Good morning. This is Celeste Brown, Head of Investor Relations. Welcome to our third quarter earnings call. Today's presentation may include forward-looking statements, which reflect management's current estimates or beliefs, and are subject to risks and uncertainties that may cause actual results to differ materially. The presentation may also include certain non-GAAP financial measures. Please see our SEC filings at morganstanley.com for 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 P. Gorman

Good morning, everyone, and thank you, Celeste. Our results and actions this quarter evidence progress and important milestones towards our long-term strategic plan, a plan we laid out for all of you several years ago. In addition to executing on the long-term strategy, we also remain nimble and have demonstrated our ability to adjust tactically.

A key to our future is increased contribution of Wealth Management to our revenue, profitability, returns and funding stability. This quarter, we continued to move forward in 2 ways. First, on the tactical front. Our margin progress, at 13% pretax margin excluding nonrecurring expenses, provides increasing support of the strategy. Second, and of greater long-term significance, we purchased 14% of the Wealth Management joint venture, while locking in the price and greater flexibility for the remaining 35%. We're pleased to have clarity about our future and are closer to recognizing the full value of Global Wealth Management for the firm and for our shareholders, value that goes beyond the short-term margin targets.

In addition, the revenue and profit contribution of MSIM, our Asset Management business, really rounds out the wealth and asset management side of the firm. Also key to our future obviously is our long-term strategy in ISG, which continues to reinforce an integrated business that best delivers for clients, leverages our historic strengths, while optimizing capital. Again, on the tactical front, our objective this quarter was to demonstrate a recovery from the challenging second quarter, though acknowledging seasonality. This was most clear in our Fixed Income results, which rebounded sharply even with the continued drag from CVA due to the tightening of our credit spreads. As discussed on our last earnings call, clients did reengage with us at the end of the second quarter and continued to do so throughout the third quarter.

Evidence of progress across the firm towards our long-term strategy is our strong Basel III capital ratio, which is now north of 9% as of September 30. We've accomplished a lot over the last several years to position this firm well for the future and the new regulatory landscape. We have great confidence we'll translate this value into greater profitability for our shareholders and drive returns higher through sensible capital actions at the appropriate time.

Now I'm going to turn it over to Ruth to take you through our earnings in detail. 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.

DVA in the quarter was a loss of $2.3 billion with $1.6 billion in Fixed Income sales and trading and $641 million in Equity sales and trading. Excluding the impact of DVA, firm-wide revenues were $7.6 billion, up 14% sequentially. Noninterest expense was $6.8 billion, up 13% versus the second quarter. Compensation expense was $3.9 billion this quarter. Noncompensation expense was $2.8 billion, up 19% from last quarter, reflecting nonrecurring expenses associated with the Global Wealth Management integration, as well as higher litigation costs. The effective tax rate from continuing operations for the third quarter was 35.4%.

Earnings from continuing operations applicable to Morgan Stanley common shareholders were approximately $535 million. Earnings from continuing operations per diluted share were $0.28 after preferred dividends. On a reported or GAAP basis, firm-wide revenues for the quarter were $5.3 billion. Earnings from continuing operations applicable to Morgan Stanley common shareholders were a loss of $1 billion. Reported earnings from continuing operations per diluted share were a loss of $0.55 after preferred dividends. Book value at the end of the quarter was $30.53 per share. Tangible book value was $26.65 per share, reflecting a reduction of $0.58 related to the increased 14% ownership stake in the Wealth Management joint venture.

Turning to the balance sheet. Our total assets were $765 billion at September 30, up from $749 billion last quarter. Our liquidity reserve was $170 billion at the end of the quarter versus $173 billion last quarter. Deposits were $71 billion, up again this quarter. Although our calculations are not final, we believe that our Tier 1 common ratio under Basel I will be approximately 13.7% and our Tier 1 capital ratio will be approximately

16.7%. Risk-weighted assets under Basel I are expected to be approximately $319 billion at September 30. Subject to final rule-making, our Tier 1 common ratio under Basel III was north of 9% as of the end of the third quarter, assuming full Basel III inflation of risk-weighted assets and 0 benefit from future mitigation.

Let me now discuss our business in detail. In Institutional Securities, revenues, excluding DVA, were $3.6 billion, up 26% sequentially. Noninterest expense was $3.3 billion, up 21% versus the second quarter. Compensation was $1.6 billion for the third quarter, reflecting a 45% ratio, excluding DVA. Noncompensation expense increased 27% from last quarter due to higher litigation costs of approximately $280 million. The business reported a pretax profit of $345 million, excluding the impact of DVA. Including the impact of DVA, the business reported a pretax loss of $1.9 billion.

In Investment Banking, revenues of $969 million were up 10% versus last quarter. According to Thomson Reuters, Morgan Stanley ranked #1 in global IPOs, #2 in global announced M&A, #3 in global equity and #4 in U.S. dollar investment-grade debt at the end of the third quarter. Notable transactions included, in equity underwriting, the $8.5 billion global IPO of Japan Airlines, which marked the second-largest IPO globally this year and the largest airline float in history. This transaction is also a great example of the power of our partnership with MUFG. In advisory, Porsche SE transferred the remaining 50.1% stake in Porsche AG to Volkswagen valued at $8.9 billion. And in debt underwriting, Blackstone's $650 million offering, its first-ever 30-year bond issuance and its largest debt offering to date.

Advisory revenues of $339 million were up 29% versus the second quarter, with increased revenues in all regions. Equity underwriting revenues were $199 million, a 30% decrease from the second quarter. Although equity underwriting volumes for the industry were up sequentially, they were more heavily weighted toward follow-on offerings and block deals versus IPOs in the second quarter.

Fixed income underwriting revenues of $431 million were up 28% versus last quarter, reflecting increased revenue in high yield and investment-grade issuance, as well as stronger loan syndication fees. Equity sales and trading revenue, excluding DVA, were $1.2 billion, an increase of 7% from last quarter. Derivatives revenues improved despite seasonality due to a combination of more favorable market conditions and expansion of our client footprint.

Prime brokerage revenues increased modestly despite reduced average hedge fund leverage in the quarter. Hedge fund leverage picked up at the end of the quarter and continues to increase. Revenues in cash equities were consistent with last quarter despite significantly reduced levels of market activity globally. Results were supported by share gains across most markets.

Fixed Income and Commodities sales and trading revenues, excluding DVA, were $1.5 billion. Revenues were up 89% versus our second quarter results. Revenues increased across most of our businesses. CVA, net of hedges, was negative again this quarter due to the tightening of our credit spreads. Year-to-date in rates, we have generated almost as much revenue as we did in the entirety of 2011. In foreign exchange, we delivered our best reported quarter since 2009. Within our credit businesses, we had particular strength in our Securitized Products business. Commodities results benefited from more favorable market conditions. Other sales and trading reflects negative revenues of $164 million compared with negative $11 million last quarter.

Turning to VAR. We implemented a new VAR model this quarter, which we have been running in parallel since 2011. Our new VAR model has been approved by regulators. The benefit of the new model is that it is more responsive to current market conditions, while also maintaining longer-term perspective. The new model is aligned with Basel 2.5 requirements. In our supplement, we provided VAR measures under both our current and previous VAR model for this quarter, the prior quarter and the prior year, and we will do the same for the fourth quarter. Our average trading VAR for the third quarter was $63 million versus $76 million in the second quarter and $99 million in the prior year.

Turning to Global Wealth Management. Revenues of $3.3 billion were flat to the prior quarter. Asset Management revenues were down modestly versus the prior quarter, reflecting lower market levels at June 30. Transaction revenues increased 6% from last quarter, consisting primarily of commissions of $521 million, which decreased 2% from last quarter, reflecting lower equity volume. Investment Banking-related fees of $199 million, which decreased 11% versus last quarter, driven by a slower equity issuance calendar and trading revenues of $312 million, which were up 41% versus the second quarter, reflecting strong fixed income secondary trading, as well as markups in our deferred compensation plans.

Noninterest expense was $3.1 billion, up 6% from last quarter. Expenses included nonrecurring items of approximately $193 million related to the integration and the purchase of the 14% stake in the joint venture. The compensation ratio was 61% versus 60% in the second quarter. Noncompensation expense was $1 billion, up 14% versus last quarter. Excluding the nonrecurring expenses associated with the joint venture, the

PBT margin was 13%. On a reported basis, the PBT margin was 7%, with profit before tax of $239 million.

Total client assets increased to $1.8 trillion, reflecting the benefit of higher equity markets and positive flows. Global fee-based asset inflows were $8 billion, fee-based assets under management increased to $556 billion at quarter end. Global representatives were 16,829. Bank deposits were $118 billion, with approximately $60 billion held in Morgan Stanley banks.

Asset Management revenues of $631 million were up from $456 million in the second quarter, due primarily to principal investment gains in Merchant Banking and Real Estate. In Traditional Asset Management, revenues of $372 million were up 10% compared to the second quarter due to higher market levels. In Real Estate Investing, revenues of $125 million were flat versus last quarter. Due to the ownership structure of these funds, the majority of these revenues are passed to third-party investors in the noncontrolling interest line.

In Merchant Banking, revenues were $134 million compared with negative $3 million in the second quarter driven primarily by principal investment gains. Compensation expense was $241 million in the quarter, up slightly from $214 million in the second quarter. Profit before tax was $198 million, up from $43 million last quarter. NCI was $50 million versus $23 million last quarter. Total assets under management increased to $331 billion driven by net inflows of $11 billion and market appreciation.

Turning to our outlook. We continue to see momentum in our businesses based on better market conditions and the strategic positioning of the firm. With respect to the market, both institutional and retail investor activity picked up on the back of the ECB's bold moves in August. We believe the ECB's actions reduced the probability of a tail risk event in Europe, although challenges remain in Europe and globally.

With respect to the firm's businesses, clients clearly reengaged with us post the ratings decision in late June and continued to do so throughout the third quarter. We saw a recovery in our Fixed Income results and continue to benefit from our cohesive sales and trading businesses. Investment Banking volumes industry-wide remain muted relative to historic levels, but pipelines are healthy. With our strong market share, we are well positioned if the fledgling economic recovery in the U.S. persists and market stability in Europe is sustained. We are increasingly benefiting from our Wealth Management business, including the advantages of being on one platform as well as our increased stake in the business. We are also yielding results from our alliance with MUFG with powerful market share gains in Japanese and cross-border M&A.

We continue to take the steps needed to realize cost savings through headcount reductions and cost-cutting, setting us up well for 2013 and 2014. Specifically, by the end of the third quarter, we were close to our headcount reduction goal for all of 2012. Our Office of Re-engineering remains on track to achieve $500 million run rate savings this year and $1.4 billion by 2014. And the results of our cost initiatives in GWM are increasingly visible now that we are on one platform.

Looking forward, we remain confident about our path to ROE expansion based on the revenue, profitability and capital strategies we have implemented. Most notably, in Institutional Securities, we have leading global businesses with momentum across the platform enhanced by capital optimization. In Wealth Management, we are already benefiting from our increased ownership both because we are earning a return on the capital held against the 14% and the growing deposit base, which will drive funding efficiency and revenue expansion. Because of these and other steps we have taken, as well as the early signs of an improving macro environment, we look forward to the future.

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

Question-and-Answer Session

Operator

[Operator Instructions] The first question will come from Howard Chen with Crédit Suisse.

Howard Chen - Crédit Suisse AG, Research Division

You both mentioned the impact of the CVA this quarter. Can you tell us how meaningful that was? And were there any hedges against that as I think is your historical practice?

Ruth Porat

So there were hedges against it as is our historical practice and as we disclosed in our filings. And the drag -- just to try and help you size it, the drag from CVA this quarter was bigger than the period-specific items we called out last quarter in our Fixed Income business. In addition, we had a drag in equities, although it was smaller than in Fixed Income.

Howard Chen - Crédit Suisse AG, Research Division

Great. And then, James, could you just update us on your long-term strategy vision for the Commodities business and how you see both the physical and the nonphysical segments of the business fitting within the regulatory framework as we go forward?

James P. Gorman

Well, Commodities has been a great business here at Morgan Stanley for a long time. It continues to be an attractive business. Obviously, with the Dodd-Frank legislation, there are potential limits to some of the activities that we can pursue in that business. So it's incumbent upon us to explore all forms of different structures, appropriate structures, that can take us forward, where we can get the benefits of the business but also meet the regulatory constraints that we operate under.

Howard Chen - Crédit Suisse AG, Research Division

Okay. And then on capital management, James, you've highlighted in the past to think about this capital management and capital trends as sequential process. So sequentially, you've retired legacy issues, you've bought the first 15% of the buy-in, crystallized the price for the rest and this Basel III Tier 1 common continues to improve. So where we are now, how do you think about the potential ability to buy back your stock, restore the dividend and/or maybe do the rest of the buy-in?

James P. Gorman

Well, it's a good question, Howard. Obviously, we have CCAR process that we and the other financial institutions go through with our regulators, both Federal Reserve and the other regulators. And in that process, one is in a position to pursue a range of capital actions. The process is now conducted twice yearly. Last couple of years, it's been once yearly. So there are opportunities going forward to put in place whatever plans we have in place. We've made it pretty clear that our major strategic objective is to complete the acquisition of MSSB, of which we have remaining 35%. And that would have a very modest capital implication for us, given the agreed-upon price and the goodwill we already hold against the position. So I don't want to get ahead of ourselves and don't want to get ahead of our regulators. We'll address what and when other actions as we get to the CCAR process in January of next year.

Howard Chen - Crédit Suisse AG, Research Division

Great. That makes sense. And just finally for me, you noted the heightened litigation costs this quarter. What specifically did those relate to, Ruth? And how far would you say we are through crisis and postcrisis litigation for the firm?

Ruth Porat

Well, it covered -- this quarter covered a number of items, including the recent decision in one matter but also expenses associated with other ongoing matters. And I think, as you put it, litigation has been an ongoing cost for the industry. And I think it will continue to be.

Operator

The next question will come from Roger Freeman with Barclays.

Roger A. Freeman - Barclays Capital, Research Division

Just going back to, I think, probably a couple of things Howard asked. Besides sort of the CCAR process, are there other things with respect to buying in the rest of the JV that factor into your decision-making? And what would cause you to accelerate that or not, separate from the capital allocation?

James P. Gorman

Well, I'll have a go, then Ruth can jump in. We agreed on a fixed price on the JV. And given that fixed price, the capital -- and you can do the math on it -- the capital implications of buying the rest of it are pretty modest. There are many advantages to pursuing that, obviously, but again we've got to go through the CCAR process and make sure it's the right time to do it. But there are advantages to pursue it and we've made that very clear. This is a strategic imperative.

Roger A. Freeman - Barclays Capital, Research Division

Got it. Okay. And then just maybe tied to that broadly, you've got to a 13% pretax margin, excluding the charges. Your target next year is mid-teens. Can you just remind us what other milestones we'd be looking for? I mean, you're obviously close to that number now. Does this continue to, as you model it out, rise over the course of next year, so you're at a higher level, above mid-teens by the end of next year?

Ruth Porat

So we're still guiding to mid-teens margin mid-next year, but 2 components I think to your question. First is we're looking forward to the fourth quarter and beyond a couple of items. One, integration expense is running lower post the second quarter. As we've talked about it, ran kind of the $80 million to $100 million per quarter area in the first half, and then we had budgeted for it to come down in the third and fourth quarters, which it did, running at lower levels, and then dropped off again next year. So the third quarter margin did benefit from that drop in integration expense, which will also benefit the fourth quarter, and then it goes down in 2013. The second thing is that we'll have a full quarter of the expense benefit associated with the charge that we took in the third quarter. We had 2 of 3 months' benefit in the third quarter. So there was some impact on the 13% margin this quarter. We get the full 3 months' benefit next quarter. Obviously, we are always careful to say that PBT margin expansion is not a straight line. For example, in the fourth quarter, we do tend to have seasonally higher expenses. But it's too soon to tell. And then I think as we look forward, and really building on James' comment about the upside, whenever it comes with the additional 35%, when we buy that in, first and foremost, we generate earnings on this capital that we're already holding against Citi's stakes. So that meaningfully improves ROE in the business. But in addition to that, we get the benefit from adding about another $55 billion in deposits over time. So not only do we benefit from efficient stable funding, but we also increase net interest income, which is higher-margin. And then beyond NCI, there's an earnings benefit from trading volumes that are now directed to Citi based on an order flow agreement. That's eliminated when we own 100%. So some contractual benefits that take it higher, and then there are certain other costs from managing a joint venture that drop away. So mid-teens margin mid-next year is the guidance, but I just wanted to give you the path forward.

Roger A. Freeman - Barclays Capital, Research Division

Got it. Okay. And then just lastly, on the Basel III Tier 1 ratio, 9%. The last quarter, I think you said you were just under 8.5%. There was some benefit from the MSSB transaction. But also is the 8.5% still a comparable number? Because I know the NPR had just come out in June. And so I don't know if there were any revisions to the historical look-back.

Ruth Porat

Yes. That's a comparable number. The increase really starts with earnings, and as you know well, DVA is not relevant for the capital calculation. So starting with earnings, there was a modest benefit from the new VAR model. But I think, very important, we continue to execute on our RWA plan, the risk-weighted asset plan.

Operator

Your next question will come from Mike Mayo with CLSA.

Michael Mayo - Credit Agricole Securities (USA) Inc., Research Division

Can you update us on your FICC risk-weighted asset reduction? How much have you done? And how much more do you have to go?

Ruth Porat

Mike, given we just laid it out at a conference recently, what I'll say is we're very much on track for the targets that we laid out at the conference.

Michael Mayo - Credit Agricole Securities (USA) Inc., Research Division

Okay. The increase in your Basel III Tier 1 ratio, was that helped out this quarter by the risk-weighted asset reduction? Or is that to come? And also did the VAR change help out your capital ratio?

Ruth Porat

Yes. The 3 components that helped the capital ratio was obviously starting with earnings, and then I just mentioned that there was a modest benefit from the new VAR model. And yes, we did continue to execute on the RWA plan, that was part of the benefit.

Michael Mayo - Credit Agricole Securities (USA) Inc., Research Division

And why did you make the change in the VAR model? Was it simply to get a shorter time series? And if so, what time frame did you have before versus now?

Ruth Porat

Yes. The primary driver was to have a VAR model that's more sensitive to changes in market volatility. So it is more weighted to 1 year data. As we've talked about in the past, our prior VAR model was really -- it was based on 4-year data. And we've been running this model and the prior model in parallel since 2011, which gives us a high level of comfort from the model. It's been approved by regulators. It is consistent with Basel requirements. And in our disclosure, what you've probably seen is we've provided the VAR measures under both models for this quarter, the prior quarter, the prior year. And we will be doing the same for the fourth quarter. I thought it would be helpful for you to be able to see the trends under both models, which are the same, VAR was down this quarter.

Michael Mayo - Credit Agricole Securities (USA) Inc., Research Division

And you can appreciate the idea of changing a VAR model gets people's attention these days. Is there anything else you've looked out at, given what's taken place recently elsewhere in putting in place a new VAR model? I mean, you've put it in place firm-wide, you've ran it in parallel for, what, 1.5 years. Anything else you can say to assure people?

Ruth Porat

Sure. So first and foremost, it's part of the overall governance around risk management where you have one centralized risk organization. It reports to the board risk committee. The risk organization built the model. It's been thoroughly vetted internally and, as I said, approved by regulators. We've been running both models in parallel for an extended period of time. And the other point is that VAR is just one of multiple measures of risk we use to assess overall risk in the organization. So we've talked in the past about our proprietary stress VAR model. That captures a longer time series and market liquidity and tail risk. And we do constant scenario modeling with stresses for volatility and price changes. So it's part of an overall to your point, very good question, overall comprehensive risk management, centralized risk management organization with multiple tools.

Michael Mayo - Credit Agricole Securities (USA) Inc., Research Division

And then last question. In Wealth Management, now that you're on one platform, I imagine you had many people working on that integration. You said you're at your headcount reduction already. So how many people were working on that integration? And I guess, they'll be redeployed for more external activities or elsewhere. What kind of additional synergies can you get now that the integration is finally done?

Ruth Porat

So as I indicated, the expenses were higher in the first half but didn't drop off completely in the third and fourth quarter because we've continued to provide support. We had built that into our upfront plan. So you're right. I don't have the numbers with me, but headcount does benefit modestly as we completed the platform and will continue to benefit.

Operator

The next question will come from Glenn Schorr with Nomura.

Glenn Schorr - Nomura Securities Co. Ltd., Research Division

A quickie on loan. Loan commitments have been coming down. They're actually down like in half. Is that a function of the environment or a little more a function of the Basel III Dodd-Frank world that we're going to live in?

Ruth Porat

So loans -- what I'd like to point you to is obviously the difference between what's in our fair value block versus HFI. As we've talked about several quarters ago, we were increasingly moving to HFI. That is up again this quarter. And overall, our loan book is actually up this quarter. So I think the change is in what's fair value versus HFI, HFI is now over half of our total loan book.

Glenn Schorr - Nomura Securities Co. Ltd., Research Division

A totally fair point. I guess, M&A performance is pretty good. But in general, industry-wide, you scratch your head, you look back and you say, "Well, conditions actually should be pretty good for a heated M&A environment," yet I think there's a lot of conversations, good pipelines and not a lot of trigger-pulling. I'm just not sure if you can think through the things that would maybe break up that log jam and what your expectations are next 4 or 5 quarters.

Ruth Porat

You're absolutely right. Our view is that the conditions that we're seeing today with lower volatility in the markets and low rates, so an attractive financing environment, if you look historically, that should set up for a -- or encourage a pretty robust M&A environment, pretty -- higher levels of activity. And very much to your point, industry-wide volumes continue to remain at very low levels. What we're hearing anecdotally is that much of that continues to be the uncertainty about the environment. Some concern, not just in Europe, but increasingly here in the U.S. and that, that is basically putting activity kind of on the sidelines. Conversation's ongoing and the pipeline's healthy, but very much to your point, need to have more clarity about the environment and some of the changes that are forthcoming, in particular, here in the U.S. for activity to move forward in a meaningful way is our expectation.

Glenn Schorr - Nomura Securities Co. Ltd., Research Division

Excellent. And last one, just more of a big picture one, I think everything you pointed out at the beginning of the call is spot-on. I think Fixed Income snapped back strong. M&A, debt underwriting, Equity is all good, Wealth Management getting better, we're going to own more. Even if you do the math of you owning more and hitting your margin target, I'm still coming up in a single-digit ROE range. And I just don't know if it's just waiting on a better environment. I'm just curious if you, in your minds, have a path towards, say, a double-digit ROE and what it takes to get there.

Ruth Porat

Sure. We do have meaningful ROE upside and are unequivocally focused on driving returns in each of our businesses. There was noise in the numbers this quarter. I'll let you model those in. But taking you to the sustainably higher ROE and focusing on those drivers we've talked about, revenue profitability, capital efficiency for the various businesses -- let me go into them in some detail. So in Wealth Management, in terms of the revenue upside, we're continuing to increase our managed accounts business. It's up above $550 billion this quarter, it's up 20% year-over-year. And that's accretive to returns. And we are increasing our lending business. We have $73 billion of deposits as of October 15 once the deposits came in from Citi associated with the 14% stake. Those come in under the drag basis -- lag basis, rather. So $73 billion of deposits, we're increasingly moving that to higher-margin products, which will increase NIM, even without any rate increase. And then on the expense side, you've seen it in the third quarter. The integration is complete, so expenses have come down and have more room to go, as I just noted. And the cost savings programs add to that even more. And then on the capital side, as you said, when we own -- as we increasingly own more of the joint venture, we generate earnings on what I have repeatedly called deadweight capital. We're holding this capital against Citi's stake and not earning -- generating earnings on it. Notably, as we buy-in the remainder of the Wealth Management joint venture, there is contractually significant revenue and profitability upsides that I commented on, things like the order flow agreement, a limit, more deposits -- so more upside beyond that contractually. And then on the Institutional Securities side, starting with revenues, we have sizable operating leverage in our institutional businesses, and we're executing on our plan. So we have a stellar platform in banking, we have a strong M&A pipeline. The same is true for equity new issuance, and both really played to our strengths. We have a leading franchise in institutional equities, and we continue to increase share even with low volumes, low market-wide volumes. And on Fixed Income, we're on track to running an optimized returns business with a strong client franchise, putting risk behind clients with smart capital efficiency. And we're pleased with the momentum in the business. On expenses, we now have very strong expense controls, comp and noncomp. And on capital, we're benefiting from more efficient use of capital across the businesses. On top of that, there would be upside from any return of capital and from an improving market over time. But we're building to a healthy increase in ROE with the revenue profitability and capital levers I've just gone through.

James P. Gorman

Hey, Glenn, it's James. You said at the beginning what an overall big picture on the ROE, and as Ruth just laid out all the components. But just step back for a minute. The first quarter, the ROE was 9%. Second quarter, obviously, we fell into a hole with the rating agency action, and there is -- clearly, we wanted to demonstrate that we've bounced back from that, which I think we have clear demonstration. You put all the pieces together, and it's not a terribly heroic assumption to get back to your cost of capital. And that's clearly what our plan and focus is on. We will be very, very, very focused on noncomp expenses. We are very attentive to our overall capital plan over the next couple of years. We're determined to make this GWM acquisition work. And as Ruth said, we have huge operating leverage across Institutional Securities. So again, I'm not sure what your math is looking like, but I don't think it takes a lot of heroic assumptions to get you to a reasonable ROE number. And then obviously from then on, as the global macro environment improves, which I believe it is on the starting basis of doing, we take it up from that point.

Operator

The next question will come from Kian Abouhossein with JPMorgan.

Kian Abouhossein - JP Morgan Chase & Co, Research Division

First question is relating to risk-weighted assets again. You mentioned at a recent conference, second quarter group risk-weighted assets were about $500 billion. Could you give us an update where we stand as of the third quarter with a 9% Tier 1 Basel III?

Ruth Porat

Given we just went through it at a recent conference, we're continuing to execute on the RWA plan. But I don't have it with me because we're not updating it at this point.

Kian Abouhossein - JP Morgan Chase & Co, Research Division

When will you give actually more details on your Basel III? Because it's been industry standard to start give a little bit more details. When should we expect you actually to either have it in the press release or in any other form that you give more details on capital as well as Basel III details?

Ruth Porat

Well, actually, I think that with the delineation we gave, and in particular in Fixed Income, we've given quite a bit of granularity because we wanted to make it clear how we're thinking about this strategically. And we've laid out some pretty key milestones. I think it might be helpful if I roll forward based on that plan where that gets you in '13. And you've probably already done this. But based on our current interpretation of the rules, consensus earnings and the RWA reduction plan that we did lay out at the conference, the math will get you to north of 10% by 2013.

Kian Abouhossein - JP Morgan Chase & Co, Research Division

Okay. Moving on to funding cost. Your funding cost is about 50 to 100 basis points higher than your peers. And I'm looking at your balance sheet, and you have about $170 billion of long-term debt. But I'm sure there's other long-term debt that I'm missing because of the way it's categorized. How much long-term debt do you actually have or what you categorize as long-term debt in your business? And how does a 50 to 100 basis points higher CDS spread impact your funding cost really going forward? How should we think about how you fund your business and the impact on the ROE?

Ruth Porat

So you've identified the long-term debt. You've got the right number there. In terms of funding, as I've said on many quarterly calls, the strategic moves that we've been making are benefiting our funding costs and our requirements. So for example, the growth of the deposit base, which is fairly consistent with our ongoing growth of the Wealth Management business funds both our corporate and retail loan books and additional products in the bank. And as we increase funding with deposits, we reduce reliance on our unsecured funding. With respect to the business mix, as we move more toward flow, which we've talked about quarter-after-quarter from structured products, we're funding more efficiently through the secured channel. And as a result of this and all that we've been doing with the balance sheet, this quarter alone, our unsecured debt is down by $3 billion. In 2012 year-to-date, it's down by about $20 billion. So in the aggregate, as a result of the strategic move, which is why I keep anchoring it back to that, the strategy is actually yielding multiple benefits. We've reduced our funding requirements, we've increased the durability of our funding because we have more efficiency given the multiple funding sources.

Kian Abouhossein - JP Morgan Chase & Co, Research Division

Okay. That's actually quite useful. And in terms of the comp ratio, I get to an IB-clean comp of 45% in the quarter. You mentioned noncomp as an improvement area. Most banks that I talk to are looking at more like high 30s as a comp target over the medium-term. How do you see your long-term comp ratio outlook, assuming no material changes in revenues?

Ruth Porat

Understood. So in recent quarters with higher revenues, we've delivered a lower compensation ratio, which evidences our philosophy and continues to drive returns. And as we've said many times, we're focused on appropriately rewarding those who drive returns while improving ROE and earnings. So it's not just about compensation dollars. We're also looking at headcount management, at location sourcing, at the overall expense management program and looking at both comp and noncomp.

Kian Abouhossein - JP Morgan Chase & Co, Research Division

But with this revenue environment, is it fair to say we should still see low 40s as a number on comp? Is it reasonable?

Ruth Porat

Well, I was going to make 2 points. The other important point to note is obviously ratios are not apples-to-apples across the Street. And as I said, we're looking at ensuring that we get the balance right so that we can reward those who drive returns while improving ROE.

Kian Abouhossein - JP Morgan Chase & Co, Research Division

Okay. And last question on your VAR model. Do you still use a Monte Carlo model or historic now?

Ruth Porat

Historic.

Operator

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

Matthew H. Burnell - Wells Fargo Securities, LLC, Research Division

I have a follow-up question, I guess, to Glenn's question about the businesses and getting to ROE, Ruth. And maybe you incorporated your comments on this, but you didn't really focus on the Asset Management businesses. You're currently running at about a 17% ROE this quarter, about half of that on a year-to-date basis. Is there any meaningful benefit to ROE given the relatively modest contribution now that you see? You mentioned

ISG and you mentioned Wealth Management. But is there anything that we might expect in terms of ROE benefit from Asset Management in the next year or 2?

Ruth Porat

Well, you've identified, given it's already a high ROE business, yes, there tends to be less of a question there. What we've consistently been doing is bringing back C capital [ph] and investing in the core business. And so again, that's accretive to returns in what's already an attractive return business.

Matthew H. Burnell - Wells Fargo Securities, LLC, Research Division

Okay. And then you mentioned that there's been some greater sense of engagement from your clients post the Moody's downgrade and that accelerated in the third quarter. My presumption is that, that is a comment basically focused on your institutional clients. Can you give us a little more color as to the sense of the retail investor engagement over the course of the third quarter? And any color you might want to provide relative to what's happened since the end of the quarter.

Ruth Porat

If I'm hearing the question correctly, there were actually almost -- maybe 2 points in there. Post-Moody's, we had -- we saw clients really reengaging, as you said, in the sales and trading side, in particular, on the Fixed Income side, which is the area that dealt with it the most. There wasn't really a Moody's impact on the retail side. And so on the retail side, the focus has been much more about what's going on in the macro environment. And as I commented, one of the impacts and the drags in the business has been, with the macro as weak as it had been or as volatile as it had been, we had lower levels industry-wide of equity new issue products. So that affected the opportunity overall for retail products to go through the system. But I think what you see in retail, which is attractive, is the consistency of revenues quarter-after-quarter.

James P. Gorman

I would just add from observing that part of the business for over a decade that there are periods where retail investors are completely disinterested in the market. There are periods when they're chasing everything that's moving. And then there are periods when they're basically sitting on the sidelines. If a good product comes along, they engage. If there's a better tone in the market, they engage. And we are in that period. We're definitely not in a fearful period. We're in a period where the money is there, the flows are still positive, a lot of money sitting in cash. And when an interesting product is coming along, they're engaging. And when there is a firmer tone, whether it's from here or Europe or anywhere else internationally, we see an uptick in activity. So as Ruth said, it's remained enormously stable during a pretty depressed period. And in my view, it wouldn't take a whole lot for that revenue outlook to turn in a positive way.

Matthew H. Burnell - Wells Fargo Securities, LLC, Research Division

Okay. And then finally, Ruth, you mentioned the hedge funds looked like they're taking a bit more leverage this quarter. Could you provide a little additional color as to if there are specific markets or products where they are willing to put on more leverage?

Ruth Porat

I think it's a pretty broad-based statement that we're saying. I can't pinpoint it to any particular market as broader.

Operator

The next question will come from Brennan Hawken with UBS.

Brennan Hawken - UBS Investment Bank, Research Division

First, a quick one on CVA. Are we done there? Or is there more of that coming in subsequent quarters?

Ruth Porat

So you specifically asked about CVA, not DVA. Obviously, both are affected by movements in credit spreads, and so we don't forecast movements in credit spreads.

Brennan Hawken - UBS Investment Bank, Research Division

Right. But I think it was last quarter where you said that there was a big change because of the downgrade. And so I was more referring to the outsized move as it related to that with the increased collateral.

Ruth Porat

Okay. Sorry about that. So there weren't more collateral calls this quarter, so you're not -- there was -- we basically had the initial flurry of collateral calls post the ratings action in June. And it pretty much subsided even before we got to the second quarter earnings call. It was initial flurry and that was it. And so you do not see an impact from collateral calls this quarter.

Brennan Hawken - UBS Investment Bank, Research Division

Okay. Good deal. And then sticking with the capital markets, nice to see a pretty solid bounce-back there in FICC and great to hear about clients reengaging. Is that still -- is there still a tailwind coming there and still continuing to benefit you? Or do you feel as though everybody now is back and FICC is up to full speed? In other words, do we have more coming, more benefit?

Ruth Porat

Well, we always want to be doing more with our clients, so I wouldn't put an endpoint on it. I think that we were helped to have the ratings action behind us and clients reengage. And you can see that in the numbers. The move by the ECB in the summer, as I noted, I do think helped bring clients back into the market more broadly, that had been a big headwind as well. But in our view, we've got a very focused approach to the businesses and are looking to continue to build share.

Brennan Hawken - UBS Investment Bank, Research Division

Yes. Sorry if I wasn't more specific. I just meant the reengagement post-Moody's, if you felt as though at this point folks are now fully back and reengaged.

Ruth Porat

It's hard to disaggregate what's going on in the macro from any particular, is there any particular lag. Our sense is that clients have reengaged and we're continuing to work to build market share with them. And it feels that it's pretty much been addressed, but I was actually very directly saying that we're continuing to drive share and looking at that. So it's hard to be more specific.

Brennan Hawken - UBS Investment Bank, Research Division

Yes. No, that's fair. Aside from benefiting from the market conditions, more favorable market conditions as you highlighted, in the Commodities business, Goldman hit on weakness and specifically highlighted weakness there. Could you give some more color on how that business went this quarter for you guys?

Ruth Porat

Yes, it was -- commodities was up meaningfully versus last quarter. But as we noted, it was much lower last quarter. And that was due to a more favorable market environment. It is still down year-over-year. So I think some of the backdrop continued to be a bit challenging. And as we've discussed before, for us, the business is a mix of flow and structured solutions for clients, and it can be quite lumpy.

Brennan Hawken - UBS Investment Bank, Research Division

Okay. And then last one for me. There was a good deal of noise made in the press on trends within FAs in Wealth Management. You never know how much of that's noise versus something real. So have you guys seen any uptick in defections post-integration? Have you seen any tangible evidence of dissatisfaction? I know the total FA headcount went up, but sometimes there's junior brokers that get at it and that can skew. So if you could give maybe some color on that, that'd be helpful.

Ruth Porat

Well, FA attrition continues to run at low levels. In fact, for the top 2 quintiles, which is what we typically call out, the attrition was lower in the third quarter than it has been for the last several quarters. And if you look at metrics like annual revenue per financial advisor or assets per financial advisor, all of the trends are going in the right direction. So there's always some movement in and out. Actually, this quarter, FAs are down a bit as it was between the first and second quarter. But attrition's lower than it has been. Or to put it differently, retention is running at higher levels.

Operator

The next question is from Richard Ramsden with Goldman Sachs.

Richard Ramsden - Goldman Sachs Group Inc., Research Division

I've got a question around Basel III again. Given the uncertainty around the outcome of the final NPRs as well as given some of the questions around the model approval process, is it possible to give a range of outcome for what your Basel III numbers ultimately could be?

Ruth Porat

Well, the way we approach the Basel III guidance is it's based on, as I said, our current interpretation of the rules. What it does not include is the benefit of model approval, which is obviously a key part of the transition. And we view model approvals as incremental upside. And so what we'll do is layer that in as we get model approvals. I mean, there are certain models that are kind of more foundational, like IMM. But if you look at CRM model approval, which I think a number of people -- a number are coming back to, we don't include the benefit of CRM model approval. So for example, in the second quarter, I mentioned that we estimated that our Tier 1 common ratio would be up about 40 basis points based on the book at that point in time. And the reason we don't bake that into our guidance, our spot guidance, is as you know, even when you receive CRM model approval, you have to wait a year to incorporate the benefit in the calculation so that by any -- under any set of facts would be an event at least a year out. And given that the book changes and we're actively reducing it, the benefit changes as well. So although we're working to get model approval, we thought it was most prudent not to include the benefit of things like that in the guidance we give you and as we put it kind of greater than 9%, and that gives us the room to take it up as we get model approval.

Richard Ramsden - Goldman Sachs Group Inc., Research Division

Okay. So to be clear, you haven't included CRM. How about things like stressed VAR and the incremental risk charge? Are those included in your number as well or not?

Ruth Porat

So CRM is not included, but things that -- I'll call them the kind of foundational models that move you from Basel I and II and through the various regimes, like IMM or IRB, are included. It's just the specific models that are available and that we're clearly working on to take risk-weighted assets down as with the CRM model.

Richard Ramsden - Goldman Sachs Group Inc., Research Division

Okay. And what do you think is a reasonable time period in terms of getting full model approval from the Fed, i.e. is this something that's months out? Or do you think it could take longer than that?

Ruth Porat

Well, the reason we're not including it in our guidance is because we can't answer that question. So we're working on it, and I think it will take -- they seem to -- there's obviously a lot going on with the various moves from I to II to 2.5 and III. So I can't estimate the date, but we will provide updates as the models get approved.

Richard Ramsden - Goldman Sachs Group Inc., Research Division

Okay. And then the second question I wanted to ask. Can you confirm buying out the remainder of Smith Barney doesn't have a significant capital impact? I think you've said that on a couple of occasions. Given that, when we think about capital returns next year, should we think about buying out the remainder of Smith Barney versus buying back stock as an either/or decision? Or do you think there's potentially room for you to do both?

Ruth Porat

Well, as I think James said, it's premature to judge the CCAR process. We haven't even seen the rules yet. But as you've seen from actions today and James' comments, the first priority is the Wealth Management joint venture, the additional 35%, given -- or portions that I've given, the strategic value of the business. So at this point, it's premature to judge CCAR.