Good morning. This is Kathleen McCabe, Head of Investor Relations. Welcome to our fourth quarter earnings call. Today's presentation may include forward-looking statements which reflect management's current estimates or beliefs and are subject to risks and uncertainties that may cause actual results to differ materially.

The presentation may also include certain non-GAAP financial measures. Please see our SEC filings at www.morganstanley.com for a reconciliation of such non-GAAP measures to the comparable GAAP figures and for a discussion of additional risks and uncertainties that may affect the future results of Morgan Stanley. 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'll now turn the call over to Chairman and Chief Executive Office James Gorman.

James Gorman

Good morning, everyone. Thank you, Kathleen. As we begin another year, I'd like to share my thoughts on the current state of Morgan Stanley, discuss our progress against last year's priorities and share our plans for 2015. During my comments, I'll be referencing a presentation that you can find on the Investor Relations section of our website.

For the past five years this management team has worked hard to the following. One, to put the trouble for the financial crisis clearly in the rear review mirror. Two, to reposition our firm to benefit from our world class and complimentary franchises in Institutional Securities, Wealth Management and Investment Management as shown on slide 3. And finally to lay out specific plans with clear signposts for investors to follow as we work towards sustained, higher returns. Each year we like to remind you of the key elements of the plan, mark those elements to market and refresh the plan for the coming year so investors can properly judge our absolute and relative performance.

Before I make my strategic comments, let me briefly touch on the quarter. Our final result this year reflect a number of idiosyncratic issues including tax benefits, compensation changes, FBA implementation and legal reserves. In addition, the quarter reflects a difficult market in trading environment across the industry especially in October and the last few weeks of December. Our trading businesses in particular fixed income and commodity sales and trading were clearly not immune to the unfavorable market environment. While Q4 had several complicating elements, it was also an important quarter as we continue to put residual issues from the financial crisis behind us. In a few minutes, Ruth will take you through the quarter in much more detail.

Before doing so, let me begin with the mark-to-market for 2014 which you can now see on slide 4. 2014 was a year focused execution against the strategic plan we have previously articulated. In Wealth Management, we continue to improve our profit margin and are well on the way to delivering 22% to 25% margin by the end of 2015. Fixed income and commodities, we continue to resize and reshape the business and doing more to drive ROE. We continue to improve our expense ratios. We made strong progress in Morgan Stanley -specific growth opportunities most notably growth in the banks. We increased our share buyback and for the first time in several years, we increased our dividend. As a result of these collective actions, we've made progress towards returns that meet and exceed our cost of capital.

With that, let me turn to the six areas of strategic focus for 2015. First, Wealth Management which is on slide 6. For full year 2014, we delivered a 20% margin on wealth management, up 200 basis points versus 2013 and we have a clear path for achieving our goal of 22% to 25% by the end of this year. After taking into account the adjustment to our compensation deferral, the pretax margin improved through the year. Our fourth quarter 2015 target is driven by the revenue and operating leverage from deposit deployment and the ongoing benefits of scale. It is important to note that this target does not take into account the benefit of eventual higher interest rates and stronger equity market levels. The target also does not include the benefit of the positive secular trend towards fee based managed account. This trend plays to the strength of our advisory based model and generally translates into more stable revenues and deeper client relationships, a trend we've discussed with you in the past.

There are several additional drivers of upside for wealth management as we've outlined on slide 7. We continue to grow our assets under management and ended the year with over $2 trillion of client asset benefiting in particular from our focus on the high net worth and ultra-high net worth client segments. Since 2009, we've grown assets in the $10 million and above household by 82%, and assets in the $1 million to $10 million segment by 35%. Our model based on providing high valued advice, helps position us to meet the broad and complex financial planning and investment needs of these clients.

We have further upside as we attract more of our clients' deposit that go consistent with our growing bank presence. Given the magnitude of the client base, even a modest increase in our share of client deposits hold significant upside for us. Greg Fleming will share more of this opportunity with you later this year.

Second is our bank strategy. On page 8, we described to you the components of revenue growth in our banks. We continue to benefit from the three tailwinds; one, growth in the deposit base and associated assets. Two, the optimization of those assets namely moving cash into [AFS] [ph] and lending, and three eventual upside from higher rates. We see strong loan demand among our sizable wealth management and institutional securities client base. With no bricks-and-mortar and embedded client base and a required infrastructure investment behind us, the incremental margin on lending product is exceptionally high. As a result of our ongoing progress in the bank, we are providing you with updated targets for 2015 as well as growth to $180 billion in assets by year-end 2016, up from $151 billion as of year-end 2014.

Based on current market rates and our expected asset mix at the end of 2016, the blended yield would be 2%. If we substitute the yield indicated by the forward curve on the same asset base, the blended yield would be 3.1%.

Turn now please to Slide 9. In our Institutional Securities business, our leadership in advisory and equity sales and trading continues to provide further stability along with upside. In advisory, we finished second in global completed and announced M&A. We've continued strength in large cap cross border M&A activity, we believe our global footprint and leadership across products and geographies, positions us well to benefit from current trends. In equity sales and trading, we build on the momentum of recent years. With full year revenues of $6.9 billion ex-DVA placing us first among US peers and we expect first globally. Our success in 2014 reflects high quality execution and share gains.

This brings us to our third area of strategic focus, Fixed Income and Commodities as seen on slide 10. Against the challenging backdrop, we made some progress on our plan to drive for return exceeding our cost of equity. Within fixed income, we reduced balance sheet, risk weighted assets and non-compensation expenses. We also maintained normalized ROEs of greater than 10% in our areas of strength namely securitized products and credit corporates. Furthermore, we continued to optimize returns in rates and roll down structured credit RWAs. Within commodities, we reduced our exposure to physical oil, most notably by selling TransMontaigne and we remained committed to selling our oil merchanting business. We are also integrating the balance of our commodities business within sales and trading.

From a capital perspective, we remain on track to reduce fixed income and commodities RWAs to $180 billion target by yearend 2015, down from $390 billion in 2011. Furthermore, as you can see on slide 11, we will have an additional $25 billion of dead weight risk weighted assets that will roll down by the end of 2018 providing incremental ROE upside.

Assuming we find the right opportunities, we will utilize the associated capital to maximize return across the franchise either within fixed income or in other areas where client demand is consistent with the highest return opportunities.

Number four. Next area where we see upside is the benefit from lower funding costs shown in some detail on slide 12. As the market is recognized improvements our business makes and balance sheet, our spreads have contracted dramatically. More so than those of our peers. This reduces our funding costs, as we finance older more expensive debt. This should result in meaningful reduction in our weighted average cost of unsecured funding on both an absolute and relative basis over the next several years providing us with a further tailwind.

Last year we issued new debt and an average spread of 100 basis points over three months LIBOR and improvement of 200 basis points since 2012. From peak to trough our average funding cost is expected to decline by approximately 25%. Fifth is our ongoing focus on expenses as shown on slide 13. The changes to the compensation structure announced in the fourth quarter reduced the overhang of prior year deferrals and decrease the portion of current new compensation deferred into future years which was the prudent thing to do. The result is a reduced liability in a muted environment and greater operating leverage in an improved revenue environment.

With these changes, we've decreased our target compensation net revenue ratio in our institutional securities business to 39% or less in 2015 and beyond. Notably, this guidance assumes a flat revenue environment. In a better revenue environment, the compensation ratio could go even lower. In addition, we reaffirmed that we are working towards the compensation ratio of 55% or lower in wealth management and 40% or lower in investment management.

We also remain focused on non-compensation expenses and achieved a 29% non-compensation efficiency ratio in 2014 excluding obviously the elevated legal expenses versus 2012 levels. With the changes to our compensation structure and our disciplined on non-compensation expenses, we remained on track to deliver an overall expense ratio excluding elevated legal of 79% or lower in 2015.

Six is the return of capital to our shareholders. We've repeatedly emphasized our commitment to prudently increase our capital returns over time subject to regulatory approval. Our plan is to increase both our share buyback program and our dividend with greater returns of capital supported by the increased proportion of our revenue and earnings coming from more stable businesses. As you can see on slide 14, since 2012 we've grown our total payout ratio from 13% to 30%. While also investing in our business through the completion of the wealth management JV. Critically, during that same period we've grown our capital base by 12%.

The key drivers of increased return to shareholders over time our consistent earnings, a strong capital ratios and a strategy that is consistent with evolving regulatory requirements.

Finally, let me address returns. Our focus remains on generating high returns for shareholders by improving our ROE to sustainable level that exceed our cost of equity independent of market conditions. We see a clear path to an ROE of 10% based on the levels we've just described you, all of which are within our control.

To summarize, this includes achieving our wealth management margin target, executing on our bank strategy, completing our exit from a physical oil business, progress on our optimization and fixed income, continued focus on disciplined expense management and continued CCAR capital approval. We also see higher than 10% returns with an improved rate environment, improved global economic growth which in turn drives our wealth management and institutional securities business performance. And higher payout ratios reflecting higher capital returns.

Now that we finished the broader, strategic discussion, let me return to Ruth who walk through the details of the fourth quarter performance and way we finished 2014.

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. Results for the fourth quarter include several significant items which complicate comparisons to prior period. They include a net discrete tax benefit of $1.4 billion or $0.77 per diluted share principally related to the restructuring of a legal entity. Compensation expense adjustments of approximately $1.1 billion or $0.40 per diluted share related to changes in discretionary incentive compensation deferrals. A pretax charge of $468 million reflected as negative revenue or a loss of $0.17 per diluted share related to the initial incorporation of funding valuation adjustments, FVA into the fair value measurements for certain over-the-counter derivatives and legal expenses of $284 million or a loss of $0.12 per diluted share associated with several legacy residential mortgage related matters. In addition, the impact of DVA in the quarter was positive $223 million with $161 million in fixed income sales and trading and $62 million in equity sales and trading. Excluding the impact of DVA, reflecting the impact of $468 million related to FVA, firm-wide revenues were $7.5 billion, down 13% versus the third quarter. And earnings from continuing operations applicable to Morgan Stanley common shareholders excluding DVA were $783 million. Earnings from continuing operation per diluted share excluding DVA were $0.40 after preferred dividend. Earnings from continuing operation include the impact of the previously mentioned funding valuation adjustment, net discrete tax benefit, and compensation expense deferral adjustment and legacy residential mortgage related matters in the quarter. On a GAAP basis including the impact of DVA firm-wide revenues for the quarter were $7.8 billion. Earnings from continuing operations applicable to Morgan Stanley common shareholders were $928 million. Reported earnings from continuing operations per diluted share were $0.47 after preferred dividends. Book value at the end of the quarter was $34.62 per share and tangible book value was $29.63 per share.

Turning to the balance sheet. Total assets were $808 billion at December 31, down from $815 billion at the end of the third quarter. Deposits as of quarter end were $134 billion, up $9 billion versus Q3, reflecting the on boarding of deposits from city and typical seasonal increases in client cash. Our liquidity reserve at the end of the quarter was $193 billion compared with $190 billion at the end of the third quarter.

Turning to capital, although our calculations are not final, we believe that our common equity Tier-1 transitional ratio will be approximately 14.2% and our Tier-1 capital ratio under this regime will be approximately 15.9%.

Basel III transitional risk-weighted assets are expected to be approximately $423 billion at December 31. Reflecting our best estimate of the final set of reserve rules our pro forma common equity Tier-1 ratio using the Basel III fully-phased in advanced approach was 12.4% at December 31, down from 12.7% in the third quarter.

Our pro forma standardized ratio was 11.7%, flat to the third quarter. Pro forma fully-phased in Basel III advanced RWAs are expected to be approximately $432 billion. We estimate our pro forma supplementary leverage ratio under the U.S. final rule to be approximately 5% at December 31, up from 4.9% at the end of 3Q, 2014. These estimates are preliminary and are subject to revision.

Turning to expenses. Our total expenses this quarter were $7.9 billion, up versus the third quarter reflecting the significant items I noted at the outset. Compensation expense was $5.1 billion in the quarter driven primarily by the change in compensation structure. Specifically the quarter include an expense of $1.1 billion representing $756 million related to the reduction in the average deferral of discretionary incentive compensation award for the 2014 performance year and $381 million for the acceleration of investing for certain outstanding deferred cash based incentive compensation award. This provides us with operating leverage in the upside and reduces liability in the down side as best evidenced by the reduced compensation ratio target for 2015 and beyond the James noted.

Non-compensation expense was $2.8billion for the quarter, up 13% quarter-over-quarter driven by increase legal expense. Let me now discuss our businesses in detail.

In institutional securities revenues, excluding DVA, were $3.2 billion, down 25% sequentially and include a pretax charge of $468 million related to the initial incorporation of funding valuation adjustment. Revenues excluding the impact of FVA and DVA were $3.7 billion, down 15% sequentially.

Non-interest expense was $4.3 billion, up versus the third quarter. Compensation expense was $2.4 billion for the fourth quarter, up 37% versus the third quarter driven by the previously mentioned compensation expense deferral adjustment.

Non-compensation expense for the fourth quarter was $1.9 billion, up 23% versus the third quarter driven by increased legal expenses. Including the impact of DVA and FVA, revenues were $3.4 billion.

In investment banking revenues of $1.3 billion were down 3% versus last quarter. According to Thomson Reuters, Morgan Stanley ranked number 1 in global IPOs and number 2 in global announced and completed M&A and global equity at the end of the fourth quarter. Notable transactions included in advisory, Morgan Stanley continued its leadership position in cross border and large transaction including as lead financial advisor to Cubist Pharmaceutical and its announced $9.5 billion sales to Merck.

In equity underwriting, Morgan Stanley a sole book runner completed a $4.7 billion H - share follow on offering on behalf of China based insurer, Ping An Insurance Group.

In debt underwriting, Morgan Stanley acted as Lead Left book runner on Alibaba's $8 billion inaugural senior notes offering. This was landmark deal, the third largest debt IPO globally and largest bond transaction for an Asian issuer ever.

Advisory revenues of $488 million increased 24% versus our third quarter results driven by increased revenues in EMEA and the Americas.

Underwriting revenues of $807 million decreased 15% versus our third quarter results driven by equity underwriting revenues of $345 million, down 26% versus the third quarter, reflecting lower volumes in Asia and the Americas.

Fixed income underwriting revenues of $462 million, down 5% versus the third quarter primarily due to decrease in investment grade loans, partly offset by increased issuance in both investment grade and high yield bond. Equity sales and trading revenues, excluding DVA were over $1.6 billion, down 9% compared to last quarter. Cash equity and derivative revenues were down sequentially due to more challenging market environment. Revenues in prime brokerage were flat versus the third quarter.

Fixed income and commodity sales and trading revenues, excluding DVA were $133 million, down significantly versus the third quarter, primarily reflecting a pretax charge of $466 million related to the initial incorporation of FVA into the fair value measurement of certain over the counter derivative. Revenues excluding DVA and the pretax charge related to FVA were $599 million for the quarter. Commodities revenues were challenged in the quarter due primarily to the decline in oil prices. Credit revenues in the quarter were down versus the third quarter driven by a difficult market environment. Average trading VaR for the fourth quarter was $47million, up from $42 million in the third quarter.

Turning to wealth management. Revenues were $3.8 billion in the fourth quarter, up 1% sequentially. Asset management revenues of $2.1 billion were flat to the last quarter.

Transaction revenues were up 7% compared to last quarter, consisting primarily of commissions of $573 million, up 14% to the prior quarter, driven by a pickup across most products. Investment banking related fees of $173 million, down 23% versus last quarter, primarily reflecting lower activity in closed end funds and trading revenues of $230 million, up 24% versus the third quarter, reflecting higher revenues from deferred compensation plans.

Net interest revenue increased 4% to $625 million, driven primarily by higher revenues from our bank deposit program and continued growth in our lending product. Other revenue of $67 million decreased 40% versus the third quarter primarily due to the absence of the gain on sale of a retail property space we discussed in the third quarter. Non-interest expense was

$3.1 billion, up 3% versus last quarter. Non-compensation expense was $777 million, down from last quarter.

Compensation expense was $2.3 billion, up versus the third quarter, primarily due to the compensation expense adjustments related to changes in discretionary incentive compensation deferral previously mentioned. The compensation ratio was 60% up versus the third quarter, reflecting the change in compensation structure.

The PBT margin was 19% which similarly reflects the impact of the change in compensation structure.

Profit before tax was $736 million. Total client assets exceeded $2 trillion, global fee based asset inflows were $20.8 billion, fee-based assets under management increased to $785 billion at quarter end, representing 39% of client assets. Global representatives were 16,076, essentially flat to the third quarter. Deposits in our bank deposit program were $137 billion, up $8 billion versus the third quarter. Approximately $128 billion were held in Morgan Stanley Bank.

Wealth Management lending balances continued to grow reflecting the ongoing execution of our bank strategy. Investment Management revenues of $588 million were down 12% sequentially. In traditional asset management revenues of $432 million were down 8% versus the third quarter, driven in part by lower market level.

In real estate investing, revenues of $103 million were down compared with the third quarter. Merchant banking revenues were $53 million down 38% driven by the absence of investment gains versus the third quarter. Non-interest expenses were $594 million, up 25% from the third quarter including compensation expense of $381 million reflecting a compensation deferral adjustment mentioned previously.

Non-compensation expense was $213 million, down 4% from the third quarter. Profit before tax was loss of $6 million in the fourth quarter. NCI was $12 million versus $18 million last quarter. And total assets under management increased to $403 million driven by higher flows, primarily offset by market depreciation.

Finally, our outlook is consistent with data that suggest ongoing growth in the U.S. and the expectation the key market outside the U.S. will benefit from central bank support. Both should benefit client activity level particularly in the sales and trading businesses. In investment banking, the M&A pipeline is up, driven by continued strength in large and cross border M&A where we are well positioned given our global franchise. The global equity underwriting pipeline remains similarly healthy, benefiting from broad base global activity. The pipeline also includes traditional issuance from transaction that was deferred to the first half of 2015 during the market choppiness of October.

In Wealth Management, which is overwhelmingly U.S. driven, our outlook is also positive. Our margin target indicates upside in the business and underscores confidence about the state of, and growing contribution from the execution of our bank strategy. As James noted, lower funding cost continue to provide upside in revenues for our sales and trading business.

Regarding the regulatory environment. Through all the actions we've taken in the last five years, we are well positioned to deal with the requirement we face. With the strong capital and liquidity ratios we've built, we have great flexibility to deliver for clients and stakeholder.

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

Question-and-Answer Session

Operator

[Operator Instructions]

Your first question comes from the line of Brennan Hawken with UBS. Please go ahead with your question.

Brennan Hawken

Good morning. Quick question on the outlook and the strategic update which is much appreciated. The potential to take FIC RWAs to $155 billion based on the passive roll down, what sort of time line should we use to think about that?

Ruth Porat

So the target is as we indicated is $180 billion by yearend 2015. And that includes the additional $25 billion of run off over time. That additional $25 billion will run off through 2018. So that would take it to the $155 billion unless of course we find opportunities to reinvest within fixed income as James said. So that's over 2018.

Brennan Hawken

Got it. Thank you. If you guys find that FIC returns sort of remain at current levels, we kind of get this current environment proves to be a bit more of the steady state rather than what many of us are hoping is a cyclical weak point, how low can that number go beyond that if you find that you need to allocate more money over to the equities and the wealth management from a capital perspective?

Ruth Porat

Well, we have ample capital and so we are supporting the client demand and activity in the equities business and don't want to leave you with that the final comment you made which is to -- is it a trade off between the two. So again very importantly given the strong capital positions in and given the strength and importance of the equity business two or three of ample capital to support client activity there and are -- as it relates to fixed income, our approach has been as we've said repeatedly to be very clinical about capital balance sheet expenses and that was the main point that we made here this morning. We've reduced each of those in 2014 and we remain very focused on how to drive returns in the business. So being very diligent on that.

Brennan Hawken

Okay, all right. Thanks for that. On FIC, there was a change leadership in the commodities business. Is that indicative of a new direction for that business? And then also as we think about the commodities business, is it possible that the overall business there has been impacted by the sort of drawn out sale process to the physical business?

James Gorman

Brennan, I think we put in place the commodity strategy couple of years ago which was completely independent of the regulatory environment we are in which was essentially we did not want to be a significant player in physical businesses. The largest physical space we had was in oil. And we completed the TransMontaigne deal and we are well underway to complete the rest of the sale when obviously ran into other issues requiring government approval. So we are still on that track. So the management changes were completely independent of that. These are big businesses. We management evolve and company of this size periodically. So I wouldn't read great deal into that. We are well on track with commodities. So with where we wanted to be. Did it affect the performance the business; the fact ran the sale process. I can't really say whether it did or didn't. Certainly, I wouldn't say materially, I think much more material was actually going on in the oil market in the last several months. We didn't have a good fourth quarter in commodities. It happens almost, probably almost volatile business segment. I don't expect that to be a permanent state.

Brennan Hawken

Okay. Thanks for all that color. And then last on capital markets. You guys highlighted lower revenues in derivatives and cash. Was there anything episodic impacting those businesses? Because we heard some of the competitors highlight some strength in some of those businesses especially cash recently.

Ruth Porat

No. I would say that overall our client franchise remains strong and so we are continuing to see levels of activity. Cash tends to be seasonal as you wind up the year. So, no, I wouldn't call out anything particular, choppier markets are more challenging for derivative.

Brennan Hawken

Sure, sure, okay. That's helpful. And then deferred comp, I think you guys weighted out, I know that it can sometimes impact both the revenue and expense line in wealth management, changes in the deferred comp. Did we -- can you quantify that for us and did that impact the pretax margin in wealth management this quarter aside from the noise that was going in the change in deferrals?

Ruth Porat

No. You just said it, the key point in the margin was really the change in this structure of compensation, usually PBT margin neutral and so, no, it didn't -- the main point was the change in structure.

Operator

Your next question comes from the line of Glenn Schorr with Evercore ISI. Please go ahead with your question.

Glenn Schorr

Thanks. So you noted the legal on the quarter. I am curious if you had handy the all in legal cost for the year? And if it is right for us because I am thinking about lot less next year given that mortgage put to bed, LIBOR setting bank and obviously had limited FX business?

Ruth Porat

So the full year a legal related expenses for 2014 were around $600 million.

Glenn Schorr

And you think I am crazy if I am thinking for next year?

Ruth Porat

Well, the point we take consistently is it litigation from the crisis and resolved that remains headwind, I appreciate the question. It is tough to forecast neither timing or announces is fully in our control. So appreciate the question but that's about all I think.

Glenn Schorr

So I like to slide on the lower funding cost and I think lots of are benefiting, you are benefiting maybe little more than most, can you put that in a dollar term for us, in terms of what means for next year, the year after. I understand that it is fallen and it is pretty dynamic conversation. I am just curious if its dollar.

Ruth Porat

Well, we realized the benefit over time given the weighted average maturity of unsecured stack is about six years. So as we refinance out of that, well leg into at over time, at this point we are refinancing some of that we issue both crisis and that's why wanted to give the trajectory and overall the trend line.

Glenn Schorr

All right. Two other clean up. So one the clean comp ratio for 2014 for ISG is a lot of ex all the FVA, DVA and comp charges?

Ruth Porat

Right. So full year again excluding all of those is full year about a point.

Glenn Schorr

Around to -- is it 40, 41?

Ruth Porat

Yes, full year 41 down from 42 after.

Glenn Schorr

Got it. Okay and then last one on deposit front. The fee based flows were huge for any quarter, fourth quarter; I don't remember being usually a big quarter for it. Usually think of that is more as beginning of the year if there was any seasonality to at all. The question is, has anything change on incentive wise or no product wise or is it just the continuation of the process?

Ruth Porat

No. We had strong flows during the fourth quarter and the full year. There can be some lumpiness as we talked about last quarter but continued strength in it as you appropriately said it is kind of -- you look at a full year and it is very strong and underscores the point that James made which is that there is a strong secular trend here and we benefit from given the scale of the business we have and the breadth of products content and service we are providing.

Operator

Your next question comes from the line of Guy Moszkowski with Autonomous. Please go ahead with your question.

Guy Moszkowski

Good morning. Just trying to read into the ROE chart at the end of the strategic presentation. Last year the base line was 9%, this year the base line number you built of is 10%. Is it really just that the 10% base line now includes higher confidence on capital actions. Is that the main difference or should we be saying that there is material underline increase when all the puts and takes are taken into account?

Ruth Porat

I am glad you pointed out because we do think it's important. There are number of items that are reflected in that. I would say the change in compensation structure is the contributor as well and so James laid out the various items. And as you know this is without the benefit from a rising rate environment. So it is what we see the upside wealth management and the bank is incorporating revenue benefit from the lower funding costs, we are continuing to make progress in fixed income. Although we are doing on the expense side as I said that compensation structure change is important and did allow us to reduce the comp ratio in ISG to 39% or lower, that's in flat revenue environment. So better revenues, we have even further operating leverage but that's an important point. And all the stuffs we've taken over the last several years. The expectations about continued increases and return to capital. So we've made some tough choices, appreciate a complicated some of the comments this morning but made these tough choices that did have a negative impact on the quarter but sets us up well and that's we put it in here as we are modeling a 10%.

James Gorman

I would just add, Guy, what we've always try to do is when we have clarity of vision on something is too laid out there for our shareholders. And we have much more clarity of vision around the 10% frankly. As Ruth said because of all the things that we have checked off and some of the things we've put behind is in the change in the comp and where we have capital, much more clarity of vision. So when we see something that we think is clearly achievable that's what we are going to put out for shareholders and we have also identified that there is obviously upside. It is depended on something which are less within our control but not unreasonable to expect at some point in the future.

Guy Moszkowski

And is that additional upside about the same as it was last year? Obviously all we have is hopefully proportional hunk of a bar chart to compare it against but it appears that's largely unchanged?

James Gorman

Yes. I wouldn't draw too much into our graphic skills and ratios of bar sizes. No, I think we are saying, we clearly see an improved rate environment. We are in a business mix that we think does well with the improving global economy and we are over-weighted to the U.S. because of wealth management which is we all know is doing best among the developed countries on risk adjusted return basis. And we clearly see additional capital returns because we are seeing all the capital ratios that we've talked about.

Guy Moszkowski

Got it. And just as a follow up on the capital ratios. Thank you, Ruth, for the fully phased figures on both advanced and standardized, why did the advanced come down a little bit?

Ruth Porat

So as you know we are governed by standardized, as flat under standardized, and the RWAs under the advanced approaches were up for a couple of reasons, primarily due to volatility but also lending growth and ops risk goes in there. So those are up; it was really RWA is up.

Guy Moszkowski

Got it. On the oil business which as you pointed out ran into a roadblock because of the Russian situation in terms of trying of sell it, what's the outlook there and if it is not sold, would you look to wind that business down and over what timeframe?

Ruth Porat

So we do remain focused on selling it as a business and we'll let you know when we have something to say on that.

James Gorman

Yes, I mean we are clearly intent on getting out of the physical oil business. We made that very clear. We had a contract for sale. We couldn't complete for reasons outside of our control. And we will get out of the physical oil business.

Guy Moszkowski

And I guess the question was really around if it's harder to sell in the current environment and you need to wind down elements of it, what kind of timeframe should we be thinking about?

Ruth Porat

We actually don't see if the question is really with lower oil and that affect the sale of the business. We don't see it negatively affecting the sale. We have excess storage capacity so that actually sets the business up well to benefit from rising oil prices and we think capacity at these levels and benefiting as oil prices rise. So it doesn't affect the sale process.

Guy Moszkowski

Okay. That's helpful color. On the FIC target just with run off down to the 155 and this is maybe a subtle change in what you are communicating but I want to make sure I understand it. I think you had said previously that as you got down to the 155 – 160 level from the run off you would look to redeploy within FIC to the 180 level. But now it sounds like you are leaving the options open to redeploy more broadly across the business. Is that right? And if so, what drives the thinking?

Ruth Porat

That is correct. And what we are saying is look there have been structural headwinds in the industry, there have been some cyclical ones as well. We have a clear plan that includes the reduction in balance sheet capital and expenses that we've talked about. And we just wanted -- we are being -- what we are saying is we're being very clinical here which is we are targeting 180, there is another 25 that comes off and the right prudent thing to do as custodians of the business is to ensure we put that incremental capital capacity to support the highest return businesses across highest return products and if that's within fixed income where we've already some products that are generating attractive return such as in corporate credit and securitized product. And there is client demand for incremental capital that's an opportunity but we will look across the franchise. So you are right. I am glad you drew that it out; it is change we just want to make it very clear how we are approaching it.

Guy Moszkowski

Good, well, I think your shareholders probably appreciate that, that flexibility so that's good to understand. In terms of the reduction in the ISG comp target. Is all of that reduction to 39% or less due to the change in the deferral strategy or is there actually a view that in the current environment you can reduce the comp payout?

Ruth Porat

It is due to the change in the comp structure. It was an important step for us to take; it gives us as I said reduced liability on the downside importantly operating leverage in the upside but by pulling forward future deferral and changing the deferral rate it enabled us to set that compensation ratio at 39% in a flat rate, flat revenue environment. It was operating leverage, a lower comp ratio and a better revenue environment and we think underscores importance of that change.

Guy Moszkowski

Cool. And then just one final one for me on the legal cost this quarter. Was that essentially a litigation reserved build because of things for which you had estimable and probable or was it actually a clean-up of current quarter expenses? And, if so, can you give us a little color on what they were?

Ruth Porat

Yes. Reserves as you just said are based and estimated each quarter based on FAS5 so probable and estimable.

Operator

[Operator Instructions] Your next question comes from the line of Mike Mayo with CLSA. Please go ahead with your question.

Mike Mayo

Hi. I was looking for more color on slide 15 with the ROE target. And does this imply that going from 9% to 10% that if you have capital action so could be 11% and on tangible basis it could be 12%? Again I am just comparing this year slide 15 with last year's slide 15. And related to that you talked about having a greater clarity of vision but this also comes in a quarter where you missed consensus expectations. So is this quarter a one-off in your mind or how do you think about all that?

James Gorman

Firstly the 9% to 10% reflects all of the things that are implied under the -- or listed on the left hand side of that page, Mike. It also talks about as last of those receiving non objection on our CCAR capital request. And what we pointed out is that obviously in future, yes, we see future upside as we make additional capital returns as we are reshaping the balance sheet and reshaping the businesses. So it's -- when we talk about clarity of vision, we are one year closer. We are seeing real progress in the wealth management business with a margin improvement of 200 basis points. We expect progress to continue. This is why we set goals which are currently above where we are performing. We see real opportunity in the lower funding cost. It is clear that our bank strategy is being well executed in building the asset side of the balance sheet and we're continuing to see roll on of deposits et cetera, et cetera. So we felt it was important to lay out for our shareholders.

Mike Mayo

And the timeframe for this target?

James Gorman

Obviously, we haven't given timeframe on these targets because we can't control the market environment around us.

Mike Mayo

Okay. Well, some more specifics related to this. In terms of higher interest rate slide 6, you talk about the margin improvement and you said your 22% to 25% wealth management pretax margin does not rely on higher interest rate. Can you describe your interest rate sensitivity if rate did increase 100 or 50 basis points?

Ruth Porat

So you are actually right, this does not include benefit of higher rate. You can somewhat say the benefit rate through the roll forward that we have on the bank side. We frequently discussed there are a real positive for us, the factors to consider in that as you are modeling it out is we do generate higher net interest income even in the flat rate environment because we are still in relatively early stages of deposit deployment. I think that's quite differentiated but rising rate environment just a component, again it does drop meaningfully to the bottom line because of the cost structure, the bank and James said, we've already invested in the infrastructure required. We don't have bricks and mortar; FAs are not paid on the grid. All the things that we've talked about with you before. And then what we did as we provided yields and assets mix to help you model the NII upside and we actually extended out the estimate of asset growth to 2016 on that slide. Previously we had out to 2015; it builds on the strength of the performance in 2014. In fact, we ended prior to our estimate for 2014. And I think the other couple of elements in it but just no update on that. So given deposit here are different from retail bank. They are very sticky given the nature of deposit and more like working capital. We continue to assume about our 45 basis point increase in deposit pricing with the first 100 basis point increase in rate. We do believe that model is conservative given the nature of our deposits and structural changes and deposit alternative. Those funds -- it continues to be more relevant rate for our business than the average ratio of bank asset is around year and half. So again rising rates benefit as quickly but the point on this on the bank side really was to extended out so that you can model in the benefit as you see-- as you escalate rising rate.

Mike Mayo

What is your efficiency ratio for the bank since you are talking about that your expense to revenue ratio? Because you highlighted the fact that you don't have bricks and mortars so I assume the efficiency ratio would be better than the typical bank?

Ruth Porat

Yes. We don't rate that out separately, but you are absolutely right which why we said it drops meaningfully to the bottom line.

James Gorman

Yes. I mean it's obviously better because the whole strategy around the bank is driving more throughputs through an existing branch structure.

Mike Mayo

And then lastly you highlighted compensation so did I hear you correctly that the compensation expense should decline from 41% on a core basis in 2014 to 39% or less in 2015? Is that correct?

Ruth Porat

Yes. Correct. In a flat revenue environment, yes.

Mike Mayo

And James you have been very vocal in the past and I guess in hindsight giving a lot of stock to people at much lower stock prices worked, but can you talk about the trade-off between paying your people and then meeting Wall Street expectation? In other words getting the desired earnings growth. There is talk about people from brokered firms going elsewhere such as private equity. So how do you manage that trade-off?

James Gorman

Well, firstly, Mike, I am delighted for all of our shareholders if the stock is appreciated, 26% I think last year, 60 something percent years before and 25% year before that including our employees who frankly deserve that. They are the ones who rode the boat. They got the job done and they deserved it. So I have no qualms about the employees benefiting from the rising stock. And listen, it is a balance. What we did coming at the crisis was we deferred up to a 100% our employees' bonuses, we did that for a very specific reason and it is unnatural act of 100%. We've recognized that and we were working our way down over a period of years to 50% and we decide to bite the bullet and get it done in 2014 and bring ourselves back where we think the industry will settle which is at 50% deferrals. We are still high relatively to our competitors so certainly from a shareholder perspective it remains a very friendly concept. It continues to tie our employees into the firm which is what we want and what they want as evidenced by a low attrition. And, no, I am not concerned about the onesies and twosies who choose to go into different paths of the financial sector, we get very attractive employee base coming in this firm and as frankly it's just not an issue.

Operator

Your next question comes from the line of James Mitchell with Buckingham Research. Please go ahead with your question.

James Mitchell

Hi, good morning. I just wanted to follow up quickly on the low-- the funding costs trajectory. I guess first is there any -- you highlight again 25% by 2016, is there -- is that presumption of the rate environment or is that pretty much locked in? Just how should we think about that net benefit?

Ruth Porat

So the funding cost reduction reflects the forward curve so it builds in that -- those higher rate, so with kind of respect rate move we do swap our debt to floating because our assets are floating but it spills off the forward curve.

James Mitchell

Okay. So but any change in the forward curve would have an impact on that assumption, okay.

Ruth Porat

Yes.

James Mitchell

And then if we think about the funding cost target, if we just look at your interest expense from last year which I think was about $3.7 billion, that how we should think about the 25% reduction of that $3.7 billion?

Ruth Porat

No. There are obviously number of components in that. So it is not quite straight forward as that.

James Mitchell

So would be a little less than that? You are not going to help, okay.

Ruth Porat

Yes, you do modeling.

James Mitchell

And was there any meaningful CVA this quarter?

Ruth Porat

CVA was a bit of drag this quarter and last year and positive last quarter. So, yes, just a bit but -- just a bit.

Operator

Your next question comes from the line of Michael Carrier with Bank of America/Merrill Lynch. Please go ahead with your question.

Michael Carrier

Thanks. First question just on the FIC outlook for RWA. Just want to see if you had any I guess lost revenues related to going from the $188 billion down to say $155 billion?

Ruth Porat

One of the points we've made over time is that these are -- we call them dead weight, it is really dead weight capital and that it is supporting assets that aren't generating revenue worth funding old positions and so they are negative ROE now. And they were loss, they go from negative ROE to neutral to zero and the objective is then to take that excess capital and put it behind client activity and areas that are most accretive to the overall franchise. But the most important point is they are negative ROE because -- it is really just the financing cost on these long dated positions.

Michael Carrier

Okay. And then just on expenses for the legal the $284 million, , I just wanted to be clear because it seems like each quarter there are some legal cost, obviously at the firm. But is this just related to the residential mortgage in a matter or is that everything in the quarter? And if it wasn't, just what was your kind of your normal legal in the quarter?

Ruth Porat

So what we call that was as we said related to the residential.

Michael Carrier

Okay, got it. And then last one just in terms of the -- where your CG1 ratio is, just given we had the buffers out there, where do you expect to run the ratio in a longer term? And then based on the Basel and SFR, any update or any guidance in terms of how you guys stand?

Ruth Porat

So in terms of the buffer on the various ratios sought, we are in a very strong position as we said, fully phased in standardized, 11.7, advanced 12.4, well above requirement even with estimates of what may occur with the incremental buffer and at this point given these are required over time not just are quantifying above or above that. But we got a --we are running substantially above the requirement which is again consistent with our view that we have capacity to continue to return capital. As it relates to the net stable funding ratio, we are above a 100% as currently proposed by Basel, obviously still awaiting the final US rules. And you probably heard me say too often that we firmly believe in the durability of funding is imperative and that's how we run the firm. One concern about the rule is that it actually isn't proper ALM, and certain transactions which create liquidity in practice or our consumers of liquidity under the NSFR construct. I think it's notable that this element, the rule has been left to national regulators to tailor in the final rules. But short answer to your question, we are in a strong position with NSFR as it stands and that's keeps us in a strong position to deliver for clients.

Operator

Your next question comes from the line of Steven Chubak with Nomura. Please go ahead with your question.

Steven Chubak

Hi, good morning. So, James, you noted in your discussion on FIC that in addition to shrinking RWAs, you also managed to shrink actual fixed balance sheet assets and when looking at the product level commentary or disclosure you provided, it does appear that businesses that are actually generating returns below their cost of equity are more concentrated in those areas like global rates where they are more balance sheet or leverage intensive than risk intensive. I just want to get an understanding as to how much more optimization potential we could see on the asset side of the equation that could help improve returns over the next couple of years?

Ruth Porat

Well, let me take that couple of point. Year-on-year, we had a sizable decline in our balance sheet and that is at the same time that we were increasing deposits. We have this ongoing contractual on boarding of deposit supporting our lending business. So what that really reflects is optimization and trading businesses and that's primarily within fixed income. And so we are continuing advertise lends on balance sheet as we go into this year. There is some growth from deposits and we are very focused on making sure to the heart of your question that we are using every -- all assets, all resources where we can drive the strongest return and that's been part of the optimization on balance sheet to date. I think the other point is as I noted our SLR is at 5% and so we've been -- we are in a good spot, we said we will be there in 2015. We are here as we ended 2014. And again that gives us -- so we've got ample opportunity and what we are looking it as to how drive returns.

Steven Chubak

Thanks, Ruth. And then just one more question on ISG, actually switching over to the expense side. I appreciate the disclosure on the comp target for

2015 assuming a flat revenue environment. I was hoping if you can give some color as to what the non personnel ratio should look like ex legal going in 2015, also assuming that you have a flat revenue environment for the coming year.

Ruth Porat

I don't have that with me.

Steven Chubak

Okay. And then just one quick final one on wealth management. Did appreciate the disclosure on the yield opportunity for the bank, but just giving your expectation as to how the funding your liability profile evolve, what the reasonable expectations for what the NIM trajectory should look like over the coming years, not just assuming a flat revenue environment but also contemplating the future yield opportunities that you highlighted on the asset side?

Ruth Porat

So the reason we laid out as we did, if we wanted to give you the growth in the slide that James went through on the bank as we also broke up the split between deposits supporting growth and institutional securities versus wealth management, we are seeing growth in both and we laid out the yield. So that you can actually, you can model it out over time.

Operator

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

Matt O'Connor

Good morning. I was just hoping the follow up on the timing of the 10% ROE target. You talk about relatively stable macro trends in terms of trading, investment banking. So it seems like it is more about execution and call it the passage of time specifically in FIC, so I guess as you think about the timing, is this 2015 target? Is this a five year target? Just trying to push a little bit on this.

Ruth Porat

Look, as James said we have given you the key drivers of it and not putting a date on it, but you see the key drivers of it and certain other steps that we took as we ended this year. Put a fine point on certain of the elements that will drive ROEs higher, for example the change in comp structure enabling us to take down the comp ratio and some of the other elements that we have delineated, so I will be repetitive I go through, we are no putting a date on it but you can see the actions we've taken put, it will give clarity about execution against them.

James Gorman

I can promise you one thing though. It is not a five year target.

Matt O'Connor

Okay and then in terms of the capital against it, obviously you've got probably more than you need on the Basel III ratio, the SLR could be the constraining factor for you guys and the peers. How do you think about how much SLR you need to run? And is there some opportunity to optimize that more so than say the Basel ratio?

Ruth Porat

Well, at this point as he said we got a strong excess above requirement on risk based capital and given the SLR it is not required until 2018 as I just said. We were looking to get to 5% in 2015 and here we are at 5% now. So we don't view that as a constraint on our ability to return capital. At this point, there are continues to be opportunity to mitigate as really primarily and reduction of the gross- up in the balance sheet, net long CDS sold and compression activity, obviously the ratio will continue to benefit from earnings but more in the gross up on the balance sheet and when you look across the ratios, given all that we've done with the business and given the strength of where we stand today and capital, that's why our view is we set ourselves up well to continue to steadily increase return of capital over time. Our philosophy is no discontinues move but steady increases over time and that's what we remain focused on.

Matt O'Connor

Okay and just separately a follow up question on the changes to the comp structure. Am I thinking correctly that essentially taking the charge on the cash, deferred cash piece, that will benefit you the most in the early years and then less later years?

Ruth Porat

It will continue to benefit us. So it is -- both of them benefit us and that's why we are free setting the comp ratio here today.

Operator

Thank you. This concludes the question-and-answer session. And please proceed with any closing remarks.

Ruth Porat

Thank you for joining us for our fourth quarter conference call. We look forward to speaking to you again in 13 week.