Good morning. This is Celeste Brown, Head of Investor Relations. Welcome to our Third 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 everyone. Thank you for joining us. In the third quarter, the fruits of our strategy were evident. Despite a challenging quarter for markets, our results demonstrated consistency and durability of our business models. Our EPS, excluding DVA and the charge for the wealth management acquisition last year, was up sequentially in a seasonally weaker quarter and with higher legal expenses. More important, however, we remain focused on our long-term objectives.

Starting with Institutional Securities, our results underscore the power of our integrated models. Our outstanding leadership and equity sales and trading again benefited us this quarter and we generated our highest revenues in the third quarter since 2008. We continue to be first or second globally with our continued success driven by the focus on clients, the sustained investments in technology and targeted investments in certain areas of the business. In investment banking, the focus we have placed on improving our wallet share in certain areas has paid dividends as growth and our market share increase in debt underwriting offset lower market wide advisory and equity underwriting volumes. Cross border activity continues to be a dominant theme and Morgan Stanley remains the number one ranked firm in terms of cross border advisory activity benefiting from the strength of our global client franchise.

The cohesiveness of our model was illustrated by the Verizon deal where we are leading one of the biggest M&A transactions in history but also co-led the $12 billion bank loans syndication and the $49 billion senior note offerings. At growing deposit base provided us with an important additional tool in this transaction. We also remain focused on ROE in the fixed income and commodities business and continuously evaluate every aspect of what we're doing. We stayed very close to home in regards to risk in third quarter due to the liquid markets and this is evidenced both by our average and period end VAR.

We continue to reduce risk weighted assets in the business and in the third quarter at 213 billion. Recalled that this number now excludes the IWA is associated with lending. However, we’re investing in other areas of fixed income that are core to our future including our people and technology. Turning now to wealth management, the third quarter was the first full quarter during which we owned a 100% of the business and we are just beginning to see the benefits. Despite seasonality and a relatively subdued trading environment revenues were essentially flat and we improved our margins and profitability once again. The revenues and margins were supported or driven by some of the benefits of the acquisition. Elimination of the order flow agreement and continued growth in net interest income both of which generate high incremental revenues and higher incremental margins I should say now traditional advice and commission revenues. In addition we retained a 100% of the earnings associated with the business. Obviously increasing net income to the firm from wealth management in this case by over 30% sequentially.

As we have discussed with you in the past, this business and the acquisition will continue to drive upside for the firm and it's stakeholders as we prudently deploy the balance of the deposits from our former partner over the next several years in both wealth management and institutional securities. We can generate attractive ROEs on the assets supporting the deposits in the retail and institutional businesses even in the low rate environment and without reaching for risk. This is due to the relatively low funding cost, the lack of bricks and mortar and our embedded client base.

While we do not discuss investment management frequently it's earnings contribution continues to grow in absolute terms. We have been very pleased with the investment and financial performance of our traditional investment management real estate and merchant banking businesses.

The continued progress in regards to performance coupled with disciplined expense management drove the highest PBT in that business since 2010. We remain focused on our expense programs more broadly and continued to make progress towards our goals although the results are less evident this quarter because of elevated legal expenses. We expect to meet or exceed our expense targets excluding litigation. In the meantime however we will continue to reap the benefits of our strategy leveraging our world class franchises upside from wealth management and deposit growth, intense focus on expense management and thoughtful capital allocation. As you would expect we began buying back stock in the quarter. This is the first time since 2008 and we look forward to increasing capital returns to shareholders overtime. I will now turn the call over to Ruth.

Ruth Porat

Good morning I'll provide both gap results and results excluding the effect of DBA. We have provided reconciliations in the foot notes to the earnings release to reconcile these non-GAAP measures. The impact of DVA in the quarter was negative 171 million with 141 million in fixed income, sales and trading and 30 million in equity sales and trading. Excluding the impact of DVA, firm-wide revenues were 8.1 billion down approximately 3% versus the second quarter.

The effective tax rate from continuing operations for the third quarter was 25.3% inclusive of a discreet benefit. Earnings from continuing operations applicable to Morgan Stanley common shareholders, excluding DVA, were approximately $983 million. Earnings from continuing operations per diluted share, excluding DVA, were $0.50 after preferred dividends. On a GAAP basis, including the impact of DVA, firm wide revenues for the quarter were $7.9 billion. Earnings from continuing operations applicable to Morgan Stanley common shareholders were $862 million. Reported earnings from continuing operations per diluted share were $0.44 after preferred dividends. Book value at the end of the quarter was $32.13 per share, up 2% versus the second quarter. Tangible book value was $26.96 per share, up 3% sequentially.

Turning to the balance sheet. Our total assets were $832 billion at September 30 up versus last quarter due primarily to the growth in our deposits pursuant to the contractual agreement associated with the acquisition of the remainder of the wealth management business. Specifically, deposits as of quarter end were $105 billion, up $23 billion versus 2Q of which $21 billion was due to on-boarding of deposits from our former JV partner and the remainder was from organic deposit growth. Our liquidity reserve at the end of the quarter was $198 billion compared with $181 billion at the end of the second quarter. The increase was also driven higher by the recently on-boarded deposits, most of which have not yet been deployed thus resulting in elevated levels of bank liquidity. Our non-bank liquidity level also remains elevated.

Turning to capital. Although our calculations are not final, we believe that our Tier 1 common ratio under Basel 1 will be approximately 12.6% and our Tier 1 capital ratio will be approximately 15.3%. Risk-weighted assets under Basel 1 and including the final market risk rules are expected to be approximately $386 billion at September 30. Reflecting our best estimate of the final Federal Reserve rules, our pro forma Tier 1 common ratio under Basel III was 10.8% as of the end of the third quarter.

Pro forma risk-weighted assets under Basel III are estimated to be $414 billion. We estimate our pro forma supplementary leverage ratio to be around 4.2%. This estimate reflects the United States proposed regulatory rules for the numerator and the denominator and is subject to change if rules evolve. Our ratio was consistent with second quarter levels despite no longer reflecting the benefit of clearing as a deduction from the denominator and the increase in deposits in the quarter, which on a combined basis, reduced the ratio by over 30 basis points. We continued to expect to exceed the required 5% level in 2015 including an assumption for a greater return of capital to shareholders.

Turning to expenses. Total expenses this quarter were $6.6 billion, down 2% versus the second quarter. Compensation expense was down 3%. Non-compensation expense was flat to 2Q notwithstanding higher litigation expenses, which have been elevated since last year and were higher in the third quarter and in each of the first and second quarters.

Let me now discuss our businesses in detail. In Institutional Securities, revenues, excluding DVA, were $3.9 billion, down 8% sequentially. Non-interest expense was $3.3 billion, down 2% versus the second quarter. Compensation was $1.6 billion for the third quarter, down 8% versus the second quarter, reflecting a 42% ratio excluding DVA. Non-compensation expense of $1.7 billion increased 5% from last quarter, driven by higher litigation expenses and a catch up for the Fed's 50 assessment of approximately $25 million, which covers all of 2012 and the first three quarters of 2013 partially offset by a decrease in activity related costs. The business reported a pre-tax profit of $542 million, excluding the impact of DVA. Including the impact of DVA, pre-tax profit was $371 million.

In Investment Banking, revenues of $992 million were down 8% versus last quarter. Results were driven by continuing strong debt new issuance activity and our integrated efforts across Institutional Securities. More generally, according to Thomson Reuters, Morgan Stanley ranked Number 3 in global completed M&A, Number 4 in announced M&A, Number 3 in global IPOs and global equity at the end of the third quarter. In addition to Verizon which James mentioned in his opening remarks notable transactions included in advisory through our Japanese Joint Venture Mitsubishi UFJ Morgan Stanley we acted as exclusive financial advisory to Tokyo Electron on it's merger with Applied Materials, Japan's first all stop cross border merger. In equity underwriting Morgan Stanley acted as lead joint global coordinator for the 2.5 billion follow on equity offerings for Grupo Financiero Banorte, the largest Mexican Stock Offering of the year.

And in debt underwriting Morgan Stanley served as joint active book runner on the General Motors 4.5 billion debt offering it's first major placement since the emerging from bankruptcy protection as well as sole book runner on the financing for the previously announced acquisition of Smithfield Foods. Advisory revenues of 275 million were down 17% versus our second quarter results driven by decreased revenues in EMEA. Equity underwriting revenues were 236 million down 28% versus the second quarter driven by lower results in both the Americas and Asia-Pacific.

Fixed income underwriting revenues were 481 million up 15% versus the second quarter driven by investment grade and loan syndication fees. Equity sales and trading revenues excluding DVA were 1.7 billion a decrease of 5% from last quarter. Results were strong across geographies and products evidencing less seasonality and it's typical for the third quarter. Derivatives revenues increased sequentially as strong risk management offset the summer slowdown in certain products. And brokerage balances remained relatively constant from the second quarter also blocking the typical summer trend. Although revenue was down due to seasonality in Europe.

Cash revenues declined modestly though held up better than industry volumes. Fixed income and commodity sales and trading revenues excluding DVA were 835 million. Revenues declined with broader market activity, client volumes, market liquidity and thus overall risk levels were generally low driven primarily by macro-products. DVA was also a drag in the quarter due to the tightening of our credit spread and was a significant driven of sequential revenue change. Credit products revenues increased despite the challenging environment. Commodities revenues were up modestly driven by higher client activity.

Investment revenues of 337 million were up significantly versus the second quarter driven predominantly by the sale of insurance broker hub. Average trading bar for the third quarter was 52 million versus 61 million in the second quarter driven by low levels of risk taking throughout the quarter in fixed income and commodities. Turning to Wealth Management, revenues were 3.5 billion in the third quarter. Asset management revenue of 1.9 billion were flat to last quarter reflecting the benefit of higher market levels at the beginning of the quarter but offset by lower deposit referral fees from our former JV partner. These fees declined pro-rata with the deposits that were on-boarded in the third quarter.

Transaction revenues decreased 4% from last quarter consisting primarily of commissions of 507 million which were down a 11% versus the prior quarter due to seasonality and generally subdued activity. Investment banking related fees of 185 million which were down 28% versus last quarter reflecting lower activity in closed-end funds and partially offset by higher trading revenues of 317 million which were up 42% versus the second quarter reflecting higher DCP as well as the benefit of elimination of the order flow agreement with our JV partner now that we are on 100% of wealth management. Net interest revenue increased 11% to 493 million driven primarily by retiring a preferred security and the JV concurrent with our acquisition of the remainder of the wealth management business as well as growth in our lending product. Other revenue decreased sequentially to 75 million from 139 million.

Last quarter this line reflected revenue from the sale of a business as well as [indiscernible] gains that did not repeat this quarter. Non-interest expense was 2.8 billion flat to last quarter the compensation ratio was 58% flat to the second quarter. Non-compensation expense was $796 million, down 5% versus last quarter due to the lack of expense items incurred in the second quarter in conjunction with the closing of the wealth management joint venture, as well as continued expense disciplines. The PBT margin was 19%. Profit before tax was $668 million, another quarter of record profitability.

Total client assets were up versus the second quarter at $1.8 trillion. Global fee-based asset inflows were $15 billion. Fee-based assets under management increased to $652 billion at quarter end. Global representatives were 16,517 higher than the second quarter. Bank deposits were $130 billion up versus the second quarter. Approximately $94 billion were held in Morgan Stanly banks. The third quarter was the first in which we did not have a drag from NCI from wealth management, because we now own 100% of the business.

Investment management revenues of $828 million were up 23% versus the second quarter. In traditional asset management, revenues of $369 million were down from the second quarter driven by lower performance fees and asset management and administration fees. In real estate investing and merchant banking, our revenues were up meaningfully reflecting strong investment performance, favorable market conditions and catch up of carried interest in two funds as we surpassed our hurdle rates.

Expenses were $528 million, up 3% from the second quarter driven by higher compensation associated with higher revenues. Profit before tax was $300 million, up 88% sequentially. NCI was $64 million versus $21 million last quarter. Total assets under management increased to $360 billion driven by market appreciations.

Turning to our outlook. The impasse in Washington over the last several weeks was an unfortunate tax on the economy. Assuming constructive steps are now taken, we expect the U.S. growth as well as broader market activity to resume the pace that was on prior to the events of the last several weeks.

Although our M&A pipeline has steadily grown over the course of 2013 and increase in transaction volume off of the recent lows hinders on CEO confidence about the economic outlook. Clearly regarding a long-term resolution as distinct from a short-term fix is likely needed before there was meaningful pickup in new activities. However, M&A revenues for the fourth quarter should not be affected to any notable extent by the recent impasse in the upcoming decision dates, because revenues are associated with deals that have already been announced and are well on the path to closings. Underwriting activity, particularly on the equity side, remained strong. Institutional trading activity started off the quarter relatively subdued, but may accelerate on the back of the recent temporary resolutions. Retail investors have been similarly cautious though they have not pulled away from the markets.

I will conclude by saying our results evidenced a stable and diverse business mix. The model weathered a slowing trading environment well but of far greater importance is one that is poised for greater upside with normal fees. With our high margin predictable wealth management business such a significant percent of our portfolio, we have a significant shock absorber in weaker markets. In addition, we expect that our earnings will be even more predictable with the ongoing execution of our bank strategy. Morgan Stanley is well positioned from a resource perspective from a return to somewhat normal market. Our bar is at the lowest levels in the earth and we are prepared to take risk on behalf of our clients when demand resumes. Liquidity is high and we have a strong and high quality capital base. Thank you for joining us. And James and I will now take your questions.

Question-and-Answer Session

Operator

(Operator Instructions) And the first question will come from Glenn Schorr with ISI.

Glenn Schorr - ISI

Hi, thanks. So I heard your comments loud and clear on fixed income in the quarter, I just want to make sure that the RWA shrinkage is on track at the same pace that you had laid out for us and that there is no necessary mindset change in offshore [ph] and still think that you can put up in the, I don’t know, $1.5 billion to $2 billion a quarter range in normalcy?

Ruth Porat

So our orderly reduction program [ph] is very much on track, has not changed that. The only thing that I did discuss at a conference in September is to provide greater clarity about our consistent perhaps to reduce [indiscernible] within fixed income. We are breaking out lending from the RWA total so we're presenting just RWAs for fixed income so in the second quarter when I said we had 239 billion of RWAs in fixed income if you exclude the lending related RWAs that number is 219 billion. This quarter we are down to 213 billion and we've similarly reset our end state it was 200 billion it's now sub 180 billion. So very much on the same path, no change there and then as it relates to how we're looking at managing the business overall we've a very keen lends on driving to and ROEs that is greater than our cost to capital. We think that the reduction and risk weighted assets is a core part of that, expense management is core part of that and that is a key driver. We're looking at revenues, expenses capital optimization but the key lens is really on in ROE and excess of our cost to capital.

Glenn Schorr - ISI

Fair enough. On that front just I noticed first is the Basel III ratio that you gave at 10.8 is that standardized versus advanced and curious on how we got 90 basis point growth in the quarter I mean earnings were okay but risk weighted assets were down 2.8% it's a big jump, was just curious how they got there.

Ruth Porat

That's on advanced, it's fully loaded and it is driven by two things, one, earnings accretion and then the associated reduction in numerator deducts under Basel III and the reduction in risk weighted assets. So both numerator benefits and denominator benefits.

Glenn Schorr - ISI

Not something we should be looking for every quarter, right? I mean it's a big, big move.

Ruth Porat

I'm not going to, I will let you do the forecast they were continuing to drive earnings and was continuing to reduce the risk weighted assets.

Glenn Schorr - ISI

Okay last one you were also on the long-term lending commitment page 12, there is a wealth management loans and lending lines that's been growing sub-45% year-on-year it's up 7% in the quarter. Is that in any way a leading indicator for deposit deployment or am I mixing apples and oranges there?

Glenn Schorr - ISI

No you are very much focused on where we’re focused strategically one of the big benefits of the acquisition is onboarding of the deposits. The rate of onboarding this quarter this past quarter, the third quarter was unusually high. We had a big slug come over immediately upon shortly after closing the acquisition and on a go forward basis we will have 1.75 billion in that area, 1.75 billion coming over on a monthly basis. So we had a bigger on boarding this quarter but the focus really is deployment of those deposits to support loan growth both in wealth management and on the institutional security side and as we've talked about in wealth management the real opportunity is we’re underpenetrated versus our peers. Now we’ve got about 5% penetration, our peers have about 10% and we see very attractive growth opportunities both with PLA product that's security based lending as well as residential mortgages and so that's what you're seeing and that's what we've been building towards since 2009 when we created the joint venture and we’re executing on that.

Glenn Schorr - ISI

I just want to know are those commitments, is that securities based lending because my gut is it's a tough environment while refi is dropping by 50% in the quarter, is that securities based lending? What am I looking at to see that kind of growth in commitments? Because something good is happening.

Ruth Porat

So PLAQUE, the securities based lending PLA you are seeing strong growth in it, residential mortgage is where you have commitments and that we've had a strong pipeline of demand there so even with the slowing environment we have more demand than we’re executing against but the bigger growth is in PLA.

Operator

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

Howard Chen - Credit Suisse

Just a follow-up on slower quarter for everyone we can see that you de-risk. I was just hoping you can discuss where returns are in the major fixed businesses today. So we can just track progress over time as the environment improves and you do evolve of what you want to do on capital and expenses?

Ruth Porat

So the – was that – it was lower volumes industry wide, I would note that and I said this in my comments given the tightening in our credit spreads, we did also have a meaningful negative swing in CVA sequentially. If you exclude CVA in both quarters, our FICC results were actually down single-digit percentages, but going through the products as you asked, rates was challenging, risk remained low. We continue to run with the historically low levels there. It tapers down in May as you may recall I talked about that last quarter. So we would look to see some upside in that business longer term if markets normalize. Foreign exchange was down quarter-over-quarter. That was volumes and mix. Electronic is better, but voice is lower and that's the higher margin. So that was bit of a drag. On credit – on the credit side as I noted, it was a bright spot. We were actually up quarter-over-quarter. We had good performance across IT distressed and high yields and was balanced across geographies. That's been a consistent strong area for Morgan Stanley. Mortgages was also quieter and commodities was up a bit modestly, but still running at lower levels. So overall, I mean, the net of it you can see in the results was slower, quieter, quarter. Our risk was down, we are always down in those areas and we would expect to see some upside as markets normalize.

Howard Chen - Credit Suisse

Okay, thanks Ruth. And switching over to supplemental leverage ratio, can you discuss what the change in centralized clearing assumptions did to the model and is it simply earnings generation during the quarter that made up to that delta for that model change and with the positive inflows you mentioned or is there something else that's going on?

Ruth Porat

So in terms of clearing in the second quarter, I think the general industry lead was clearing would benefit the denominator. And obviously in the second quarter, the rules have just come out prior to various earnings calls and we have now had time to assess clarify certain items. There were changes in both the numerator and the denominator. And in particular with respect to central clearing the rules clarified clearing unto itself doesn't – isn't a deduct, it does facilitate compression trades and we are still very focused on back loading. And we have seen an acceleration in interest in compression trades by banks both in the U.S. and in Europe, because it's one of the few tools to reduce exposures. The other thing that changed quarter-over-quarter is the on-boarding of deposits that I mentioned, we on-boarded $21 billion of deposits. So just those two were – was about a 30 basis point reduction and the offset to that really was in the numerator between earnings and some of the numerator deducts was the offset.

Howard Chen - Credit Suisse

Okay, thanks. And then you have been speaking to higher litigation expenses over the past few quarters, James, you have talked about it more broadly to the investment community, I was just hoping you could take a step back and just give us a sense of what inning you believe Morgan Stanley is in working through just crisis related litigation issues?

James Gorman

Well, that's an interesting question, Howard. I think we have obviously fully disclosed all of the litigation risks that we have out there and we are working our way through it. I can't really tell you what inning we have been taking elevated expenses for a couple of quarters, I am sure there will be – some of that will continue, but we are managing our way through. We have I guess the good fortune to be one of the smaller dogs in this price, and as an institution and we obviously have less of the traditional mortgage exposure. So in some areas, we are just not participants happily, but in the traditional – in some of the litigation we are.

Howard Chen - Credit Suisse

Okay thanks. And maybe just a last follow-up to that one, Ruth, how would you sort of size the incremental litigation expenses this quarter and could you also just give us the size on the gain on sale of Hub as well? Thanks.

Ruth Porat

So litigation has been running about $200 million to $300 million higher per quarter than one would assume in the end state and state the obvious it's lumpy, it's unpredictable, but we got to tell you more it's on the same set of issues associated with pre-crisis matters and so it should come down when these issues are behind the industry, but it's been about $200 million to $300 million. And then with respect to the sale – the gain on sale, it's part of the overall investments line. There are number of items in that. And I think on a go-forward basis, if you look at prior quarter, prior year that's probably more reflective of future run rates.

Howard Chen - Credit Suisse

Okay, thanks.

Operator

Next question will come from Guy Moszkowski with Autonomous Research.

Guy Moszkowski - Autonomous Research

I just wanted to clarify a little bit the comments that Ruth made about the receipt but not really deployment of the deposits. I mean there must have been some impact on net interest income for GWM and maybe more broadly for the corporation from the receipt of those deposits or is that not fair?

Ruth Porat

I know that ain't fair. What I was trying to say is that with the on-boarding of deposits we did have a big portion come over in this quarter, a lot still in cash and we're deploying it into AFS and loan growth and so you do see this quarter some of the upside in net interest income and wealth management is due to growth in our lending balances. The other benefit you see in NII is associated with the acquisition part of the acquisition we eliminated outstanding preferred with Citi and the expenses associated with it. So two drivers of net interest income but you're absolutely right, there is upside this quarter in that and we expect to continue to see more upside as we're deploying out of cash into AFS and loan growth.

Guy Moszkowski - Autonomous Research

And then you gave a you told us that your quotes are one of 10.8 under Basel III was under the advanced basis. Can you tell us what the calculation is on standardized basis?

Ruth Porat

So on a standardized basis RWAs are a bit higher it's obviously the second test we establish a minimum and if we're running greater than the required we're not required to report it but we are above that minimum.

Guy Moszkowski - Autonomous Research

So you're saying the RWAs are higher and so the standardized ratio would be lower?

Ruth Porat

Yeah. The standardized ratio will be lower; I guess that's most relevant actually under CCAR moving to standardized for 2015 but of course requirements under CCAR for standardized is 4.5%.

Guy Moszkowski - Autonomous Research

Right. Goldman gave some comments on their investment banking backlog and said that it was actually the best it's been in five years. Can you give us a sense for your comments sounded a little bit more cautious in that regard but can you give us a sense for the direction of your backlog relative to last quarter?

Ruth Porat

The backlog is up, it's actually it's high been in years. My comment with respect to in particular M&A is the backlog in M&A has been growing nicely throughout the year consistently but the main factor really is while we have talked about on many other quarters which is M&A is proxy of CEO confidence and given the impacts in the last couple of weeks and the fact that we don't have a final deal in DC but it's kind of an interim step here. I just had a caveat that until there is confidence about the economic outlook I wouldn't want to suggest that that growing pipeline actually goes through to announce and closed.

It's frustrating because all signs had been that DC was improving and confidence was up and the pipeline was building accordingly and hopefully we get a resolution and we actually see that work its way through. The equity pipeline is also very strong, the highest it's been in years and I think that we would expect to see more activity that moving through the pipeline. The fourth quarter tends to be seasonally better than the third quarter given July blackouts and August and it's a very strong high-quality pipeline.

Guy Moszkowski - Autonomous Research

And then the final question is on FICC, you have someone else had asked identified in the past a minimum target revenue of 6 billion and I think the implication has been that in order to exceed your cost of capital you need to generate that kind of revenue levels year-to-date on a cleaned up ex-DVA basis. You have done about 3.5, so let's say that you're cracking for 4.5ish this year. That's still well below the 6 billion, do you remain as confident as you might have been a couple of quarters ago that the $6 billion is a realistically achievable level and if not have you, are you making any incremental changes to your resource deployments?

Ruth Porat

We remain very focused and confident about the path to a higher ROE in fixed income and as I said there are three major levels, revenues which is a function of the operating environment among other things. And so we will put that to the side expenses and capital. And we are looking at all three levers, but the main thing is controlling that which we control to drive ROEs greater than the cost of capital within fixed income. And so between expense management, some of the things that we have been doing there continue to do and capital optimization we have a flight path to an ROE in excess of cost of capital. And that's the real value. If there is one metric to stay focused on, it's ROE. That's the way we are managing the business.

Guy Moszkowski - Autonomous Research

Got it. So it sounds like you feel that you might be able to achieve that cost of – that, that return ahead of the cost of equity without necessarily achieving $6 billion in revenue given the expense and other capital levers that you can use. Is that fair?

Ruth Porat

Yes.

Guy Moszkowski - Autonomous Research

Okay, great. That's really helpful. Thank you so much.

Ruth Porat

Thank you.

Operator

Our next question will come from Mike Mayo with CLSA.

Mike Mayo - CLSA

Hi. I just wanted to follow-up on your comment James that you are just beginning to see the benefits from acquisition of the 100% of the joint venture. I mean your branches are already down your profit margin is up some to have the deposits aside from additional loan penetration to your customers, what other benefits are still to be achieved?

Ruth Porat

So I will start on that. There are quite a number if you just go through the items that we talked about that are the contractual benefit as a result of the acquisition that will probably give you a sense of why we believe we are just beginning to see it. So one is the order flow agreement that we terminated that upon completion of the acquisition and so order flow previously went down over JV partner stays at Morgan Stanley, that's in the principle trading line. However, given industry volumes were lower in the third quarter just with the overall markets having seasonality, we had a more modest benefit lower than we would expect on a quarterly basis and then a more normal environment still upside there.

Net interest income I already commented on, but with continued loan deployment, that's a very important area additional upside, in particular, given the margin on that – on loan products we see real upside in NIM. There are couple of other ins and outs to deposit referrals in the FDIC fees smaller and then obviously the elimination of NCI, which is below the line, but does benefit earnings. And so again a more normalized environment continuing to build out the loan book the upside from that lending product are dropping to the bottom lines.

James Gorman

And I think, Mike, I would add a couple of additional thoughts. One is if you look at where the industry, the wealth management industry now is it's very concentrated. And during the period of turmoil of the crisis, post-crisis and then our acquisition of Smith Barney and various staggered pieces that we hurdle on the way, there was a lot of attrition, a lot of moving people between different firms. And that is the tax on the industry obviously and it's inconvenient for clients in many cases, but that level of turnover has dropped significantly and we expect it to continue to drop. So that reduces your overall compensation costs, because obviously recruiting deals can be very expensive, number one. Number two, the strength of the old Smith Barney business at its core was its managed money program and the strength of the Morgan Stanley business at its core was its capital markets capability, which is based upon Westchester. And we are continuing to see each of those strengths sort of populate the other side of the house. So it's now become together as one firm. And that's why you are seeing so much growth in the managed money side and you are seeing very good retail distribution of institutional underwriting. So I think just fundamentally it's a more robust business and the broader industry structure is more accommodating to better performance over time.

Mike Mayo - CLSA

As far as the outlook for the number of reps, the number of offices, how much you are looking to organically grow the business from here and also how long will it take to deploy the new $20 billion of deposits again?

Ruth Porat

So in terms of FA headcount, it was up this quarter for a couple of reasons. One, attrition has been running at low levels for some time. It was even lower this quarter and then we had a higher number of trainees with the probably the training program and the time of the year. You could see that number going up a bit. Really, we are not managing it to a number. It’s we are still focused very much on as a productivity and we just had a larger training program, strong for your needs [ph] we’re just starting. So kind of in and around that level. In terms of branches you saw the number of branches come down this quarter, the way we look at that it it's a function of really market by market analysis, [indiscernible] the question is do you have completely fully staffed offices within any market, strong culture, no more room in this space. No need to consolidate or should you consolidate so at this point the big reductions that we've seen are really behind us now it's just market by market analysis and then in terms of the deployment of the deposits to support loan growth, you're really going to see that the deposits deployment go not just into wealth management products but also institutional products and of course the AFS portfolio and as we consistently have said we’re very much leading with risk management credit risk management. So there is nice growth near-term and we've been building that infrastructure as I've said since we created the joint venture back in 2009 but we’re leading with risk management, we're not, just going to keep using the term prudent study pace and you will continue to see it deployed over the next continued study phase.

Mike Mayo - CLSA

Then last follow-up what specific loan products by category would it be a lot of mortgages or what else in addition to that?

Ruth Porat

Well the main thing is really this PLA product, the securities based lending product which is a more flexible product for our clients really enables them to retain their securities portfolio, continued to be invested in the market that's the primary one. We’re underpenetrated as I said, residential mortgage is next on the list, the next major category for our retail area and we continue to have strong demand because we’re off of such a small base and again given the low levels of penetration. And then on the institutional security side its product very consistent with our strong areas within our franchise to James opening comment where we have strong client franchise, strong bankers that built the incremental infrastructure required. So for example in commercial real estate, in project finance areas consistent with the businesses we’re already in where we are already serving clients, we're now just expanding the suite of products. So it's growth in both areas.

Operator

The next question will come from Mike Carrier with Bank of America Merrill Lynch.

Mike Carrier - Bank of America Merrill Lynch

Just a follow up on the SLR, you mentioned some changes in that process. You guys have gone through the proposal, in terms of getting from 4% to 5% in 2015. Can you just give us an update on that glide path again in the past you said collapsing is in trade but anything that has changed based on further review of the proposal?

Ruth Porat

Certainly so greater than 5% in 2015 we're very confident with the supply path there because there are opportunities with both the numerator and denominator and very consistent with the strategy against which we're then executing. So we're not assuming any benefits from potential changes in the rules and starting with the denominator where we see the biggest opportunity, the first is with our focus on reducing risk-weighted assets and fixed income that leads to a reduction in the balance sheet, a reduction in the grossed up balance sheet of this relationship between RWAs and grossed up balance sheet. So that's number one, its very much on strategy. The second is derivatives growth as I said can be reduced through compression trade; we've been focused on that for some time. We had not previous as of the second quarter hadn't quantified it and viewed it as an additional upside opportunity. All that we've done in central clearing, our focus in particular on back loading helps facilitate the pace of compression trades and just in the SLR was announced and the BIS proposal was announced, we have seen an interesting in compression we think both in U.S. and in Europe and the total compression opportunity is greater than what we had assumed from clearing. So that is very much in the plan. There is also numerator benefits from capital accretion and some of the numerator mitigation so that the combined gets us to a strong glide path to greater than 5% in 2015 and also important to know it includes the assumption that we would have spiteful capital returns to shareholders.

Mike Carrier - Bank of America Merrill Lynch

And then just on the asset management business it seems like each quarter it comes in stronger than expected. I guess just two questions on that on the traditional side it seems like it was a little weaker you mentioned performance fees to just trying to figure out how much that impacted it? And then when I think about the real estate and merchant banking, just longer term you just want to try to gauge how much of that business you guys can still do meaning its funds managed by others versus anything that you might have to shrink over time. Just want to get an update on that?

Ruth Porat

Sure. So on the traditional asset management side, you identified that it's – it was down due to higher performance fees in the second quarter. And then we had higher waivers on liquidity funds this quarter. And then on real estate and merchant banking as I said the upside was gains there. We recently broke through hurdle rates on two funds. So we had catch up on carry for those two funds. We are now close to the end of the catch up for those two funds. We are earning carry on several other funds, but good performance and had attractive catch up on carry. And then in terms of looking forward and those funds we have strong teams in place. We are pleased with the returns there. And it's clearly a function of how much capital you have in those businesses.

James Gorman

Yes, I don't think there is any constraint or in fact I think the business is in some ways more attractive, because increasingly it's fee-based businesses, because you have less capital at risk, where we are in private equity, we are in mezzanine finance, we are in real estate, we are in infrastructure funding, we have a pretty broad-based merchant bank. And a number of those groups are in fundraising right now. And I think its good teams as Ruth said, good performance, limited capital and it's a nice business model.

Mike Carrier - Bank of America Merrill Lynch

Got it. Thanks a lot.

Ruth Porat

Thank you.

Operator

Next question will come from Brennan Hawken with UBS.

Brennan Hawken - UBS

Good morning.

James Gorman

Good morning.

Brennan Hawken - UBS

So just to follow up there real quick on Mike's question, is it possible to quantify the carry in the catch up that you guys had this quarter just so we can understand how much is recurring and how much was sort of more one-time?

Ruth Porat

No, we don't break that. I can leave that to you.

Brennan Hawken - UBS

That's alright, okay. I figured I'd give it a shot. And then on asset management just to sort of verify because I think there was a little bit of confusion before to be open on this, would you guys had a bump in your investments line in the investment management division, but that really – it's my understanding that primarily washes out in NCI for that segment, is that right?

Ruth Porat

No, within investment management, we had carry catch up as we indicated, because we broke through the hurdle rate on a couple of funds. And so a majority of that actually is retained at Morgan Stanley and NCI can see as well, there is still NCI associated with the funds, but now we retain a large portion of that in-house.

Brennan Hawken - UBS

Okay. So that was the primary source of the carry and then we have got to just basically come up with our own assumptions about how much is catch up and how much is repeatable?

Ruth Porat

Correct.

Brennan Hawken - UBS

Okay. And then you gave some great color on the strength in the equities business of remarkably strong quarter really especially looking at the U.S. counterparts, they have reported here to-date. And it didn't sound like, there were any kind of one-time components or things that wouldn't repeat, but just kind of just want to verify, is there anything that we should think about as one-time in nature in that number?

Ruth Porat

No, we have consistent – I feel like quarter-after-quarter we talk about the strength in our Institutional Equities business. There was another strong quarter across products and geographies and I have said that a number of quarters in a row here balanced across the franchise. DV balances were very resilient and that was notable given summer seasonality. And cash equities, the market data indicates that we outperformed with industry volumes down, so a strong quarter. Typically, the fourth quarter is lower in part with PB balances lower as managers go into year-end, but nothing to note other than consistent strong performance by the Institutional Equities business.

James Gorman

One of the things that has been a determined move by the equities management is to provide a much more integrated approach across cash derivatives prime brokerage to our clients. And I think that help me as gain market share and obviously helps with the stability of the revenues.

Brennan Hawken - UBS

Terrific. Thanks. And then last one for me just on the buybacks, is this the right pace we should assume or should we assume some pick up here in 4Q and the buyback is approved through the first quarter too, so we should carry that through that right, just want to verify my understanding there?

Ruth Porat

Yes. The approval process for CCAR through the end of the first quarter of 2014. So you should assume that we will use it no later than the end of the first quarter of 2014.

Brennan Hawken - UBS

And is it okay; is it right for us to assume that there is a space for a pickup in the phase?

Ruth Porat

Well the map would just that given what we've used so far.

Operator

The next question will come from with Fiona Swaffield with RBC.

Fiona Swaffield - RBC

I just have a couple of follow-up questions on [indiscernible] and deductions. Firstly on the deductions they seem to have fallen quite significantly on 1.5 billion sequentially, could you explain what's driving that, what kind of things whether its into institute GTA [PH] or private equity funds I'm not sure and then the secondary is on the Basel III RWAs, they have gone down outside of fixed income I think for the first time, I remember it. Are you doing something particularly outside fixed income as well on the Basel III efficiency basis? Thanks.

Ruth Porat

So in terms of Basel III RWAs the main focus really is in the fixed income as you know as you said I think it just consistent with overall wider market low volumes the backdrop that we have been talking about. In terms of the Tier 1 common and numerator and deductions there obviously the buckets and waterfall of numerator deductions based on Tier 1 common levels and so again as we create capital there are reduced deductions, numerator deductions kind of the waterfall.

Operator

The next question will come from Eric Wasserstrom with SunTrust Robinson.

Eric Wasserstrom - SunTrust Robinson

Just two clarifying questions, one back to the SLR glide path, does the continued on-boarding of deposits is that done sort of ratably over the period of time in terms of their contemplation in SLR or is the endpoint somehow fully loaded in the current figure?

Ruth Porat

So there are two parts to that question, the on-boarding of deposits was very large in the third quarter due the, that was contractual nature of the acquisition, one large tranche came on as I said a couple of weeks after closing and then the balance of fit is about 1.75 billion per month through the middle of 2015. So the big increase that we saw this quarter you're not going to see on a go forward basis that's the terms of the contract 1.75 per month through mid-2015 and yes that is fully loaded into the estimate of greater than 5% in 2015.

Eric Wasserstrom - SunTrust Robinson

Got it, it's just that the influence of the incremental is just not so significant over the-

Ruth Porat

Exactly and as you have deployment you have greater earnings though you've a couple of variables going on as well.

Eric Wasserstrom - SunTrust Robinson

Got it and then just returning to FICC, it sounds like the most significant comment you made is that adjusting for some of the items that your results quarter-on-quarter would have been down actually relatively little and so I'm just trying to reconcile that with the and of course it looked like there was a little bit of share gain in credits from some of your commentary. And so I'm just trying to reconcile that with the continued reduction in RWAs to understand how it is that there is this group of assets that seem to have so little profitability associated with it.

Ruth Porat

That's precisely the problem they have so little profitability, associated with them currently and on a go forward basis. So the RWAs that we identified that we're reducing structure credit, long dated uncollateralized derivatives are drag on the overall returns in the business and through passive and active mitigation we are pleased to be shutting them at the fastest pace that we can. You've seen that we are materially ahead of anything that we laid out you know we were 390 billion on the old [ph] basis, RWA is back in the third quarter of '11 it's been a lot of heavy lifting and we are getting near to the -- there is light at the end of the tunnel given the pace of execution and with business leaders having the analytics, dashboards to know how to reduce risk weighted assets that's helped the pace. So we are pleased to be exiting them and it does help on the overall returns because it not only helps free-up capital from fixed income but I think that it's providing us with more consistent quality earnings base within fixed income which is one of the key elements as we're thinking about how to resize any kind of capital return on a go forward basis.

Operator

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

Roger Freeman - Barclays Capital

Hi, good morning. Just on the – back on the share repurchases, you think you commented I think earlier, greater share repurchases to hit the greater than 5% target. And obviously also as part of the ROE expansion, does that – that doesn't assume anything sort of beyond the pace that you have been approved for, is that right?

Ruth Porat

I mean the answer what I think your question was and then let you have a follow-up if I missed it.

Roger Freeman - Barclays Capital

Okay.

Ruth Porat

So I was answering one question regarding the very small share repurchase program we approved to do this year that ends through March, we enter the end of the first quarter. And as we look forward given all that we have done to build capital given the greater consistency of results, the accretion of capital, we are building in our view increased flexibility to return more capital on a go-forward basis. We are not going to judge CCAR or timing cadence, but it does build greater flexibility on a go-forward basis and that's what I was trying to convey. I am not sure if I hit your questions.

Roger Freeman - Barclays Capital

Yes, mostly. I guess the point being that greater share repurchases is part of the active hitting 5% and that's 2015 target, that's kind of implies that you would expect to do higher than the small repurchase next year as that gives you a year?

Ruth Porat

We have certainly built in that in providing this guidance of higher than 5%, but until we see the CCAR number, we have the capacity to do it.

Roger Freeman - Barclays Capital

Got it.

Ruth Porat

As what the greater than 5% means and my caveat, we haven't seen the CCAR rolls, the shocks. So we are not going to prejudge CCAR as that I am not going to say what it will be next year, but we certainly have the capacity with the glide path to greater than 5% with much higher share repurchase even included in that number.

Roger Freeman - Barclays Capital

Okay. And then I just wanted to maybe get any updated thoughts you have on the physical commodities business obviously, we don't have final walker yet, but there has been a lot of obviously discussion in the industry and others have gotten out, this is where -- how do you think this stands for you strategically?

Ruth Porat

Well, I don't think there is much change from what we commented on previously. It's been a good business for us for many years. We want to be smart about what we do to drive returns in the business for the firm overall and so really no update at this point.

Roger Freeman - Barclays Capital

Okay. And just a small one on the – back on the carry, I know you are not quantifying the size, but what percentage of the way – the carry catch up, is this typical 80-20 in catch up?

Ruth Porat

Yes, probably I think a bit more than that. So basically…

Roger Freeman - Barclays Capital

Right, 75% and 80% away there?

Ruth Porat

No, so we have done a carry catch up this quarter and we are almost through it. And so again it's going to be a function of the market in the economy.

Roger Freeman - Barclays Capital

Okay. So there is a little bit to go. Okay.

Ruth Porat

Right.

Roger Freeman - Barclays Capital

Alright, okay, thanks.

Operator

The next question will come from Jim Mitchell with Buckingham Research.

Jim Mitchell - Buckingham Research

Hey, good morning. One quick follow-up on the SLRs, are compression trades and OTC clearing, are they in your guidance? I thought it was excluding that, it was just sort of the run-off would get you to 5% or did I misunderstand that?

Ruth Porat

So in the second quarter as I said, the general industry read was that clearing would benefit the denominator. Since then its clarified clearing unto itself does not, so take that out. When you take that out and you add the deposit growth that's the 30 basis point deduct that I mentioned previously. However, what we have separately – we have the time now to do is go through and quantify the benefit from compression trades. So compression trades is distinct from clearing, reduce the denominator and it's really the pace of activity with compression trades volume that we are targeting with compression trades is what helps is one component of what drives the leverage ratio higher. The fact that we have been focused on central clearing for some time and that we have been focused on back loading facilitates the pace of compression but put those two as distinct issues and it's not the clearing itself, but just compressions.

Jim Mitchell - Buckingham Research

Fair enough, the compression in your guidance of that.

Ruth Porat

Yes. Compression is in the guidance.

Jim Mitchell - Buckingham Research

Okay, thanks. And then on the cost saves, can you give us some sense in where you are, you targeting $1.6 billion net by the end of next year? Where do you stand at this point?

Ruth Porat

So we are very much on track for the expense reduction goals. When we set out the goal, as you may recall, of $1.6 billion reduction, it's at the end of 2012 and said by the end of 2014 we would be down by 1.6 billion but we're also very careful to say that that was predicated on revenues flat to 2012 and indicated that it was higher revenues which we expected certain expenses would go up in particular those that are activity-based but that we would measure progress based on overall expense ratios, we're trying to hold for it number of different components and when you look at the components of non-composition expense year-to-date, activity related costs like brokerage and clearing and transaction taxes are up while non-activity related costs like occupancy and market data are down and so when you kind of go through the map take 2012 revenues, deducts that our expense ratio back then was I think it was 84%. If you deduct the 1.6 billion expense savings, we said we would get that takes your expense ratio down to 79%. We now have revenues up from activity related costs up but net-net we're at that level and if you exclude elevated litigation expense we're ahead and our view is that litigation expense will be a cost for the industry for the near-term but we're improving our fundamental cost base and we will get through that at some point. So very much on-track for the expense program ex-litigation.

Jim Mitchell - Buckingham Research

Right I mean I understand what you're saying you had targeted ratios but revenues are up where do you think they should be current revenues or I guess another way to say if you think your 50% of the way through it 25% or 75%. I mean obviously you must have some kind of thoughts on absolute headcount or something like that?

Ruth Porat

Just on the numbers given we are already at the 79% expense ratio that was implied back in 2012. One way to answer I would say that we're excluding litigation that we're, that we have achieved but we're only partially way through executing it and so we have the balance of next year fourth quarter balance of next year to continue to execute on programs that we've laid out and for that reason we say that and I would say that we're there but we're continuing to execute on the programs that we identified back at the end of 2012. So we're feeling very good about our ability to continue to reduce expense rate.

James Gorman

I will just add that there is a culture of expense management across the firm but we haven't seen for long time whenever I travel around the world local offices, sub-business groups everybody understands the program; everybody understands what we're doing. We have a very well-coordinated program with 40 or 50 executives as part of it. So this is going to be continuous process. As Ruth said on the percentage basis I mean we're already at the 79% but that's honestly that's not our focus, our focus is continue to make the firm more efficient by bringing in together as one firm which we did taking three platforms to one in wealth management, operating wealth management closer to institutional securities, lot of the electronic development within institutional securities. So there have been a lot of things that are going to be ongoing for next several years and I think we will continue to add.

Ruth Porat

So we completed three of eight quarters and achieved the target in the end state and we're continuing to work.

Operator

The final question will come from Matt O'Connor with Deutsche Bank.

Matt O'Connor - Deutsche Bank

You guys provided a lot of details on fixed RWAs but if you talked about the total assets in that business?

Ruth Porat

We have not broken that up, no.

Matt O'Connor - Deutsche Bank

I guess if I can take a stab at trying to get to the opportunity of reducing those assets if we think about RWAs coming down by 30 billion to 40 billion obviously there is a multiplier effect for the overall firm. I will thing it's more for FICC. It seems like it might be in the 100 billion to 150 billion range in terms of total assets within FICC that might come down?

Ruth Porat

I'm going to go through the map on the call if there is some technical you want to follow up with IR, you can do that.

Matt O'Connor - Deutsche Bank

Okay but it should be a multiple of RWAs I would think, right?

Ruth Porat

So we're looking at the RWA reduction, we're looking at grossed up balance sheet and we're managing all of our businesses through a risk based capital lends, leverage based capital lends, increase doing an SLR lend. So again while we're driving is the strongest return in that business so balance sheet is coming down as we -- and grossed up balance sheet is coming down even more as we reduce risk weighted assets.

Matt O'Connor - Deutsche Bank

Okay and then just separately as we think about the remaining 35 billion or so deposits coming in some of the benefits that you still get from what just came on, how should we think about the blended yields you deploy that into. Obviously, this could be a mix of retail loans, corporate loans and some securities, but what's maybe a good blended yield to think about?

Ruth Porat

In a recent presentation, James actually laid out the return on cash, AFS, lending product and so we are continuing to deploy the cash into AFS and then between both the wealth management and institutional book and so let you build out the growth there. The components are in the presentation.