Good morning. This is Celeste Brown, Head of Investor Relations, and 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 morganstanley.com for a reconciliation of such non-GAAP measures to the comparable GAAP figures and for a discussion of additional risks and uncertainties that may affect the future results of Morgan Stanley. This presentation, which is copyrighted by Morgan Stanley and may not be duplicated or reproduced without our consent, is not an offer to buy or sell any security or instrument.

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

James Gorman

Thank you, Celeste. Good morning everybody and thanks for joining us. Before I comment on our performance this quarter, I'll discuss our thoughts on capital returns both for this year and for the medium to long term. The recently completed CCAR was a significant inflection point for us. As you know, we secured a non-objection to increase our capital returns. We respect the CCAR process and made significant investments in that process over the past several years and we have a program specifically focused on continuing to raise the bar each cycle.

In 2013, we asked for and received a non-objection to maintain our dividend and the ability to purchase the balance of the wealth management business. In mid-2013, we applied for our first buyback since 2007 of $500 million. In this latest CCAR, we applied to double the dividend, our first increase since 2007 and a $1 billion buyback. We intend to (indiscernible) to our capital request in future years.

Going forward, we will look to drive our dividend yield to at least levels commensurate with the broader S&P, which has historically been around 2%, sustained by growing earnings from wealth and investment management. In fact, an 80 to 100% payout on just the earnings from wealth and investment management suggests an annual dividend at two or three times our recent increased level just based on 2013 earnings and share count.

In addition to growing our dividend substantially, we expect to continue to increase our buyback with a focus on both mitigating employee issuance and reducing our share count. Share buybacks will make up the difference between dividends and the total payouts which we intend to drive toward

100% of churn earnings over the next several years. Now clearly when we can do this is obviously a function of regulatory approval.

Turning now to the businesses in the first quarter, in challenging markets for institutional and retail investors, we drove our revenues and PBT higher across our three business segments versus a year ago as we continued to execute against our strategic plan. Ex-DVA, our revenues were up 4% versus the first quarter of 2013 while our expenses were up 1%. Our expense ratios improved across the segments and our overall earnings per share grew 13%. In fact, ex-DVA our earnings grew despite a significantly higher tax rate than a year ago.

ROTE from continuing operations excluding DVA improved as well to 9.8% while ROE improved to 8.3%, up 130 basis points and 80 basis points year-over-year respectively. We continue to work towards sustainably higher ROEs across all of our businesses through the execution of our strategy with a particular focus on growth in the bank, which we believe is substantial, as well as on a fixed income ROE and our broader firm-wide expenses.

I look forward to your questions at the end of the call. I'll now turn it over to Ruth to discuss the results in detail.

Ruth Porat

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

The impact of DVA in the quarter was positive $126 million with $76 million in fixed income sales and trading and $50 million in equities sales and trading. Excluding the impact of DVA, firm-wide revenues were $8.8 billion, up 7% versus the fourth quarter. The effective tax rate from continuing operations was 33%. Earnings from continuing operations applicable to Morgan Stanley common shareholders excluding DVA were approximately $1.3 billion. Earnings from continuing operations per diluted share excluding DVA were $0.68 after preferred dividends. On a GAAP basis including the impact of DVA, firm-wide revenues for the quarter were $8.9 billion, earnings from continuing operations applicable to Morgan Stanley common shareholders were $1.4 billion, reported earnings from continuing operations per diluted share were $0.72 after preferred dividends. Book value at the end of the quarter was $32.38 per share and tangible book value was $27.41 per share.

Turning to the balance sheet, our total assets were $835 billion at March 31. Deposits at quarter-end were $117 billion, up $4 billion versus 4Q. Our liquidity reserve at the end of the quarter was $203 billion compared with $202 billion at the end of the fourth quarter.

Turning to capital, although our calculations are not final, we believe that our common equity Tier 1 transitional ratio will be approximately 14.1% and our Tier 1 capital ratio under this regime will be approximately 15.6%. Risk-weighted assets are expected to be approximately $398 billion at March 31. Reflecting our best estimate of the final Federal Reserve rules, our common equity Tier 1 ratio using the pro forma Basel III fully phased in advanced approach was 11.6% at March 31. Our pro forma standardized ratio was 10.2%. We estimate our pro forma supplementary leverage ratio under the recent U.S. regulatory proposal to be approximately 4.2%. For reference, under the prior methodology, our supplementary leverage ratio is 4.5%, up from 4.2%. These estimates are preliminary and are subject to revision.

We continue to expect to see the required 5% level in 2015, including an assumption for increasing returns of capital to shareholders despite the Fed's recently announced more demanding requirements. In addition to the mitigation items we highlighted on the fourth quarter call, we see opportunities to mitigate the recent inclusion of the CDS long add-on through steps such as compression, re-hedging, and roll down.

Turning to expenses, our total expenses this quarter were $6.6 billion, down 18% versus the fourth quarter due to significantly lower legal expense, seasonality, and our focus on cost reduction. Compensation expense was up 8% versus the prior quarter on higher revenue. Non-compensation expense was $2.3 billion primarily reflecting lower legal expenses, seasonality, and cost management.

Let me now discuss our businesses in detail. In institutional securities, revenues excluding DVA were $4.5 billion, up 21% sequentially. Non-interest expense was $3.3 billion, down 29% versus the fourth quarter. Compensation was $1.9 billion for the first quarter, up versus the fourth quarter on higher revenue, reflecting a 41% ratio excluding DVA. The decline in non-compensation expense to $1.4 billion primarily reflected significantly lower legal expenses. The business reported a pre-tax profit of $1.2 billion excluding the impact of DVA. Including the impact of DVA, revenues were $4.6 billion and pre-tax profit was $1.4 billion.

In investment banking, revenues of $1.1 billion were down 17% versus last quarter, reflecting seasonality. Results represent strong performance for our first quarter across all products. According to Thomson Reuters, Morgan Stanley ranked number one in global announced M&A and number two in global IPOs and global equity and equity linked at the end of the first quarter. Notable transactions included: in advisory, Morgan Stanley acted as advisor on the five largest transactions, including as exclusive financial advisor to WhatsApp on its $16 billion sale to Facebook – this transaction reflects Morgan Stanley's continued leadership in the largest and most complex transactions in the technology sector; and as exclusive financial advisor to Suntory Holdings in its acquisition of Beam Inc. for $16 billion. This continues our leadership in cross-border activity as well as in Japan.

In equity underwriting, Morgan Stanley acted as joint global coordinator for the $2 billion IPO of Altice Group. This is the largest ever IPO of a cable operator in EMEA. Morgan Stanley also recently acted as lead financial advisor to Altice Numericable on its acquisition of Vivendi's phone unit, SFR, including acting as joint book runner on its €16 billion of non-investment grade acquisition financing.

In debt underwriting, Morgan Stanley also acted as active book runner for Exxon Mobile Corporation's $5.5 billion offering of senior unsecured notes. This transaction is Exxon's first U.S. dollar senior unsecured debt offering.

Advisory revenues of $336 million declined 25% versus our fourth quarter results due primarily to seasonality. Announced advisory transactions were up significantly versus a year ago. Equity underwriting revenues of $315 million were down 24% versus the fourth quarter driven by lower global market volumes and typical seasonality. Fixed income underwriting revenues were $485 million, essentially flat to the fourth quarter as market activity remained at very high levels. Equity sales and trading revenues excluding DVA were $1.7 billion, an increase of 13% from last quarter. Revenues were strong across regions and products driven by higher client activity. Case revenues were up driven by increased volumes in all regions. Prime brokerage revenues were up significantly driven by higher balances and robust client portfolio management activities. Derivatives revenues grew as volatility trended higher.

Fixed income and commodities sales and trading revenues excluding DVA were $1.7 billion, up significantly from the fourth quarter. Revenues increased significantly in all major products. Commodities saw broad-based strength across the energy complex driven by extreme weather in North America and increased client demand. Revenues outside of commodities were driven higher by seasonality and strength in credit products. Average trading VAR for the first quarter was $50 million, essentially flat to the fourth quarter.

Turning to wealth management, revenues were $3.6 billion in the first quarter. Asset management revenues of $2 billion were up versus last quarter, reflecting the benefit of higher market levels at the beginning of the period and positive flows. Transaction revenues decreased 10% from last quarter, consisting primarily of commissions of $540 million, down 6% versus the prior quarter due to fewer trading days; investment banking-related fees of $181 million, down 12% versus last quarter, reflecting a lower U.S. equity underwriting calendar, most notably with fewer closed-in funds; and trading revenues of $275 million, down 15% versus the fourth quarter, reflecting lower gains in deferred compensation plans.

Net interest revenue increased 2% to $539 million driven primarily by higher revenues from our bank deposit program and continued growth in our lending products. Other revenue decreased to $62 million from $110 million. Net interest expense was $2.9 billion, down 3% versus last quarter. The compensation ratio was 60%, up versus the fourth quarter due to seasonality. Non-compensation expense was $762 million, down 13% versus last quarter due to the absence of an impairment charge as well as continued expense discipline.

The PBT margin was 19%. Profit before tax was $691 million. Total client assets surpassed $1.9 trillion. Global fee-based asset flows were $19 billion, a record level. Fee-based assets under management increased to a record $724 billion at quarter-end, representing 37% of client assets. Global representatives were 16,426, essentially flat to the fourth quarter. Bank deposits were $132 billion, down $1.6 billion versus the fourth quarter. Approximately $108 billion were held in Morgan Stanley banks.

We continued to grow our wealth management lending balances and increase our penetration rates with our retail client base. Our mortgage balances increased 10% and our PLA balances increased 9%, while our committed undrawn PLA facilities grew at an even more rapid pace.

Investment management revenues of $740 million were down 12% from the fourth quarter. In traditional asset management, revenues of $437 million were up 2% from the fourth quarter driven by higher market levels and client flows. In real estate investing, revenues of $131 million were down 18% driven by lower investment gains. Merchant banking revenues were $172 million, down 32% driven by a tough comparison to very strong investment gains in the fourth quarter. Expenses were $477 million, down 6% from the fourth quarter due to declines in compensation and non-compensation expenses.

Profit before tax was $263 million, down 22% sequentially. MCI was $54 million versus $46 million last quarter. Total assets under management increased to $382 billion driven by market appreciation and increased flows.

Turning to our outlook, as we begin the second quarter, our investment banking pipeline is strong across all products. M&A is particularly robust. The pipeline is growing with an increase in activity from EMEA and Asia. On the financing side, the flow is healthy for both equity and fixed income underwriting. With respect to sales and trading, overall economic and market conditions continue to be favorable for equities; however, the challenges that weighed on certain parts of fixed income markets for much the quarter persist. On the retail side, trading activity is consistent with levels we saw in the first quarter, though we enter the tailwind from higher equity markets. In addition, we continue to have momentum with FA adoption and client penetration is increasing, an important driver of growth, profitability, and increased earnings consistency.

Over the last several years, we have assiduously worked to reposition our businesses in a way that is aligned with regulatory change. We have made the tough decisions, provided metrics to demonstrate our progress, and have a suite of businesses that are complementary.

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

Question and Answer Session

Operator

[Operator instructions]

Your first question comes from the line of Glenn Schorr with ISI.

Glenn Schorr – ISI

Hello. So I have a couple parter on commodities first, just if you could frame how much of a contributor it was to FIC in the quarter, whether it be relative to last year or prior peaks – obviously something went very well there.

Ruth Porat

Well, there were a number of important factors in the overall FIC performance, strength in commodities clearly being a big driver given volatility in the market due to weather and robust client activity; but as I noted, we also had strength in credit corporate and mortgages, and those continue to be strong areas for us. So overall, it was up meaningfully. It was the biggest driver in year-over-year performance.

Glenn Schorr – ISI

Okay, and I don't know if there's anything you can update us on. There's one of the competitors sold a piece of their physical business. You guys have been contemplating that. A, if there's an update on that/ and b, in the quarter how much of a contributor was that, just for the thought process on the go-forward?

Ruth Porat

Sure, yeah. To try and help you size it, you exclude the two physical oil businesses that we're selling, overall fixed income was up slightly year-over-year on a percentage basis, so still up excluding those two physical oil businesses. And then in terms of where we stand on that, we're continuing to work on the sale of Transmontaigne and we'll give you an update when we have something more to say on that.

Glenn Schorr – ISI

Okay, that's cool. You also mentioned and we could see it in the numbers, prime brokerage is doing awesome. Curious on how you weigh that business doing as good as it's doing with the fact that you still have the lowest leverage ratio in the group and have some work to do. So I heard your comments on what you can do in derivs land, but is there any pricing benefit that you can pass through on prime brokerage? Just curious how you balance that.

Ruth Porat

Well, I think there are really two different points within your question. Prime brokerage is a gem franchise for us. We've spent a lot of time talking about how we manage our business across nine boxes, product on the one hand, cash, derivatives and PB and geography on the other hand – Americas, Europe and Asia – and we manage really intently within each box. But over many quarters, I've talked about the importance of adjacencies, in particular with our PB clients. The deeper we go with them, the deeper they go across our franchise, so we think have a very positive, strong, mutually productive relationship with our PB clients, and that's an important franchise for us.

If I switch to the leverage part of your question, in our view we have a very strong, clear path to improve our leverage ratio, and it is consistent with the business strategy we've talked about. The real levers are things that go to things like compression trades or RWA rundown and spec, so that's a very different answer. It doesn't affect what we are talking about here on the PB franchise side.

Glenn Schorr – ISI

Okay, cool. I appreciate that. Last one – without opening too many cans of worms here, I wanted to get your thoughts on all the focus on high frequency and what it means for your equity business. How can you help us frame that? That would be super-helpful.

Ruth Porat

Sure. You know, since 2009 Morgan Stanley has been very vocal with regulators and has been on the record about the necessity for changes to market structure to protect clients. We've advocated for increased transparency and trading protocol. You can see that in docs we've filed with regulators as far back as 2009 – they're all in the public domain, so we welcome ongoing enhancement to equity market structure. I think we've been a leading voice in this area for a long time and in fact we've implemented protocol and governance consistent with this in our business.

Glenn Schorr – ISI

And then maybe just to be annoying, the book mentions a really big number for Speedway, and I think it controls a lot of volume. I don't know if you want to help us with what's the real number in terms of contribution or size that.

Ruth Porat

Well, just to clarify what it is, it's an execution tool in our electronic trading toolkit. It's consistent with offerings across the Street. We make it available to all our clients, many of whom you're familiar with, and the key to us in all that we do is risk management. Risk management checks add latency, and latency is inconsistent with extreme speed strategies. And also to clear up any source of confusion, it facilitates connectivity only to (indiscernible) around the world. It doesn't connect to any dark pool anywhere, and overall H&Ps (ph) are not a meaningful driver of our business.

Glenn Schorr – ISI

Okay, that's good for me. Thank you.

Operator

Your next question comes from the line of Guy Moszkowski with Autonomous Research.

Guy Moszkowski – Autonomous Research

Thanks, good morning. I noticed that the capital allocated to the institutional business came down by about $1.5 billion linked quarter. Is that directly related to RWA reductions that you would have had in the fixed income business, or it more complicated than that? And if it is, maybe you can explain to us what's driving it.

Ruth Porat

Sure. It is more complicated than that, but we did have a further reduction in risk-weighted assets in fixed income. They're in fact down to $199 billion as of the first quarter, down from $210 billion in the fourth quarter, so continuing to make progress there.

The way we calculate required capital is based on whatever the capital regime is in place at a point in time. In this quarter as a result of the regime change, in particular with the Basel I numerator moving to the transitional Basel III numerator, that drove the capital reallocation. The Basel III transitional numerator by definition has deductions that phase in over time, so in managing the business we look towards a Basel III fully phased in lens. There are a couple of moving pieces – yes, we reduced the risk-weighted assets, but the biggest driver here at the table is the regime change.

Guy Moszkowski – Autonomous Research

Got it. And if I can just relate the comment that you made about the increase in the old-style SLR in the quarter, which I think you alluded to about 30 basis points, how does that relate to the target that you laid out back in January for a 30 or 40 basis point increase just from exposure, compression and the like? Is that being driven by that, or were there other puts and takes?

Ruth Porat

So there were a number of drivers. As I said, we're still very comfortable – greater than 5% in 2015, and with increasing returns of capital. This quarter in the numerator, we benefited from higher earnings, and as we talked in prior calls, that adds what I keep calling a multiplier effect because it reduces the deductions on DTAs, and importantly it also increases the investment capacity for those items that get into that 10% bucket, thereby reducing the numerator deduction.

In addition to that, we have been quite focused on mitigating some of the numerator deductions, so you're seeing the benefit of that beginning to flow through, and then in the denominator of course we continue in with compression trades in RWA reductions, as I indicated.

Guy Moszkowski – Autonomous Research

Got it, and then just to beat a little bit on the SLR horse, there has been a proposal made just in the month of March by Basel—people assign different acronyms to it, but I've heard SACCR, which would be a standardized approach to counterparty credit, which I've heard broadly could be a plus as well. I was wondering if you had done any numbers on that preliminarily.

Ruth Porat

Yeah, if SACCR is adopted, that would be about a 50 basis point benefit to the SLR and a 30 basis point benefit to the standardized ratio.

Guy Moszkowski – Autonomous Research

Wow, so it's quite meaningful.

Ruth Porat

It is.

Guy Moszkowski – Autonomous Research

And you're calling it SACCR – is that a patented Morgan Stanley term?

Ruth Porat

You can use it if you want.

Guy Moszkowski – Autonomous Research

Okay, thanks. I guess the only other question that I would really have would be if you could—you know, we talked a little bit about commodities and the fact that fixed income would still have been up, or FIC would still have been up year-over-year even with the planned sales having taken place. Can you give us a little bit more color on what you saw in the rates business in the quarter, because obviously for banks that have a heavier contribution from rates and from FX, so what's called the macro businesses, we saw much, much weaker results so far.

Ruth Porat

Well look, I think that we—and I said this—and we saw the same headwinds you've heard from others with lower client activity. That was a tougher market, just given all that was going on in the environment. For our rates business, it was down year-over-year, reflecting lower volumes, but up nicely versus last quarter. We are really focused on this centralized, federalized resource management across all of the macro product, but it was a tougher part of the market.

Guy Moszkowski – Autonomous Research

Got it. So mix was just one of the more important differentiators for you guys, I guess?

Ruth Porat

It was. As I said, it was commodities, it was credit, it was mortgage.

Guy Moszkowski – Autonomous Research

Right. Just one final question on wealth management – a 10% increase in the loan balances linked quarter is obviously strategically what we want to see, but it is a very large percentage on what's starting to be a fairly sizeable business. How comfortable are you that your risk controls are where they need to be in what's obviously been a tough mortgage market?

Ruth Porat

So the growth—again, we've got a couple of things going for us. One is very low penetration with a very large client base. We're meaningfully underpenetrated versus our peers, and we've been slow to build this product precisely for the reason you flagged, which is top of our list, which is ensure tight, proper credit risk management and all of the processes around it, as well as ensuring that it's a good experience for our clients and our financial advisors. So it's up a nice percentage.

I would say the other thing that's benefiting that is it's up a nice percentage off of a small number, and we're continuing to see good growth in the mortgage side given this low penetration. We're finding that FAs who use the product are using it longer and increasing their penetration. The credit standards are very tight – you know, FICO (indiscernible) 50, LTV 60%; and again, it's with our client base so we know the clients. We have their assets here.

The other growth area in PLA is a very—is the highly over-collateralized, significantly over-collateralized product, as I think you know. It's securities-based lending, and again it's all with our existing client base. There's virtually no credit losses to date, and risk management has been the driver across all of these businesses.

Guy Moszkowski – Autonomous Research

Great. Thanks so much for taking my questions.

Ruth Porat

Thank you.

Operator

Your next question comes from the line of Brennan Hawken with UBS.

Brennan Hawken – UBS

Good morning guys. So just a real quick one to clarify, I believe, Ruth, you said that your IB backlog is up. Just wanted to make sure – is that based on year-end, because Goldman highlighted that their IB backlog actually shrunk since year-end.

Ruth Porat

So our backlog is up across all products from year-end. M&A, as I noted, in particular is strong and the pipeline continues to build. I think you can see that just from the flurry of announcements that have occurred since quarter-end.

Brennan Hawken – UBS

Yeah – no, it's great. It's just good to see continued momentum there. Then another one – the CCAR was sort of a surprise here to some firms this year, and I guess the Fed highlighted some process improvements in their comments. Do you guys have any outstanding process improvements with the Fed, and was there anything in that CCAR process that sort of jumped out that investors should be aware of?

Ruth Porat

So I think the whole industry is waiting kind of the formal Fed feedback process, but I think—you know, we generally received positive feedback about our processes. As James said in his opening comments, we've invested meaningfully in the process and for the last several years, we had something we call our CIP program – continuous improvement program. So regardless of what we even hear back, we look to up the approach and the analytics each year, and that process hasn't stopped. We continue to raise the bar for ourselves on the overall process. We feel good about our processes around CCAR.

Brennan Hawken – UBS

Terrific. And is it your view that the Fed feels good about your processes as well? I understand you can't—based on the information you received from the Fed, is that your perception?

James Gorman

Brennan, I don't think we want to get in the business of trying to explain what the Fed's view or isn't. All that mattered to us is we put in for a buyback and dividend and they are approved, and we're continuing down the path that we laid out.

Brennan Hawken – UBS

Appreciate it. Just trying to maybe get some insights into what is proving to be a very murky process for all of us on this end.

James Gorman

Understood.

Brennan Hawken – UBS

Then is it right that you guys have slimmed down your management structure in wealth management? I think we saw a reduction in the number of divisions and regions. And maybe, could you help us think about whether that's driven by potential expense basics or whether that's done to slim down decision-making and the like. Maybe help us understand that move a little bit.

James Gorman

I think it's probably what I would describe as the last gasp post-the integration. This has been a four-year integration, and now that the business is very stable, I think the FA account was flat to maybe modestly up. The new leadership under Shelley O'Connor determined that she could make some changes there to just make the organization faster moving, a little more nimble, a little more efficient, and put the team in place to make that happen.

Brennan Hawken – UBS

Great. Thanks a lot for taking the questions.

James Gorman

No problem.

Operator

Your next question comes from the line of Mike Mayo with CLSA.

Mike Mayo – CLSA

Hi. So to the extent that prime brokerage has performed better, can you give us any numbers around that – what are the prime brokerage revenues this quarter versus a year or two ago, or can you give us some market share figures around your prime brokerage business?

Ruth Porat

Well as you know, we don't break out components within businesses. The client balances and revenues are all up quarter-over-quarter and year-over-year.

Mike Mayo – CLSA

Okay, and how does it compare to the time of the crisis? I remember a lot of clients were leaving Morgan Stanley and then they've come back. Have you gotten back to pre-crisis levels? Do you expect to get back there?

Ruth Porat

These are the highest balances that we've had since the crisis. We've continued to nicely steadily build.

Mike Mayo – CLSA

Okay. Shifting over to wealth management, you're redeploying the deposits. What are the yields and margin that you're getting as you deploy those deposits?

Ruth Porat

So last quarter in the deck, we laid out a couple of things because we thought it was important as everyone was doing their analysis that we show you what the asset growth would be and the changing mix over time as we moved from cash into FAS and loan deployment and included yields there, current yields, and then just to follow the forward yield curve. Those really haven't—you know, we're getting the benefit of the improving mix, but yield by product hasn't really changed much, as you can see, with the rate environment. But really, the upside to us is the ongoing deployment across the portfolio.

Mike Mayo – CLSA

Separately, I'm looking at your deck from January where you said you wanted to drive ROE above 10% in fixed income and commodities. Did you exceed that in the first quarter, and how is that progressing?

Ruth Porat

Well, we've certainly had progress because you can see the revenues, and I just provided the RWAs. So we've had higher revenues, reduced RWAs, now down to $199 billion – that's relative to the $210 billion last quarter, and to about 250-ish last year. So we're certainly getting better returns in that business, and our view is that we have more do to there.

As we said, when we look at ROE and we're managing to ROE in that business, it's about revenues, expenses and capital optimization, and the team is continuing to focus on all of those.

Mike Mayo – CLSA

Can you give us any update on the run-off of legacy assets in FIC?

Ruth Porat

I think you sort of get that, Mike, in the RWA rundown. So that's a combination of passive and active, and part of the active is how trades are structured and part of it is actually running down as much as we can as rapidly as we can. So if you go back to third quarter of '11, we had $390 billion of risk-weighted assets in our fixed income business, and as you know, we keep bringing forward our target in time. We dropped for that $180 billion from 2016 to 2015, and what that really captures is your question – we're running down those legacy assets as rapidly as we can. We are pleased to have that deadweight capital pushed out of the business.

Mike Mayo – CLSA

And then my last question – your ROE target is for a 9% ROE, and this quarter you're still below that. Can you either re-affirm or give us a time frame when you think you'll achieve your ROE target? I'm not seeing return on tangible common equity – if you can give that to us, too.

Ruth Porat

Right. So on the ROE, we're looking at an ROE in excess of cost of capital. We're talking about a 10% ROE. I appreciate you're looking at the building blocks we provided last quarter. We did see progress across our businesses, and our view is that the upside continues to come from the bank. It's in its early days, and given the opportunity with the bank and moving again from over-weighted in cash to deployment into loans as well as AFFs, there's a real benefit there, the continued focus on expense management and then the ongoing higher return to capital. That 9% number is obviously without higher capital returns. We're pleased to have doubled our dividend, doubled our share repurchase program, and as James said, our intent is to continue increasing return to capital over time.

Mike Mayo – CLSA

So just to be clear, so now your target—since you're able to return capital now, your target is now 10% return on common equity?

Ruth Porat

Our target has consistently been 10%. What we tried to break out last quarter was what it would be without higher return to capital, and then the return to capital takes it above and beyond that. But we continue to be focused on 10% return on capital as kind of the next stop along the way.

Mike Mayo – CLSA

Okay, and this quarter return on tangible common equity was what?

Ruth Porat

Nine-point-three—9.8, I apologize Mike. Nine-point-eight.

Mike Mayo – CLSA

Okay, 9.8. Okay, thanks a lot.

Operator

Your next question comes from the line of Steve Chubak with Nomura.

Steve Chubak – Nomura

Good morning. I wanted to discuss your 10% FIC ROE target for a moment. Clearly the progress you've made in mitigating RWAs has been nothing short of extraordinary, which has driven required capital levels down pretty meaningfully. What I'm wondering is given the tough treatment for derivatives under the modified SLR approach, even when we contemplate some of the future benefits from various forms of mitigation, whether it's CDS maturity matching, SACCR model approval, et cetera, it appears that required capital for FIC under the modified SLR calculation could still be pretty materially above that under the risk-based framework. So essentially, I just wanted to clarify that the 10% FIC ROE target which you've highlighted in the past is still achievable whether one evaluates under a leveraged or a risk-based lens.

Ruth Porat

Yes, and we look at our businesses under a risk-based and leverage-based capital lens now. It's the current leverage-based capital rule; but again, we have the added lens of what's at the SLR and business unit leaders have their balance sheet under that SLR lens, and that's helping really put a spotlight on the opportunities for mitigation in the areas where mitigation is absolutely key. So as you pointed out in your question, there are additional work streams that can added to that, which we discussed last quarter, with the inclusion now of net long CDS, so that opens up an added work stream. So we do see a good path forward to greater than 5% under the SLR, including higher return to capital; and yes, we hold ourselves accountable for that greater of risk-based capital and leverage-based capital.

Steve Chubak – Nomura

Okay, thanks. That's really helpful. One of the things I wanted to inquire about was the Fed had clearly stated its plan to consider applying additional capital surcharges on wholesale borrowings. The details that have been disclosed thus far regarding the methodology or the potential approach remain somewhat murky, but I wanted to see if you had any additional thoughts or insights regarding how that rule-making could potentially shake out.

Ruth Porat

So you're right – the rule is—the discussion at this point is unclear. I think the terms that have been used, such as short term wholesale funding is one phrase. We talk a lot about the difference between short-term wholesale funding and durable funding, and we've invested quite meaningfully, as we've talked about on many calls, to term out our secured book, and that's built in durability that has been evident in all sorts of periods of market stress, market stress in Europe. We think that liquidity durability is important. You know, our LCR, we're well north of the 100% requirement in large part because of all that we've done, all that we've invested. I mean, it doesn't come for free – it's expensive to term it out and get that durability, but we have an LCR that's higher than 100% for that reason and we're very supportive of the Federal Reserve's focus on CLAR, the mirror test of CCAR but focused on liquidity, given all that we've done to build in what is a very durable approach to liquidity and funding.

So don't know which way it goes because some terms are being used in a sort of broad way; but again, given what we've done with our capital stack, we feel that we've built in a lot of the durability that is what regulators are looking for.

Steve Chubak – Nomura

Okay, and I guess one more question on the SLR proposal. Parsing out the language in the Fed's document, it highlighted two key size criteria for identifying systemically important banks, one being GAAP assets in excess of $700 billion and AUC in excess of $10 trillion. Based on your interpretation of the Fed proposal, do you believe that the GSIV (ph) classification can potentially be avoided for those banks which operate below those designated thresholds, and specifically would you consider optimizing your balance sheet size if it enabled you to potentially bypass the tougher 5% leverage rule, or is that simply not a viable strategic option given growth initiatives at the bank and other potential opportunities that will drive future balance sheet growth?

Ruth Porat

Well, given our suite of businesses and the strength of these businesses, we don't see going below $700 billion as practical. In particular, we see the opportunity to mitigate a number of the items, as I've already discussed, both the gross up in the denominator and reduce some of the deductions in the numerator, which are accretive to the SLR. If you look at some of the—the relationship across our various businesses, so for example as I talked about on prior calls, within our investment banking franchise, quarter after quarter after quarter, we've had about $500 million of fixed income underwriting, and that's a service that our clients want, it's accretive to the overall relationship, it's accretive to the bottom line for the firm, and it does require that we have a corporate credit capability – you know, origination and distribution. So there are a lot of linkages between the businesses, increasingly so with the wealth management business, and our view is that when we look to the single most important thing, which is how do we drive ROE for this firm given there is a path to increase the SLR that enables us to keep the suite of products as we've defined them and as we've reshaped what we're doing in fixed income, our judgment is that the best way to drive ROE is with this suite of products, and we don't see how that would take us lower than $700 billion of assets.

Steve Chubak – Nomura

Okay, understood. And just one final one on the numerator upside you had discussed regarding the SLR. We really appreciate the helpful detail in terms of the individual components that you disaggregated driving the 80 basis point build in the SLR over—towards that 5% goal. I was hoping you could at least clarify the level of incremental preferred issuance that's assumed to help close that gap, just to get some clarify on those which will impact future earnings versus those which will have—essentially be earnings neutral.

Ruth Porat

Sure. So the—as you saw, we did about $2 billion of preferred last year – that was in two transactions. We will continue to optimize our capital stack and do think that preferred plays a valuable role in that, so we're going to continue to leg into more over time. I think when you—you know, the two that we did last year, you can see that we tried to size them—modestly size them or appropriately size them, whatever word you want to use for it, and we'll continue to leg into more of time. So that is another addition to the numerator.

I would say that what we're quite pleased about is the pace with which we've been able to mitigate a number of those numerator deductions, and that investment basket has within it a couple of opportunities to continue to mitigate some of the numerator drag.

Steve Chubak – Nomura

That's great. Thank you for taking my questions, and congrats on a strong quarter.

Ruth Porat

Thank you.

Operator

Your next question comes from the line of Matt O'Connor with Deutsche Bank.

Matt O'Connor – Deutsche Bank

Good morning. Can you update us on the expense efforts? Obviously good revenue this quarter, so expenses were higher; but it sounded like in the past that there's still some opportunities within FIC to manage the expense base. I was hoping for an update either on FIC expenses or just overall expenses.

Ruth Porat

So we're very much on track for the expense target ratio that we laid out at the end of 2012, going into 2013; and just as a reminder, at the time we had an 84% expense ratio, and with the $1.6 billion reduction, assuming revenue's constant so you don't have to adjust for the noise around activity-based revenues, we said we would get to a 79% expense ratio, excluding elevated legal expenses and, if there any write-offs, any write-offs, and that would be by the end of 2014.

This quarter, we're at a 75% expense ratio excluding DVA, so I think what that underscores is expense—you know, very much part of the DNA of all of our business leaders. We have the balance of the year to continue focusing on expense reduction, but it's built into programs across all of the various businesses and we're constantly looking for ways to add to the program. It doesn't end this year; it keeps going. It's just business as usual at this point, but we're pleased that we're at a 75% expense ratio relative to that 79% with still more time to get to the end of the year, when we said we would hit that number.

Matt O'Connor – Deutsche Bank

Okay, and if the revenue environment improves, a little bit tougher from here in, say, the markets businesses, do you feel like you can still maintain the expense ratio around here, or still look back towards a 79% goal?

Ruth Porat

So what we indicated was that we would be at a 79—back at the end of 2012 when we laid out the $1.6 billion, we said a 79% expense ratio assuming revenues were flat to 2012. Again, depending on where the world goes, I think what we've evidenced over the last many years here is that we don't stand still, but we're pleased with the way we're starting off the year.

Matt O'Connor – Deutsche Bank

Okay. Outside of the core expenses, it didn't seem like there was any unusual litigation this quarter. I know it's really hard to tell looking forward, but any thoughts on how we should be modeling out litigation expense from here?

Ruth Porat

Well, you sort of answered the question – it is lumpy, as you've seen. Our view is that litigation does remain a headwind for the industry. We're pleased to have FHFA behind us, but legal can be lumpy, as you've seen.

Matt O'Connor – Deutsche Bank

Okay. And then just switching to the wealth management, the 19% PBT was in line with what we had for this quarter. Just any updates on how you feel about the 22 to 25% target by the end of next year?

Ruth Porat

We still feel very good about that, and I'll hold that as something that we are looking to deliver. As you know, that doesn't assume any benefit from rates in the environment. We've got a number of factors that are taking that higher. I think one of the important ones really is what we're continuing to do with lending product and the benefit from the growth in lending, and you can see the ongoing momentum there. What we're pleased about is we've always said we have a bit of a tailwind given we're underpenetrated with our clients, and what we're seeing is as FAs starting working with their clients with lending product, they continue to further penetrate their client base and we see much more of a take-up. So that is an important element of it, along with, back to your prior question, the continued focus on expense management.

Matt O'Connor – Deutsche Bank

Okay. All right, thank you very much.

Operator

Your next question comes from the line of Michael Carrier with Bank of American Merrill Lynch.

Michael Carrier – Bank of America Merrill Lynch

Thanks for taking the questions. Just maybe a follow up on the wealth management business. You mentioned some seasonality in the first quarter versus the fourth quarter, I think fewer days. Maybe just a little color on the comp – Matt just asked about the margin, about how that impacts it, and just the outlook as we kind of go throughout the year, just assuming less seasonality.

Ruth Porat

So as you said, seasonality comes from a couple of things. One is several fewer trading days relative to the fourth quarter. There's also seasonality on the comp line because FICA is a first quarter event, so when we compare our 19% quarter this year to our 17% quarter last year, that's really isolating the difference in quarterly seasonality and a nice pick-up from the 17% last year to the 19% this year.

What we also saw in the first quarter this year was some lower issuance activity, in particular in closed end funds, and what's of greatest interest within the wealth management system is U.S. new issue product, and in particular closed in funds, and that was just a bit lower. We had a nice underwriting calendar but it was more skewed outside of the U.S. and very little in closed end fund activity. So as we're looking forward to the second quarter, we have a couple tailwinds going into the second quarter. Asset management fees will be modestly higher given the starting S&P level, and we're clearly focused on the transaction volume which is a function of the environment and the new issue calendar; but the pipeline is stronger in the U.S. It's clearly too early to tell, but it's stronger in the U.S. And then in aggregate, expenses should be a bit lower given the comp point I made – FICA being a first quarter event, and non-comps do tend to be a little bit higher in the second quarter but overall should result in an improved margin here.

Michael Carrier – Bank of America Merrill Lynch

Okay, thanks. And then just as a follow-up, just on the trading side, whether it's on equities or fixed income, anything lumpy this quarter, and then any color—I know it's still early, but on the fixed income side in terms of the OTC markets transitioning on to SEF, like any color there. Thanks.

Ruth Porat

So as it relates—nothing really lumpy to note. I mean, we had—there was a good volume of activity, prime brokerage activity with portfolio rebalancing, just given volatility in equity markets; and then in terms of the impact of SEF on the market, we really think the lower volumes last quarter were related to broader market events, and in particular lower volumes in macro, as I've already commented on, given all that was going on globally, and markets lack conviction – they traded in a tight range. Spread product did better, but macro was weaker, and we think it's very tough to disaggregate the extent to which, if at all, that was really SEF-related. We think that it was swamped by what was going on in macro.

Operator

Your next question comes from the line of Jim Mitchell with Buckingham Research.

Jim Mitchell – Buckingham Research

Good morning. Just a quick follow-up on the expense question. I just want to check – if you think about your closest competitor on an apples-to-apples basis, they're at around a 70% expense ratio. You guys are 75% in the strongest quarter, a target of 79%. Do you think this is an interim target and you can get more as you move forward as revenues get better, and/or you still have some more expense leverage elsewhere? Can you just kind of walk through that?

Ruth Porat

Well, I obviously can’t comment on any other peers, and we each have different business mixes. You know, I’m often asked the question about our comp ratio, as an example, and the comp ratio in wealth management is off of a formulaic grid so it starts higher than their institutional securities business. And is it trending lower? Yes, it absolutely is trending lower. We’ve talked about that quite a bit. It will continue to benefit from the growth in lending product, but you’ve got some real apples-to-oranges comparisons if you just start with that line.

As it relates to our non-comp expenses, we’re continuing to see benefit across the franchise, the ability to use technology more broadly across the franchise as an example, and so we are focused on the items that we identified internally as part of the 2014 plan, as I said. We’re continuing to add to it because it’s part of the DNA within all of the business unit leaders to look for opportunities to be efficient, whether it’s working across divisions or in any other approach to the business. But just going back to my comp differential, I’d say part of it is also business mix.

And to be clear, those business mixes also have different capital requirements, and there are a whole host of different elements that go along with it. So when we talk about ROE, it’s revenue, expenses and capital.

Jim Mitchell – Buckingham Research

Fair enough. I was just talking about the institutional business, but I hear your point. Maybe just quickly another question on the dividend. I think James had mentioned looking at a payout that would approximately or get close to the net income of the wealth management business, but as that business grows, it seems like if you were to approach that level of dividend payout, you’d exceed the sort of 30% soft cap with the Fed. Do you think that is doable?

James Gorman

I don’t want to get into sort of hard projections, but what we’re indicating is that with our business mix now, with half the firm’s business essentially coming from a relatively stable annuitized set of businesses in wealth and asset management, one thinks about your dividend payout a little bit differently as it relates to your ability to afford it coming from things that you know are fairly predictable.

Obviously when you aggregate it all, you come up against what appropriate payout levels are at a regulated level, and that’s a different question. We’re simply indicating we believe we have capacity, given our business mix.

Jim Mitchell – Buckingham Research

Okay – no, that's helpful. One last quickie – on the physical oil sale, you mentioned or sort of gave a guide on the revenue impact. What would be the net income impact? I assume it's a lot smaller.

Ruth Porat

In terms of the businesses that we are looking to sell, as I indicated last quarter, one of the things that was quite intriguing was precisely that, is the more modest PBT and we're reducing risk-weighted assets pretty meaningfully.

Jim Mitchell – Buckingham Research

So it's ROE-accretive?

Ruth Porat

Yeah, and that's over—obviously over time. You have to transition these things.

Jim Mitchell – Buckingham Research

Sure, right. Okay, great. Thanks.

Operator

Your next question comes from the line of Devin Ryan with JMP Securities.

Devin Ryan – JMP Securities

Hey, good morning. How are you? I just have a couple follow ups on investment banking. So I guess first with respect to M&A, announced activity in North America has actually recovered since August levels 2007, but you guys have been noting on the last couple calls here that EMEA more recently has been feeling better. I just wanted to get some thoughts – does it feel like we're still on a distressed asset sale cycle in Europe, or are you starting to see more traditional strategic M&A accelerating there, which I think would be necessary to see a real recovery in activity in that region.

Ruth Porat

Well, we've seen some broadening across industries of activity, and what we still haven't seen is a real growth in the number of deals, but if you look at the dollar volume in EMEA, it's up, and the acquirer activity out of EMEA, cross-border activity is up. So again, it's early days but what's very positive is whenever a negative trend reverses itself. And comparable to GDP growth in EMEA is still modest, but it's gone from negative to positive and we're starting to see the knock-on benefit to some of the activity levels.

James Gorman

And I would just add the largest economy and the economy that's doing best over there is Germany, and having made a couple of trips recently, I think the corporate CEOs are still quite conservative in their views, so there will be a tipping point here. Obviously with what's going on with Russia and the Ukraine, that's putting a damper particularly on the German CEO view until we get better clarity there, but I think there will be a tipping point and we're not there yet. There have been isolated transactions across the U.K., Spain and other places.

Devin Ryan – JMP Securities

Great. Appreciate that color. And then fixed income underwriting results have obviously also remained really resilient, and I know it's still an attractive rate environment but are you starting to see a mix shift there at all in terms of what products are really driving this strength? Has there been any change in mix?

Ruth Porat

There has in the sense that it's been much more of a refinancing story, and now we're starting to see the benefit of the higher levels of M&A. In the first quarter, I think what was notable was there were a lot of deals across investment grade, high yield, leveraged loans. It wasn't as though there were some really big, chunky items that drove the quarter. It was a balance across the various products. But what you're starting to see is much more of this is event-related, and we think given the pipeline in M&A, that bodes well for continuation of strong debt underwriting, notwithstanding the fact that we've had a long string here of strong quarters with debt underwriting.

Devin Ryan – JMP Securities

Okay. I guess just with respect to how that ties in with FIC results, there was a flurry of activity in corporate issuance in March, so I'm just trying to get a better understanding around the strong results within credit and maybe how much of that was a function of issuance really starting to pick up towards the tail end of the quarter. Any color around maybe how credit specifically progressed throughout the first quarter.

Ruth Porat

Credit on the fixed income side was pretty consistent throughout the quarter. I think if you go back a couple of quarters ago when there was more volatility in credit markets, what you saw was notwithstanding a strong new issue calendar, it was pretty much buy and hold and you didn't see the follow-through to secondary trading. You're seeing more of that follow-through to secondary trading now, and hopefully that continues, in particular given the volume of what we would expect would continue to be new issue product on the fixed income side, assuming the M&A pipeline continues to hold up and we see the execution continuing as it has these first couple of weeks in the quarter.