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

The presentation may also include certain non-GAAP financial measures. Please see our SEC filings including this quarter’s earnings release and financial supplement 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 will now turn the call over to Chairman and Chief Executive Officer, James Gorman.

James Gorman

Thank you, Kathleen. Good morning, and apologies for my winter cold. I wanted to start off just by saying, obviously after a relatively strong first half the third quarter was obviously disappointing. It reflected a difficult market environment throughout the quarter.

Before we discuss some of the things that are behind these numbers and that drove this result, let me touch on a few of the positive aspects of the last three months.

Our M&A franchise remained strong this quarter, benefiting from a robust deal environment. While much of the underwriting calendar was deferred from the third quarter, we expect the business to take place in the fourth quarter and early 2016.

Equities once again finished number one in the US this quarter, and we expect to be number one once all global peers have reported over the coming weeks. After a strong first half, the business held together in a challenging environment across regions and products, including cash, derivatives and prime brokerage. We expect this trend to continue.

Our wealth management franchise was impacted by a lack of new issue product and a general retail investor step back from markets, given volatility. While we do not expect this to be a long-term trend, we remain focused on expenses in the meantime.

Our year-over-year earnings improved, in spite of lower revenues and we generated a 23% margin, which is consistent with our stated goals.

Turning now to the challenges, of which there are three to note, and of which Jon will take you through in more detail in a moment. First, and obviously fixed income underperformed in the quarter, largely due to a very challenging market environment, in which we were significantly impacted given our business mix, particularly our focus on credit and rates.

Second, most of the investment management business performed solidly, but the aggregate results significantly underperformed. This was driven largely by a reversal of carry in our Asia private equity business, a business which historically has been a strong contributor for over a decade.

And third, we also had $320 million in legal expenses in the quarter, an increase of $250 million from last year, driven largely by the settlement of the CDS litigation.

We remain focused on resolving outstanding legal issues and have made significant progress to date. Notwithstanding the challenges of the quarter, our core long-term strategy remains in place, namely, a balanced business model in which the consistency of wealth management offsets potential volatility in institutional securities.

The team is highly focused on those levers within our control that enable us to manage the business in a way that reflects the environment we are in, and whatever the environment we may face in the future. This includes a continued focus on expenses.

We recently made significant management changes in two businesses to better leverage our business model. Ted Pick, who has managed equities to the number one position on the Street has become Global Head of Sales and Trading.

Having institutional equities, fixed incomes and research under Ted will allow us to leverage our infrastructure while continuing to make sensible investments in the ongoing electronification of both our equities and fixed income franchises.

Dan Simkowitz has become Head of Investment Management, which includes Merchant Banking, real estate investing, and traditional asset management. Dan will report to me and work to broaden our platform and products, while leveraging distribution channels that we have in place. Investment management is an important business for Morgan Stanley for the future and deserves our intense focus. Finally, our capital funding and liquidity positions remain robust.

With that, Jon will take you through the quarter in more detail, then we will open up for questions to both of us. Thank you very much.

Jonathan Pruzan

Thank you, James. Good morning, everyone. I will review our quarterly financial performance and business results, and then James and I will be happy to take your questions.

Before I discuss the individual businesses, I will first make a few comments on our overall performance. The quarter was very challenging. In contrast to the first half, the third quarter backdrop was less constructive.

Besides the normal summer seasonality, the quarter was characterized by global equity markets trending lower, volatility metrics increasing, spreads widening, policy uncertainty and periodic bouts of risk aversion.

Against this backdrop, revenues were $7.8 billion in the third quarter or $7.3 billion excluding DVA, down 20% versus second quarter '15, or 23% excluding DVA. Our expenses for the quarter were $6.3 billion, down 10% versus $7 billion in 2Q '15. Compensation expense was $3.4 billion, down 22% versus $4.4 billion last quarter, driven by lower revenues.

Non-compensation expenses were $2.9 billion, up 9% versus $2.6 billion in 2Q '15, driven by an increase in litigation reserves, which included an increase related to the settlement of the credit default swap antitrust litigation matter.

Our effective tax rate of approximately 29% was lower than last quarter, driven by our geographic mix of earnings. ROE for the third quarter was 5.6% or 3.9% ex-DVA.

Now to the businesses. Our institutional securities franchise had a difficult third quarter, with revenues of $3.9 billion or $3.5 billion excluding DVA, down 25% and 30% respectively versus second quarter of 2015.

We saw underperformance in fixed income, driven by relative mix of our business, primarily by lower revenue in credit and securitized products in a challenging credit market, in addition to lower activity and rates given investor uncertainty on said action.

More broadly in our sales and trading and capital market businesses, we were impacted by seasonality and lower than typical levels of activity in September. However, we continued to demonstrate strength in several key franchises.

Equity sales and trading revenues were strong, as clients remained engaged across regions and products, and in advisory, we had our best quarter in several years, as M&A volumes remain strong.

Non-interest expense was down 9% versus the second quarter. Non-compensation expenses were $1.9 billion for the quarter, up 15%, driven primarily by increased litigation reserve, I mentioned previously.

Compensation expenses were $1.3 billion, down 31% quarter-over-quarter. Excluding DVA, the ISG compensation ratio was held flat at the first half rate of 38%.

In investment banking, we saw strong performance in our M&A business offset by weakness in the debt and equity underwriting markets, resulting in investment banking revenues of $1.2 billion, down 18% sequentially.

As of September 30, Morgan Stanley ranked number one in global IPOs, number two in global announced M&A and number three in global equity. In advisory, we benefited from a continuation of a robust M&A market.

We saw strength in cross border M&A and large cap transactions and acted as M&A advisor on several of the quarter's most significant transactions. We acted as sole financial advisor to Cigna on their merger with Anthem in the transaction valued at $54 billion in cash and stock. The combined company will be the leading health insurer in the US.

Morgan Stanley also acted as sole financial advisor to ACE on their acquisition of Chubb for $28 billion in cash and stock. Advisory revenues for the quarter were $557 million, 32% higher than the second quarter.

The M&A pipeline remains strong, up both year-over-year and sequentially. We have seen a strong start to deal activity in the fourth quarter, and board room engagement and dialogue remains high.

Turning to underwriting. Our underwriting business slowed significantly, as the typical pick up in September deal activity was delayed due to uncertain markets. We had a significant number of deals delayed in September.

For the market, equity underwriting volume was down 55%, IPO underwriting volume was down 72%, and debt underwriting volume was down 23% versus last quarter.

Underwriting revenues were $624 million this quarter, down 39% versus last quarter. Equity underwriting revenues were $250 million, down 49% versus second quarter, primarily reflecting declines across all products, particularly for IPOs and follow-ons.

Fixed income underwriting revenues were down 29% versus the second quarter driven by decreases in both investment grade and non-investment grade loan and bond underwriting.

Notable underwriting transactions in the quarter includes in equity, Morgan Stanley acted as joint underwriter and joint lead manager on a $3.6 billion rights offering for Commonwealth Bank of Australia. We also acted as a joint global coordinator, lead left book writer and stabilization agent for Citizens Financial Group in their $2.6 billion follow-on offering.

In capital markets, we see a strong pipeline building for future quarters, as clients await a more stable market. As volatility abates, we would expect to see a pickup in activity.

In the first 12 days of the quarter, we have begun to see many of the delayed deals from September's price. However, the sustainability of this activity will be predicated on the market backdrop.

Coming off of two strong quarters, equity sales and trading again was solid, against a backdrop of significantly more volatility. The business remained number one in the US, and we believe we continue to be number one globally, driven by our focus on clients and execution, which has led us to our leadership position.

Ex-DVA, revenues of $1.8 billion in the quarter were down 22% sequentially, but essentially flat year-over-year, as clients remained active and engaged.

Cash equity revenues were down versus the second quarter and year-over-year, driven by a more challenging environment, including a lighter primary calendar and periods of risk aversion.

Prime brokerage revenues remained solid, although down from a very strong second quarter, which is seasonally high related to European dividend activities. Revenues were up year-over-year due to increased client engagement.

Derivative revenues were down quarter-over-quarter, driven by lower corporate derivative activity, but remained strong and were up year-over-year. Year-to-date, we have delivered strong performance in equities, with revenues, excluding DVA, up 19% year over year. Despite very different market backdrops, we have been able to serve our clients' needs while prudently managing risk.

In fixed income and commodities, we saw a very challenging market environment. We were particularly impacted by spread widening in credit and mortgages and lower levels of client activity and rates throughout the quarter.

For the quarter, fixed income and commodity sales and trading revenue were $583 million, excluding DVA, down 54% versus the second quarter.

Revenues and credit and securitized products were hardest hit and were down significantly quarter-over-quarter due to difficult market conditions.

Rates revenues in the quarter were down sequentially, driven by significant policy uncertainty, that led to sporadic client activity and engagement.

FX results were up modestly versus second quarter as increased volatility led to continued client engagement. Over time, FX has been a much smaller relative business for us.

Commodities results were up modestly quarter-over-quarter, and our risk-weighted assets, X lending, ended the quarter at $158 billion, essentially flat to second quarter.

The fourth quarter end sales and trading is typically seasonally weakest. So far in the quarter some of the key drivers that will likely drive client activity are mixed. Drivers of near-term uncertainty, including the Fed, China, commodities and global growth, have not diminished.

However, we have seen a modest rebound in global markets and reduction in some volatility indices, including the VIX.

Investment revenues were up quarter-over-quarter and year-over-year, driven by gains on business-related investments. Other revenues were down versus last quarter, driven primarily by markdowns on our relationship and event books. Lastly, average trading VAR for the second quarter was $53 million, stable versus last quarter. Although we saw increases in volatility, it was offset by a reduction in risk.

Turning to wealth management, our wealth management business provided stability in the quarter, even in a turbulent and declining global market. While revenues were down 6% for the quarter, largely driven by lower marks in our deferred compensation plans, we maintained a 23% margin. Our bank strategy continued to play out, as we had previously discussed.

Over the past few years, our daily revenues are a good indication of the stability and consistency of our wealth management business and they have consistently been between $50 million and $70 million, with no day year-to-date below this range.

Asset management revenues were flat from last quarter with higher revenues from fee-based accounts, partially offset by lower mutual fund activity.

Global fee-based asset inflows were $7.7 billion in the quarter, continuing the trend we see toward client demand for managed accounts. Total fee-based client assets were $770 billion at quarter end, representing 40% of client assets. The assets are down quarter-over-quarter, reflecting the market decline of the third quarter.

We saw continued softness in transactional revenues, which were down 25% compared to the last quarter. This was primarily driven by lower marks in our deferred compensation plans, as well as lower new issue activity, consistent with a slower equity underwriting calendar, which impacted ISG.

Transactional revenues were also impacted by subdued levels of retail investor activity, driven by ongoing uncertainty and global volatility.

Our deposit deployment strategy continues to yield results. Net interest income revenue increased 2% quarter-over-quarter, driven by steady, prudent growth in lending, consistent with the continued execution of our US bank strategy.

Funded lending balances in wealth management grew approximately $3 billion during the quarter and $12 billion year-over-year. In the mortgage business, average FICO scores continue to be greater than 750, with weighted average LTVs of less than 65%. And securities-based lending remains highly over collateralized and continued to perform well despite the quarter's volatility.

Non-interest expenses were $2.8 billion, down 6% quarter-over-quarter, showing continued expense discipline in this business. Compensation expenses was $2 billion, down 8% quarter-over-quarter, driven by lower marks on deferred compensation plans, and lower FA compensation, as a result of lower compensable revenues. Non-compensation expense was flat sequentially.

Deposits in our bank deposit program were $139 billion, up $7 billion versus the second quarter, as clients moved into cash and a volatile market. This is another indicator of subdued retail activity. But we would expect clients to redeploy this cash over time.

Wealth management representatives were up slightly versus the second quarter on lower attrition. This business not only provides stability and consistency, but also growth. PBT for the first nine months of 2015 is up 14% over the same period in 2014.

In investment management, the quarter was difficult, for Asia valuations in particular in China and monetization events, which resulted in revenues of $274 million, down 64% sequentially.

The vast majority of the sequential declines in revenue could be attributed to the reversal of previously-accrued carried interest in our Asia private equity business and no material gains in our other funds versus last quarter.

We have a strong history in Asia private equity and in particular, China. This quarter however, we had to reverse more than two-thirds of the carry that our Asia private equity funds had accrued.

This reversal accounted for virtually all of the loss reported on the investments line in the investment management segment. The ultimate realization of carry in these funds will be based on investment performance over the next several years.

In traditional asset management, revenues for the quarter were $389 million, down 10% quarter-over-quarter. The focus in this business continues to be on product innovation, distribution and growth.

For example, this quarter, we transferred certain portfolio managers and their portfolios from wealth management to investment management to better align our capabilities with client demand.

This move allows the portfolio management teams to distribute their strategies in multiple vehicles across a broader and fully integrated distribution channel, while also enhancing the product mix available to our investment management clients.

Non-interest expenses were $312 million, down 41%, driven primarily by a reduction in compensation expense versus last quarter, due to a decrease in deferred compensation associated with carried interest. Total assets under management ended the quarter at approximately $404 billion.

Turning to the balance sheet and capital, total assets were $834 billion at September 30, up from $826 billion at the end of the second quarter. However, average balance sheet for the quarter was $828 billion, down from $848 billion in the second quarter.

Our global liquidity reserve at the end of the quarter was $191 billion compared with $188 billion at the end of the second quarter.

Now onto capital, reflecting our best estimate of the final Federal Reserve rules, our pro forma common equity Tier 1 ratio base, using the Basel III fully phased-in advanced approach was 12.4% at September 30.

Pro forma fully phased-in Basel III advanced RWAs are expected to be approximately $434 billion, up from $427 billion in the second quarter. We estimate our pro forma supplementary leverage ratio under the US final rule to be approximately 5.5% at September 30, up from 5.3% at the end of the second quarter. All of these estimates are preliminary, and subject to revisions.

During the third quarter, we repurchased $625 million of common stock, or approximately 17 million shares, and our Board declared a $0.15 dividend per share.

With that, we will open up the line to questions.

Question-and-Answer Session

Operator

[Operator Instructions] Your first question comes from the line of Guy Moszkowski with Autonomous. Please go ahead.

Guy Moszkowski

Good morning. First a question on equities. It is, as you pointed out, flat year-over-year, and industry leading. But your peers were all up mostly double-digits or very high single digits year-over-year.

I guess the question is, we know that some of the strength year-to-date, especially for firms with a strong prime brokerage franchise, has been from repricing of some of the more scarce resources down feed driven activities.

I guess the question is, for you, has some of that pricing benefit lapsed or anniversaried, or are what we actually seeing is that underlying all of that, maybe you had more significant weakness in cash equities, like because of blocks or something?

Jonathan Pruzan

So Guy, I guess there were a couple different questions in there. I think in terms of our equities performance, as we said, we continued to maintain our leadership position and we are number one. Quarter-over-quarter all of the products were down. We obviously had a very strong first half.

PB was down due to some lack of the dividend seasonality that we see third quarter versus second quarter, but as you said, up year-over-year, derivatives were lower quarter over quarter, on less corporate derivative activity, but was up year-over-year.

So the weakness year-over-year was really in the cash products, where we saw, obviously, a much more challenging market environment, sporadic bouts of risk aversion, as well as slower – excuse me, primary calendar.

The other point I would make is that the third quarter of '14 for us in equities was a very strong quarter, driven really by a very strong primary calendar. So it was a tough comp from that perspective, but again, essentially flat year-over-year.

And then lastly, I think on the repricing question, I would answer by saying that we've been focused on the returns to the prime brokerage business, and we've done that in partnership with our clients and looking at the relationship holistically across the nine boxes that we've discussed before.

We've done this through a combination of better business mix, optimization and wider pricing, and we've seen the revenue per balance sheet usage increase over the last year. So the prime brokerage business has been and will continue to be a strong business for us, and it's been really a business that the client engagement has led to good results.

Guy Moszkowski

I guess just to hone in on that last part a little bit, were a lot of the pricing changes that you were able to put through in the third quarter a year ago and therefore are we beginning to see kind of an anniversary effect of the benefit that you get from that pricing?

Jonathan Pruzan

I wouldn't necessarily describe it like that. We've been continually trying to optimize the return we get on our assets. And I would say it's been an evolutionary process, and we will continue to work with our clients to deliver good products and a good relationship.

Guy Moszkowski

Okay. Thanks. And then moving on to asset management, the decline in the additional [ph] revenues away from the merchant banking and real estate issues that we were talking about, the decline in revenue there is about I think 17% year-over-year, and yet your assets under management our flat. Do we attribute that decline to a lack of performance fees relative to a year ago?

Jonathan Pruzan

I'm sorry, in the traditional asset management business?

Guy Moszkowski

If you look at the traditional line that you break out, the revenue in the third quarter is down 17% year-over-year. but the assets under management look like they are unchanged.

And so I'm just wondering, what's driving that decline in the revenue. Is it performance fees that were not present in the current quarter or is there something else?

Jonathan Pruzan

No, I mean, I think it's more driven by mix. As you know, in that business we have a narrow product set in our equity businesses. We also are only in active products, so - and we've seen, as you can see from that chart, an increase in our liquidity product, where we've also seen decreases in certain of our equity products. As you see from the disclosure, we have an emerging market fund that saw significant outflows this quarter.

The other point that I would make is that it's related somewhat to the markdowns on the deferred compensation plans that we've talked about in the past, and that was also a driver to that decline.

Guy Moszkowski

Got it. And just a broad question on fixed. Given the results that you saw in the quarter, and I'm conscious of the mix difference that you talk about between yourselves and many of your peers.

But does the sharp decline and the magnitude of the revenue at this point spark any incremental thinking as to size and structure that's appropriate for the unit or the risk management that's appropriate for the unit?

Jonathan Pruzan

Listen, as we discussed in both James' and my comments, this was a very different market that we saw in the first quarter. I think the volatility, the lack of conviction, the policy uncertainty, coupled with really no macro themes or events that investors embrace.

So it was a very difficult market. It was not particularly conducive for our relative business mix, as you mentioned. But keep in mind that we've reshaped and resized this business based on the market opportunity that we think exists.

We brought down our RWAs in this business by over $200 billion. We've brought down our balance sheet. We've brought down our non-comp expenses. We've brought down our headcount. We've sold several commodities businesses and we closed another one and we've also revamped our distribution strategy.

We've resized this business, while maintaining a presence across products and geographies. And we continue to optimize this business in the face of challenges, both for the industry and the business.

We've seen cyclical, secular, structural, and regulatory changes in this business and many of these have led to announcements, particularly out of Europe, of people rethinking their overall strategies, and we do think that this market dislocation can create opportunity for us.

But we're focused on what we can control to drive improved performance. We've done a lot of work in this business, and we will continue to try to drive performance.

James Gorman

I'll just add a couple of things to what Jon said, Guy. Firstly, if you look at the performance of fixed this year, you've seen three very different quarters. First quarter being $4 billion revenues, second quarter being $1 billion, obviously this quarter a little under $600 million, very different macro environments, very different performance. This one, the least favorable environment to the particular business, we have obviously.

As Jon said, this has been a multi-year journey. We have dramatically reduced RWAs in this business and restructured it. I think combining the fixed income business with equities under the leadership of Mr. Pick here will prevent opportunities for further synergies with those businesses, which I would expect. And we continue to watch this space very carefully.

We're by no means complacent about this, and but at the same time, there are elements of our fixed income business which are essential to everything else that we do in investment banking with our wealth management and so on.

So it's a continuing focus of us, but I'm not taking everything from one single quarter. On the other hand, we want to make sure that if this isn't a long-term trend, than clearly we'll take whatever steps we need to take.

Guy Moszkowski

Okay. That's all very helpful. Thank you so much.

James Gorman

Sure.

Operator

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

Glenn Schorr

Hi, thanks. Just one follow-up on the FICC conversation. Because I agree with you Jon, that all the stuff that you've done have been an improvement in terms of reshaping and resizing.

But the results are the results, and I don't want to focus on any one given quarter. Let's look year-to-date, let's look at the last five years, it doesn't matter.

FICC is still having a hard time becoming, I guess, a fully functioning business, such that, in any given quarter if credit is bad, you're overweight credit.

So I guess, back to the same question, you moved it under Ted's supervision for a reason. What are you hoping that he can bring. Because he obviously did a great job in equities, but what are the things that transfer, what are the synergies that can come out of there, because I'm assuming the moves happened for a reason?

James Gorman

Well, Glenn, let me deal with that. Firstly, I think let's give Ted a little time in the saddle here, to come back to you, and I'm not going to speak for him right now. We'll give him a little time to get his arms around the business with the management team there, which they will do, and I'm sure in the New Year, we'll be saying a lot more about it.

But you have to see our fixed income business in the context of everything else we have at Morgan Stanley. It is obviously a significantly smaller business for us than equities or wealth management.

And frankly, has been smaller than investment banking over the last couple of years. So that's sort of the size of it, relative to what we are doing as an institution is an important factor here.

The idiosyncratic aspect of credit for this quarter is obviously important. Clearly, if foreign exchange was a weak quarter, then that would affect the Universal Banks differently from the way it would affect us. So I'm not going to get too caught up in one quarter's performance.

We understand the issues with fixed income. We are not alone in understanding those. I don't think there is a day that you don't read in the newspaper about one of the large banks thinking through the new fixed income market.

What it means in this very low rate environment, and what the outlook is and given the regulatory changes, how much balance sheet and what sort of risk weighted assets you can hold in the business.

As Jon said, we've made frankly very aggressive moves over three years, bringing the RWAs down from $390 billion-plus to $150 billion-plus today. We think bringing it together with equities and having one sales and trading business is the most efficient and effective way to serve our clients and we'll come back over time with whatever changes that might imply.

Glenn Schorr

Okay. We'll move on. Just one other, in Asia private equity, I wondered, it was helpful, you said over two-thirds of the accrued performance fees were reversed out. I don't know if you want to share what's the dollar amount that's left, just so people could see the downside. But the reality is I just want to make sure, the Asian markets are up already in October.

So does it swing as quickly on the other way if markets hold the year? Would we see a turnaround in the investment line, and maybe you could size the amount of funds in the Asian private equity business?

Jonathan Pruzan

So I think you picked up on one important point. I did say it's about two-thirds of the carry from Asia private equity. I also mentioned that virtually all of the investment line in the IM segment would be driven by that reversal. So hopefully that can give you a rough size.

I'm not going to comment on where that carry will go, going forward. It's obviously going to be based on the investment performance and the valuations in the market. As James said, we have a long history in Asia. We have a strong team. That's been a good business for us.

We're on Asia PE Fund Four, so we've had four separate funds in that market. The first two are effectively finished and delivered strong returns to investors. Fund three, even after the reversal of carry and the performance this quarter is above, its preferred return hurdle, and fund four is really in the investment period, but that is also above book value.

So this has been a strong business for us historically, just had a tough quarter. And again, carry going forward is going to be a function of investments and valuation.

Glenn Schorr

Okay. Thanks.

Operator

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

Mike Mayo

Hi. I just want to try on that last question again. So what was your write-down on Asia private equity this quarter, since it's so large compared to other quarters? It would be helpful to have that number?

Jonathan Pruzan

What I would say, Mike, is if you look at that line in our supplement there in terms of the investment, it was negative $235 million this quarter versus a positive $232 million in the second quarter.

The two drivers of that is one, virtually all of that negative number can be attributed to the reversal of carry from our Asia PE business, and two, in the second quarter, we saw significant monetization events across the entire fund complex and we didn't see any material monetization events in this quarter. So that's how I would try to size that for you.

Mike Mayo

As it relates to FICC, your RWAs are close to $150 billion. They are down a lot over the last few years. But I thought you said that might start to increase. And there was also a late June Wall Street Journal article that said that Morgan Stanley would weigh more of a comeback in fixed income. So the bigger picture question is, what does Morgan Stanley want to be in FICC?

On the one hand, you have the strategy of UBS, which really has retreated and built the franchise around their wealth management business, and that's really paying off. And I know a lot of investor’s kind of wanted Morgan Stanley to go the route of UBS. On the other hand, you have some large US banks that still want to be the dominant fixed income players.

So which is it, because we're seeing some press reports, some RWA forecasts that imply that you're getting big. And at the same time we see these articles we have, I think it's the worst core FICC quarter since the financial crisis. So if you could provide some more color, that would be helpful?

James Gorman

Well, you're right about the last thing, I think it probably is the worst core FICC since the financial crisis, Mike. And secondly, I think what we said was, if we saw opportunity as some of the non-core assets rolled off, I think there was about $20 billion if memory serves me, that we would be open to utilizing those.

But we certainly weren't expanding from where we are now. So it's more replacement cost or replacement opportunity, if you will, and we're obviously not seeing that opportunity right now. So don't fret too much about that.

On the newspaper article, again if memory serves me, that was something which I found a little bizarre. Actually related to the expansion of the mortgage business that we are doing in wealth management, which has been a phenomenal business, as we take relatively affluent people who have money with us and we re-lend them the money back, because they don't want to create a liquidity event in their portfolio.

And that has been a business with FICO scores I think about 750. Loan to values less than 65%, thereabouts and almost zero, I think we've had one credit loss out of over 20,000 individual loans.

So a pretty spectacular business. For some reason the journalists wrote that headline, that expanding retail mortgage is somehow implied we're expanding mortgage trading in fixed income, and it did not.

We corrected it and they said they understood, but the press had written a story. So don't worry about that. That was completely separate from what we're trying to do.

So the story remains as is. Listen, we have radically restructured our fixed income business from what it was. Clearly, this quarter it did not perform anywhere near where we want and expect and need it to.

The first quarter was very different. The second quarter was about halfway between the two. And watch this space, we're not complacent, but on the other hand, we don't have a knee-jerk reaction based upon a 13 week period, and a very unusual 13 week period at that.

But on the other hand, we're focused on driving up returns to Morgan Stanley. We've been focused on that for many years. We are seeing the results of it on the Wealth Management side.

We had clearly an unusual hiccup in the merchant bank this quarter, which is highly unlikely to repeat itself. And the core banking and equities businesses continued doing what they were doing. So not sure I can add a whole lot more to it.

Mike Mayo

How much do you have in the non-core assets left in FICC?

James Gorman

I don't think we've broken down the total amount. Jon?

Jonathan Pruzan

Yes. I think, listen. As we said, I think in the beginning of the year, that we had through passive mitigation some level, about $25 billion of assets that would run off over time. As James said, we never committed one way or another what we would do with that passive roll off.

We look at our balance sheet and our businesses holistically. If there are return opportunities across the platform, whether that be equities, fixed income, wealth, we will put those assets to work. But those are basically the sizing of that number, Mike.

James Gorman

And I can promise you one thing. If we do not see opportunity, we will not keep those assets in-house. We will not keep the balance sheet in the position it is.

Mike Mayo

And last question, James, or just a comment. You said a goal for Morgan Stanley is to show better consistency and this quarter did not show that consistency. So how should investors think about this quarter in the context of your goal?

James Gorman

I hope that they would think it in the context of 23 quarters that this management team has presided over. It was a very unusual macro environment. The volatility in China was almost historic.

July was, we're still dealing with will Greece, won't Greece. September was will she, won't she, which was Yellen, and in the middle was China, which went up and down in a six month period at an extraordinary rate, with artificial intervention by the CSRC and other things that really threw the markets sideways.

So I'd like to think that investors would see those things for what they were, and focus on the core business strategy for what it is. We delivered 23% margin on lower revenues in wealth management, which is exactly what we said we would do in strategy.

We had over $500 million in fees in M&A, which is exactly in our wheelhouse of strategy. And we will have, I think when all fully report, the number one equities franchise on the globe, which is exactly what we said we would do in our strategy.

So I'm not making excuses from it. We said right at the outset this was a difficult environment, but a disappointing quarter and it was. And we hold ourselves accountable for that, and we will drive performance as a result of that.

Mike Mayo

Thank you.

Operator

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

Michael Carrier

Hi, thanks a lot. Jonathan, just on the wealth management business, if we look at the transaction revenues not just for the quarter, but even year-to-date, looks like they've been weaker. And I don't know if that's a transition of certain accounts into sort of the fee side or if it's just environmental

But I also just wanted to understand, like how significant - you mentioned the deferred comp component, how significant is that for that line item?

Jonathan Pruzan

For that line item specifically, if you look quarter-over-quarter, I think the revenues were down 6%. If you back at the deferred comp impact in both quarters, it would be low single digits. So stable, pretty stable revenues.

The mix as we've talked about in the past is continuation of growth in the NII line, continued year-over-year growth in the managed account line and then some softness in the transactional revenues.

We've seen the volatility in markets and one of the description of the third quarter James left out in August, we saw a 1,000 point drop in the Dow one day. That was not really constructive for our retail engagement numbers.

So there's been a lot of volatility. It's been a softer calendar, and as you said, there's been a shift into some of these managed accounts as well. So all of those are factors.

Michael Carrier

Okay. That's helpful. And then just one follow-up on the merchant banking business, I mean, not really on the Asia fund. But when we look at that business and maybe the overall portfolio, I just want to get a sense on the mix of the assets that are in there.

And then it sounds like on the Asia fund, you didn't go under the high watermark or the hurdle. So it was just a negative environment. And so you take the hit and you get the negative carry.

But going forward, if the investments are positive, there's nothing that we should be thinking about differently, meaning, if it's positive, we'll see the positive carry return.

But really want to understand the mix of that business, because when we're in more volatile environments, we can see some quarters where some weird things happen. So any color you could provide there?

Jonathan Pruzan

Sure. So a couple of things. In terms of - I think in the supplement, we break out where the assets under management are. We have a broad private equity and merchant banking real estate investment business. So you can see the different strategies and the different dollars of assets under management.

In terms of your comment about reversal of carry or then I guess, the restatement of carry going forward, there is - these funds are structured like traditional private equity funds, and there is a phase where you accrue and carry, where there is a catch-up phase that accelerates the accrual of carry, when you go above the preferred return hurdle.

You then - when the carry reverses itself, you have the inverse of that. We saw that in a second half of 2013, where we had the just sort of breaking through that preferred return hurdle, where we had the acceleration, and this was the inverse of that.

And specifically to your last question, we are, on fund three, we are still above our preferred return. So there is still some carry that has been accrued in that fund.

Michael Carrier

Okay. All right. Thanks a lot.

Operator

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

Brennan Hawken

Thanks. Good morning. Jon, quick follow-up on that question on wealth management from Mike with the deferred comp. Can you give us what your margin would be if we backed out the deferred comp noise in the wealth management business?

Jonathan Pruzan

I don't have that number.

Brennan Hawken

But it would probably be a little bit lower than what you reported, right, because it's going to lower your comp by a similar amount as your revenue?

Jonathan Pruzan

Well, it's clearly neutral to the bottom line, and this is a line item that sort of has been running through quarter-to-quarter. So I don't know what the margin would be without it. But it's definitely neutral to the bottom line.

Brennan Hawken

Okay. But it is right just in thinking about it, that it's going to move expenses by the same amount, its right?

Jonathan Pruzan

Yes. Yes, neutral to the bottom line.

Brennan Hawken

Got it. Okay. Thanks for that. And then tax rates have been kind of volatile this year. I know it's tricky, but is there any way we should think about the full year here this year on taxes?

Jonathan Pruzan

Yes. The tax rate has been volatile. We've said in the past it's a function of the geographic mix of earnings. I think we steered you towards 32% last quarter. For the full year, right, there is an adjustment period as the geographic mix, there is the actual mix of earnings based on legal entity versus a managed business, as well as sort of a look forward of what we think that mix is going to look like.

So it is a volatile number, but I would say 32% effective tax rate for the entire year is still what we would say, plus or minus.

Brennan Hawken

Okay. Thank you. And then lastly on wealth management, you guys saw deposits grow this quarter, was there anything specific driving that?

And then when we think about the loan to deposit ratio, as you guys continue to show nice growth in the loan book. How should we frame loan growth, and where the loan book can get to, based on that?

Jonathan Pruzan

So two questions, I think on the bank deposit program. I did highlight that we saw an increase in $7 billion and that was really based on the volatility in the markets and we saw that investors either stayed or moved into cash, relative to those volatile markets. And as I said, we would expect over time as that volatility abates and their confidence returns, that will be reinvested in the market.

In terms of the loan growth, we have seen good progress against our deposit deployment plan. We still have excess liquidity to deploy. We see a healthy and diversified pipeline. And we continue to expect to grow the loans in the bank. It's primarily going to be driven by wealth management.

It's going to be primarily driven by the mortgage product and the SBL product. And as I said, quarter-over-quarter, we were up $3 billion and year-over-year up $12 billion.

So we still see a healthy pipeline. I would say the penetration rates in terms of FAs engaging with their clients on these products are still high, and we would expect the growth to continue.

Brennan Hawken

Okay. And then, thinking about wealth management and the potential new rule on the Department of Labor's fiduciary proposal. How much of your wealth management client assets are in retirement accounts, and what percentage of those are advisory?

Jonathan Pruzan

So we don't break that out, and obviously the fiduciary duty standard has gotten a lot of attention, and there's been a lot of industry dialogue around it. I think the comment period was extended, and we saw that there were over 300,000 comment letters on this proposal.

We like to provide our clients with choice. We're hoping that the final rules allow us to do that, and we'll wait for those final rules to come out.

Brennan Hawken

Okay. But not anything that you can size for us?

Jonathan Pruzan

Again, we will wait for the final rules to come out, and then we'll come back to you.

Brennan Hawken

Okay. Last one, just on FICC, sorry to sort of beat this a little bit here. But as – sort of has been alluded to, equities and wealth management has seemed to have gone well and this is the one business that has continued to draw attention.

And James, I think there's a quote in the press release for you about addressing areas of underperformance. That seems clearly tied to FICC. Is that the right inference? And then does the timing of Ted getting in charge of the FICC business now to tie into this weak quarter and does it also circle back to previous comments that you all have made as being 2015 a really important year for FICC to prove that they can generate good enough results?

James Gorman

A lot of questions in there, Brennan. I think we've probably said all we want to say about FICC. It was one quarter, it was a disappointing quarter. The timing of the organization announcement was not related to this quarter.

The timing of the organization announcement is related to our desire to bring ourselves and trading businesses together, make them as efficient and effective as we can.

We're all working very hard on that. Ted, Collum, myself, Michael Heaney and Rob Rooney in fixed income and all of their team. Listen, I think we've said what we've wanted to say about this quarter. It is what it is and we move forward. We're not here asleep at the wheel.

Brennan Hawken

Fair enough. Thank you very much.

Operator

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

Devin Ryan

Hey, thanks. Good morning. We talked quite a bit about margin targets in GWM. But looking at ISG, it seems to be some pretty big margin tailwinds just from the bank growth and optimization there and then lower funding costs.

Just taking a step back from the challenges of this quarter, how should we think about incremental margin potential in ISG, particularly as you benefit from some of these revenue tailwinds.

I'm trying to think through how much of that benefit will flow to the bottom line versus being reinvested back into other parts of ISG?

Jonathan Pruzan

So on the ISG side, we are clearly focused on expenses and trying to be disciplined there. As I mentioned, the comp ratio at 38% is below our stated target from the beginning of the year.

On the non-comp side, we obviously have the increase in the litigation reserve this quarter. We've also highlighted for you last quarter, called out some professional fees related to the regulatory agenda.

Our hope is that today, when we look back, that we're sort of - we have accomplished more of the regulatory agenda behind us than we have in front of us. But we still have a large regulatory agenda and trying to figure out went those costs abate, is really challenging.

We are very focused on expenses. We're trying to control those expenses that we can control, and we will continue to do that going forward.

Devin Ryan

Okay. And then just within ISG additionally, lending exposure to energy. Can you quantify that, and then any other counterparty exposures related to energy would be helpful?

Jonathan Pruzan

In terms of energy exposure, we do have an institutional lending business, which includes exposure to energy. I would say that our energy exposure quarter-to-quarter hasn't changed materially. Most of the energy lending is to large, multinational corporations and about two thirds of that lending exposure is to investment grade counterparties.

E&P, which is been a big focus of the market, that exposure for us is a much smaller portion of our overall exposure. And approximately half of that - of our E&P exposure is secured, excuse me, by reserves.

Like others, we have seen some deterioration in credit in that portfolio, but we haven't taken any significant losses there. As with all our exposures, we are managing them very tightly. And when appropriate, we are also hedging those exposures.

I would say, given that environment, we would expect continued pressure in this area. But we are focused on it, and we are managing it tightly.

Devin Ryan

Okay. Great. Thank you.

Operator

Your next question comes from the line of Fiona Swaffield with RBC. Please go ahead.

Fiona Swaffield

Hi. Good morning. I have two questions. One was on the wealth management net interest income, where in the previous couple of quarters, certainly Q2 you mentioned the realization of the forward curve and your investment securities proposal has been a factor.

I don't know if you could talk us through Q3, Q2 in that respect, within the wealth management net interest income.

And the second area was on the supplementary leverage exposure, the SLR, and the total exposure number. It seems to have gone down. I mean, is there some - have you been successful on reducing add-ons or I think in the past, you talked about securities financing. I just wonder if you could talk a bit about that strategy? Thank you.

Jonathan Pruzan

I'll take the second one first. In terms of the SLR, that's an average calculation and as I said, we saw average assets decline over the quarter. And we continue to make progress on the balance sheet add-ons. So I would say it's a combination of a reduction in average assets, as well as some good work around compression and other things on the add-ons.

The first question around the forward curve, I think what we've said historically is that the growth in NII is primarily driven off of our deposit deployment strategy and taking our excess liquidity out of available for sale securities and putting them into the loan products.

That will be primary driver going forward. Clearly, the forward curve is helpful, as we reinvest our available for sale securities portfolio. I think since we talked last time, I think we probably in an environment of lower, longer - and lower and longer.

So that will have an impact. But again, our NII growth has been primarily driven by the loan growth.

Fiona Swaffield

Can I just follow-up, so if I look to Q3, Q2, there wouldn't have been a negative from AFS or anything like that, it just may have been less positive than in the past couple of quarters?

Jonathan Pruzan

That's probably a reasonable characterization.

Fiona Swaffield

Okay. Thanks very much.

Operator

Your final question comes from the line of Christian Bolu with Credit Suisse. Please go ahead.

Christian Bolu

Good morning, Jon. Good morning, James.

Jonathan Pruzan

Morning.

James Gorman

Morning.

Christian Bolu

On the relationship lending losses, can you give some more color on what drove that? Was it mostly energy related or more broad-based?

And then just any comments you have, how you feel in terms of your credit metrics of the book would be helpful also?

Jonathan Pruzan

As I did highlight, we did have markdowns on our held for sale relationship and event loans, as a result of the market environment. I wouldn't call out any individual or specific sector or event.

However, I would also highlight that the bottom line impact was minimal, as we hedge many of our fair value loans as appropriate.

Christian Bolu

Okay. Thanks. That's helpful. And then just on wealth management, quick question. FA count ticked up this quarter. Curious if that's just trainees or are you start to see a better environment for advisor recruitment?

Jonathan Pruzan

I would say it's a little bit of lower attrition and a little bit on the trainee side.

Christian Bolu

Okay. Thank you.