Good morning. This is Celeste Mellet Brown, Head of Investor Relations. Welcome to our First Quarter Earnings Call. Today's presentation may include forward-looking statements, which reflect management's current estimates or beliefs and are subject to risks and uncertainties that may cause actual results to differ materially. The presentation may also include certain non-GAAP financial measures. Please see our SEC filings at morganstanley.com for a reconciliation of such non-GAAP measures to the comparable GAAP figures and for a discussion of additional risks and uncertainties that may affect the future results of Morgan Stanley. This presentation, which is copyrighted by Morgan Stanley and may not be duplicated or reproduced without our consent, is not an offer to buy or sell any security or instrument.

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

James P. Gorman

Thank you, Celeste. Good morning, everyone. We will review the progress we've made towards the sixth comprehensive steps we laid out in January that will drive our return on equity and return on tangible equity, excluding DVA to greater than 10% and 12% respectively, assuming a flat revenue environment. We'd like to update you on the progress we've made towards each goal during this quarter and we remained committed to the targets as laid out.

First and the first point number one to acquire 100% of the Wealth Management joint venture. As hopefully you know during the first quarter we received a non-objection in the CCAR process to our request to use $400 million of our excess capital to buying the remaining 35% of the joint venture from Citi. We're now waiting further approval from the bid consistent with the process for the 14% purchase last year and we look forward to hearing from the Fed over the next several weeks or months.

Number two, to achieve Wealth Management goals through expense management and to exceed them through revenue growth. Due to better expense controls and a more robust revenue environment we were able to drive another 17% margin resulting Wealth Management in the first quarter, despite seasonally higher expenses.

In addition, our flows in the managed accounts were very strong at over $15 billion. Long-term we continue to believe this is an extremely attractive business for Morgan Stanley. There is continued upside to profitability driven by a constructive environment in expense controls that gradually shifts back into equities by our clients, continue migration of managed accounts from commission based accounts, and finally revenue and margin upside from earning a 100% of Wealth Management.

Point three, to significantly reduce risk weighted assets in fixed income and commodities. We made good progress with the fixed income risk-weighted asset reductions and in the quarter at $253 billion, down from $280 billion at the end of 2012 and slightly below our year-end target of $255 billion. Our progress was partially driven by passive mitigation with much of the decline driven by credit derivative contract expiries. Although we are pleased with that progress, we remain comfortable with our year-end target of $255 billion.

Point four was to drive expenses lower in 2013, 2014 and beyond. Non-compensation expenses continue to come down sequentially consistent with the progress we have made last year and the targets we outlined in January. In addition, our firm-wide NIC compensation ratios excluding DVA in severance well below our full-year 2012 ratios, while our total compensation dollars were also below those from year-ago. This largely reflects the significant headcount reduction we made over the past 12 months across that business.

Point number five, was to grow earnings through Morgan Stanley's specific opportunities. As we discussed when we reported the fourth quarter, we believe there is significant revenue upside and expense savings for both institutional securities and Wealth Management as we move closely along those businesses. Institutional securities and Wealth Management launch the joint venture in September 2012 to increase collaboration between the businesses and there are currently of 40 initiatives in various stages of execution. We are already seeing the benefits in the first quarter and expect additional upside over the next several years.

For example, prior to 2013 the firm had two separate groups focused on fixed income middle markets institutional clients. In January these groups were integrated under a uniform platform on leadership and are evidencing positive early results. Revenue generated on these accounts was up despite aggregate market volume declines for the particular products in the same period.

During the quarter, we continue to deploy our excess bank deposits more efficiently. Our mortgage lending was again higher and we made significant progress in regards to our PLE or Portfolio Lending Efforts, where we expect to drive the majority of our retail lending growth over the next several years.

On the Institutional side, we added two new initiatives to our bank suite platform in the first quarter, and we are in the early stages of execution for commercial real estate and warehouse lending. There remain significant opportunities from growing our bank. As we have previously discussed, our deposits will grow to approximately $140 billion after we acquire 100% of the Wealth Management joint venture. And we have a prudent disciplined strategy to deploy those deposits over the next three years.

Point number 6, so how does all this set up? Well, our 8% ROE and 9% ROT both excluding DVA or solid start to the year; we expect that these levels will improve driven by the steps I've updated you on. The consistency of our returns is as important as the absolute level of our returns and we have made progress in this regard as well, particularly over the last several quarters. In addition, we believe many of the regulatory headwinds face the industry are already reflected in our results such as the cost of subsidiarization and because our growth areas of those that are unlikely to be much impacted by further regulation, our path is clearer.

In closing, I'd like to briefly touch on that Japanese business before I turn the call back to Ruth. Its top of mind because of the trip I made to Tokyo last week to meet with our partners. I saw firsthand the impact of new monetary and fiscal policies on the markets there and the impact they're having on our business. Joint ventures with MUFG, Morgan Stanley MUFG Securities and Mitsubishi UFJ Morgan Stanley Securities are uniquely positioned in Japan to take advantage of what is a macro resurgence due to the global client network and capabilities of Morgan Stanley and the domestic Japanese corporate and retail footprint of MUFG.

Combined, we have an unparalleled distribution in mediating invested capital flows into Japan and helping Japanese companies grow abroad. In Japan we have top three positions in equity and fixed income underwriting and M&A. As Japanese domestic firms consolidate their IBD market share, JV is differentiated as a domestic firm but truly unique origination capabilities. Outbound M&A volume was up significantly in 2012 and Japan became the number two acquirer nation globally versus number nine in 2009. We're also well positioned in sales and trading and have and will continue to benefit from cross-border flows into Japanese equities where we have a nearly 14% share in equity trading.

As we approach the third anniversary of the JV on May 1st, the financial contribution of Morgan Stanley continues to show positive momentum which we expect to continue for some time and was worth calling out at this unique point in transition in Japan. So now let me get back to the broader results and particularly the first quarter and turn it over to Ruth. Thank you.

Ruth Porat

Good morning. I will provide both GAAP results and results excluding the effect of DVA. We have provided reconciliations in the footnotes to the earnings release to reconcile these non-GAAP measures. The negative impact of DVA in the quarter was 370 million with 238 million in fixed income sales and trading and 79 million in equities sales and trading. Excluding the impact of DVA, online revenues were 8.5 billion, up approximately 13% versus the fourth quarter.

Non-interest expense was 6.5 billion, up 7% versus the fourth quarter. Compensation expense was 4.2 billion this quarter which included approximately 132 million related to severance. Non-compensation expense was 2.3 billion, down 6% from last quarter. The effective tax rate from continuing operations for the first quarter was 21%. Excluding discrete items, the effective tax rate was about 30%.

Earnings from continuing operations applicable to Morgan Stanley common shareholders excluding DVA were approximately 1.2 billion. Earnings from continuing operations per diluted share were $0.61 after preferred dividends. On a GAAP basis, including the impact of DVA, firm-wide revenues for the quarter were 8.2 billion. Earnings from continuing operations applicable to Morgan Stanley common shareholders were 977 million. Reported earnings from continuing operations per diluted share were $0.50 after preferred dividends.

Book value at the end of the quarter was $31.22 per share; tangible book value was $27.39 per share.

Turning to the balance sheet, our total assets were $801 billion at March 31, up from $781 billion last quarter. Deposits were $81 billion consistent with fourth quarter levels. Our liquidity reserve at the end of the quarter was $186 billion compared with $182 billion at the end of the fourth quarter. $118 billion of our liquidity this quarter was parent and non-bank liquidity versus $111 billion at the end of the fourth quarter. We increased our liquidity reserve to ensure we're well positioned for the potential acquisition of the 35% stake in the Wealth Management joint venture.

With respect to our capital ratios, as a reminder beginning this quarter the definition of Basel I capital ratios reflect the implementation of the Basel Committee's market risk capital framework which is commonly referred to as Basel 2.5. Although our calculations are not final we believe that our Tier 1 common ratio under Basel I will be approximately 11.5% and our Tier 1 capital ratio with be approximately 13.9%. For the fourth quarter the pro forma Tier 1 common ratio under the new framework would be 10.6%. Risk-weighted assets under Basel I are expected to be approximately $403 billion at March 31. Subject to final rule making and reflecting our best assessment of the rules, our pro forma Tier 1 common ratio under Basel III was 9.8% as of the end of the first quarter.

Let me now discuss our businesses in detail. In Institutional Securities, revenues, excluding DVA, were $4.4 billion, up 22% sequentially. Non-interest expense was $3.3 billion, up 8% versus the fourth quarter. Compensation which included severance of $113 million was $1.9 million for the first quarter, reflecting a 43% ratio excluding DVA. Excluding DVA and severance the compensation ratio was 40%. Non-compensation expense of $1.4 billion decreased 6% from last quarter. The business reported a pretax profit of $1.1 billion, excluding the impact of DVA. Including the impact of DVA, the business reported a pretax profit of $830 million.

In investment banking, revenues of $945 million were down 23% versus last quarter. According to Thomson Reuters, Morgan Stanley ranked #2 in global completed M&A, and #3 in global equity at the end of the first quarter. Notable transactions included in equity underwriting, Zoetis which raised $2.6 billion in its public offering, the largest IPO of the U.S. Company -- of a U.S. Company in almost a year. In advisory, Benckiser acquired DE Master Blenders for €7.6 billion and Morgan Stanley served as financial advisor and joint leader ranger on committed financing to the bidder group. And in debt underwriting as joint book runner we successfully priced $3.5 billion of senior unsecured notes for Intelsat, Luxembourg to refinance existing indebtedness.

Advisory revenues of $251 million were down versus our strong fourth quarter results due to lower industry wide volumes and timing of the recognition. Declines were primarily in the Americas. Equity underwriting revenues were $283 million up 19% versus the fourth quarter, driven by improved performance in the U.S. and Asia offset by declines in EMEA. Overall revenue mix for the market was less favorable in the quarter with fewer IPOs in greater block activity. Fixed income underwriting revenues reflected continued strong demand across products although our revenues of $411 million were down versus our record fourth quarter. This quarter the market was more heavily driven by high-yield and leverage loans where our share has historically been lower versus investment grade where we have stronger positioning.

Equity, sales and trading revenues excluding DVA, were $1.6 billion, an increase of 14% from last quarter. Equity revenues were up broadly across products, regions and client segments versus the fourth quarter. Client revenues were the highest levels in over a year driven by market share gains and growth in prime brokerage balances. Prime brokerage balance growth in fact outpaced the overall market due to greater balances from existing clients and from new business. Strength in our core businesses was partially offset by the PDT spin-off that was effective January 1, of this year.

Fixed Income Commodities and Commodity sales and trading revenues, excluding DVA, were $1.5 billion. Revenues increased versus our fourth quarter results reflecting seasonal patterns, despite a period of challenging market conditions in March.

CVA, net of hedges, continued to be a drag this quarter in part due to the tightening of our credit spreads. Results in both macro and credit products were up versus the fourth quarter, driven by strong client activity. In general, clients focused on higher yielding products.

Credit corporates were up significantly as secondary trading volumes increased. Securitized products results outperformed due to very strong volume and several CMBS securitizations in the quarter.

Commodities sales and trading revenues continued to be challenged by cyclical headwinds but were ahead of fourth quarter results. Other sales and trading revenues of 73 million compared with negative revenues of 34 million last quarter. Average trading VAR for the first quarter was 72 million versus 78 million in the fourth quarter.

Turning to Global Wealth Management; revenues of 3.5 billion were up 4% versus the fourth quarter. Asset Management revenues were consistent with the fourth quarter reflecting comparable market levels at the beginning of each period. Transaction revenues increased 15% from last quarter, consisting primarily of commissions of 559 million which increased 5% reflecting greater mutual fund activity despite fewer trading days versus the fourth quarter.

Investment Banking related fees of 274 million which increased 32% versus last quarter, driven by strong activity for closed-end funds and trading revenues of 298 million which were up 22% versus the fourth quarter, reflecting the impact of deferred compensation plans and higher fixed income revenues.

Net interest revenue increased 6% to 413 million, in part driven by higher average BDP balances and more efficient deployment of our investment portfolio. Non-interest expense was 2.9 billion, up 4% from last quarter. The compensation ratio was 60% versus 57% in the fourth quarter, reflecting seasonally higher compensation expenses in the first quarter.

Non-compensation expense was 808 million, down 6% versus last quarter, reflecting continued expense discipline and the roll off of platform integration expenses. The PBT margin was 17%.

Profit before tax was 597 million, the highest level of absolute profitability since the inception of the joint venture. Non-controlling interest was 121 million, up from 103 million in the fourth quarter, reflecting stronger results in the joint venture.

Total client assets increased 6% to 1.8 trillion, reflecting higher market levels and inflows. Global fee-based asset inflows were 15.3 billion, fee-based assets under management increased to 621 billion at quarter end. Global representatives were 16,284, essentially unchanged from the fourth quarter.

Bank deposits were 126 billion versus 131 billion at year-end, as clients began to shift back into the market in January. Approximately 69 billion is held in Morgan Stanley banks.

In Asset Management we continued to benefit from the steps we have taken to strengthen the business with higher revenues and another quarter of positive flows into fixed income funds, which is an area of focus for us.

In addition, as of March, in excess of 76% of our Long-Only strategies, excluding liquidity, outperformed their benchmarks over three, five and 10 years. Specifically Asset Management revenues of 645 million were up 8% versus the fourth quarter, driven by higher marks and growth in management and admin fees.

In Traditional Asset Management, revenues of 401 million were up from the fourth quarter, driven by higher global equity markets and continued positive net flows into the Long-Only Business, partially offset by outflows in our liquidity funds.

In Real Estate Investing, revenues increased 24% versus the fourth quarter. Due to the ownership structure of these funds, the majority of these revenues are passed to third-party investors in the non-controlling interest line.

In Merchant Banking, revenues were down compared to the fourth quarter. Expenses were $458 million, up 21% from fourth quarter on higher compensation expense primarily due to DCP. Profit before tax was $187 million, down 15% sequentially. NCI of $51 million was essentially flat in the last quarter, total assets under management increased to $341 billion driven by market appreciation.

In terms of our outlook, a number of factors continue to support our expectation for healthy activity levels not withstanding the persistent structural issue that must be addressed globally. In the U.S. positive economic data are encouraging with monetary policies supporting momentum despite the negative impact of the federal spending reductions rippling through the public and private sectors. Strong liquidity inflow supports both equity and credit market activity as evidenced for example by higher PB balances and the greater engagement by retail investors that was first evidenced in January.

In the euro zone there is work still to be done, however the market liquidity facilitated by the ECB has inspired some reentry by investors, a modest uptick from the low market volumes in prior periods. The Japanese market is clearly benefiting from a surge in investor and corporate activity on the back of the recent bold Central Bank moves there. Notably Japanese retail investors are still heavily in cash while many international investors are under weight the market, suggesting the potential for continued healthy activity.

On the corporate side, global M&A dialogue is active, the CEO seem to require sustained evidence of economic strength to act. The periodic setbacks as evidenced in markets over the last several weeks remainders that global economic recovery and market healing may not come in a straight-line even if major economies are clearly on firmer putting just a year-ago. Against this backdrop we're confident about the step we've taken to enhance Morgan Stanley's business mix benefiting from leadership position within institutional securities, demonstrable upside in Wealth Management and effective capital optimization. Similarly, the firm's balance sheet is a source of strength driven by our success in doubling our capital base since 2010 and fundamentally improving both the quantum and durability of liquidity.

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

Question-and-Answer Session

Operator

(Operator Instructions) The first question will come from Guy Moszkowski with Autonomous.

Guy Moszkowski - Autonomous Research LLP

Good morning.

James P. Gorman

Hi, Guy.

Guy Moszkowski - Autonomous Research LLP

So a handful of questions for you. The first one is I think we can see plenty of evidence of the cost management moving towards, capturing your $1.6 billion expense targets, but what's the best way for us to track as we go through the year, your specific progress against the $1.6 billion?

Ruth Porat

So, on the $1.6 billion that was based on the calendar year '12 actual compensation and our compensation expense I think you know through 2014 and predicated on a flat revenue scenario, so we do remain very comfortable with that target. There is some quarterly seasonality, so I think as we go through the year you will continue to see progress against the $1.6 billion.

Guy Moszkowski - Autonomous Research LLP

Is there some way that maybe starting with next quarter you could actually track against those base lines what you've actually captured?

Ruth Porat

We will try and highlight, so you can see the progress that we have in other areas where we've laid out the marker and it's continuing to hit and exceed the goal.

Guy Moszkowski - Autonomous Research LLP

Okay, great. I think that will be helpful. Moving on to just the whole question of the risk-weighted assets and what we saw happening in the fixed income business more broadly in the quarter, you – what you call that rates and commodities as contributing to the year-over-year decline in fixed income revenues. But what we did see the commodities VaR come down quite a bit if we measure year-over-year the rates bar was actually up pretty materially. Can you help us square that with both the revenue momentum and with the decline that you called out in terms of the FICC RWAs that got you ahead of your year-end targets by the end of the first quarter?

Ruth Porat

Sure. Obviously a couple of questions in that. So, within VaR the interest rate line is obviously both an interest rate and credit line and as you know that it was up year-over-year flat to the last quarter and its effective by couple of things. First and foremost is the measure of risk not necessarily correlated with revenues. It does pick up the activity in credit as you know that I call that out as an area that was quite strong for us both corporate credit and securitized products and mortgage business generally. So it's the function of the shape of the book and volatility of the market generally, but I think what we're looking at when you look at the total line is pretty consistent with prior period, prior year. I think you then had another question regarding risk-weighted assets.

Guy Moszkowski - Autonomous Research LLP

Yeah, I mean to the extent that risk-weighted assets are going to be driven in some measure by your stress VARs, I was just wondering if you could try and reconcile for us the movement in VAR versus the decline in RWAs? And I guess the follow-up question on the RWAs is, if you already exceeded your year-end target, why stick with that as a target basically for the end of the year a couple billion more?

Ruth Porat

So the reduction – when we look at this reduction over the next period of time to 2016, it's ballpark 60% passive and 40% active. This quarter it was mostly passive. It benefited from the structured credit contract maturities, as James noted, but it also reflected a change in the shape of the book and some other changes such as active mitigation. And our view is that we're very confident that we'll be at that year-end target of 255 billion if not lower, but given part of the reduction was the change in the shape of the book we just built in some degrees of flexibility over the year. And as I said, we're confident we're going to at least meet that year-end target. It may not be a straight-line down quarter-over-quarter just depending on the shape of the book to be higher in the second or third quarter. And again, we remain very committed to the reduction this year and taking it down to that sub-200 level by 2016.

Guy Moszkowski - Autonomous Research LLP

Okay, thanks for that. And then just to sort of continue I guess along the same lines, you allocated a large part of the parent company capital down to ISG, 11 billion in the quarter, after holding a lot of that really at the parent for a pretty long time. Can you talk about what prompted the decision? And is there anything about that move that kind of traps capital in the business in any way if in fact your RWA declines continue and you might otherwise free up capital?

Ruth Porat

So the way we run the business and the way we look at capital is we really won it with a Basel III lens. And as I think you know, we actually charged capital and liquidity down to the business unit – for the product level, so we can look fully-loaded at risk-adjusted returns. The question then became over the last year or so is what do we do with parent capital given the rule for Basel II and a half and Basel III were still in flight and they hadn't been implemented. And our view was that once the Basel II and a half rules were implemented at the end of last year and so there was complete clarity on it, no guess work and what was being charged to the very segment, it was the appropriate time to take that parent capital number and allocate it up to the businesses. So consistent with moving our Tier 1 common ratio to the Basel II and a half metrics, we allocated the parent capital. And just to make sure it's clear because it can be confusing given the nomenclature. It is still Basel I even though it's using the market risk rules under Basel II and a half, our fourth quarter '12 Basel I number was 14.6, the Basel II and a half for the fourth quarter was 10.6. So if you're looking at where our Basel I ratios were last quarter under an apples-to-apples basis to Basel II and a half 10.6 last quarter going to 11.5 this quarter consistent with reporting ratios that way, parent capital has allocated into the businesses. And then to your very good question of does that mean that there is trapped capital, as we think about the businesses we look at a – again, a Basel III lens with that [SIFY] buffer and then above that, we believe we have degrees of flexibility with respect to capital return and we're continuing to build that Basel III ratio based on that capital accretion from earnings as well as the capital optimization through things like the risk-weighted asset reduction and so that does give us greater degree of flexibility.

Guy Moszkowski - Autonomous Research LLP

Okay, that's a very helpful description. Thanks. I'll just ask one more which is the Moody's announcement and conference call a couple of weeks back, kind of puts into focus that Morgan Stanley still has a lot of its derivates booked held outside of the bank unit and I was wondering if given what they're talking about doing, that pushes you to try to move more into the bank to the extent that you can?

Ruth Porat

Well, we've been focused on moving more into the bank. We continue to write new foreign exchange derivatives in the bank as we've talked about on prior calls and move old foreign exchange derivatives into the bank and we do plan to write new interest rates derivatives into the bank this year and timing and speed is really a function of some of the regulatory processes. But I think more broadly on your question about Moody's we feel good about the steps we've taken to position Morgan Stanley for greater quality and consistency of results and accept us up well. We’ve talked a lot about the changes to the business mix and funding on calls like this with clients and counterparties which really all go to the strength of our standalone credit profile and what we’ve done. And I think also when you look at the change in the business mix for example with fixed income, it really moved more towards cash than derivatives, and so that puts us in a good spot. And obviously the industry changed as well in the past year with adjustments post the ratings action. So, it would mute the impact of anything that maybe done on the ratings front, but I think the main thing is our – we think that all that we’re doing continues to build our standalone credit profile.

Guy Moszkowski - Autonomous Research LLP

Great. Thank you very much.

Ruth Porat

Thank you.

Operator

The next question will come from Glenn Schorr with Nomura.

Glenn Schorr - Nomura Securities Co. Ltd.

Hello.

Ruth Porat

Hi, Glenn.

Glenn Schorr - Nomura Securities Co. Ltd.

Just one quickie follow-up on the RWA reduction and FICC. It doesn’t sound like it had much of an impact on revenues. I just want to make sure that – I clarify that point.

Ruth Porat

Correct. The majority of it was passive. The active was P&L neutral, and on the structured credit position there wasn’t a P&L impact as we really heads out the revenue and risk.

Glenn Schorr - Nomura Securities Co. Ltd.

Okay, great. And then on commodities; it's been a tough revenue backdrop for everybody given the lower trending prices. I just want to make sure that you still feel this is mostly cyclical trending lower oil and things like that and make sure that there aren’t any structural changes needed to the business.

Ruth Porat

Our view is that, it is a cyclical headwind as you said, it continued backwardation and it won't turn on a dime. Cyclical changes can take time to turn, but it is cyclical. It affects opportunities for us. It affects opportunities for clients related to in particular structured solutions which benefited us last year, but we do view it as cyclical.

Glenn Schorr - Nomura Securities Co. Ltd.

Got you. And in terms of the physical oil, you tend to hedge that at all times, correct?

Ruth Porat

Yeah, we don’t take out right positions. We hedge our physical inventory.

Glenn Schorr - Nomura Securities Co. Ltd.

Super. And last one is, there were some not overly – not that big but modest shifts of revenues and expenses in the reporting from last quarter from Wealth Management to the institutional securities group, I mean had a drop of an effect on – positive effect on the margin. But the real impact on the margin besides the good markets was a core drop in non-comp at Wealth Management. And I just want to see is that a function of the systems integration cost running off and this is good run rate to run with?

Ruth Porat

So, a couple of things. In terms of the international Wealth Management market and you nailed it, it's a small move. If you look at the supplement from the fourth quarter to now, it's about a 10 basis point difference, so a small portion of the – a small difference. In terms of the overall margin, I think I’d highlight two points. One was the strength of the new issue underwriting activity. In particular closed-end fund activity was very favorable last quarter and that helped on the top line. So, that you can assume we’re going to have the same volume in the next quarter, that was a positive. Expenses clearly we have remained focused on and the integration being done and rolling off was very much as planned and we’re continuing to stay focused on the expense line. But I think if you’re looking forward to the second quarter assume expense is pretty much hold at that level, not withstanding the fact that we remain tight on expense discipline, you’ve got the closed-end fund new issue activity hard to forecast. We do see new issues activity generally a lot of that is outside the U.S. and the real catalyst comes from the U.S. At the same time the S&P is about 10% higher than at the end of the first quarter which benefited our fee based revenues. I think those two revenue items sort of offset one and other. And so at this point we’re holding kind of our margin expectation pretty much in the area where it is although you can see we’ve got a number of leverage that we’re continuing to push.

Glenn Schorr - Nomura Securities Co. Ltd.

Awesome. Thanks, Ruth.

Ruth Porat

Thank you.

Operator

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

Howard Chen - Credit Suisse AG

Hi, good morning, James. Good morning, Ruth.

Ruth Porat

Good morning.

James P. Gorman

Morning.

Howard Chen - Crédit Suisse AG

On the remainder of the MS/SB volume, what specific approval are you waiting for from the Fed regarding that?

Ruth Porat

We've gone through obviously the CCAR which is a capital approval and gotten the non-objection there and then the approval Dodd-Frank process approval. We did the same thing last year when we did the 14% buy-in. That approval – so it's process approval versus capital approval, that approval last year came in May which wasn't really as relevant for timing because we didn't have the call until June and then we went through the arbitration process which took it out basically to the end of the summer. And I'm not suggesting they can read anything into that May date but it's the only proxy we have for what that timeline was at least last year.

Howard Chen - Crédit Suisse AG

Great, thanks for reviewing that, Ruth. And then James, speaking of the CCAR, the test results came in a bit – your own test results came in a bit below down to the Fed and I just wanted to get your thoughts on what you believe drove that difference? What's in your control to maybe bridge that gap going forward? And how does it impact timing and quantum of the next stage of capital return post the buy-in?

Ruth Porat

Why don't I start on some of the technical? I think you're pointing in particular to our PPNR versus the Fed, which you could see in the disclosure. Our understanding is that the Fed had its own model which relies on historic data and given we've invested meaningfully to increase the quality and consistently of earnings, there have been charges that have obviously been going through the P&L such as MBIA which are negatives and short financials, but on a go-forward basis eliminated drag, improved the quality and consistently of results. And so it's understandable there's a difference between the two if one forecast is based on historic results on the impact and the other is looking at a fundamentally different business mix. We don't know the extent to which those historic results in the Fed model were adjusted and so it's hard to know precisely how the models are different. But that in our view is one of the key things that we're focused on working on over the next period of time before the next submission to (inaudible). That being said if you just look at our fourth quarter earnings and our first quarter earnings, the first two quarters of the CCAR submission that would add an additional 60 basis points to our ratios. So we will be focused on dealing with the PPNR differences and methodology. We are continuing to accrete capital and we think that that does continue to give us degrees of flexibility.

James P. Gorman

And I think Howard, the difference between what we submitted and believed the models should throw out and what ultimately came out of the black box that is the CCAR process was actually narrower – the difference was narrower than what it was last year. We've obviously got better at it and I think it was relative to some of the other firms out there was frankly not a very surprising result. So we'll play this forward. Our focus now is getting the Smith Barney which we got the capital approved.

Howard Chen - Crédit Suisse AG

Understood, thanks. And then quick numbers on Ruth. I realized – you said that RWA reduction this quarter was P&L neutral, but what's driving the other sales and trading results. It seems to be less of a headwind than it was in the past.

Ruth Porat

Well, it's a number of items that does move around and it's difficult to model. It includes things like our long-term debt hedging program and our bank liquidity portfolio, our loan book, DCP. So it's kind of an aggregation of a number of different items.

Howard Chen - Crédit Suisse AG

Okay, thanks. And then just finally from me, it remains a pretty fragile environment for you and peers within the Institutional Securities business. I was just hoping you could comment on overall attrition levels, both absolutely and relative to your expectations? Thanks.

Ruth Porat

I think that beginning of the year and having some departures is not in any way unusual. We actually feel very good about the strength of the team. We've got a very talented senior team, been together for many years. We've hired and think it's a great time at Morgan Stanley to be adding senior talent. People are excited to join given the clarity of where we're going and the momentum moving in that direction. So it's kind of seasonal and we don't read anything into it.

James P. Gorman

And more specifically, the attrition is actually trekking along exactly what it was last year. And I believe and Celeste will correct me later, a little low than what it was the year before.

Howard Chen - Crédit Suisse AG

Perfect. Thanks so much for taking questions.

Ruth Porat

Thank you.

Operator

The next question will come from Mike Mayo with CLSA.

Michael Mayo - CLSA Asia-Pacific Markets

Hi. I guess my questions can be grouped into the good, bad and the ugly; so I'll start with the ugly. Financial advisory, if you look at it linked quarter or year-over-year among the five largest U.S. players, it looks to perform the worst based on fees and you had some management changes there. Can you reassure that franchise is still as strong as it's been historically?

Ruth Porat

Yes, it is. The M&A lead tables are exactly the same as they were last year, it tends to be lumpy in the first quarter and particular given market environment with low activity of levels and we're consistent leader of a very strong M&A franchise as I noted in my comments, part of it is just that lower volume and it tends to be lumpy and part of it we had a very strong fourth quarter and there were some fee realization that moved in – within the fourth quarter, so that partially explains it as well, but we feel very good about this and I think if you're just objectively look at the lead table, this year and last year it [dwells] throughout the year.

Michael Mayo - CLSA Asia-Pacific Markets

And then in my bad category the actions of buybacks, I know you're not able to do that, but trading at such a big discounted tangible book if you have confidence in the value of your balance sheet, which I assume you do, why wouldn't you take more aggressive actions to downsize and why not be more aggressive with your big targets? Why not take some other action to strength to move up that Basel III ratio even faster?

James P. Gorman

Well, I think Mike there are couple of questions meshed together there. I think the actions on reducing our risk-weighted assets and fixed income from I believe it was $390 billion in the third quarter of '11 to $253 billion this year, we're a year ahead of schedule last year and we're at the end of the years point already in the first quarter of this year, it would be easy to reduce it faster, but you would also destroy revenues and destroy good businesses. So, our job is to balance a sensible risk-weighted asset reduction without destroying revenues and parts of that business that we find very attractive. So, we actually think we've been very aggressive bringing it down from $390 billion to a committed sub $200 billion by 2016. If we see more sensible opportunities which don't destroy value, obviously we'd be all over it.

The capital buyback is completely different topic. The – as we said at the beginning of the year, we adopted a very clear posture with our regulators, which was that our focus was on the strategic benefits of buying Smith Barney for two reasons. One, it was an attractive business and being already carrying the effective cost of the capital for that business, so we wanted the earnings from it. And its $600 million pre-tax a quarter, 35% is real money. So that was our focus. We didn't want anything to get into the road to that focus. We did not want to jeopardize that focus by prejudging where we come out on CCAR or prejudging how the beginning of the year would start. The beginning of the year has started at $1.2 billion, significantly above where we were in the fourth quarter as CCAR came out at 5.7, I think 5.6 net of the capital allocation in this. So we're now waiting for the federal reserves to go through the application process. When they do that we know our number and as we go through the year, obviously the next question we've for ourselves is when and under what conditions we have to see buybacks, but we're not going to react very short-term on this. We're trying to do get this firm back on the rails which we've done over the last couple of years in a very deliberate path and we believe we're now well on that path.

Michael Mayo - CLSA Asia-Pacific Markets

And then the good category would be the brokerage margin which came in higher than what you guys had expected last quarter. What is your brokerage margin target? Is it still 15%, it seems pretty low and you had one peer yesterday reported margin over 20%. So what are you really trying to achieve margin wise in that business?

James P. Gorman

Well, I have to take that one again Mike, because I was the one who foolishly couple of years ago went out with a 20% margin when we had then three years of zero interest rates following out. So I admitted to my mistake on that and we set a more conservative margin target for the middle of this year, which was 15%. The fact, we're ahead of it is good news. Now we're certainly not going to turnaround and reset margins based upon short-term impact. So our job is less around what's setting the margins is actually delivering them and what I'm pleased about is the fact that we're delivering those margins. The competitor numbers I'm not going to talk about except to observe that they actually have a different business mix that comprises that ultimate margin number.

Michael Mayo - CLSA Asia-Pacific Markets

Was there anything unusual with the 17% margin this quarter or can we consider that a base looking ahead?

Ruth Porat

No, there was nothing unusual. As I said the strength versus what is usually a seasonally lower margin, it's typically seasonally low because compensation expense tends to be a bit higher in the first quarter. But what we had offsetting that, as I noted, was the stronger transactional volume, the new issue activity with closed-end funds. That really helped coupled with the ongoing expense discipline. And so if we look forward, you're starting with the good base in the first quarter was at 17%.

Michael Mayo - CLSA Asia-Pacific Markets

Thank you.

Ruth Porat

Thank you.

Operator

The next question will come from Matt Burnell with Wells Fargo Securities.

Matthew H. Burnell - Wells Fargo Securities, LLC

Good morning. Thanks for taking my questions. Just a couple of questions. First of all, on the deposits, you saw about 4% decline in deposits in Wealth Management, I think overall 3% down. Was that largely seasonal or was there something else going on there?

Ruth Porat

Deposits came up in December. We saw some selling out of the markets. We think it was primarily tax driven by investors as distinct from real concern about the market. But our expectation was that it would come back into the market in the beginning of the first quarter and it did. So it's really just the positioning by investors at the end of last year, then coming back into the market and staying in the market as they have. So no, there's not anything more to it than that.

Matthew H. Burnell - Wells Fargo Securities, LLC

Okay. And then just thinking about your debt underwriting business, given that there's obviously been pretty strong demand for that product over the last couple of years, you've admitted that you're a little bit subscale on high yields relative to some of your competitors. Does that have any effect on your desire for a couple 100 basis points of market share gains within fixed income if that business continues to be relatively robust over the next couple of years?

Ruth Porat

No. We set a target of 2% market share increase, kind of 8% total market share for fixed income sales and trading. We feel very confident with that given the products that our fixed income underwriting, which is actually reported – those sales are reported in the investment banking line and we did have a record – we had a record quarter last quarter. The first quarter was actually the best ever first quarter that we've had. What that ends up driving is the secondary sales and trading as you know well, but we feel very good about – we remain very much focused on our share gains, equally focused on how we optimize returns. So it's really both of those, but no change.

Matthew H. Burnell - Wells Fargo Securities, LLC

Okay. And then let me just confirm finally; the 60% compensation ratio in Wealth Management, you mentioned last quarter that that we should about that ratio being pretty unchanged for the next couple of quarters. What would allow you to get that ratio down presuming a steady revenue environment? And is that something that we should be looking for towards the end of the year?

Ruth Porat

The 60% compensation ratio in the first quarter is precisely the reason we had indicated that the margin tends to be seasonally weaker in the first quarter, these tend to have fairly higher comp in the first quarter or things like FICA and other factors. So it does tend to be a bit higher. Coming down a point or so near term is very – it's a reasonable way to think about it, but the great – the best driver of the comp ratio over time is really the growth of our lending product. As we talked about, we're going to have deposits up to about 140 billion in the two years, post buying in the rest of the Wealth Management business. That's going to support growth of both Wealth Management lending product and Institutional product. And on the Wealth Management side, it's on a different compensation grid relative to the [formulate] grid that generally drives that comp ratio and that is what really gives us meaningful operating leverage in the comp line and that brings it down to the high 50s.

Matthew H. Burnell - Wells Fargo Securities, LLC

Okay. Thank you very much.

Ruth Porat

Thank you.

Operator

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

James Mitchell - Buckingham Research

Hi. Good morning.

James P. Gorman

Good morning.

James Mitchell - Buckingham Research

Just want to follow-up on – you're sitting on about 23% of your balance sheet in excess liquidity. Can you discuss where you are sitting in terms of the LCR, do you feel like you're pretty comfortable for that or do you need to build more?

Ruth Porat

On the LCR, we're over 125% and that really has given all that we've done terming out the secured book. It's obviously just a 30-day test and we do triangulate, as we've talked about on some prior calls, with an outlook over 12-month period of time in a stress environment. One of the reasons liquidity is running at these higher levels as I noted, is that we want to ensure that we have ample liquidity assuming we do acquire the 35% of Wealth Management. So there's a bit of flexibility thereafter.

James Mitchell - Buckingham Research

Okay, maybe just to follow-up on -- as you buy in the rest, should we -- what is the timing around the deposits and how quickly do you think you can reinvest, and then I guess longer term do you think that can help you bring down the excess liquidity and obviously help to improve profitability?

Ruth Porat

So, the deposits, the way it works is, they come in over the two-year period of time. We get about 14 billion of deposits within a few weeks of closing, and then 40 billion ratably over the following 24 months. And that will -- that supports as I just said both retail lending as well as institutional lending. And I think the best way to think about it is, one it gives us growth opportunities because there's a suite of products within institutional securities that haven't grown as much as they could because they would be funded with unsecured debt versus substantially more efficient deposits, but they're still bank appropriate areas and areas where we have, we'll expertise. So, whether you're talking about project finance or commercial real-estate those are good examples of areas where we get our incremental growth opportunities based on our competencies today and our clients today, but it would be funded with more efficient deposits in the bank. And then there are also areas where we will be able to move businesses from institutional securities into the bank and that enabled us to do it dollar-for-dollar substitution, reducing unsecured debt and replacing that with deposit funding which is more efficient. And so yes there is some efficiency that comes in, in that way. And then overall if the question is also and what does that do for liquidity. As those deposits which are currently really supporting the AFS portfolio go into support the lending product the bank liquidity comes down as those are moving into support loan growth.

James Mitchell - Buckingham Research

So we should see that excess liquidity start to come down, as those deposits come in?

Ruth Porat

Yeah, it's all – if you take a look over time the answer to that is yes, but as those deposits come in for example that first 14 billion of deposits …

James Mitchell - Buckingham Research

Oh, sure. Right, in the short-term it could go up.

Ruth Porat

It goes up; then it goes into the AFS portfolio; it's positive carry on the AFS portfolio as it comes down again because it's supporting loan growth. Yes, it does come down again but at a higher return.

James Mitchell - Buckingham Research

Right. Okay, thanks a lot.

Ruth Porat

Thanks.

Operator

The final question will come from Brennan Hawken with UBS.

Brennan Hawken - UBS Investment Bank, Research Division

Knocking under the wire. Good morning, guys.

Ruth Porat

Brennan, good morning.

James P. Gorman

Good morning.

Brennan Hawken - UBS Investment Bank, Research Division

So, just a quick follow-up on FICC, it was obviously pretty volatile in some of these markets here this quarter. Is there any, which we think about maybe the fact that revenue might have been a little bit lower than usual just because there might have been some principal loss given some of that volatility and this is actually really a pretty lousy run rate?

Ruth Porat

You know the run rate we do think given the markets where more challenging especially in March just affected activity and as I noted rates was lower and then commodities is dealing with a cyclical headwinds we've talked about. So, I think it is very fair to say we don't deal a $1.5 billion of revenues. Our revenues this quarter is a ceiling on what's attainable, even with quarterly seasonality. And you know I point you to the strength that we have in a lot of areas like credit and the mortgage product and foreign exchange and we'd expect that rate – rates are higher, so we do think that given the strength of the client activity levels that there is upside from here. I think an interesting way to even just look at client activity and volumes across the platform is just looking at the brokerage and clearing line which is up, which really goes to client activity. So long way of saying it, if we don't think that $1.5 billion in revenues is a ceiling and look forward to the continued activity.

Brennan Hawken - UBS Investment Bank, Research Division

But where there any principal losses to specifically highlight or was it mostly volume driven within the FICC line?

Ruth Porat

It was not principal losses, no.

Brennan Hawken - UBS Investment Bank, Research Division

Okay, great. Thanks. And on capital, once I understand that its uncertain about when you get the green light on MSSB, but if we assume that happens prior to mid-year, is it too aggressive for us to think about given where you guys are on the capital ratio front. In fact at MSSB is already fully baked into

Basel III that you could be looking to take a second bite of the apple here with the regulators in a potential buyback with a – with the new submission?

Ruth Porat

Well as James said, our number one focus is closing the Wealth Management acquisitions, given the strategic benefit in the upside, promoting 100%. So, we're just focused on closing that acquisition, which was our capital progress. We are accreting capital. Your question is fair, but we want to get it closed before we think about anything else.

Brennan Hawken - UBS Investment Bank, Research Division

I figured I'd give that a shot. And then the last one. The lending platform, is there anything operationally that you guys are waiting on to get going because it seems as though you have excess deposits currently. So it's not really a matter of funding and not having the right funding. So, is there like a system investment process you need to go through in order to get everything up and running? Or is there any operational issues holding you back? Do you want to have all of MS/SB completely bought in before you really start more aggressively pushing the lending platform? I guess I don't understand what's – why it's been so slow to ramp so far?

Ruth Porat

In 2009, it became clear that over time we would be buying in the remainder of the Wealth Management business, and at that point started investing in the systems, the risk management personnel, analytics to ensure that at the point we ended up with the full 140 billion in place, we had the systems and infrastructure requirements there. The gating factor is and we've used this word so often in describing how we're building up the banking team and the banking effort within Wealth Management its prudent consistent growth. There is no reason to rush it. We want to make sure that we do it in a high quality way and that we're leading with risk management. So, it is better to do it prudently over time than to try and rush it. That is really the governor of the growth in that business. We feel good about the strength and the build. As James said, it's both on the mortgage side and on the PLA side and that's what we're continuing to do.

Brennan Hawken - UBS Investment Bank, Research Division

Okay.

Ruth Porat

I will note one other thing, we've said this I think last quarter that relative to our peers we are under penetrated in the lending product, and so what we're seeing is good take up and we're just keeping it at a measured pace.

Brennan Hawken - UBS Investment Bank, Research Division

Okay. At some point after that book assuming that you guys want to grow that book to a certain size. Does that mean that there will be a transition to accrual accounting and we'll start to see sort of that level of detail for you all?

Ruth Porat

Well, so we talked about the fact a couple of quarters – I think over a year ago now that we moved from fair value to HFI for our lending products, that's most relevant for what we're doing on the institutional side. And at this point, about 69% of the book is on HFI. So that has been the approach that was very clear coming out of the CCAR process over a year ago that that was a logical way to approach it and that's what we've been doing systematically.