I think the results show that. We had a positive return in the first half of the year. We had a deficit in the last quarter. But we've got to manage this over time. There's a lot of complexity around the exposure, and it's not something that we are chomping at the bit to have results tomorrow.

Operator

The next question will come from Glenn Schorr with Nomura.

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

So you've spoken loud and clear on liquidity rising, PB actually not affected, the number of clients actually went up. Just curious, finishing off on the hoopla on the quarter, were there many novations away in the quarter? It sounds like you defended the fort great, just figured I'd ask.

Ruth Porat

No. Simple answer.

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

On the liquidity front, and we have some upcoming debt maturities, but obviously you have lots of liquidity to handle that. What's the right -- how do you strike the balance? What's the right long-term average maturity or duration of the debt outstanding? It's come down over the last couple of years to about 5 years and I didn't know how you strike the balance. Maybe that's in response to the balance sheet coming down.

Ruth Porat

Well, the reason I gave the roll forward is I think one of the critical elements in sizing a liquidity reserve is whether the likely outflows in a stressed environment -- one of the clear outflows that we can measure is what are upcoming maturities over the next 12 months. And the fact that maturities are coming down indicates that with the current liquidity reserve, if you roll forward to the first quarter and your outflows from that point on are $10 billion lower, you have flexibility within your liquidity pool. So we ended the quarter at $180 billion. We're sitting there today at $180 billion. That gives us a very nice liquidity pool going into the fourth quarter, in particular as our near-term outflows are declining because we're really knocking off the maturities as we go through the balance of -- because we have reserve for all of 2012 at this point. So that's probably one of the most important ways to think about how do you size liquidity reserve. I think as it relates to WAM, long-term debt WAM, it's generally in the same area. And we're trying to manage what we think is a prudent level. And as I've said also, when we look at what we're doing in the secured book, I think we were early and quite aggressive and thoughtful in pushing out WAM in the secured book and have continued to have that extension of WAM serving as well with the durability you've seen in liquidity.

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

In FFIEC, if you add in all your comments on both DVA from both quarters and the MBIA gain and loss, it looks like FFIEC was only down about 4% quarter on quarter, just want to see if I did the math right. And then just curious on what got better since Barclays because something clearly got better.

Ruth Porat

So we did see greater stirrings coming into the latter half of September. I think the strong areas I've highlighted, rates in particular, performed very well. And I would say commodities was strong in particular as we went through the balance of September, and up nicely, granted off of a weak second quarter, but a strong performance. The tough area continues to be credit. Although I think there was some moderation there as well.

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

Great. Last very simple one. You mentioned the cost saves projections going up net of the cost to implement. How big are we looking on the cost to implement?

Ruth Porat

We haven't broken that out separately. But the way to think about is in 2011 we're not indicating any savings. And the reason is we're really investing or spending what we need to do in order to make some of the moves, in particular in technology and location sourcing that will then yield benefit 3 years out.

Operator

The next question will come from Mike Mayo with CLSA.

Michael Mayo - Credit Agricole Securities (USA) Inc., Research Division

Question related to FFIEC. I guess there are a couple of hung deals during the quarter in the syndicated loan market or leveraged loans, Kinetic Concepts and Blackboard. Just in aggregate, how much were the write-downs on the leveraged loans that were on your books?

Ruth Porat

Well, the write-downs were about 400.

Michael Mayo - Credit Agricole Securities (USA) Inc., Research Division

So all things equal, that should go away if the market stays stable?

Ruth Porat

If the markets stay stable, it should. I mean, obviously we're mark-to-market. I think when we look at the loans, and in particular the ability to move loans through -- that the thing that we point to is that the loans have been very well structured with covenants and pricing flex that give us the ability to move some of this.

Michael Mayo - Credit Agricole Securities (USA) Inc., Research Division

And do you have any other sizable negative mark-to-market adjustments in FFIEC. And if so, which businesses?

Ruth Porat

No. As I indicated, the tough market across the board was in credit. But no there's nothing else to raise.

Michael Mayo - Credit Agricole Securities (USA) Inc., Research Division

And as far as the outlook in the leveraged loan market, there's been a little bit more noise about some issues in some high-profile companies. Have you pulled back there? Or can you consider those one-off events?

Ruth Porat

Industry-wide, you saw volumes were down meaningfully in the third quarter. And I think really what we're seeing at this point is financial sponsor activity is also down quite a bit. As we look at the M&A pipeline, it's strong, it's very healthy, but not seeing real preponderance or the growth in sponsor activity. And so at this point what we're focused on is leveraged loans in the pipeline and ongoing syndication. And as I indicated with pricing flex, we have the ability, in our view, to execute on this.

Michael Mayo - Credit Agricole Securities (USA) Inc., Research Division

And then lastly, just your outlook for the fourth quarter. With the way the markets have been, should we expect something similar to this quarter?

Ruth Porat

The wild card, as I indicated, continues to be the macro environment. So the pipeline in banking overall is healthy. I just commented on M&A. The equity pipeline continues to build. And our view is that with some moderation in the VIX, we should start to see more of those deals working their way out of the pipeline and into execution. And the benefit is not just within banking but clearly goes to the secondary trading, also goes through the Morgan Stanley Smith Barney. So that's going to be an important driver and hard to forecast. What we're seeing though, healthy volumes on the banking side. And I think a lot of the real challenge in credit, but hopefully it starts to moderate given how tough it really was the levels at which we're currently operating. So if you can give me the outlook for the macro, I could answer your question more directly.

Michael Mayo - Credit Agricole Securities (USA) Inc., Research Division

If I can squeeze one more in. The compensation ratio seems a bit higher than some of your peers, probably a lot higher than you'd like. Is that because you gave some guarantees to new traders or what's happening there?

Ruth Porat

Definitely not because of guarantees. Year-to-date -- just let me break it down. First of all, obviously the firm compensation ratio is affected by the compensation ratio in MSSB, which is as you know, formulaic running at 60% plus. And so that's one important differentiation from other firms. Within ISG, excluding DVA, it was at 51% this quarter. That brings us to about 46% year-to-date. And what we're continuing to be focused on is ensuring that we can appropriately compensate those that are delivering returns for the franchise while balancing with what we need to do to deliver returns for shareholders. So it's a balancing act but I did want to at least catch you up on the year-to-date 46%, give you a sense that the third quarter had a bit of a catch up in it.

Operator

The next question is from Brennan Hawken with UBS.

Brennan Hawken - UBS Investment Bank, Research Division

Quick question on equities. You guys highlighted high levels of client activity. But if we x out that DVA revenues were down a bit quarter-over-quarter, just trying to get a sense for what the right flow level is there? Was there some noise in the last quarter that maybe we should be looking through as far as maybe some benefit from positioning? Or can you help me kind of get my head around that one?

Ruth Porat

Certainly. So the performance was off of a record second quarter. There are, I think, probably 2 items to highlight. One is that a lot of the activity this quarter went through the electronic trading platform, or MSET electronic trading platform, which is a terrific asset but it tends to be lower margin revenue than broadly in our cash equities business. So that's one driver to where is that revenue coming from. The second, as I noted, is that the second quarter tends to be seasonally strong in Europe on an annual basis. And so we were -- we knew that coming off of the second quarter, we had that strength in the second quarter that wasn't going to flow through to the third quarter. That was well offset in certain regards with the strength in derivatives and cash equities and PB. But it did create -- it explains some of the difference.

Brennan Hawken - UBS Investment Bank, Research Division

Yes, tough comp, okay. And then just quickly on peripheral European exposure, the table is great. Thanks for that. Is it possible maybe for you to give us an idea of the impact of collateral on the net counterparty exposure column that you've got in there?

Ruth Porat

So the net counterparty exposure line, as I indicated, captures a number of different things like repo transactions. So it's really running a matchbook, and so we haven't broken that out.

Operator

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

Roger A. Freeman - Barclays Capital, Research Division

A lot has been covered here. I guess on VAR, I wanted to ask you the interest rate VAR came down, I guess that was an average basis. I guess one question, do you have the end of quarter VAR? Was it any different? And b, just want to kind of square that with the market share gains that -- it sounds like you continue to make in the third quarter or just the activity levels were a lot higher so there was less capital commitment required that brought the VAR down?

Ruth Porat

So overall, the -- if you follow with IR, I think we have all the breakdown of the various categories, which I don't have in front of me. I think the main point, VAR did come down because we saw starting mid-June client activity really coming down. And I think this line item, which I found helpful hopefully, is for you to break out credit portfolio VAR, just focus on where we're making risk decisions today, really punctuates the point about the extent to which risk is lower this quarter than it has been actually in quite some time.

Roger A. Freeman - Barclays Capital, Research Division

Okay, yes -- no, I was asking about the interest rate VAR. In that table in the back that came down. That kind of stood out given the increased commitment you've been making in that business.

Ruth Porat

Right. And that, I think that really goes to it's very much of a flow business and so you don't see as much VAR utilized there.

Roger A. Freeman - Barclays Capital, Research Division

Got it, okay. The debt that you repurchased during the quarter, what was the -- can you say what the gain was on that?

Ruth Porat

It was less than $100 million in the P&L.

Roger A. Freeman - Barclays Capital, Research Division

Okay. And are you blocked out like companies are with stock repurchases around earnings or I think can you buy debt any time?

Ruth Porat

On debt repurchases there's a window when you're blocked out, so we bought not all the way through the quarter because there was a bit of a block out again.

Roger A. Freeman - Barclays Capital, Research Division

Okay. So there probably wouldn't have been an opportunity to buy yet this quarter?

Ruth Porat

No, I think it's 2 weeks on either side.

Roger A. Freeman - Barclays Capital, Research Division

Got it, okay. Just I guess, I know there is not a lot to really answer on Volcker, but as you look at -- to whatever extent you look at the draft yet, did anything -- or what stood out as surprising relative to what you expected to see from discussions that you've had with the regulators in the preceding months?

James P. Gorman

What stood out to me was that a simple proposition of ensuring that depositor institutions don't take on aggressive proprietary trading was converted into 290 pages with an additional 394 comments, questions asking for commentary, some of which have multiple parts to them. I'm not criticizing the regulators, this is very a complex thing they're trying to find and fortunately they've opened up a healthy, I think, it's 5 to 6 months for the industry to weigh in with directive and providing a list of all of the questions that they felt needed addressed. Everybody, maybe not everybody, I think most sensible people are trying to get to a sensible outcome, which is to protect deposits from the kind of natural crisis we had, but not lose any of the robust liquidity strength of the global capital markets. So we've got 6 months to work on it and work on it we will.

Roger A. Freeman - Barclays Capital, Research Division

Is it your sense, James, that there's a lot kind of thrown in here to, because they've asked a lot of questions that they want to put more rather than less in there and have a full template to work off of?

James P. Gorman

I think it's a reflection of this is a very complex set of changes that potentially going through, and they want to be very careful to make sure they get real input from all the market participants to make sure we don't somehow mess this up.