

MORGAN STANLEY
Form 10-Q
May 07, 2012
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

☒ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES

EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2012

OR

☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES

EXCHANGE ACT OF 1934

Commission File Number 1-11758

(Exact Name of Registrant as specified in its charter)

Delaware

1585 Broadway

36-3145972

(212) 761-4000

(State or other jurisdiction of

New York, NY 10036

(I.R.S. Employer Identification No.)

(Registrant's telephone number,
including area code)

incorporation or organization)

(Address of principal executive
offices, including zip code)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the Registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the Registrant was required to submit and post such files). Yes ☒ No ☐

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer ☒
Non-Accelerated Filer ☐

Accelerated Filer ☐
Smaller reporting company ☐

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(Do not check if a smaller reporting company)

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

As of April 30, 2012, there were 1,977,775,881 shares of the Registrant's Common Stock, par value \$0.01 per share, outstanding.

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QUARTERLY REPORT ON FORM 10-Q

For the quarter ended March 31, 2012

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AVAILABLE INFORMATION

Morgan Stanley files annual, quarterly and current reports, proxy statements and other information with the Securities and Exchange Commission (the "SEC"). You may read and copy any document we file with the SEC at the SEC's public reference room at 100 F Street, NE, Washington, DC 20549. Please call the SEC at 1-800-SEC-0330 for information on the public reference room. The SEC maintains an internet site that contains annual, quarterly and current reports, proxy and information statements and other information that issuers (including Morgan Stanley) file electronically with the SEC. Morgan Stanley's electronic SEC filings are available to the public at the SEC's internet site, www.sec.gov.

Morgan Stanley's internet site is www.morganstanley.com. You can access Morgan Stanley's Investor Relations webpage at www.morganstanley.com/about/ir. Morgan Stanley makes available free of charge, on or through its Investor Relations webpage, its proxy statements, Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and any amendments to those reports filed or furnished pursuant to the Securities Exchange Act of 1934, as amended (the "Exchange Act"), as soon as reasonably practicable after such material is electronically filed with, or furnished to, the SEC. Morgan Stanley also makes available, through its Investor Relations webpage, via a link to the SEC's internet site, statements of beneficial ownership of Morgan Stanley's equity securities filed by its directors, officers, 10% or greater shareholders and others under Section 16 of the Exchange Act.

Morgan Stanley has a Corporate Governance webpage. You can access information about Morgan Stanley's corporate governance at www.morganstanley.com/about/company/governance. Morgan Stanley posts the following on its Corporate Governance webpage:

Amended and Restated Certificate of Incorporation;

Amended and Restated Bylaws;

Charters for its Audit Committee; Internal Audit Subcommittee; Compensation, Management Development and Succession Committee; Nominating and Governance Committee; and Risk Committee;

Corporate Governance Policies;

Policy Regarding Communication with the Board of Directors;

Policy Regarding Director Candidates Recommended by Shareholders;

Policy Regarding Corporate Political Contributions;

Policy Regarding Shareholder Rights Plan;

Code of Ethics and Business Conduct;

Code of Conduct; and

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Integrity Hotline information.

Morgan Stanley's Code of Ethics and Business Conduct applies to all directors, officers and employees, including its Chief Executive Officer, Chief Financial Officer and Deputy Chief Financial Officer. Morgan Stanley will post any amendments to the Code of Ethics and Business Conduct and any waivers that are required to be disclosed by the rules of either the SEC or the New York Stock Exchange LLC (NYSE) on its internet site. You can request a copy of these documents, excluding exhibits, at no cost, by contacting Investor Relations, 1585 Broadway, New York, NY 10036 (212-761-4000). The information on Morgan Stanley's internet site is not incorporated by reference into this report.

Table of Contents**Part I Financial Information.****Item 1. Financial Statements.****MORGAN STANLEY****Condensed Consolidated Statements of Financial Condition****(dollars in millions, except share data)****(unaudited)**

	March 31, 2012	December 31, 2011
Assets		
Cash and due from banks (\$534 and \$511 at March 31, 2012 and December 31, 2011, respectively, related to consolidated variable interest entities generally not available to the Company)	\$ 10,133	\$ 13,165
Interest bearing deposits with banks	28,592	34,147
Cash deposited with clearing organizations or segregated under federal and other regulations or requirements	30,152	29,454
Financial instruments owned, at fair value (approximately \$144,873 and \$140,749 were pledged to various parties at March 31, 2012 and December 31, 2011, respectively):		
U.S. government and agency securities	59,690	63,449
Other sovereign government obligations	32,235	29,059
Corporate and other debt (\$3,442 and \$3,007 at March 31, 2012 and December 31, 2011, respectively, related to consolidated variable interest entities, generally not available to the Company)	69,518	68,923
Corporate equities	59,063	47,966
Derivative and other contracts	40,016	48,064
Investments (\$1,797 and \$1,666 at March 31, 2012 and December 31, 2011, respectively, related to consolidated variable interest entities, generally not available to the Company)	8,329	8,195
Physical commodities	9,573	9,697
Total financial instruments owned, at fair value	278,424	275,353
Securities available for sale, at fair value	32,528	30,495
Securities received as collateral, at fair value	17,728	11,651
Federal funds sold and securities purchased under agreements to resell (includes \$318 and \$112 at fair value at March 31, 2012 and December 31, 2011, respectively)	136,451	130,155
Securities borrowed	141,610	127,074
Receivables:		
Customers	38,962	33,977
Brokers, dealers and clearing organizations	5,718	5,248
Fees, interest and other	10,263	9,444
Loans (net of allowances of \$26 and \$17 at March 31, 2012 and December 31, 2011, respectively)	16,729	15,369
Other investments	4,688	4,832
Premises, equipment and software costs (net of accumulated depreciation of \$5,079 and \$4,852 at March 31, 2012 and December 31, 2011, respectively) (\$231 and \$234 at March 31, 2012 and December 31, 2011, respectively, related to consolidated variable interest entities, generally not available to the Company)	6,410	6,457
Goodwill	6,700	6,686
Intangible assets (net of accumulated amortization of \$994 and \$910 at March 31, 2012 and December 31, 2011, respectively) (includes \$99 and \$133 at fair value at March 31, 2012 and December 31, 2011, respectively)	4,170	4,285
	11,772	12,106

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Other assets (\$343 and \$446 at March 31, 2012 and December 31, 2011, respectively, related to consolidated variable interest entities, generally not available to the Company)

Total assets	\$ 781,030	\$ 749,898
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See Notes to Condensed Consolidated Financial Statements.

Table of Contents**MORGAN STANLEY****Condensed Consolidated Statements of Financial Condition (Continued)****(dollars in millions, except share data)****(unaudited)**

	March 31, 2012	December 31, 2011
Liabilities and Equity		
Deposits (includes \$1,980 and \$2,101 at fair value at March 31, 2012 and December 31, 2011, respectively)	\$ 66,441	\$ 65,662
Commercial paper and other short-term borrowings (includes \$1,321 and \$1,339 at fair value at March 31, 2012 and December 31, 2011, respectively)	2,017	2,843
Financial instruments sold, not yet purchased, at fair value:		
U.S. government and agency securities	25,589	19,630
Other sovereign government obligations	26,354	17,141
Corporate and other debt	8,547	8,410
Corporate equities	27,725	24,497
Derivative and other contracts	42,765	46,453
Physical commodities		16
Total financial instruments sold, not yet purchased, at fair value	130,980	116,147
Obligation to return securities received as collateral, at fair value	23,366	15,394
Securities sold under agreements to repurchase (includes \$347 and \$348 at fair value at March 31, 2012 and December 31, 2011, respectively)	107,330	104,800
Securities loaned	34,431	30,462
Other secured financings (includes \$13,081 and \$14,594 at fair value at March 31, 2012 and December 31, 2011, respectively) (\$1,918 and \$2,316 at March 31, 2012 and December 31, 2011, respectively, related to consolidated variable interest entities and are non-recourse to the Company)	21,435	20,719
Payables:		
Customers	119,045	117,241
Brokers, dealers and clearing organizations	12,143	4,082
Interest and dividends	2,712	2,292
Other liabilities and accrued expenses (\$117 and \$121 at March 31, 2012 and December 31, 2011, respectively, related to consolidated variable interest entities and are non-recourse to the Company)	13,815	15,944
Long-term borrowings (includes \$43,224 and \$39,663 at fair value at March 31, 2012 and December 31, 2011, respectively)	176,723	184,234
	710,438	679,820
Commitments and contingent liabilities (see Note 11)		
Equity		
Morgan Stanley shareholders' equity:		
Preferred stock	1,508	1,508
Common stock, \$0.01 par value;		
Shares authorized: 3,500,000,000 at March 31, 2012 and December 31, 2011;		
Shares issued: 2,038,893,979 at March 31, 2012 and 1,989,377,171 at December 31, 2011;		
Shares outstanding: 1,978,337,922 at March 31, 2012 and 1,926,986,130 at December 31, 2011	20	20
Paid-in capital	22,930	22,836
Retained earnings	40,118	40,341
Employee stock trust	3,252	3,166
Accumulated other comprehensive loss	(60)	(157)
	(2,192)	(2,499)

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Common stock held in treasury, at cost, \$0.01 par value; 60,556,057 shares at March 31, 2012 and 62,391,041 shares at December 31, 2011		
Common stock issued to employee trust	(3,252)	(3,166)
Total Morgan Stanley shareholders' equity	62,324	62,049
Noncontrolling interests	8,268	8,029
Total equity	70,592	70,078
Total liabilities and equity	\$ 781,030	\$ 749,898

See Notes to Condensed Consolidated Financial Statements.

Table of Contents**MORGAN STANLEY****Condensed Consolidated Statements of Income****(dollars in millions, except share and per share data)****(unaudited)**

	Three Months Ended March 31,	
	2012	2011
Revenues:		
Investment banking	\$ 1,063	\$ 1,214
Principal transactions:		
Trading	2,407	2,977
Investments	85	329
Commissions and fees	1,177	1,439
Asset management, distribution and administration fees	2,152	2,083
Other	110	(474)
Total non-interest revenues	6,994	7,568
Interest income	1,542	1,859
Interest expense	1,601	1,853
Net interest	(59)	6
Net revenues	6,935	7,574
Non-interest expenses:		
Compensation and benefits	4,431	4,285
Occupancy and equipment	392	397
Brokerage, clearing and exchange fees	403	401
Information processing and communications	459	440
Marketing and business development	146	142
Professional services	412	403
Other	489	605
Total non-interest expenses	6,732	6,673
Income from continuing operations before income taxes	203	901
Provision for (benefit from) income taxes	54	(244)
Income from continuing operations	149	1,145
Discontinued operations:		
Gain (loss) from discontinued operations	27	(28)
Provision for (benefit from) income taxes	42	(13)
Net gain (loss) from discontinued operations	(15)	(15)
Net income	\$ 134	\$ 1,130
Net income applicable to noncontrolling interests	228	162
Net income (loss) applicable to Morgan Stanley	\$ (94)	\$ 968

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Earnings (loss) applicable to Morgan Stanley common shareholders	\$	(119)	\$	736
Amounts applicable to Morgan Stanley:				
Income (loss) from continuing operations	\$	(78)	\$	984
Net gain (loss) from discontinued operations		(16)		(16)
Net income (loss) applicable to Morgan Stanley	\$	(94)	\$	968
Earnings (loss) per basic common share:				
Income (loss) from continuing operations	\$	(0.05)	\$	0.52
Net gain (loss) from discontinued operations		(0.01)		(0.01)
Earnings (loss) per basic common share	\$	(0.06)	\$	0.51
Earnings (loss) per diluted common share:				
Income (loss) from continuing operations	\$	(0.05)	\$	0.51
Net gain (loss) from discontinued operations		(0.01)		(0.01)
Earnings (loss) per diluted common share	\$	(0.06)	\$	0.50
Average common shares outstanding:				
Basic		1,876,961,836		1,456,015,979
Diluted		1,876,961,836		1,472,307,592

See Notes to Condensed Consolidated Financial Statements.

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MORGAN STANLEY

Condensed Consolidated Statements of Comprehensive Income

(dollars in millions)

(unaudited)

	Three Months Ended March 31,	
	2012	2011
Net income	\$ 134	\$ 1,130
Other comprehensive income (loss), net of tax:		
Foreign currency translation adjustments(1)	\$ 20	\$ 37
Amortization of cash flow hedges(2)	2	1
Net unrealized gain (loss) on Securities available for sale(3)	(19)	(36)
Pension, postretirement and other related adjustments(4)	2	5
Total other comprehensive income	\$ 5	\$ 7
Comprehensive income	\$ 139	\$ 1,137
Net income applicable to noncontrolling interests	228	162
Other comprehensive income (loss) applicable to noncontrolling interests	(92)	(34)
Comprehensive income applicable to Morgan Stanley	\$ 3	\$ 1,009

(1) Amounts are net of provision for (benefit from) income taxes of \$4 million and \$(68) million for the quarters ended March 31, 2012 and 2011, respectively.

(2) Amounts are net of provision for income taxes of \$1 million and \$2 million for the quarters ended March 31, 2012 and 2011, respectively.

(3) Amounts are net of (benefit from) income taxes of \$(13) million and \$(24) million for the quarters ended March 31, 2012 and 2011, respectively.

(4) Amounts are net of provision for (benefit from) income taxes of \$2 million and \$(4) million for the quarters ended March 31, 2012 and 2011, respectively.

See Notes to Condensed Consolidated Financial Statements.

Table of Contents**MORGAN STANLEY****Condensed Consolidated Statements of Cash Flows****(dollars in millions)****(unaudited)**

	Three Months Ended March 31,	
	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 134	\$ 1,130
Adjustments to reconcile net income to net cash provided by (used for) operating activities:		
Deferred income taxes		
Loss on equity method investees	32	660
Compensation payable in common stock and options	372	340
Depreciation and amortization	375	379
Gain on sale of securities available for sale	(1)	(12)
(Gain) loss on retirement of long-term debt	(14)	23
Impairment charges and other-than-temporary impairment charges	12	3
Changes in assets and liabilities:		
Cash deposited with clearing organizations or segregated under federal and other regulations or requirements	(698)	(2,752)
Financial instruments owned, net of financial instruments sold, not yet purchased	14,176	7,568
Securities borrowed	(14,536)	(4,207)
Securities loaned	3,969	6,990
Receivables, loans and other assets	(6,784)	(7,417)
Payables and other liabilities	11,115	1,350
Federal funds sold and securities purchased under agreements to resell	(6,296)	(14,670)
Securities sold under agreements to repurchase	5,575	9,293
Net cash provided by (used for) operating activities	7,431	(1,322)
CASH FLOWS FROM INVESTING ACTIVITIES		
Net proceeds from (payments for):		
Premises, equipment and software costs	(212)	(409)
Purchases of securities available for sale	(3,487)	(3,357)
Sales, maturities and redemptions of securities available for sale	1,003	6,311
Net cash provided by (used for) investing activities	(2,696)	2,545
CASH FLOWS FROM FINANCING ACTIVITIES		
Net proceeds from (payments for):		
Commercial paper and other short-term borrowings	(826)	46
Distributions related to noncontrolling interests	(7)	(7)
Derivatives financing activities	(169)	89
Other secured financings	(1,674)	2,312
Deposits	779	(317)
Net proceeds from:		
Excess tax benefits associated with stock-based awards	34	29
Issuance of long-term borrowings	5,320	14,285
Payments for:		
Long-term borrowings	(16,043)	(13,046)
Repurchases of common stock for employee tax withholding	(183)	(273)
Cash dividends	(112)	(302)
Net cash provided by (used for) financing activities	(12,881)	2,816

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Effect of exchange rate changes on cash and cash equivalents	93	644
Effect of cash and cash equivalents related to variable interest entities	(534)	310
Net increase in cash and cash equivalents	(8,587)	4,993
Cash and cash equivalents, at beginning of period	47,312	47,615
Cash and cash equivalents, at end of period	\$ 38,725	\$ 52,608
Cash and cash equivalents include:		
Cash and due from banks	\$ 10,133	\$ 8,120
Interest bearing deposits with banks	28,592	44,488
Cash and cash equivalents, at end of period	\$ 38,725	\$ 52,608

SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION

Cash payments for interest were \$1,169 million and \$1,697 million for the quarters ended March 31, 2012 and 2011, respectively.

Cash payments for income taxes were \$145 million and \$250 million for the quarters ended March 31, 2012 and 2011, respectively.

See Notes to Condensed Consolidated Financial Statements.

Table of Contents**MORGAN STANLEY****Condensed Consolidated Statements of Changes in Total Equity****Three Months Ended March 31, 2012****(dollars in millions)****(unaudited)**

	Preferred Stock	Common Stock	Paid-in Capital	Retained Earnings	Employee Stock Trust	Accumulated Other Comprehensive Income (Loss)	Common Stock Held in Treasury at Cost	Common Stock Issued to Employee Trust	Non- controlling Interests	Total Equity
BALANCE AT DECEMBER 31, 2011	\$ 1,508	\$ 20	\$ 22,836	\$ 40,341	\$ 3,166	\$ (157)	\$ (2,499)	\$ (3,166)	\$ 8,029	\$ 70,078
Net income				(94)					228	134
Dividends				(129)						(129)
Shares issued under employee plans and related tax effects			94		86		490	(86)		584
Repurchases of common stock							(183)			(183)
Net change in cash flow hedges						2				2
Pension, postretirement and other related adjustments						2				2
Foreign currency translation adjustments						112			(92)	20
Change in net unrealized gains on securities available for sale						(19)				(19)
Other increases in noncontrolling interests									103	103
BALANCE AT MARCH 31, 2012	\$ 1,508	\$ 20	\$ 22,930	\$ 40,118	\$ 3,252	\$ (60)	\$ (2,192)	\$ (3,252)	\$ 8,268	\$ 70,592

See Notes to Condensed Consolidated Financial Statements.

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MORGAN STANLEY

Condensed Consolidated Statements of Changes in Total Equity (Continued)

Three Months Ended March 31, 2011

(dollars in millions)

(unaudited)

	Preferred Stock	Common Stock	Paid-in Capital	Retained Earnings	Employee Stock Trust	Accumulated Other Comprehensive Income (Loss)	Common Stock Held in Treasury at Cost	Common Stock Issued to Employee Trust	Non- controlling Interests	Total Equity
BALANCE AT DECEMBER 31, 2010	\$ 9,597	\$ 16	\$ 13,521	\$ 38,603	\$ 3,465	\$ (467)	\$ (4,059)	\$ (3,465)	\$ 8,196	\$ 65,407
Net income				968					162	1,130
Dividends				(302)						(302)
Shares issued under employee plans and related tax effects			(1,336)		3		1,877	(3)		541
Repurchases of common stock							(273)			(273)
Net change in cash flow hedges						1				1
Pension, postretirement and other related adjustments						5				5
Foreign currency translation adjustments						71			(34)	37
Change in net unrealized losses on securities available for sale						(36)				(36)
Other decreases in noncontrolling interests									(2)	(2)
BALANCE AT MARCH 31, 2011	\$ 9,597	\$ 16	\$ 12,185	\$ 39,269	\$ 3,468	\$ (426)	\$ (2,455)	\$ (3,468)	\$ 8,322	\$ 66,508

See Notes to Condensed Consolidated Financial Statements.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Introduction and Basis of Presentation.

The Company. Morgan Stanley, a financial holding company, is a global financial services firm that maintains significant market positions in each of its business segments Institutional Securities, Global Wealth Management Group and Asset Management. Unless the context otherwise requires, the terms Morgan Stanley and the Company mean Morgan Stanley and its consolidated subsidiaries.

A summary of the activities of each of the Company's business segments is as follows:

Institutional Securities provides capital raising; financial advisory services, including advice on mergers and acquisitions, restructurings, real estate and project finance; corporate lending; sales, trading, financing and market-making activities in equity and fixed income securities and related products, including foreign exchange and commodities; and investment activities.

Global Wealth Management Group, which includes the Company's 51% interest in Morgan Stanley Smith Barney Holdings LLC (MSSB), provides brokerage and investment advisory services to individual investors and small-to-medium sized businesses and institutions covering various investment alternatives; financial and wealth planning services; annuity and other insurance products; credit and other lending products; cash management services; retirement services; and trust and fiduciary services and engages in fixed income principal trading, which primarily facilitates clients' trading or investments in such securities.

Asset Management provides a broad array of investment strategies that span the risk/return spectrum across geographies, asset classes and public and private markets to a diverse group of clients across the institutional and intermediary channels as well as high net worth clients (see Discontinued Operations Retail Asset Management Business herein).

Discontinued Operations.

Saxon. On October 24, 2011, the Company announced that it had reached an agreement to sell Saxon, a provider of servicing and subservicing of residential mortgage loans, to Ocwen Financial Corporation. During the first quarter of 2012, the transaction was restructured as a sale of Saxon's assets, the first phase of which was completed in the second quarter of 2012. The remaining operations of Saxon are expected to be wound down within the year. The Company expects to incur incremental wind-down costs in future periods. The results of Saxon are reported as discontinued operations within the Institutional Securities business segment for all periods presented.

Quilter. On April 2, 2012, the Company closed the sale of Quilter Holdings Ltd. (Quilter), its retail wealth management business in the United Kingdom (U.K.). The Company has classified Quilter as held for sale within the Global Wealth Management Group business segment and the results of its operations are presented as discontinued operations for all periods presented.

Prior period amounts have been recast for discontinued operations. See Note 20 for additional information on discontinued operations.

Basis of Financial Information. The condensed consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America (U.S.), which require the Company to make estimates and assumptions regarding the valuations of certain financial instruments, the valuation of goodwill and intangible assets, compensation, deferred tax assets, the outcome of litigation and tax matters, and other matters that affect the condensed consolidated financial statements and related disclosures. The Company believes that the estimates utilized in the preparation of the condensed consolidated financial statements are prudent and reasonable. Actual results could differ materially from these estimates.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Intercompany balances and transactions have been eliminated.

The condensed consolidated financial statements should be read in conjunction with the Company's consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2011 (the "Form 10-K"). The condensed consolidated financial statements reflect all adjustments that are, in the opinion of management, necessary for the fair presentation of the results for the interim period. The results of operations for interim periods are not necessarily indicative of results for the entire year.

Consolidation. The condensed consolidated financial statements include the accounts of the Company, its wholly owned subsidiaries and other entities in which the Company has a controlling financial interest, including certain variable interest entities ("VIE") (see Note 6). For condensed consolidated subsidiaries that are less than wholly owned, the third-party holdings of equity interests are referred to as noncontrolling interests. The portion of net income attributable to noncontrolling interests for such subsidiaries is presented as Net income (loss) applicable to noncontrolling interests in the condensed consolidated statements of income, and the portion of the shareholders' equity of such subsidiaries is presented as Noncontrolling interests in the condensed consolidated statements of financial condition and condensed consolidated statements of changes in total equity.

For entities where (1) the total equity investment at risk is sufficient to enable the entity to finance its activities without additional support and (2) the equity holders bear the economic residual risks and returns of the entity and have the power to direct the activities of the entity that most significantly affect its economic performance, the Company consolidates those entities it controls either through a majority voting interest or otherwise. For VIEs (i.e., entities that do not meet these criteria), the Company consolidates those entities where the Company has the power to make the decisions that most significantly affect the economic performance of the VIE and has the obligation to absorb losses or the right to receive benefits that could potentially be significant to the VIE, except for certain VIEs that are money market funds, investment companies or are entities qualifying for accounting purposes as investment companies. Generally, the Company consolidates those entities when it absorbs a majority of the expected losses or a majority of the expected residual returns, or both, of the entities.

For investments in entities in which the Company does not have a controlling financial interest but has significant influence over operating and financial decisions, the Company generally applies the equity method of accounting with net gains and losses recorded within Other revenues. Where the Company has elected to measure certain eligible investments at fair value in accordance with the fair value option, net gains and losses are recorded within Principal transactions - Investments (see Note 3).

Equity and partnership interests held by entities qualifying for accounting purposes as investment companies are carried at fair value.

The Company's significant regulated U.S. and international subsidiaries include Morgan Stanley & Co. LLC ("MS&Co."), Morgan Stanley Smith Barney LLC, Morgan Stanley & Co. International plc ("MSIP"), Morgan Stanley MUFG Securities, Co., Ltd. ("MSMS"), Morgan Stanley Bank, N.A. and Morgan Stanley Private Bank, National Association.

Income Statement Presentation. The Company, through its subsidiaries and affiliates, provides a wide variety of products and services to a large and diversified group of clients and customers, including corporations, governments, financial institutions and individuals. In connection with the delivery of the various products and services to clients, the Company manages its revenues and related expenses in the aggregate. As such, when assessing the performance of its businesses, primarily in its Institutional Securities business segment, the Company considers its principal trading, investment banking, commissions and fees and interest income, along with the associated interest expense, as one integrated activity.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

2. Significant Accounting Policies.

For a detailed discussion about the Company's significant accounting policies, see Note 2 to the consolidated financial statements for the year ended December 31, 2011 included in the Form 10-K.

During the quarter ended March 31, 2012, other than the following, no other updates were made to the Company's significant accounting policies.

Financial Instruments and Fair Value Valuation Process.

The Valuation Review Group (VRG) within the Financial Control Group (FCG) is responsible for the Company's fair value valuation policies, processes and procedures. VRG is independent of the business units and reports to the Chief Financial Officer (CFO), who has final authority over the valuation of the Company's financial instruments. VRG implements valuation control processes to validate the fair value of the Company's financial instruments measured at fair value including those derived from pricing models. These control processes are designed to assure that the values used for financial reporting are based on observable inputs wherever possible. In the event that observable inputs are not available, the control processes are designed to assure that the valuation approach utilized is appropriate and consistently applied and the assumptions are reasonable.

The Company's control processes include:

Model Review. VRG, in conjunction with the Market Risk Department (MRD) and, where appropriate, the Credit Risk Management Department, both of which report to the Chief Risk Officer, independently review the valuation model's theoretical soundness, the appropriateness of the valuation methodology and calibration techniques developed by the business units using observable inputs. Where inputs are not observable, VRG reviews the appropriateness of the proposed valuation methodology to ensure it is consistent with how a market participant would arrive at the unobservable input. The valuation methodologies utilized in the absence of observable inputs may include extrapolation techniques and the use of comparable observable inputs. As part of the review, VRG develops a methodology to independently verify the fair value generated by the business unit's valuation model. Before trades are executed using new valuation models, those models are required to be independently reviewed. All of the Company's valuation models are subject to an independent annual review.

Independent Price Verification. The business units are responsible for determining the fair value of financial instruments using approved valuation models and valuation methodologies. Generally on a monthly basis, VRG independently validates the fair values of financial instruments determined using valuation models by determining the appropriateness of the inputs used by the business units and testing compliance with the documented valuation methodologies approved in the model review process described above.

VRG uses recently executed transactions, other observable market data such as exchange data, broker/dealer quotes, third-party pricing vendors and aggregation services for validating the fair values of financial instruments generated using valuation models. VRG assesses the external sources and their valuation methodologies to determine if the external providers meet the minimum standards expected of a third-party pricing source. Pricing data provided by approved external sources is evaluated using a number of approaches; for example, by corroborating the external sources' prices to executed trades, analyzing the methodology and assumptions used by the external source to generate a price and/or by evaluating how active the third-party pricing source (or originating sources used by the third-party pricing source) is in the market. Based on this analysis, VRG generates a ranking of the observable market data to ensure that the highest-ranked market data source is used to validate the business unit's fair value of financial instruments.

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For financial instruments categorized within Level 3 of the fair value hierarchy, VRG reviews the business unit's valuation techniques to ensure these are consistent with market participant assumptions.

The results of this independent price verification and any adjustments made by VRG to the fair value generated by the business units are presented to management of the three business segments (*i.e.*, Institutional Securities, Global Wealth Management Group and Asset Management), the CFO and the Chief Risk Officer on a regular basis.

Review of New Level 3 Transactions. VRG reviews the model and valuation methodology used to price all new material Level 3 transactions and both FCG and MRD management must approve the fair value of the trade that is initially recognized.

Securities Available for Sale Other-than-temporary Impairment.

For available for sale (AFS) debt securities, a credit loss exists if the present value of cash flows expected to be collected is less than the amortized cost basis of the security. When determining if a credit loss exists, the Company considers all relevant information including the length of time and the extent to which the fair value has been less than the amortized cost basis; adverse conditions specifically related to the security, an industry, or geographic area; changes in the financial condition of the issuer of the security, or in the case of an asset-backed debt security, changes in the financial condition of the underlying loan obligors; the historical and implied volatility of the fair value of the security; the payment structure of the debt security and the likelihood of the issuer being able to make payments that increase in the future; failure of the issuer of the security to make scheduled interest or principal payments; any changes to the rating of the security by a rating agency and recoveries or additional declines in fair value after the balance sheet date. When estimating the present value of expected cash flows, information shall include the remaining payment terms of the security, prepayment speeds, financial condition of the issuer(s), expected defaults and the value of any underlying collateral.

For AFS equity securities, the Company considers various factors including the intent and ability to hold the equity security for a period of time sufficient to allow for any anticipated recovery in market value in evaluating whether an other-than-temporary impairment (OTTI) exists. If the equity security is considered other-than-temporarily impaired, the security will be written down to fair value, with the full difference between fair value and cost recognized in earnings.

Accounting Developments.

Reconsideration of Effective Control for Repurchase Agreements.

In April 2011, the Financial Accounting Standards Board (the FASB) issued accounting guidance that modifies the criteria that must be satisfied for a transfer of financial assets to be accounted for as a sale. If the transferor maintains effective control over the transferred assets, the transaction is to be accounted for as a financing. This guidance eliminates from the assessment of effective control (1) the criterion requiring the transferor to have the ability to repurchase or redeem the financial assets on substantially the agreed terms, even in the event of default by the transferee, and (2) the collateral maintenance implementation guidance related to that criterion. This guidance is effective for transfers occurring on and after January 1, 2012. The adoption of this accounting guidance did not have a material impact on the Company's condensed consolidated financial statements.

Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS.

In May 2011, the FASB issued an accounting update that clarifies existing fair value measurement guidance and changes certain principles or requirements for measuring fair value or disclosing information about fair value

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

measurements. This update results in common principles and requirements for measuring fair value and for disclosing information about fair value measurement in accordance with U.S. GAAP and International Financial Reporting Standards (IFRS). The guidance became effective for the Company beginning on January 1, 2012. See Note 3 for additional disclosures as required by this accounting guidance.

Goodwill Impairment Test.

In September 2011, the FASB issued accounting guidance that simplifies how entities test goodwill for impairment. This guidance allows entities an option to first assess qualitative factors to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. Under that option, an entity no longer would be required to calculate the fair value of a reporting unit unless the entity determines, based on that qualitative assessment, that it is more likely than not that its fair value is less than its carrying amount. This guidance became effective for the Company beginning on January 1, 2012. The adoption of this accounting guidance did not have a material impact on the Company's condensed consolidated financial statements.

3. Fair Value Disclosures.

Fair Value Measurements.

A description of the valuation techniques applied to the Company's major categories of assets and liabilities measured at fair value on a recurring basis follows.

Financial Instruments Owned and Financial Instruments Sold, Not Yet Purchased.

U.S. Government and Agency Securities.

U.S. Treasury Securities. U.S. Treasury securities are valued using quoted market prices. Valuation adjustments are not applied. Accordingly, U.S. Treasury securities are generally categorized in Level 1 of the fair value hierarchy.

U.S. Agency Securities. U.S. agency securities are composed of three main categories consisting of agency-issued debt, agency mortgage pass-through pool securities and collateralized mortgage obligations. Non-callable agency-issued debt securities are generally valued using quoted market prices. Callable agency-issued debt securities are valued by benchmarking model-derived prices to quoted market prices and trade data for identical or comparable securities. The fair value of agency mortgage pass-through pool securities is model-driven based on spreads of the comparable To-be-announced (TBA) security. Collateralized mortgage obligations are valued using quoted market prices and trade data adjusted by subsequent changes in related indices for identical or comparable securities. Actively traded non-callable agency-issued debt securities are generally categorized in Level 1 of the fair value hierarchy. Callable agency-issued debt securities, agency mortgage pass-through pool securities and collateralized mortgage obligations are generally categorized in Level 2 of the fair value hierarchy.

Other Sovereign Government Obligations.

Foreign sovereign government obligations are valued using quoted prices in active markets when available. To the extent quoted prices are not available, fair value is determined based on a valuation model that has as inputs interest rate yield curves, cross-currency basis index spreads, and country credit spreads for structures similar to the bond in terms of issuer, maturity and seniority. These bonds are generally categorized in Level 1 or Level 2 of the fair value hierarchy.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Corporate and Other Debt.

State and Municipal Securities. The fair value of state and municipal securities is determined using recently executed transactions, market price quotations and pricing models that factor in, where applicable, interest rates, bond or credit default swap spreads and volatility. These bonds are generally categorized in Level 2 of the fair value hierarchy.

Residential Mortgage-Backed Securities (RMBS), Commercial Mortgage-Backed Securities (CMBS) and other Asset-Backed Securities (ABS). RMBS, CMBS and other ABS may be valued based on price or spread data obtained from observed transactions or independent external parties such as vendors or brokers. When position-specific external price data are not observable, the fair value determination may require benchmarking to similar instruments and/or analyzing expected credit losses, default and recovery rates. In evaluating the fair value of each security, the Company considers security collateral-specific attributes, including payment priority, credit enhancement levels, type of collateral, delinquency rates and loss severity. In addition, for RMBS borrowers, Fair Isaac Corporation (FICO) scores and the level of documentation for the loan are also considered. Market standard models, such as Intex, Trepp or others, may be deployed to model the specific collateral composition and cash flow structure of each transaction. Key inputs to these models are market spreads, forecasted credit losses, default and prepayment rates for each asset category. Valuation levels of RMBS and CMBS indices are also used as an additional data point for benchmarking purposes or to price outright index positions.

RMBS, CMBS and other ABS are generally categorized in Level 2 of the fair value hierarchy. If external prices or significant spread inputs are unobservable or if the comparability assessment involves significant subjectivity related to property type differences, cash flows, performance and other inputs, then RMBS, CMBS and other ABS are categorized in Level 3 of the fair value hierarchy.

Corporate Bonds. The fair value of corporate bonds is determined using recently executed transactions, market price quotations (where observable), bond spreads or credit default swap spreads obtained from independent external parties such as vendors and brokers adjusted for any basis difference between cash and derivative instruments. The spread data used are for the same maturity as the bond. If the spread data do not reference the issuer, then data that reference a comparable issuer are used. When position-specific external price data are not observable, fair value is determined based on either benchmarking to similar instruments or cash flow models with yield curves, bond or single name credit default swap spreads and recovery rates as significant inputs. Corporate bonds are generally categorized in Level 2 of the fair value hierarchy; in instances where prices, spreads or any of the other aforementioned key inputs are unobservable, they are categorized in Level 3 of the fair value hierarchy.

Collateralized Debt Obligations (CDO). The Company holds cash CDOs that typically reference a tranche of an underlying synthetic portfolio of single name credit default swaps collateralized by corporate bonds (credit-linked notes) or cash portfolio of asset-backed securities (asset-backed CDOs). Credit correlation, a primary input used to determine the fair value of credit-linked notes, is usually unobservable and derived using a benchmarking technique. The other credit-linked note model inputs such as credit spreads, including collateral spreads, and interest rates are typically observable. Asset-backed CDOs are valued based on an evaluation of the market and model input parameters sourced from similar positions as indicated by primary and secondary market activity. Each asset-backed CDO position is evaluated independently taking into consideration available comparable market levels, underlying collateral performance and pricing, deal structures, as well as liquidity. Cash CDOs are categorized in Level 2 of the fair value hierarchy when either the credit correlation input is insignificant or comparable market transactions are observable. In instances where the credit correlation input is deemed to be significant or comparable market transactions are unobservable, cash CDOs are categorized in Level 3 of the fair value hierarchy.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Corporate Loans and Lending Commitments. The fair value of corporate loans is determined using recently executed transactions, market price quotations (where observable), implied yields from comparable debt, and market observable credit default swap spread levels obtained from independent external parties such as vendors and brokers adjusted for any basis difference between cash and derivative instruments, along with proprietary valuation models and default recovery analysis where such transactions and quotations are unobservable. The fair value of contingent corporate lending commitments is determined by using executed transactions on comparable loans and the anticipated market price based on pricing indications from syndicate banks and customers. The valuation of loans and lending commitments also takes into account fee income that is considered an attribute of the contract. Corporate loans and lending commitments are categorized in Level 2 of the fair value hierarchy except in instances where prices or significant spread inputs are unobservable, in which case they are categorized in Level 3 of the fair value hierarchy. Corporate loans and lending commitments are presented within Loans and lending commitments in the fair value hierarchy table.

Mortgage Loans. Mortgage loans are valued using observable prices based on transactional data or third party pricing for identical or comparable instruments, when available. Where position-specific external prices are not observable, the Company estimates fair value based on benchmarking to prices and rates observed in the primary market for similar loan or borrower types or based on the present value of expected future cash flows using its best estimates of the key assumptions, including forecasted credit losses, prepayment rates, forward yield curves and discount rates commensurate with the risks involved or a methodology that utilizes the capital structure and credit spreads of recent comparable securitization transactions. Mortgage loans valued based on observable market data for identical or comparable instruments are categorized in Level 2 of the fair value hierarchy. Where observable prices are not available, due to the subjectivity involved in the comparability assessment related to mortgage loan vintage, geographical concentration, prepayment speed and projected loss assumptions, mortgage loans are categorized in Level 3 of the fair value hierarchy. Mortgage loans are presented within Loans and lending commitments in the fair value hierarchy table.

Auction Rate Securities (ARS). The Company primarily holds investments in Student Loan Auction Rate Securities (SLARS) and Municipal Auction Rate Securities (MARS) with interest rates that are reset through periodic auctions. SLARS are ABS backed by pools of student loans. MARS are municipal bonds often wrapped by municipal bond insurance. ARS were historically traded and valued as floating rate notes, priced at par due to the auction mechanism. Beginning in fiscal 2008, uncertainties in the credit markets have resulted in auctions failing for certain types of ARS. Once the auctions failed, ARS could no longer be valued using observations of auction market prices. Accordingly, the fair value of ARS is determined using independent external market data where available and an internally developed methodology to discount for the lack of liquidity and non-performance risk.

Inputs that impact the valuation of SLARS are independent external market data, the underlying collateral types, level of seniority in the capital structure, amount of leverage in each structure, credit rating and liquidity considerations. Inputs that impact the valuation of MARS are independent external market data when available, the maximum rate, quality of underlying issuers/insurers and evidence of issuer calls. ARS are generally categorized in Level 2 of the fair value hierarchy as the valuation technique relies on observable external data. SLARS and MARS are presented within Asset-backed securities and State and municipal securities, respectively, in the fair value hierarchy table.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Corporate Equities.

Exchange-Traded Equity Securities. Exchange-traded equity securities are generally valued based on quoted prices from the exchange. To the extent these securities are actively traded, valuation adjustments are not applied, and they are categorized in Level 1 of the fair value hierarchy; otherwise, they are categorized in Level 2 or Level 3 of the fair value hierarchy.

Unlisted Equity Securities. Unlisted equity securities are valued based on an assessment of each underlying security, considering rounds of financing and third-party transactions, discounted cash flow analyses and market-based information, including comparable company transactions, trading multiples and changes in market outlook, among other factors. These securities are generally categorized in Level 3 of the fair value hierarchy.

Fund Units. Listed fund units are generally marked to the exchange-traded price or net asset value (NAV) and are categorized in Level 1 of the fair value hierarchy if actively traded on an exchange or in Level 2 of the fair value hierarchy if trading is not active. Unlisted fund units are generally marked to NAV and categorized as Level 2; however, positions which are not redeemable at the measurement date or in the near future are categorized in Level 3 of the fair value hierarchy.

Derivative and Other Contracts.

Listed Derivative Contracts. Listed derivatives that are actively traded are valued based on quoted prices from the exchange and are categorized in Level 1 of the fair value hierarchy. Listed derivatives that are not actively traded are valued using the same approaches as those applied to over-the-counter (OTC) derivatives; they are generally categorized in Level 2 of the fair value hierarchy.

OTC Derivative Contracts. OTC derivative contracts include forward, swap and option contracts related to interest rates, foreign currencies, credit standing of reference entities, equity prices or commodity prices.

Depending on the product and the terms of the transaction, the fair value of OTC derivative products can be either observed or modeled using a series of techniques and model inputs from comparable benchmarks, including closed-form analytic formulas, such as the Black-Scholes option-pricing model, and simulation models or a combination thereof. Many pricing models do not entail material subjectivity because the methodologies employed do not necessitate significant judgment, and the pricing inputs are observed from actively quoted markets, as is the case for generic interest rate swaps, certain option contracts and certain credit default swaps. In the case of more established derivative products, the pricing models used by the Company are widely accepted by the financial services industry. A substantial majority of OTC derivative products valued by the Company using pricing models fall into this category and are categorized in Level 2 of the fair value hierarchy.

Other derivative products, including complex products that have become illiquid, require more judgment in the implementation of the valuation technique applied due to the complexity of the valuation assumptions and the reduced observability of inputs. This includes certain types of interest rate derivatives with both volatility and correlation exposure and credit derivatives including credit default swaps on certain mortgage-backed or asset-backed securities, basket credit default swaps and CDO-squared positions (a CDO-squared position is a special purpose vehicle that issues interests, or tranches, that are backed by tranches issued by other CDOs) where direct trading activity or quotes are unobservable. These instruments involve significant unobservable inputs and are categorized in Level 3 of the fair value hierarchy.

Derivative interests in credit default swaps on certain mortgage-backed or asset-backed securities, for which observability of external price data is limited, are valued based on an evaluation of the market and

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model input parameters sourced from similar positions as indicated by primary and secondary market activity. Each position is evaluated independently taking into consideration available comparable market levels as well as cash-synthetic basis, or the underlying collateral performance and pricing, behavior of the tranche under various cumulative loss and prepayment scenarios, deal structures (*e.g.*, non-amortizing reference obligations, call features, etc.) and liquidity. While these factors may be supported by historical and actual external observations, the determination of their value as it relates to specific positions nevertheless requires significant judgment.

For basket credit default swaps and CDO-squared positions, the correlation input between reference credits is unobservable for each specific swap or position and is benchmarked to standardized proxy baskets for which correlation data are available. The other model inputs such as credit spread, interest rates and recovery rates are observable. In instances where the correlation input is deemed to be significant, these instruments are categorized in Level 3 of the fair value hierarchy; otherwise, these instruments are categorized in Level 2 of the fair value hierarchy.

The Company trades various derivative structures with commodity underlyings. Depending on the type of structure, the model inputs generally include interest rate yield curves, commodity underlier price curves, implied volatility of the underlying commodities and, in some cases, the implied correlation between these inputs. The fair value of these products is determined using executed trades and broker and consensus data to provide values for the aforementioned inputs. Where these inputs are unobservable, relationships to observable commodities and data points, based on historic and/or implied observations, are employed as a technique to estimate the model input values. Commodity derivatives are generally categorized in Level 2 of the fair value hierarchy; in instances where significant inputs are unobservable, they are categorized in Level 3 of the fair value hierarchy.

For further information on derivative instruments and hedging activities, see Note 10.

Investments.

The Company's investments include direct investments in equity securities as well as investments in private equity funds, real estate funds and hedge funds, which include investments made in connection with certain employee deferred compensation plans. Direct investments are presented in the fair value hierarchy table as Principal investments and Other. Initially, the transaction price is generally considered by the Company as the exit price and is the Company's best estimate of fair value.

After initial recognition, in determining the fair value of non-exchange-traded internally and externally managed funds, the Company generally considers the NAV of the fund provided by the fund manager to be the best estimate of fair value. For non-exchange-traded investments either held directly or held within internally managed funds, fair value after initial recognition is based on an assessment of each underlying investment, considering rounds of financing and third-party transactions, discounted cash flow analyses and market-based information, including comparable company transactions, trading multiples and changes in market outlook, among other factors. Exchange-traded direct equity investments are generally valued based on quoted prices from the exchange.

Exchange-traded direct equity investments that are actively traded are categorized in Level 1 of the fair value hierarchy. Non-exchange-traded direct equity investments and investments in private equity and real estate funds are generally categorized in Level 3 of the fair value hierarchy. Investments in hedge funds that are redeemable at the measurement date or in the near future are categorized in Level 2 of the fair value hierarchy; otherwise, they are categorized in Level 3 of the fair value hierarchy.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Physical Commodities.

The Company trades various physical commodities, including crude oil and refined products, natural gas, base and precious metals and agricultural products. Fair value for physical commodities is determined using observable inputs, including broker quotations and published indices. Physical commodities are categorized in Level 2 of the fair value hierarchy; in instances where significant inputs are unobservable, they are categorized in Level 3 of the fair value hierarchy.

Securities Available for Sale.

Securities available for sale are composed of U.S. government and agency securities (*e.g.*, U.S. Treasury securities, agency-issued debt, agency mortgage pass-through securities and collateralized mortgage obligations), Federal Family Education Loan Program (FFELP) student loan asset-backed securities, auto loan asset-backed securities, corporate bonds and equity securities. Actively traded U.S. Treasury securities, non-callable agency-issued debt securities and equity securities are generally categorized in Level 1 of the fair value hierarchy. Callable agency-issued debt securities, agency mortgage pass-through securities, collateralized mortgage obligations and FFELP student loan asset-backed securities, auto loan asset-backed securities and corporate bonds are generally categorized in Level 2 of the fair value hierarchy. For further information on securities available for sale, see Note 4.

Deposits.

Time Deposits. The fair value of certificates of deposit is determined using third-party quotations. These deposits are generally categorized in Level 2 of the fair value hierarchy.

Commercial Paper and Other Short-term Borrowings/Long-term Borrowings.

Structured Notes. The Company issues structured notes that have coupon or repayment terms linked to the performance of fixed income or equity securities, indices, currencies or commodities. Fair value of structured notes is determined using valuation models for the derivative and debt portions of the notes. These models incorporate observable inputs referencing identical or comparable securities, including prices that the notes are linked to, interest rate yield curves, option volatility and currency, commodity or equity prices. Independent, external and traded prices for the notes are also considered. The impact of the Company's own credit spreads is also included based on the Company's observed secondary bond market spreads. Most structured notes are categorized in Level 2 of the fair value hierarchy.

Securities Purchased under Agreements to Resell, and Securities Sold under Agreements to Repurchase.

The fair value of a reverse repurchase agreement or repurchase agreement is computed using a standard cash flow discounting methodology. The inputs to the valuation include contractual cash flows and collateral funding spreads, which are estimated using various benchmarks, interest rate yield curves and option volatilities. In instances where the unobservable inputs are deemed significant, reverse repurchase agreements and repurchase agreements are categorized in Level 3 of the fair value hierarchy; otherwise, they are categorized in Level 2 of the fair value hierarchy.

The following fair value hierarchy tables present information about the Company's assets and liabilities measured at fair value on a recurring basis at March 31, 2012 and December 31, 2011.

Table of Contents**MORGAN STANLEY****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Assets and Liabilities Measured at Fair Value on a Recurring Basis at March 31, 2012.**

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3) (dollars in millions)	Counterparty and Cash Collateral Netting	Balance at March 31, 2012
Assets at Fair Value					
Financial instruments owned:					
U.S. government and agency securities:					
U.S. Treasury securities	\$ 35,781	\$	\$	\$	\$ 35,781
U.S. agency securities	1,804	22,082	23		23,909
Total U.S. government and agency securities	37,585	22,082	23		59,690
Other sovereign government obligations	29,069	3,158	8		32,235
Corporate and other debt:					
State and municipal securities		2,676	3		2,679
Residential mortgage-backed securities		1,548	43		1,591
Commercial mortgage-backed securities		1,829	127		1,956
Asset-backed securities		1,076	3		1,079
Corporate bonds		25,115	899		26,014
Collateralized debt obligations		957	1,165		2,122
Loans and lending commitments		14,940	8,597		23,537
Other debt		10,483	57		10,540
Total corporate and other debt		58,624	10,894		69,518
Corporate equities(1)	56,582	1,927	554		59,063
Derivative and other contracts:					
Interest rate contracts	914	786,488	4,117		791,519
Credit contracts		90,206	9,790		99,996
Foreign exchange contracts	1	47,378	720		48,099
Equity contracts	991	44,359	1,188		46,538
Commodity contracts	7,325	30,287	2,504		40,116
Other		61			61
Netting(2)	(8,687)	(895,017)	(7,896)	(74,713)	(986,313)
Total derivative and other contracts	544	103,762	10,423	(74,713)	40,016
Investments:					
Private equity funds			1,994		1,994
Real estate funds		6	1,338		1,344
Hedge funds		318	623		941
Principal investments	98		3,194		3,292
Other	157	74	527		758
Total investments	255	398	7,676		8,329
Physical commodities		9,573			9,573
Total financial instruments owned	124,035	199,524	29,578	(74,713)	278,424

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Securities available for sale	13,822	18,706			32,528
Securities received as collateral	17,542	186			17,728
Federal funds sold and securities purchased under agreements to resell		318			318
Intangible assets(3)			99		99
Total assets measured at fair value	\$ 155,399	\$ 218,734	\$ 29,677	\$ (74,713)	\$ 329,097

Liabilities at Fair Value

Deposits	\$	\$ 1,980	\$	\$	\$ 1,980
Commercial paper and other short-term borrowings		1,306	15		1,321
Financial instruments sold, not yet purchased:					
U.S. government and agency securities:					
U.S. Treasury securities	23,544				23,544
U.S. agency securities	1,727	318			2,045
Total U.S. government and agency securities	25,271	318			25,589
Other sovereign government obligations	24,979	1,374	1		26,354
Corporate and other debt:					
State and municipal securities		4			4

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	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3) (dollars in millions)	Counterparty and Cash Collateral Netting	Balance at March 31, 2012
Residential mortgage-backed securities		2	61		63
Commercial mortgage-backed securities		9			9
Corporate bonds		6,888	193		7,081
Collateralized debt obligations		17			17
Unfunded lending commitments		931	60		991
Other debt		349	33		382
Total corporate and other debt		8,200	347		8,547
Corporate equities(1)	26,271	1,452	2		27,725
Derivative and other contracts:					
Interest rate contracts	1,053	757,445	4,095		762,593
Credit contracts		88,357	5,409		93,766
Foreign exchange contracts	2	50,275	654		50,931
Equity contracts	1,226	47,293	2,630		51,149
Commodity contracts	8,177	30,628	1,701		40,506
Other		49	23		72
Netting(2)	(8,687)	(895,017)	(7,896)	(44,652)	(956,252)
Total derivative and other contracts	1,771	79,030	6,616	(44,652)	42,765
Total financial instruments sold, not yet purchased	78,292	90,374	6,966	(44,652)	130,980
Obligation to return securities received as collateral	23,167	199			23,366
Securities sold under agreements to repurchase		161	186		347
Other secured financings		12,487	594		13,081
Long-term borrowings	2	41,079	2,143		43,224
Total liabilities measured at fair value	\$ 101,461	\$ 147,586	\$ 9,904	\$ (44,652)	\$ 214,299

(1) The Company holds or sells short for trading purposes equity securities issued by entities in diverse industries and of varying size.

(2) For positions with the same counterparty that cross over the levels of the fair value hierarchy, both counterparty netting and cash collateral netting are included in the column titled Counterparty and Cash Collateral Netting. For contracts with the same counterparty, counterparty netting among positions classified within the same level is included within that level. For further information on derivative instruments and hedging activities, see Note 10.

(3) Amount represents mortgage servicing rights (MSR) accounted for at fair value. See Note 6 for further information on MSRs.

Transfers Between Level 1 and Level 2 During the Quarter Ended March 31, 2012.

For assets and liabilities that were transferred between Level 1 and Level 2 during the period, fair values are ascribed as if the assets or liabilities had been transferred as of the beginning of the period.

Financial instruments owned Derivative and other contracts and *Financial instruments sold, not yet purchased* Derivative and other contracts. During the quarter ended March 31, 2012, the Company reclassified approximately \$1.1 billion of derivative assets and approximately \$1.2 billion of derivative liabilities from Level 2 to Level 1 as these listed derivatives became actively traded and were valued based on quoted prices from the exchange. Also during the quarter ended March 31, 2012, the Company reclassified approximately \$0.3 billion

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of derivative assets and approximately \$0.4 billion of derivative liabilities from Level 1 to Level 2 as transactions in these contracts did not occur with sufficient frequency and volume to constitute an active market.

Table of Contents**MORGAN STANLEY****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Assets and Liabilities Measured at Fair Value on a Recurring Basis at December 31, 2011.**

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3) (dollars in millions)	Counterparty and Cash Collateral Netting	Balance at December 31, 2011
Assets at Fair Value					
Financial instruments owned:					
U.S. government and agency securities:					
U.S. Treasury securities	\$ 38,769	\$ 1	\$	\$	\$ 38,770
U.S. agency securities	4,332	20,339	8		24,679
Total U.S. government and agency securities	43,101	20,340	8		63,449
Other sovereign government obligations	22,650	6,290	119		29,059
Corporate and other debt:					
State and municipal securities		2,261			2,261
Residential mortgage-backed securities		1,304	494		1,798
Commercial mortgage-backed securities		1,686	134		1,820
Asset-backed securities		937	31		968
Corporate bonds		25,873	675		26,548
Collateralized debt obligations		1,711	980		2,691
Loans and lending commitments		14,854	9,590		24,444
Other debt		8,265	128		8,393
Total corporate and other debt		56,891	12,032		68,923
Corporate equities(1)	45,173	2,376	417		47,966
Derivative and other contracts:					
Interest rate contracts	1,493	906,082	5,301		912,876
Credit contracts		123,689	15,102		138,791
Foreign exchange contracts		61,770	573		62,343
Equity contracts	929	44,558	800		46,287
Commodity contracts	6,356	31,246	2,176		39,778
Other		292	306		598
Netting(2)	(7,596)	(1,045,912)	(11,837)	(87,264)	(1,152,609)
Total derivative and other contracts	1,182	121,725	12,421	(87,264)	48,064
Investments:					
Private equity funds		7	1,936		1,943
Real estate funds		5	1,213		1,218
Hedge funds		473	696		1,169
Principal investments	161	104	2,937		3,202
Other	141	21	501		663
Total investments	302	610	7,283		8,195
Physical commodities		9,651	46		9,697
Total financial instruments owned	112,408	217,883	32,326	(87,264)	275,353
Securities available for sale	13,437	17,058			30,495

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Securities received as collateral	11,530	121			11,651
Federal funds sold and securities purchased under agreements to resell		112			112
Intangible assets(3)			133		133
Total assets measured at fair value	\$ 137,375	\$ 235,174	\$ 32,459	\$ (87,264)	\$ 317,744

Liabilities at Fair Value

Deposits	\$	\$ 2,101	\$	\$	\$ 2,101
Commercial paper and other short-term borrowings		1,337	2		1,339
Financial instruments sold, not yet purchased:					
U.S. government and agency securities:					
U.S. Treasury securities	17,776				17,776
U.S. agency securities	1,748	106			1,854
Total U.S. government and agency securities	19,524	106			19,630
Other sovereign government obligations	14,981	2,152	8		17,141

Table of Contents**MORGAN STANLEY****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3) (dollars in millions)	Counterparty and Cash Collateral Netting	Balance at December 31, 2011
Corporate and other debt:					
State and municipal securities		3			3
Residential mortgage-backed securities			355		355
Commercial mortgage-backed securities		14			14
Corporate bonds		6,217	219		6,436
Collateralized debt obligations		3			3
Unfunded lending commitments		1,284	85		1,369
Other debt		157	73		230
Total corporate and other debt		7,678	732		8,410
Corporate equities(1)	24,347	149	1		24,497
Derivative and other contracts:					
Interest rate contracts	1,680	873,466	4,881		880,027
Credit contracts		121,438	9,288		130,726
Foreign exchange contracts		64,218	530		64,748
Equity contracts	877	45,375	2,034		48,286
Commodity contracts	7,144	31,248	1,606		39,998
Other		879	1,396		2,275
Netting(2)	(7,596)	(1,045,912)	(11,837)	(54,262)	(1,119,607)
Total derivative and other contracts	2,105	90,712	7,898	(54,262)	46,453
Physical commodities		16			16
Total financial instruments sold, not yet purchased	60,957	100,813	8,639	(54,262)	116,147
Obligation to return securities received as collateral	15,267	127			15,394
Securities sold under agreements to repurchase		8	340		348
Other secured financings		14,024	570		14,594
Long-term borrowings	10	38,050	1,603		39,663
Total liabilities measured at fair value	\$ 76,234	\$ 156,460	\$ 11,154	\$ (54,262)	\$ 189,586

(1) The Company holds or sells short for trading purposes equity securities issued by entities in diverse industries and of varying size.

(2) For positions with the same counterparty that cross over the levels of the fair value hierarchy, both counterparty netting and cash collateral netting are included in the column titled Counterparty and Cash Collateral Netting. For contracts with the same counterparty, counterparty netting among positions classified within the same level is included within that level. For further information on derivative instruments and hedging activities, see Note 10.

(3) Amount represents MSRs accounted for at fair value. See Note 6 for further information on MSRs.

Transfers Between Level 1 and Level 2 During Quarter Ended March 31, 2011.

Financial instruments owned Derivative and other contracts and *Financial instruments sold, not yet purchased* Derivative and other contracts. During the quarter ended March 31, 2011, the Company reclassified approximately \$0.6 billion of derivative assets and approximately \$0.8 billion of derivative liabilities from Level 2 to Level 1 as these listed derivatives became actively traded and were valued based on quoted prices from the exchange.

Level 3 Assets and Liabilities Measured at Fair Value on a Recurring Basis.

The following tables present additional information about Level 3 assets and liabilities measured at fair value on a recurring basis for the quarters ended March 31, 2012 and 2011, respectively. Level 3 instruments may be hedged with instruments classified in Level 1 and Level 2. As a result, the realized and unrealized gains (losses) for assets and liabilities within the Level 3 category presented in the tables below do not reflect the related realized and unrealized gains (losses) on hedging instruments that have been classified by the Company within the Level 1 and/or Level 2 categories.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Additionally, both observable and unobservable inputs may be used to determine the fair value of positions that the Company has classified within the Level 3 category. As a result, the unrealized gains (losses) during the period for assets and liabilities within the Level 3 category presented in the tables below may include changes in fair value during the period that were attributable to both observable (*e.g.*, changes in market interest rates) and unobservable (*e.g.*, changes in unobservable long-dated volatilities) inputs.

For assets and liabilities that were transferred into Level 3 during the period, gains (losses) are presented as if the assets or liabilities had been transferred into Level 3 at the beginning of the period; similarly, for assets and liabilities that were transferred out of Level 3 during the period, gains (losses) are presented as if the assets or liabilities had been transferred out at the beginning of the period.

Table of Contents**MORGAN STANLEY****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Changes in Level 3 Assets and Liabilities Measured at Fair Value on a Recurring Basis for the Three Months Ended March 31, 2012.**

	Beginning Balance at December 31, 2011	Total Realized and Unrealized Gains (Losses)(1)	Purchases	Sales	Issuances	Settlements	Net Transfers	Ending Balance at March 31, 2012	Unrealized Gains (Losses) for Level 3 Assets/ Liabilities Outstanding at March 31, 2012(2)
(dollars in millions)									
Assets at Fair Value									
Financial instruments owned:									
U.S. agency securities	\$ 8	\$	\$ 42	\$ (26)	\$	\$	\$ (1)	\$ 23	\$
Other sovereign government obligations	119	(1)	8	(118)				8	
Corporate and other debt:									
State and municipal securities							3	3	
Residential mortgage-backed securities	494	(21)	6	(245)			(191)	43	(18)
Commercial mortgage-backed securities	134	23	5	(21)		(1)	(13)	127	16
Asset-backed securities	31	1		(28)			(1)	3	1
Corporate bonds	675	45	426	(225)			(22)	899	39
Collateralized debt obligations	980	123	296	(161)			(73)	1,165	82
Loans and lending commitments	9,590	(20)	496	(1,018)		(421)	(30)	8,597	(35)
Other debt	128	2	27	(123)			23	57	
Total corporate and other debt	12,032	153	1,256	(1,821)		(422)	(304)	10,894	85
Corporate equities	417	(45)	901	(758)			39	554	(9)
Net derivative and other contracts(3):									
Interest rate contracts	420	170	6		(5)	(139)	(430)	22	179
Credit contracts	5,814	(1,381)	63		(10)	(47)	(58)	4,381	(1,786)
Foreign exchange contracts	43	(99)				162	(40)	66	(83)
Equity contracts	(1,234)	(99)	199	(58)	(50)	(250)	50	(1,442)	(161)
Commodity contracts	570	199	4		(4)	37	(3)	803	101
Other	(1,090)	58				269	740	(23)	56
Total net derivative and other contracts	4,523	(1,152)	272	(58)	(69)	32	259	3,807	(1,694)
Investments:									
Private equity funds	1,936	(7)	101	(36)				1,994	1
Real estate funds	1,213	52	87	(14)				1,338	5
Hedge funds	696	25	22	(33)			(87)	623	23
Principal investments	2,937	38	180	(65)			104	3,194	57
Other	501	(33)	34	(3)			28	527	(41)
Total investments	7,283	75	424	(151)			45	7,676	45
Physical commodities	46					(46)			
Intangible assets	133	(34)						99	(34)

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Liabilities at Fair Value

Commercial paper and other short-term borrowings	\$	2	\$		\$		\$	13	\$		\$		\$	15	\$	
Financial instruments sold, not yet purchased:																
Other sovereign government obligations		8			(7)									1		
Corporate and other debt:																
Residential mortgage-backed securities		355			(294)									61		(61)
Corporate bonds		219		(59)	(186)		126				(25)			193		(74)
Unfunded lending commitments		85		25										60		25
Other debt		73		1					(55)		16			33		3
Total corporate and other debt		732		(33)	(480)		126		(55)		(9)			347		(107)
Corporate equities		1		(2)	(2)		10				(9)			2		
Securities sold under agreements to repurchase		340		1							(153)			186		3
Other secured financings		570		(44)				12		(32)				594		(44)
Long-term borrowings		1,603		(173)				262		(78)		183		2,143		(171)

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

- (1) Total realized and unrealized gains (losses) are primarily included in Principal transactions Trading in the condensed consolidated statements of income except for \$75 million related to Financial instruments owned Investments, which is included in Principal transactions Investments.
- (2) Amounts represent unrealized gains (losses) for the quarter ended March 31, 2012 related to assets and liabilities still outstanding at March 31, 2012.
- (3) Net derivative and other contracts represent Financial instruments owned Derivative and other contracts net of Financial instruments sold, not yet purchased Derivative and other contracts. For further information on derivative instruments and hedging activities, see Note 10.

Financial instruments owned Net derivative and other contracts. The net loss in Net derivative and other contracts were primarily driven by tightening of credit spreads on underlying reference entities of basket credit default swaps.

Table of Contents**MORGAN STANLEY****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Changes in Level 3 Assets and Liabilities Measured at Fair Value on a Recurring Basis for the Three Months Ended March 31, 2011.**

	Beginning Balance at December 31, 2010	Total Realized and Unrealized Gains (Losses)(1)	Purchases	Sales	Issuances	Settlements	Net Transfers	Ending Balance at March 31, 2011	Unrealized Gains (Losses) for Level 3 Assets/ Liabilities Outstanding at March 31, 2011(2)
(dollars in millions)									
Assets at Fair Value									
Financial instruments owned:									
U.S. agency securities	\$ 13	\$	\$ 103	\$ (52)	\$	\$	\$ (7)	\$ 57	\$
Other sovereign government obligations	73		59				(6)	126	
Corporate and other debt:									
State and municipal securities	110	(1)	4	(96)			(13)	4	
Residential mortgage-backed securities	319	(58)	198	(183)		(1)	86	361	(21)
Commercial mortgage-backed securities	188	16	9	(30)			(51)	132	10
Asset-backed securities	13		12	(19)			(6)		
Corporate bonds	1,368	33	255	(215)			(75)	1,366	55
Collateralized debt obligations	1,659	254	355	(595)		(36)	(44)	1,593	93
Loans and lending commitments	11,666	386	1,023	(643)		(1,024)	(190)	11,218	382
Other debt	193	(6)	1	(22)			(1)	165	(16)
Total corporate and other debt	15,516	624	1,857	(1,803)		(1,061)	(294)	14,839	503
Corporate equities	484	(53)	101	(98)			68	502	(18)
Net derivative and other contracts(3):									
Interest rate contracts	424	169	1		(663)	(114)	125	(58)	100
Credit contracts	6,594	(673)	128		(152)	71	111	6,079	(245)
Foreign exchange rate contracts	46	(124)				127	(3)	46	(100)
Equity contracts	(762)	75	65	(12)	(85)	15	59	(645)	75
Commodity contracts	188	(9)	161		(132)	85	37	330	(4)
Other	(913)	209			(5)	205	(4)	(508)	203
Total net derivative and other contracts	5,577	(353)	355	(12)	(1,037)	389	325	5,244	29
Investments:									
Private equity funds	1,986	107	32	(190)			71	2,006	95
Real estate funds	1,176	64	14	(3)				1,251	102
Hedge funds	901	(9)	135	(189)			33	871	(9)
Principal investments	3,131	66	202	(301)			(41)	3,057	(85)
Other	560	8	1	(14)			(157)	398	3
Total investments	7,754	236	384	(697)			(94)	7,583	106
Securities received as collateral	1			(1)					
Intangible assets	157	(15)	3	(1)				144	(14)

Table of Contents**MORGAN STANLEY****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

	Beginning Balance at December 31, 2010	Total Realized and Unrealized Gains (Losses)(1)	Purchases	Sales	Issuances	Settlements	Net Transfers	Ending Balance at March 31, 2011	Unrealized Gains (Losses) for Level 3 Assets/ Liabilities Outstanding at March 31, 2011(2)
Liabilities at Fair Value									
Deposits	\$ 16	\$ 2	\$	\$	\$	\$ (14)	\$	\$	\$
Commercial paper and other short-term borrowings	2				4	(2)		4	
Financial instruments sold, not yet purchased:									
Corporate and other debt:									
Corporate bonds	44	1	(27)	155			(21)	150	8
Collateralized debt obligations		1		3				2	1
Unfunded lending commitments	263	92						171	92
Other debt	194						(14)	180	
Total corporate and other debt	501	94	(27)	158			(35)	503	101
Corporate equities	15	(1)	(8)	1				9	
Obligation to return securities received as collateral	1		(1)						
Securities sold under agreements to repurchase	351	(2)				(1)		352	(2)
Other secured financings	1,016	(12)				(117)	(306)	605	(12)
Long-term borrowings	1,316	(84)			141	(180)	13	1,374	(83)

(1) Total realized and unrealized gains (losses) are primarily included in Principal transactions. Trading in the condensed consolidated statements of income except for \$236 million related to Financial instruments owned. Investments, which is included in Principal transactions. Investments.

(2) Amounts represent unrealized gains (losses) for the quarter ended March 31, 2011 related to assets and liabilities still outstanding at March 31, 2011.

(3) Net derivative and other contracts represent Financial instruments owned. Derivative and other contracts net of Financial instruments sold, not yet purchased. Derivative and other contracts. For further information on derivative instruments and hedging activities, see Note 10.

Financial instruments owned Corporate and other debt. During the quarter ended March 31, 2011, the Company reclassified approximately \$1.6 billion of certain Corporate and other debt, primarily corporate loans, from Level 3 to Level 2. The Company reclassified the corporate loans as external prices and/or spread inputs for these instruments became observable.

The Company also reclassified approximately \$1.3 billion of certain Corporate and other debt from Level 2 to Level 3. The reclassifications were primarily related to certain corporate loans and were generally due to a reduction in market price quotations for these or comparable instruments, or a lack of available broker quotes, such that unobservable inputs had to be utilized for the fair value measurement of these instruments.

Table of Contents**MORGAN STANLEY****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Quantitative Information about and Sensitivity of Significant Unobservable Inputs used in Recurring Level 3 Fair Value Measurements at March 31, 2012**

The disclosures below provide information on the valuation techniques, significant unobservable inputs and their ranges for each major category of assets and liabilities measured at fair value on a recurring basis with a significant Level 3 balance. The level of aggregation and breadth of products cause the range of inputs to be wide and not evenly distributed across the inventory. Further, the range of unobservable inputs may differ across firms in the financial services industry because of diversity in the types of products included in each firm's inventory. The disclosures below also include qualitative information on the sensitivity of the fair value measurements to changes in the significant unobservable inputs.

	Balance at March 31, 2012 (dollars in millions)	Valuation Technique(s)	Significant Unobservable Input(s) / Sensitivity of the Fair Value to Changes in the Unobservable Inputs	Range
Assets(1)				
Financial instruments owned:				
Corporate and other debt:				
Commercial mortgage-backed securities	\$ 127	Comparable pricing(2)	Comparable bond price / (A)	0 to 85 points
Corporate bonds	899	Comparable pricing(2)	Comparable bond price / (A)	2 to 120 points
Collateralized debt obligations	1,165	Comparable pricing(2)	Comparable bond price / (A)	15 to 82 points
		Correlation model	Credit correlation / (B)	21% to 39%
Loans and lending commitments				26 to 1,109
	8,597	Corporate loan model	Credit spread / (C)	basis points
		Comparable pricing(2)	Comparable bond or loan price / (A)	10 to 100 points
Other debt	57	Comparable pricing(2)	Comparable bond price / (A)	1 to 9 points
Corporate equities(3)	554	Net asset value	Discount to net asset value / (C)	0% to 31%
		Discounted cash flow	Implied weighted average cost of capital / (C)	9% to 40%
		Market approach	Earnings before interest, taxes, depreciation and amortization (EBITDA) multiple / (A)	3 to 21 times
Net derivative and other contracts:				
Interest rate contracts				
	22	Option model	Interest rate volatility concentration liquidity multiple / (C)(D)	0 to 12 times
			Interest rate volatility skew / (A)(D)	-1% to 81%
Credit contracts				
	4,381	Comparable pricing(2)	Cash synthetic basis / (C)	0 to 10 points
			Comparable bond price / (C)	5 to 97 points
		Correlation model	Credit correlation / (B)	9% to 82%
Foreign exchange contracts	66	Option model	Interest rate - Foreign exchange correlation / (A)	5% to 68%
Equity contracts				
	(1,442)	Option model	At the money volatility / (C)(D)	8% to 26%
			Volatility skew / (C)(D)	-5% to 0%
			Equity - Equity correlation / (C)(D)	40% to 97%
			Equity - Foreign exchange correlation / (C)(D)	-45% to 35%
			Equity - Interest rate correlation / (C)(D)	8% to 65%
Commodity contracts				
	803	Option model	Forward power price / (C)(D)	\$22 to \$134 per Megawatt hour
			Commodity volatility / (A)(D)	13% to 113%
			Cross commodity correlation / (C)(D)	21% to 99%
Investments (3):				
Principal investments				
	3,194	Discounted cash flow	Implied weighted average cost of capital / (C)(D)	10% to 19%
			Exit multiple / (A)(D)	5 to 10 times
		Discounted cash flow	Capitalization rate / (C)(D)	5% to 9%

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		Equity discount rate / (C)(D)	16% to 35%
		EBITDA multiple / (A)	3 to 24 times
Other	527	Discounted cash flow	Implied weighted average cost of capital / (C)(D)
			9% to 14%
		Exit multiple / (A)(D)	4 to 10 times
		Market approach	EBITDA multiple / (A)
			3 to 11 times

Table of Contents**MORGAN STANLEY****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

	Balance at March 31, 2012 (dollars in millions)	Valuation Technique(s)	Significant Unobservable Input(s) / Sensitivity of the Fair Value to Changes in the Unobservable Inputs	Range
Liabilities				
Financial instruments sold, not yet purchased:				
Corporate and other debt:				
Residential mortgage-backed securities	\$ 61	Comparable pricing(2)	Comparable bond price / (A)	0 to 100 points
Corporate bonds	193	Comparable pricing(2)	Comparable bond price / (A)	6 to 121 points
Unfunded lending commitments				45 to 1,014
	60	Corporate loan model	Credit spread / (C)	basis points
Securities sold under agreements to repurchase				45 to 300
	186	Discounted cash flow	Funding spread / (A)	basis points
Other secured financings	594	Comparable pricing(2)	Comparable bond price / (A)	34 to 108 points
				267 to 269
		Discounted cash flow	Funding spread / (A)	basis points
Long-term borrowings	2,143	Option model	At the money volatility / (A)(D)	10% to 15%
			Volatility skew / (A)(D)	-2% to 0%
			Equity - Equity correlation / (C)(D)	70% to 97%
			Equity - Foreign exchange correlation / (A)(D)	-70% to -40%

- (1) Intangible assets consisting of MSRs of \$84 million included in discontinued operations related to Saxon are excluded from the table. See Notes 1 and 20 for further information.
- (2) Prices for the identical instrument are not available and significant subjectivity may be involved when fair value is determined using pricing data available for comparable instruments.
- (3) Investments in funds measured using an unadjusted net asset value are excluded.

Sensitivity of the fair value to changes in the unobservable inputs:

- (A) Significant increase (decrease) in the unobservable input in isolation would result in a significantly higher (lower) fair value measurement.
- (B) Significant changes in credit correlation may result in a significantly higher or lower fair value measurement. Increasing (decreasing) correlation drives a redistribution of risk within the capital structure such that junior tranches become less (more) risky and senior tranches become more (less) risky.
- (C) Significant increase (decrease) in the unobservable input in isolation would result in a significantly lower (higher) fair value measurement.
- (D) There are no predictable relationships between the significant unobservable inputs.

Table of Contents**MORGAN STANLEY****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)*****Fair Value of Investments that Calculate Net Asset Value.***

The Company's Investments measured at fair value were \$8,329 million and \$8,195 million at March 31, 2012 and December 31, 2011, respectively. The following table presents information solely about the Company's investments in private equity funds, real estate funds and hedge funds measured at fair value based on net asset value at March 31, 2012 and December 31, 2011, respectively.

	At March 31, 2012		At December 31, 2011	
	Fair Value	Unfunded Commitment	Fair Value	Unfunded Commitment
	(dollars in millions)			
Private equity funds	\$ 1,955	\$ 813	\$ 1,906	\$ 938
Real estate funds	1,310	288	1,188	448
Hedge funds(1):				
Long-short equity hedge funds	511		545	5
Fixed income/credit-related hedge funds	23		124	
Event-driven hedge funds	71		163	
Multi-strategy hedge funds	336	2	335	
Total	\$ 4,206	\$ 1,103	\$ 4,261	\$ 1,391

- (1) Fixed income/credit-related hedge funds, event-driven hedge funds, and multi-strategy hedge funds are redeemable at least on a six-month period basis primarily with a notice period of 90 days or less. At March 31, 2012, approximately 36% of the fair value amount of long-short equity hedge funds is redeemable at least quarterly, 34% is redeemable every six months and 30% of these funds have a redemption frequency of greater than six months. The notice period for long-short equity hedge funds at March 31, 2012 is primarily greater than six months. At December 31, 2011, approximately 38% of the fair value amount of long-short equity hedge funds is redeemable at least quarterly, 32% is redeemable every six months and 30% of these funds have a redemption frequency of greater than six months. The notice period for long-short equity hedge funds at December 31, 2011 is primarily greater than six months.

Private Equity Funds. Amount includes several private equity funds that pursue multiple strategies including leveraged buyouts, venture capital, infrastructure growth capital, distressed investments, and mezzanine capital. In addition, the funds may be structured with a focus on specific domestic or foreign geographic regions. These investments are generally not redeemable with the funds. Instead, the nature of the investments in this category is that distributions are received through the liquidation of the underlying assets of the fund. At March 31, 2012, it is estimated that 6% of the fair value of the funds will be liquidated in the next five years, another 33% of the fair value of the funds will be liquidated between five to 10 years and the remaining 61% of the fair value of the funds have a remaining life of greater than 10 years.

Real Estate Funds. Amount includes several real estate funds that invest in real estate assets such as commercial office buildings, retail properties, multi-family residential properties, developments or hotels. In addition, the funds may be structured with a focus on specific geographic domestic or foreign regions. These investments are generally not redeemable with the funds. Distributions from each fund will be received as the underlying investments of the funds are liquidated. At March 31, 2012, it is estimated that 4% of the fair value of the funds will be liquidated within the next five years, another 40% of the fair value of the funds will be liquidated between five to 10 years and the remaining 56% of the fair value of the funds have a remaining life of greater than 10 years.

Hedge Funds. Investments in hedge funds may be subject to initial period lock-up restrictions or gates. A hedge fund lock-up provision is a provision that provides that, during a certain initial period, an investor may not make a withdrawal from the fund. The purpose of a gate is to restrict the level of redemptions that an investor in a particular hedge fund can demand on any redemption date.

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Long-short Equity Hedge Funds. Amount includes investments in hedge funds that invest, long or short, in equities. Equity value and growth hedge funds purchase stocks perceived to be undervalued and sell stocks perceived to be overvalued. Investments representing approximately 8% of the fair value of the

Table of Contents**MORGAN STANLEY****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

investments in this category cannot be redeemed currently because the investments include certain initial period lock-up restrictions. The remaining restriction period for these investments subject to lock-up restrictions ranged from three years or less at March 31, 2012. Investments representing approximately 7% of the fair value of the investments in long-short equity hedge funds cannot be redeemed currently because an exit restriction has been imposed by the hedge fund manager. The restriction period for these investments subject to an exit restriction was primarily one year or less at March 31, 2012.

Fixed Income/Credit-Related Hedge Funds. Amount includes investments in hedge funds that employ long-short, distressed or relative value strategies in order to benefit from investments in undervalued or overvalued securities that are primarily debt or credit related. At March 31, 2012, investments representing approximately 17% of the fair value of the investments in fixed income/credit-related hedge funds cannot be redeemed currently because the investments include certain initial period lock-up restrictions. The remaining restriction period for these investments subject to lock-up restrictions was primarily one year or less at March 31, 2012.

Event-Driven Hedge Funds. Amount includes investments in hedge funds that invest in event-driven situations such as mergers, hostile takeovers, reorganizations, or leveraged buyouts. This may involve the simultaneous purchase of stock in companies being acquired and the sale of stock in its acquirer, hoping to profit from the spread between the current market price and the ultimate purchase price of the target company. At March 31, 2012, there were no restrictions on redemptions.

Multi-strategy Hedge Funds. Amount includes investments in hedge funds that pursue multiple strategies to realize short- and long-term gains. Management of the hedge funds has the ability to overweight or underweight different strategies to best capitalize on current investment opportunities. At March 31, 2012, investments representing approximately 74% of the fair value of the investments in this category cannot be redeemed currently because the investments include certain initial period lock-up restrictions. The remaining restriction period for these investments subject to lock-up restrictions was primarily two years or less at March 31, 2012.

Fair Value Option.

The Company elected the fair value option for certain eligible instruments that are risk managed on a fair value basis to mitigate income statement volatility caused by measurement basis differences between the elected instruments and their associated risk management transactions or to eliminate complexities of applying certain accounting models. The following tables present net gains (losses) due to changes in fair value for items measured at fair value pursuant to the fair value option election for the quarters ended March 31, 2012 and 2011, respectively.

	Principal Transactions- Trading	Interest Income (Expense) (dollars in millions)	Gains (Losses) Included in Net Revenues
<i>Three Months Ended March 31, 2012</i>			
Federal funds sold and securities purchased under agreements to resell	\$ (4)	\$ 1	\$ (3)
Deposits	10	(22)	(12)
Commercial paper and other short-term borrowings	(129)		(129)
Securities sold under agreements to repurchase	(2)	(1)	(3)
Long-term borrowings	(2,951)	(344)	(3,295)
<i>Three Months Ended March 31, 2011</i>			

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Deposits	\$ 13	\$ (30)	\$ (17)
Commercial paper and other short-term borrowings	(5)		(5)
Securities sold under agreements to repurchase	(2)		(2)
Long-term borrowings	(1,266)	(290)	(1,556)

Table of Contents**MORGAN STANLEY****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

In addition to the amounts in the above table, as discussed in Note 2 to the consolidated financial statements for the year ended December 31, 2011 included in the Form 10-K, all of the instruments within Financial instruments owned or Financial instruments sold, not yet purchased are measured at fair value, either through the election of the fair value option, or as required by other accounting guidance. The amounts in the above table are included within Net revenues and do not reflect gains or losses on related hedging instruments, if any.

The changes in overall fair value of the short-term and long-term borrowings (primarily structured notes) are attributable to changes in foreign currency exchange rates, interest rates, movements in the reference price or index for structured notes and (as presented in the table below) an adjustment to reflect the change in the Company's credit spreads and other credit factors.

The following tables present information on the Company's short-term and long-term borrowings (primarily structured notes), loans and unfunded lending commitments for which the fair value option was elected.

Gains (Losses) due to Changes in Instrument Specific Credit Risk.

	Three Months Ended March 31,	
	2012	2011
	(dollars in millions)	
Short-term and long-term borrowings(1)	\$ (1,978)	\$ (189)
Loans(2)	293	140
Unfunded lending commitments(3)	407	10

- (1) The change in the fair value of short-term and long-term borrowings (primarily structured notes) includes an adjustment to reflect the change in credit quality of the Company based upon observations of the Company's secondary bond market spreads.
- (2) Instrument-specific credit gains (losses) were determined by excluding the non-credit components of gains and losses, such as those due to changes in interest rates.
- (3) Gains (losses) were generally determined based on the differential between estimated expected client yields and contractual yields at each respective period end.

Net Difference between Contractual Principal Amount and Fair Value.

	Contractual Principal Amount Exceeds Fair Value	
	At March 31, 2012	At December 31, 2011
	(dollars in billions)	
Short-term and long-term borrowings(1)	\$ 1.2	\$ 2.5
Loans(2)	23.9	27.2
Loans 90 or more days past due and/or on non-accrual status(2)(3)	21.3	22.1

- (1) These amounts do not include structured notes where the repayment of the initial principal amount fluctuates based on changes in the reference price or index.
- (2) The majority of this difference between principal and fair value amounts emanates from the Company's distressed debt trading business, which purchases distressed debt at amounts well below par.
- (3)

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The aggregate fair value of loans that were in non-accrual status, which includes all loans 90 or more days past due, was \$1.5 billion and \$2.0 billion at March 31, 2012 and December 31, 2011, respectively. The aggregate fair value of loans that were 90 or more days past due was \$0.9 billion and \$1.5 billion at March 31, 2012 and December 31, 2011, respectively.

The tables above exclude non-recourse debt from consolidated VIEs, liabilities related to failed sales of financial assets, pledged commodities and other liabilities that have specified assets attributable to them.

Table of Contents**MORGAN STANLEY****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Assets and Liabilities Measured at Fair Value on a Non-recurring Basis.**

Certain assets were measured at fair value on a non-recurring basis and are not included in the tables above. These assets may include loans, equity method investments, premises and equipment, intangible assets and real estate investments.

The following tables present, by caption on the condensed consolidated statements of financial condition, the fair value hierarchy for those assets measured at fair value on a non-recurring basis for which the Company recognized a non-recurring fair value adjustment for the quarters ended March 31, 2012 and 2011, respectively.

Three Months Ended March 31, 2012.

	Carrying Value At March 31, 2012	Fair Value Measurements Using:			Total Gains (Losses) for the Three Months Ended March 31, 2012(1)
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2) (dollars in millions)	Significant Unobservable Inputs (Level 3)	
Loans(2)	\$ 298	\$	\$ 144	\$ 154	\$ (6)
Other investments(3)	47			47	(3)
Premises, equipment and software costs(3)	3			3	(1)
Intangible assets(4)	2	2			(2)
Total	\$ 350	\$ 2	\$ 144	\$ 204	\$ (12)

(1) Losses are recorded within Other expenses in the condensed consolidated statement of income except for fair value adjustments related to Loans and losses related to Other investments, which are included in Other revenues.

(2) Non-recurring changes in fair value for loans held for investment were calculated based upon the fair value of the underlying collateral. The fair value of the collateral was determined using internal expected recovery models. The non-recurring change in fair value for mortgage loans held for sale is based upon a valuation model incorporating market observable inputs.

(3) Losses recorded were determined primarily using discounted cash flow models.

(4) Losses were determined primarily using discounted cash flow models or a valuation technique incorporating an observable market index.

In addition to the losses included in the table above, there was a pre-tax gain of approximately \$51 million (related to Other assets) included in discontinued operations in the quarter ended March 31, 2012 in connection with the planned disposition of Saxon (see Notes 1 and 20). This pre-tax gain was primarily due to the subsequent increase in fair value of Saxon, which had incurred impairment losses of \$98 million in the quarter ended December 31, 2011. The fair value of Saxon was determined based on the revised purchase price agreed upon with the buyer.

There were no liabilities measured at fair value on a non-recurring basis during the quarter ended March 31, 2012.

Table of Contents**MORGAN STANLEY****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)***Three Months Ended March 31, 2011.*

	Carrying Value At March 31, 2011	Fair Value Measurements Using:			Total Gains (Losses) for the Three Months Ended March 31, 2011(1)
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
			(dollars in millions)		
Loans(2)	\$ 559	\$	\$ 46	\$ 513	\$ 16
Other investments(3)	77			77	(9)
Intangible assets(4)					(3)
Total	\$ 636	\$	\$ 46	\$ 590	\$ 4

(1) Losses are recorded within Other expenses in the condensed consolidated statement of income except for fair value adjustments related to Loans and losses related to Other investments, which are included in Other revenues.

(2) Non-recurring changes in fair value for loans held for investment were calculated based upon the fair value of the underlying collateral. The fair value of the collateral was determined using internal expected recovery models. The non-recurring change in fair value for mortgage loans held for sale is based upon a valuation model incorporating market observable inputs.

(3) Losses recorded were determined primarily using discounted cash flow models.

(4) Losses primarily related to investment management contracts, including contracts associated with FrontPoint, and were determined primarily using discounted cash flow models.

There were no liabilities measured at fair value on a non-recurring basis during the quarter ended March 31, 2011.

Financial Instruments Not Measured at Fair Value.

The table below presents the carrying value, fair value and fair value hierarchy category of certain financial instruments that are not measured at fair value in the condensed consolidated statements of financial condition. The table below excludes certain financial instruments such as equity method investments and all non-financial assets and liabilities such as the value of the long-term relationships with our deposit customers.

The carrying value of cash and cash equivalents, including Interest bearing deposits with banks, and other short-term financial instruments such as Federal funds sold and securities purchased under agreements to resell, Securities borrowed, Securities sold under agreements to repurchase, Securities loaned, certain receivables and payables arising in the ordinary course of business, certain Deposits, Commercial paper and other short-term borrowings and Other secured financings approximate fair value because of the relatively short period of time between their origination and expected maturity.

The fair value of sweep facilities whereby cash balances are swept into separate money market savings deposits and transaction accounts included within Deposits is determined from observable market data, where available. Otherwise, the fair value is determined using a standard cash flow discounting methodology.

For longer-dated Federal funds sold and securities purchased under agreements to resell, Securities borrowed, Securities sold under agreements to repurchase, Securities loaned and Other secured financings, fair value is determined using a standard cash flow discounting methodology. The

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inputs to the valuation include contractual cash flows and collateral funding spreads, which are estimated using various benchmarks and interest rate yield curves.

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For consumer and residential real estate loans where position-specific external price data is not observable, the fair value is based on the credit risks of the borrower using a probability of default and loss given default method, discounted at the estimated external cost of funding level. The fair value of corporate loans is determined using recently executed transactions, market price quotations (where observable), implied yields from comparable debt, and market observable credit default swap spread levels along with proprietary valuation models and default recovery analysis where such transactions and quotations are unobservable.

Quoted prices are used when available for long-term borrowings. Where quoted prices are not available, fair value is determined based on current interest rates and credit spreads for debt instruments with similar terms and maturity.

Financial Instruments Not Measured at Fair Value at March 31, 2012.

	At March 31, 2012		Fair Value Measurements using:		
	Carrying Value	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1) (dollars in millions)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial Assets:					
Cash and due from banks	\$ 10,133	\$ 10,133	\$ 10,133	\$	\$
Interest bearing deposits with banks	28,592	28,592	28,592		
Cash deposited with clearing organizations or segregated under federal and other regulations or requirements	30,152	30,152	30,152		
Federal funds sold and securities purchased under agreements to resell	136,133	135,773		135,161	612
Securities borrowed	141,610	141,609		141,484	125
Receivables:(1)					
Customers	38,962	38,962		38,962	
Brokers, dealers and clearing organizations	5,718	5,718		5,718	
Fees, interest and other	6,220	5,922			5,922
Loans(2)	16,729	16,791		1,923	14,868
Financial Liabilities:					
Deposits	\$ 64,461	\$ 64,603	\$	\$ 64,603	\$
Commercial paper and other short-term borrowings	696	696		439	257
Securities sold under agreements to repurchase	106,983	107,041		99,539	7,502
Securities loaned	34,431	34,913		34,646	267
Other secured financings	8,354	8,383		6,527	1,856
Payables:(1)					
Customers	119,045	119,045		119,045	
Brokers, dealers and clearing organizations	12,143	12,143		12,143	
Long-term borrowings	133,499	127,962		120,471	7,491

(1) Accrued interest, fees and dividend receivables and payables where carrying value approximates fair value have been excluded.

(2) Includes all loans measured at fair value on a non-recurring basis.

Table of Contents**MORGAN STANLEY****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****4. Securities Available for Sale.**

The following tables present information about the Company's available for sale securities:

	Amortized Cost	Gross Unrealized Gains	At March 31, 2012 Gross Unrealized Losses (dollars in millions)	Other-than- Temporary Impairment	Fair Value
Debt securities available for sale:					
U.S. government and agency securities:					
U.S. Treasury securities	\$ 13,680	\$ 129	\$ 1	\$	\$ 13,808
U.S. agency securities	16,352	69	17		16,404
Total U.S. government and agency securities	30,032	198	18		30,212
Corporate and other debt:					
Auto loan asset-backed securities	237				237
Corporate bonds	631	1	1		631
FFELP student loan asset-backed securities(1)	1,431	4	1		1,434
Total Corporate and other debt	2,299	5	2		2,302
Total debt securities available for sale	32,331	203	20		32,514
Equity securities available for sale	15		1		14
Total	\$ 32,346	\$ 203	\$ 21	\$	\$ 32,528

(1) Amounts are backed by a guarantee from the U.S. Department of Education of at least 95% of the principal balance and interest on such loans.

	Amortized Cost	Gross Unrealized Gains	At December 31, 2011 Gross Unrealized Losses (dollars in millions)	Other-than- Temporary Impairment	Fair Value
Debt securities available for sale:					
U.S. government and agency securities:					
U.S. Treasury securities	\$ 13,240	\$ 182	\$	\$	\$ 13,422
U.S. agency securities	16,083	54	20		16,117
Corporate and other debt(1)	944		3		941
Total debt securities available for sale	30,267	236	23		30,480
Equity securities available for sale	15				15
Total	\$ 30,282	\$ 236	\$ 23	\$	\$ 30,495

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- (1) Amounts represent FFELP student loan asset-backed securities, in which the loans are backed by a guarantee from the U.S. Department of Education of at least 95% of the principal balance and interest on such loans.

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The tables below present the fair value of investments in securities available for sale that have been in an unrealized loss position:

At March 31, 2012	Less than 12 Months Fair Value	Gross Unrealized Losses	12 Months or Longer Fair Value	Gross Unrealized Losses	Total Fair Value	Gross Unrealized Losses
			(dollars in millions)			
Debt securities available for sale:						
U.S. government and agency securities:						
U.S. Treasury securities	\$ 1,923	\$ 1	\$ 1,292	\$ 5	\$ 1,923	\$ 1
U.S. agency securities	3,973	12	1,292	5	5,265	17
Total U.S. government and agency securities	5,896	13	1,292	5	7,188	18
Corporate and other debt:						
Corporate bonds	458	1			458	1
FFELP student loan asset-backed securities	450	1			450	1
Total Corporate and other debt	908	2			908	2
Total debt securities available for sale	6,804	15	1,292	5	8,096	20
Equity securities available for sale	14	1			14	1
Total	\$ 6,818	\$ 16	\$ 1,292	\$ 5	\$ 8,110	\$ 21

At December 31, 2011	Less than 12 Months Fair Value	Gross Unrealized Losses	12 Months or Longer Fair Value	Gross Unrealized Losses	Total Fair Value	Gross Unrealized Losses
			(dollars in millions)			
Debt securities available for sale:						
U.S. government and agency securities:						
U.S. agency securities	\$ 6,250	\$ 15	\$ 1,492	\$ 5	\$ 7,742	\$ 20
Corporate and other debt	679	3			679	3
Total	\$ 6,929	\$ 18	\$ 1,492	\$ 5	\$ 8,421	\$ 23

Gross unrealized losses are recorded in Accumulated other comprehensive income.

For the debt securities available for sale, the Company does not intend to sell these securities or expect to be required to sell these securities prior to recovery of the amortized cost basis. In addition, the Company does not expect the U.S. government and agency securities to experience a credit loss given the explicit and implicit guarantee provided by the U.S. government. The Company believes that the debt securities with an unrealized loss in Accumulated other comprehensive income were not other-than-temporarily impaired at March 31, 2012 and December 31, 2011.

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For the equity securities available for sale, the Company does not intend to sell these securities or expect to be required to sell these securities prior to the recovery of the amortized cost basis. The Company believes that the equity securities with an unrealized loss in Accumulated other comprehensive income were not other-than-temporarily impaired at March 31, 2012.

Table of Contents**MORGAN STANLEY****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The following table presents the amortized cost and fair value of debt securities available for sale by contractual maturity dates at March 31, 2012.

March 31, 2012	Amortized Cost	Fair Value	Annualized Average Yield
	(dollars in millions)		
U.S. government and agency securities:			
U.S. Treasury securities:			
Due within 1 year	\$ 2,298	\$ 2,319	1.4%
After 1 year but through 5 years	10,214	10,314	0.9%
After 5 years	1,168	1,175	1.4%
Total	13,680	13,808	
U.S. agency securities:			
After 5 years	16,352	16,404	
Total	16,352	16,404	1.2%
Total U.S. government and agency securities	30,032	30,212	1.1%
Corporate and other debt:			
Auto loan asset-backed securities:			
After 1 year but through 5 years	237	237	0.8%
Total	237	237	
Corporate bonds:			
Due within 1 year	43	43	0.7%
After 1 year but through 5 years	570	570	1.1%
After 5 years	18	18	1.7%
Total	631	631	
FFELP student loan asset-backed securities:			
After 5 years	1,431	1,434	1.2%
Total	1,431	1,434	
Total Corporate and other debt	2,299	2,302	1.1%
Total debt securities available for sale	\$ 32,331	\$ 32,514	1.1%

See Note 6 for additional information on securities issued by VIEs, including U.S. agency residential mortgage-backed securities, auto loan asset-backed securities and FFELP student loan asset-backed securities.

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The following table presents information pertaining to sales of securities available for sale during the three months ended March 31, 2012 and 2011:

	Three Months Ended March 31, 2012 2011 (dollars in millions)	
Gross realized gains	\$ 1	\$ 12
Gross realized losses	\$ 1	\$
Proceeds of sales of securities available for sale	\$	\$ 6,121

Gross realized gains and losses are recognized in Other revenues in the condensed consolidated statements of income.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

5. Collateralized Transactions.

The Company enters into reverse repurchase agreements, repurchase agreements, securities borrowed and securities loaned transactions to, among other things, acquire securities to cover short positions and settle other securities obligations, to accommodate customers' needs and to finance the Company's inventory positions. The Company's policy is generally to take possession of Securities received as collateral, Securities purchased under agreements to resell and Securities borrowed. The Company manages credit exposure arising from reverse repurchase agreements, repurchase agreements, securities borrowed and securities loaned transactions by, in appropriate circumstances, entering into master netting agreements and collateral arrangements with counterparties that provide the Company, in the event of a customer default, the right to liquidate collateral and the right to offset a counterparty's rights and obligations. The Company also monitors the fair value of the underlying securities as compared with the related receivable or payable, including accrued interest, and, as necessary, requests additional collateral to ensure such transactions are adequately collateralized. Where deemed appropriate, the Company's agreements with third parties specify its rights to request additional collateral.

The Company also engages in securities financing transactions for customers through margin lending. Under these agreements and transactions, the Company either receives or provides collateral, including U.S. government and agency securities, other sovereign government obligations, corporate and other debt, and corporate equities. Customer receivables generated from margin lending activity are collateralized by customer-owned securities held by the Company. The Company monitors required margin levels and established credit limits daily and, pursuant to such guidelines, requires customers to deposit additional collateral, or reduce positions, when necessary. Margin loans are extended on a demand basis and are not committed facilities. Factors considered in the review of margin loans are the amount of the loan, the intended purpose, the degree of leverage being employed in the account, and overall evaluation of the portfolio to ensure proper diversification or, in the case of concentrated positions, appropriate liquidity of the underlying collateral or potential hedging strategies to reduce risk. Additionally, transactions relating to concentrated or restricted positions require a review of any legal impediments to liquidation of the underlying collateral. Underlying collateral for margin loans is reviewed with respect to the liquidity of the proposed collateral positions, valuation of securities, historic trading range, volatility analysis and an evaluation of industry concentrations. For these transactions, adherence to the Company's collateral policies significantly limits the Company's credit exposure in the event of customer default. The Company may request additional margin collateral from customers, if appropriate, and, if necessary, may sell securities that have not been paid for or purchase securities sold but not delivered from customers. At March 31, 2012 and December 31, 2011, there were approximately \$19.4 billion and \$16.2 billion, respectively, of customer margin loans outstanding.

Other secured financings include the liabilities related to transfers of financial assets that are accounted for as financings rather than sales, consolidated VIEs where the Company is deemed to be the primary beneficiary, and certain equity-linked notes and other secured borrowings. These liabilities are generally payable from the cash flows of the related assets accounted for as Financial instruments owned (see Note 6).

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The Company pledges its financial instruments owned to collateralize repurchase agreements and other securities financings. Pledged financial instruments that can be sold or repledged by the secured party are identified as Financial instruments owned (pledged to various parties) in the consolidated statements of financial condition. The carrying value and classification of financial instruments owned by the Company that have been loaned or pledged to counterparties where those counterparties do not have the right to sell or repledge the collateral were as follows:

	At March 31, 2012	At December 31, 2011
	(dollars in millions)	
Financial instruments owned:		
U.S. government and agency securities	\$ 8,795	\$ 9,263
Other sovereign government obligations	4,128	4,047
Corporate and other debt	11,292	17,024
Corporate equities	28,719	21,664
Total	\$ 52,934	\$ 51,998

The Company receives collateral in the form of securities in connection with reverse repurchase agreements, securities borrowed and derivative transactions, and customer margin loans. In many cases, the Company is permitted to sell or repledge these securities held as collateral and use the securities to secure repurchase agreements, to enter into securities lending and derivative transactions or for delivery to counterparties to cover short positions. The Company additionally receives securities as collateral in connection with certain securities-for-securities transactions in which the Company is the lender. In instances where the Company is permitted to sell or repledge these securities, the Company reports the fair value of the collateral received and the related obligation to return the collateral in the consolidated statements of financial condition. At March 31, 2012 and December 31, 2011, the fair value of financial instruments received as collateral where the Company is permitted to sell or repledge the securities was \$586 billion and \$488 billion, respectively, and the fair value of the portion that had been sold or repledged was \$420 billion and \$335 billion, respectively.

At March 31, 2012 and December 31, 2011, cash and securities deposited with clearing organizations or segregated under federal and other regulations or requirements were as follows:

	At March 31, 2012	At December 31, 2011
	(dollars in millions)	
Cash deposited with clearing organizations or segregated under federal and other regulations or requirements	\$ 30,152	\$ 29,454
Securities(1)	8,229	15,120
Total	\$ 38,381	\$ 44,574

(1) Securities deposited with clearing organizations or segregated under federal and other regulations or requirements are sourced from Federal funds sold and securities purchased under agreements to resell and Financial instruments owned in the consolidated statements of financial condition.

6. Variable Interest Entities and Securitization Activities.

The Company is involved with various special purpose entities (SPEs) in the normal course of business. In most cases, these entities are deemed to be VIEs.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Company applies accounting guidance for consolidation of VIEs to certain entities in which equity investors do not have the characteristics of a controlling financial interest. Excluding entities subject to the Deferral (as defined in Note 2 to the consolidated financial statements included in the Form 10-K), the primary beneficiary of a VIE is the party that both (1) has the power to direct the activities of a VIE that most significantly affect the VIE's economic performance and (2) has an obligation to absorb losses or the right to receive benefits that in either case could potentially be significant to the VIE. The Company consolidates entities of which it is the primary beneficiary.

The Company's variable interests in VIEs include debt and equity interests, commitments, guarantees, derivative instruments and certain fees. The Company's involvement with VIEs arises primarily from:

Interests purchased in connection with market-making activities, securities held in its available for sale portfolio and retained interests held as a result of securitization activities, including re-securitization transactions.

Guarantees issued and residual interests retained in connection with municipal bond securitizations.

Servicing residential and commercial mortgage loans held by VIEs.

Loans made to and investments in VIEs that hold debt, equity, real estate or other assets.

Derivatives entered into with VIEs.

Structuring of credit-linked notes (CLN) or other asset-repackaged notes designed to meet the investment objectives of clients.

Other structured transactions designed to provide tax-efficient yields to the Company or its clients.

The Company determines whether it is the primary beneficiary of a VIE upon its initial involvement with the VIE and reassesses whether it is the primary beneficiary on an ongoing basis as long as it has any continuing involvement with the VIE. This determination is based upon an analysis of the design of the VIE, including the VIE's structure and activities, the power to make significant economic decisions held by the Company and by other parties, and the variable interests owned by the Company and other parties.

The power to make the most significant economic decisions may take a number of different forms in different types of VIEs. The Company considers servicing or collateral management decisions as representing the power to make the most significant economic decisions in transactions such as securitizations or CDOs. As a result, the Company does not consolidate securitizations or CDOs for which it does not act as the servicer or collateral manager unless it holds certain other rights to replace the servicer or collateral manager or to require the liquidation of the entity. If the Company serves as servicer or collateral manager, or has certain other rights described in the previous sentence, the Company analyzes the interests in the VIE that it holds and consolidates only those VIEs for which it holds a potentially significant interest of the VIE.

The structure of securitization vehicles and CDOs are driven by several parties, including loan seller(s) in securitization transactions, the collateral manager in a CDO, one or more rating agencies, a financial guarantor in some transactions and the underwriter(s) of the transactions, who serve to reflect specific investor demand. In addition, subordinate investors, such as the B-piece buyer in commercial mortgage backed securitizations or equity investors in CDOs, can influence whether specific loans are excluded from a CMBS transaction or investment criteria in a CDO.

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For many transactions, such as re-securitization transactions, CLNs and other asset-repackaged notes, there are no significant economic decisions made on an ongoing basis. In these cases, the Company focuses its analysis on

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decisions made prior to the initial closing of the transaction and at the termination of the transaction. Based upon factors, which include an analysis of the nature of the assets, including whether the assets were issued in a transaction sponsored by the Company and the extent of the information available to the Company and to investors, the number, nature and involvement of investors, other rights held by the Company and investors, the standardization of the legal documentation and the level of the continuing involvement by the Company, including the amount and type of interests owned by the Company and by other investors, the Company concluded in most of these transactions that decisions made prior to the initial closing were shared between the Company and the initial investors. The Company focused its control decision on any right held by the Company or investors related to the termination of the VIE. Most re-securitization transactions, CLNs and other asset-repackaged notes have no such termination rights.

Except for consolidated VIEs included in other structured financings and managed real estate partnerships in the tables below, the Company accounts for the assets held by the entities primarily in Financial instruments owned and the liabilities of the entities as Other secured financings in the condensed consolidated statements of financial condition. For consolidated VIEs included in other structured financings, the Company accounts for the assets held by the entities primarily in Premises, equipment and software costs, and Other assets in the condensed consolidated statements of financial condition. For consolidated VIEs included in managed real estate partnerships, the Company accounts for the assets held by the entities primarily in Financial instruments owned Investments in the condensed consolidated statements of financial condition. Except for consolidated VIEs included in other structured financings, the assets and liabilities are measured at fair value, with changes in fair value reflected in earnings.

The assets owned by many consolidated VIEs cannot be removed unilaterally by the Company and are not generally available to the Company. The related liabilities issued by many consolidated VIEs are non-recourse to the Company. In certain other consolidated VIEs, the Company has the unilateral right to remove assets or provides additional recourse through derivatives such as total return swaps, guarantees or other forms of involvement.

The following tables present information at March 31, 2012 and December 31, 2011 about VIEs that the Company consolidates. Consolidated VIE assets and liabilities are presented after intercompany eliminations and include assets financed on a non-recourse basis.

	At March 31, 2012				
	Mortgage and Asset-backed Securitizations	Collateralized Debt Obligations	Managed Real Estate Partnerships (dollars in millions)	Other Structured Financings	Other
VIE assets	\$ 1,977	\$ 129	\$ 2,308	\$ 896	\$ 2,796
VIE liabilities	\$ 1,304	\$ 65	\$ 115	\$ 2,611	\$ 549

	At December 31, 2011				
	Mortgage and Asset-Backed Securitizations	Collateralized Debt Obligations	Managed Real Estate Partnerships (dollars in millions)	Other Structured Financings	Other
VIE assets	\$ 2,414	\$ 102	\$ 2,207	\$ 918	\$ 1,937
VIE liabilities	\$ 1,699	\$ 69	\$ 102	\$ 2,576	\$ 556

In general, the Company's exposure to loss in consolidated VIEs is limited to losses that would be absorbed on the VIE's assets recognized in its financial statements, net of losses absorbed by third-party holders of the VIE's liabilities. At March 31, 2012 and December 31, 2011, managed real estate partnerships reflected noncontrolling

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interests in the Company's condensed consolidated financial statements of \$1,719 million and \$1,653 million, respectively. The Company also had additional maximum exposure to losses of approximately \$194 million and \$200 million at March 31, 2012 and December 31, 2011, respectively. This additional exposure related primarily to certain derivatives (e.g., instead of purchasing senior securities, the Company has sold credit protection to synthetic CDOs through credit derivatives that are typically related to the most senior tranche of the CDO) and commitments, guarantees and other forms of involvement.

The following tables present information about certain non-consolidated VIEs in which the Company had variable interests at March 31, 2012 and December 31, 2011. The tables include all VIEs in which the Company has determined that its maximum exposure to loss is greater than specific thresholds or meets certain other criteria. Most of the VIEs included in the tables below are sponsored by unrelated parties; the Company's involvement generally is the result of the Company's secondary market-making activities or through securities held in its available for sale portfolio (see Note 4).

	At March 31, 2012				
	Mortgage and Asset-Backed Securitizations	Collateralized Debt Obligations	Municipal Tender Option Bonds	Other Structured Financings	Other
	(dollars in millions)				
VIE assets that the Company does not consolidate (unpaid principal balance)(1)	\$ 195,492	\$ 20,910	\$ 6,650	\$ 1,899	\$ 28,678
Maximum exposure to loss:					
Debt and equity interests(2)	\$ 16,785	\$ 748	\$ 134	\$ 937	\$ 2,436
Derivative and other contracts	92	98	4,133		1,102
Commitments, guarantees and other	592			775	990
Total maximum exposure to loss	\$ 17,469	\$ 846	\$ 4,267	\$ 1,712	\$ 4,528
Carrying value of exposure to loss Assets:					
Debt and equity interests(2)	\$ 16,785	\$ 748	\$ 134	\$ 596	\$ 2,436
Derivative and other contracts	91	42	7		338
Total carrying value of exposure to loss Assets	\$ 16,876	\$ 790	\$ 141	\$ 596	\$ 2,774
Carrying value of exposure to loss Liabilities:					
Derivative and other contracts	\$ 13	\$ 3	\$ 1		\$ 128
Commitments, guarantees and other				13	168
Total carrying value of exposure to loss Liabilities	\$ 13	\$ 3	\$ 1	\$ 13	\$ 296

(1) Mortgage and asset-backed securitizations include VIE assets as follows: \$11.3 billion of residential mortgages; \$55.4 billion of commercial mortgages; \$110.3 billion of U.S. agency collateralized mortgage obligations; and \$18.5 billion of other consumer or commercial loans.

(2) Mortgage and asset-backed securitizations include VIE debt and equity interests as follows: \$0.7 billion of residential mortgages; \$0.9 billion of commercial mortgages; \$13.5 billion of U.S. agency collateralized mortgage obligations; and \$1.7 billion of other consumer or commercial loans.

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	At December 31, 2011				
	Mortgage and Asset-Backed Securitizations	Collateralized Debt Obligations	Municipal Tender Option Bonds	Other Structured Financings	Other
	(dollars in millions)				
VIE assets that the Company does not consolidate (unpaid principal balance)(1)	\$ 231,110	\$ 7,593	\$ 6,833	\$ 1,944	\$ 20,997
Maximum exposure to loss:					
Debt and equity interests(2)	\$ 16,469	\$ 491	\$ 201	\$ 978	\$ 2,413
Derivative and other contracts	103	843	4,141		1,209
Commitments, guarantees and other	208			804	561
Total maximum exposure to loss	\$ 16,780	\$ 1,334	\$ 4,342	\$ 1,782	\$ 4,183
Carrying value of exposure to loss Assets:					
Debt and equity interests(2)	\$ 16,469	\$ 491	\$ 201	\$ 640	\$ 2,413
Derivative and other contracts	101	657	24		338
Total carrying value of exposure to loss Assets	\$ 16,570	\$ 1,148	\$ 225	\$ 640	\$ 2,751
Carrying value of exposure to loss Liabilities:					
Derivative and other contracts	\$ 13	\$ 159	\$	\$	\$ 114
Commitments, guarantees and other				14	176
Total carrying value of exposure to loss Liabilities	\$ 13	\$ 159	\$	\$ 14	\$ 290

(1) Mortgage and asset-backed securitizations include VIE assets as follows: \$9.1 billion of residential mortgages; \$81.7 billion of commercial mortgages; \$121.6 billion of U.S. agency collateralized mortgage obligations; and \$18.7 billion of other consumer or commercial loans. Prior period amounts were adjusted to conform to the current period's presentation.

(2) Mortgage and asset-backed securitizations include VIE debt and equity interests as follows: \$0.6 billion of residential mortgages; \$1.1 billion of commercial mortgages; \$13.5 billion of U.S. agency collateralized mortgage obligations; and \$1.3 billion of other consumer or commercial loans. Prior period amounts were adjusted to conform to the current period's presentation.

The Company's maximum exposure to loss often differs from the carrying value of the VIE's assets. The maximum exposure to loss is dependent on the nature of the Company's variable interest in the VIEs and is limited to the notional amounts of certain liquidity facilities, other credit support, total return swaps, written put options, and the fair value of certain other derivatives and investments the Company has made in the VIEs. Liabilities issued by VIEs generally are non-recourse to the Company. Where notional amounts are utilized in quantifying maximum exposure related to derivatives, such amounts do not reflect fair value writedowns already recorded by the Company.

The Company's maximum exposure to loss does not include the offsetting benefit of any financial instruments that the Company may utilize to hedge these risks associated with the Company's variable interests. In addition, the Company's maximum exposure to loss is not reduced by the amount of collateral held as part of a transaction with the VIE or any party to the VIE directly against a specific exposure to loss.

Securitization transactions generally involve VIEs. Primarily as a result of its secondary market-making activities, the Company owned additional securities issued by securitization SPEs for which the maximum exposure to loss is less than specific thresholds. These additional securities totaled \$3.7 billion at March 31, 2012. These securities were either retained in connection with transfers of assets by the Company, acquired in connection with secondary market-making activities or held in the Company's available for sale portfolio.

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Securities issued by securitization SPEs consist of \$0.7 billion of securities backed primarily by residential mortgage loans, \$1.0 billion of securities backed by U.S. agency collateralized mortgage obligations, \$0.8 billion of securities backed by commercial mortgage loans, \$0.6 billion of securities backed by collateralized debt obligations or collateralized loan obligations and \$0.6 billion backed by other consumer loans, such as credit card receivables, automobile loans and student loans. The Company's primary risk exposure is to the securities issued by the SPE owned by the Company, with the risk highest on the most subordinate class of beneficial interests. These securities generally are included in Financial instruments owned - Corporate and other debt or Securities available for sale and are measured at fair value. The Company does not provide additional support in these transactions through contractual facilities, such as liquidity facilities, guarantees or similar derivatives. The Company's maximum exposure to loss generally equals the fair value of the securities owned.

The Company's transactions with VIEs primarily include securitizations, municipal tender option bond trusts, credit protection purchased through CLNs, other structured financings, collateralized loan and debt obligations, equity-linked notes, managed real estate partnerships and asset management investment funds. The Company's continuing involvement in VIEs that it does not consolidate can include ownership of retained interests in Company-sponsored transactions, interests purchased in the secondary market (both for Company-sponsored transactions and transactions sponsored by third parties), derivatives with securitization SPEs (primarily interest rate derivatives in commercial mortgage and residential mortgage securitizations and credit derivatives in which the Company has purchased protection in synthetic CDOs), and as servicer in residential mortgage securitizations in the U.S. and Europe and commercial mortgage securitizations in Europe. Such activities are further described in Note 7 to the consolidated financial statements for the year ended December 31, 2011 included in the Form 10-K.

Transfers of Assets with Continuing Involvement.

The following tables present information at March 31, 2012 regarding transactions with SPEs in which the Company, acting as principal, transferred financial assets with continuing involvement and received sales treatment.

	At March 31, 2012			
	Residential Mortgage Loans	Commercial Mortgage Loans	U.S. Agency Collateralized Mortgage Obligations	Credit- Linked Notes and Other
	(dollars in millions)			
SPE assets (unpaid principal balance)(1)	\$ 40,715	\$ 78,844	\$ 23,591	\$ 13,824
Retained interests (fair value):				
Investment grade	\$ 13	\$ 20	\$ 493	\$ 3
Non-investment grade	113	51		1,549
Total retained interests (fair value)	\$ 126	\$ 71	\$ 493	\$ 1,552
Interests purchased in the secondary market (fair value):				
Investment grade	\$ 24	\$ 227	\$ 60	\$ 394
Non-investment grade	153	76		13
Total interests purchased in the secondary market (fair value)	\$ 177	\$ 303	\$ 60	\$ 407
Derivative assets (fair value)	\$ 12	\$ 1,214	\$	\$ 151
Derivative liabilities (fair value)	\$ 28	\$ 23	\$	\$ 392

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(1) Amounts include assets transferred by unrelated transferors.

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	Level 1	At March 31, 2012 Level 2 Level 3 (dollars in millions)		Total
Retained interests (fair value):				
Investment grade	\$	\$ 526	\$ 3	\$ 529
Non-investment grade		154	1,559	1,713
Total retained interests (fair value)	\$	\$ 680	\$ 1,562	\$ 2,242
Interests purchased in the secondary market (fair value):				
Investment grade	\$	\$ 705	\$	\$ 705
Non-investment grade		223	19	242
Total interests purchased in the secondary market (fair value)	\$	\$ 928	\$ 19	\$ 947
Derivative assets (fair value)	\$	\$ 745	\$ 632	\$ 1,377
Derivative liabilities (fair value)	\$	\$ 380	\$ 63	\$ 443
The following tables present information at December 31, 2011 regarding transactions with SPEs in which the Company, acting as principal, transferred assets with continuing involvement and received sales treatment.				

	At December 31, 2011			Credit-Linked Notes and Other
	Residential Mortgage Loans	Commercial Mortgage Loans	U.S. Agency Collateralized Mortgage Obligations	
	(dollars in millions)			
SPE assets (unpaid principal balance)(1)	\$ 41,977	\$ 85,333	\$ 33,728	\$ 14,315
Retained interests (fair value):				
Investment grade	\$ 14	\$ 22	\$ 1,151	\$ 2
Non-investment grade	106	44		1,545
Total retained interests (fair value)	\$ 120	\$ 66	\$ 1,151	\$ 1,547
Interests purchased in the secondary market (fair value):				
Investment grade	\$ 45	\$ 164	\$ 20	\$ 411
Non-investment grade	149	82		11
Total interests purchased in the secondary market (fair value)	\$ 194	\$ 246	\$ 20	\$ 422
Derivative assets (fair value)	\$ 18	\$ 1,200	\$	\$ 223
Derivative liabilities (fair value)	\$ 30	\$ 31	\$	\$ 510

(1) Amounts include assets transferred by unrelated transferors.

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	Level 1	At December 31, 2011		Total
		Level 2	Level 3	
		(dollars in millions)		
Retained interests (fair value):				
Investment grade	\$	\$ 1,186	\$ 3	\$ 1,189
Non-investment grade		74	1,621	1,695
Total retained interests (fair value)	\$	\$ 1,260	\$ 1,624	\$ 2,884
Interests purchased in the secondary market (fair value):				
Investment grade	\$	\$ 638	\$ 2	\$ 640
Non-investment grade		126	116	242
Total interests purchased in the secondary market (fair value)	\$	\$ 764	\$ 118	\$ 882
Derivative assets (fair value)	\$	\$ 869	\$ 572	\$ 1,441
Derivative liabilities (fair value)	\$	\$ 541	\$ 30	\$ 571

Transferred assets are carried at fair value prior to securitization, and any changes in fair value are recognized in the condensed consolidated statements of income. The Company may act as underwriter of the beneficial interests issued by securitization vehicles. Investment banking underwriting net revenues are recognized in connection with these transactions. The Company may retain interests in the securitized financial assets as one or more tranches of the securitization. These retained interests are included in the condensed consolidated statements of financial condition at fair value. Any changes in the fair value of such retained interests are recognized in the condensed consolidated statements of income.

Net gains on sales of assets in securitization transactions at the time of the sale were not material in the quarters ended March 31, 2012 and 2011.

During the quarters ended March 31, 2012 and 2011, the Company received proceeds from new securitization transactions of \$6.0 billion and \$7.9 billion, respectively. During the quarters ended March 31, 2012 and 2011, the Company received proceeds from cash flows from retained interests in securitization transactions of \$1.7 billion and \$2.4 billion, respectively.

The Company has provided, or otherwise agreed to be responsible for, representations and warranties regarding certain assets transferred in securitization transactions sponsored by the Company (see Note 11).

Failed Sales.

In order to be treated as a sale of assets for accounting purposes, a transaction must meet all of the criteria stipulated in the accounting guidance for the transfer of financial assets. If the transfer fails to meet these criteria, that transfer of financial assets is treated as a failed sale. In such case, the Company continues to recognize the assets in Financial instruments owned, and the Company recognizes the associated liabilities in Other secured financings in the condensed consolidated statements of financial condition.

The assets transferred to many unconsolidated VIEs in transactions accounted for as failed sales cannot be removed unilaterally by the Company and are not generally available to the Company. The related liabilities issued by many unconsolidated VIEs are non-recourse to the Company. In certain other failed sale transactions, the Company has the unilateral right to remove assets or provide additional recourse through derivatives such as total return swaps, guarantees or other forms of involvement.

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The following table presents information about the carrying value (equal to fair value) of assets and liabilities resulting from transfers of financial assets treated by the Company as secured financings:

	At March 31, 2012		At December 31, 2011	
	Assets	Carrying Value of Liabilities	Assets	Carrying Value of Liabilities
	(dollars in millions)			
Commercial mortgage loans	\$ 111	\$ 111	\$ 121	\$ 121
Credit-linked notes	318	268	383	339
Equity-linked transactions	812	778	1,243	1,214
Other	90	90	75	74

Mortgage Servicing Activities.

Mortgage Servicing Rights. The Company may retain servicing rights to certain mortgage loans that are sold. These transactions create an asset referred to as MSRs, which totaled approximately \$99 million and \$133 million at March 31, 2012 and December 31, 2011, respectively, and are included within Intangible assets and carried at fair value in the condensed consolidated statements of financial condition.

SPE Mortgage Servicing Activities. The Company services residential mortgage loans in the U.S. and commercial mortgage loans in Europe owned by SPEs, including SPEs sponsored by the Company and SPEs not sponsored by the Company. The Company generally holds retained interests in Company-sponsored SPEs. In some cases, as part of its market-making activities, the Company may own some beneficial interests issued by both Company-sponsored and non-Company sponsored SPEs.

The Company provides no credit support as part of its servicing activities. The Company is required to make servicing advances to the extent that it believes that such advances will be reimbursed. Reimbursement of servicing advances is a senior obligation of the SPE, senior to the most senior beneficial interests outstanding. Outstanding advances are included in Other assets and are recorded at cost, net of allowances. Advances at March 31, 2012 and December 31, 2011 totaled approximately \$1.2 billion and \$1.3 billion, respectively, net of allowances of \$5 million and \$14 million at March 31, 2012 and December 31, 2011, respectively.

The following tables present information about the Company's mortgage servicing activities for SPEs to which the Company transferred loans at March 31, 2012 and December 31, 2011:

	At March 31, 2012			
	Residential Mortgage Unconsolidated SPEs	Residential Mortgage Consolidated SPEs	Commercial Mortgage Unconsolidated SPEs	Commercial Mortgage Consolidated SPEs
	(dollars in millions)			
Assets serviced (unpaid principal balance)	\$ 9,545	\$ 2,119	\$ 6,157	\$ 924
Amounts past due 90 days or greater (unpaid principal balance)(1)	\$ 2,867	\$ 339	\$	\$
Percentage of amounts past due 90 days or greater(1)	30.0%	16.0%		
Credit losses	\$ 167	\$ 18	\$	\$

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- (1) Amounts include loans that are at least 90 days contractually delinquent, loans for which the borrower has filed for bankruptcy, loans in foreclosure and real estate owned.

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	At December 31, 2011			
	Residential Mortgage Unconsolidated SPEs	Residential Mortgage Consolidated SPEs	Commercial Mortgage Unconsolidated SPEs	Commercial Mortgage Consolidated SPEs
	(dollars in millions)			
Assets serviced (unpaid principal balance)	\$ 9,821	\$ 2,180	\$ 5,750	\$ 1,596
Amounts past due 90 days or greater (unpaid principal balance)(1)	\$ 3,087	\$ 354	\$	\$
Percentage of amounts past due 90 days or greater(1)	31.4%	16.2%		
Credit losses	\$ 631	\$ 81	\$	\$

(1) Amounts include loans that are at least 90 days contractually delinquent, loans for which the borrower has filed for bankruptcy, loans in foreclosure and real estate owned.

The Company also serviced residential and commercial mortgage loans for SPEs sponsored by unrelated parties with unpaid principal balances totaling \$10 billion and \$11 billion at March 31, 2012 and December 31, 2011, respectively.

The agreement to sell Saxon assets includes MSRs which totaled approximately \$84 million and approximately \$119 million at March 31, 2012 and December 31, 2011, respectively. After the completion of this asset sale, the Company will retain the servicing rights for residential mortgage loans held by consolidated SPEs with an unpaid principal balance of approximately \$836 million and approximately \$872 million at March 31, 2012 and December 31, 2011, respectively (see Notes 1 and 20).

7. Financing Receivables.*Loans held for investment.*

The Company's loans held for investment are recorded at amortized cost and classified as Loans in the condensed consolidated statements of financial condition.

The Company's loans held for investment at March 31, 2012 and December 31, 2011 included the following:

	At March 31, 2012	At December 31, 2011
	(dollars in millions)	
Commercial and industrial	\$ 5,358	\$ 5,083
Consumer loans	5,462	5,170
Residential real estate loans	5,092	4,674
Wholesale real estate loans	406	328
Total loans held for investment(1)	\$ 16,318	\$ 15,255

(1) Amounts are net of allowances of \$26 million and \$17 million at March 31, 2012 and December 31, 2011, respectively.

The above table does not include loans held for sale of \$411 million and \$114 million at March 31, 2012 and December 31, 2011, respectively.

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The Company's Credit Risk Management Department evaluates new obligors before credit transactions are initially approved, and at least annually thereafter for consumer and industrial loans. For corporate and

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commercial loans, credit evaluations typically involve the evaluation of financial statements, assessment of leverage, liquidity, capital strength, asset composition and quality, market capitalization and access to capital markets, cash flow projections and debt service requirements, and the adequacy of collateral, if applicable. The Company's Credit Risk Management Department will also evaluate strategy, market position, industry dynamics, obligor's management and other factors that could affect the obligor's risk profile. For residential real estate and consumer loans, the initial credit evaluation includes, but is not limited to, review of the obligor's income, net worth, liquidity, collateral, loan-to-value ratio, and credit bureau information. Subsequent credit monitoring for residential real estate loans is performed at the portfolio level. Consumer loan collateral values are monitored on an ongoing basis.

At March 31, 2012, the Company collectively evaluated for impairment, gross of the allowance, commercial and industrial loans, consumer loans, residential real estate loans and wholesale real estate loans of \$5,326 million, \$5,465 million, \$5,094 million and \$373 million, respectively. The Company individually evaluated for impairment, gross of the allowance, commercial and industrial loans and wholesale real estate loans of \$52 million and \$34 million, respectively. Commercial and industrial loans of approximately \$31 million and wholesale real estate loans of approximately \$34 million were impaired at March 31, 2012. Approximately 99% of the Company's loan portfolio was current at March 31, 2012.

At December 31, 2011, the Company collectively evaluated for impairment gross commercial and industrial loans, consumer loans, residential real estate loans and wholesale real estate loans of \$4,934 million, \$5,072 million, \$4,675 million and \$278 million, respectively. The Company individually evaluated for impairment gross commercial and industrial loans, consumer and wholesale real estate loans of \$163 million, \$100 million and \$50 million, respectively. Commercial and industrial loans of approximately \$33 million and wholesale real estate loans of approximately \$50 million were impaired at December 31, 2011. Approximately 99% of the Company's loan portfolio was current at December 31, 2011.

The Company assigned an internal grade of "doubtful" to certain commercial asset-backed and wholesale real estate loans totaling \$35 million and \$87 million at March 31, 2012 and December 31, 2011, respectively. Doubtful loans can be classified as current if the borrower is making payments in accordance with the loan agreement. The Company assigned an internal grade of "pass" to the majority of its remaining loan portfolio.

For a description of the Company's loan portfolio and credit quality indicators utilized in its credit monitoring process, see Note 8 to the consolidated financial statements for the year ended December 31, 2011 included in the Form 10-K.

Employee Loans.

Employee loans are granted primarily in conjunction with a program established in the Global Wealth Management Group business segment to retain and recruit certain employees. These loans are recorded in Receivables—Fees, interest and other in the consolidated statements of financial condition. These loans are full recourse, generally require periodic payments and have repayment terms ranging from one to 12 years. The Company establishes a reserve for loan amounts it does not consider recoverable from terminated employees, which is recorded in Compensation and benefits expense. At March 31, 2012, the Company had \$6,053 million of employee loans, net of an allowance of approximately \$131 million. At December 31, 2011, the Company had \$5,610 million of employee loans, net of an allowance of approximately \$119 million.

The Company has also granted loans to other employees primarily in conjunction with certain after-tax leveraged investment arrangements. At March 31, 2012, the balance of these loans was \$167 million, net of an allowance of

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

approximately \$131 million. At December 31, 2011, the balance of these loans was \$162 million, net of an allowance of approximately \$133 million. The Company establishes a reserve for non-recourse loan amounts not recoverable from employees, which is recorded in Other expense.

Collateralized Transactions.

In certain instances, the Company enters into reverse repurchase agreements and securities borrowed transactions to acquire securities to cover short positions, to settle other securities obligations and to accommodate customers' needs. The Company also engages in securities financing transactions for customers through margin lending (see Note 5).

Servicing Advances.

As part of its servicing activities, the Company may make servicing advances to the extent that it believes that such advances will be reimbursed (see Note 6).

8. Goodwill and Net Intangible Assets.

The Company tests goodwill for impairment on an annual basis and on an interim basis when certain events or circumstances exist. The Company tests for impairment at the reporting unit level, which is generally at the level of or one level below its business segments. For both the annual and interim tests, the Company has the option to first assess qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If after assessing the totality of events or circumstances, the Company determines it is more likely than not that the fair value of a reporting unit is greater than its carrying amount, then performing the two-step impairment test is not required. However, if the Company concludes otherwise, then it is required to perform the first step of the two-step impairment test. Goodwill impairment is determined by comparing the estimated fair value of a reporting unit with its respective carrying value. If the estimated fair value exceeds the carrying value, goodwill at the reporting unit level is not deemed to be impaired. If the estimated fair value is below carrying value, however, further analysis is required to determine the amount of the impairment. Additionally, if the carrying value of a reporting unit is zero or a negative value and it is determined that it is more likely than not the goodwill is impaired, further analysis is required. The estimated fair values of the reporting units are derived based on valuation techniques the Company believes market participants would use for each of the reporting units.

The estimated fair values of the reporting units are generally determined utilizing methodologies that incorporate price-to-book and price-to-earnings multiples of certain comparable companies. The Company also utilizes a discounted cash flow methodology for certain reporting units.

The Company completed its annual goodwill impairment testing at July 1, 2011. The Company's testing did not indicate any goodwill impairment. Due to the volatility in the equity markets, the economic outlook and the Company's common shares trading below book value during the quarter ended March 31, 2012, the Company performed additional impairment testing at March 31, 2012, which did not result in any goodwill impairment. Adverse market or economic events could result in impairment charges in future periods.

Table of Contents**MORGAN STANLEY****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)*****Goodwill.***

Changes in the carrying amount of the Company's goodwill, net of accumulated impairment losses for the quarter ended March 31, 2012, were as follows:

	Institutional Securities	Global Wealth Management Group	Asset Management	Total
		(dollars in millions)		
Goodwill at December 31, 2011(1)	\$ 330	\$ 5,616	\$ 740	\$ 6,686
Foreign currency translation adjustments and other	14			14
Goodwill at March 31, 2012(1)	\$ 344	\$ 5,616	\$ 740	\$ 6,700

(1) The amount of the Company's goodwill before accumulated impairments of \$700 million, which included \$673 million related to the Institutional Securities business segment and \$27 million related to the Asset Management business segment, was \$7,400 million and \$7,386 million at March 31, 2012 and December 31, 2011, respectively.

Net Intangible Assets.

Changes in the carrying amount of the Company's intangible assets for the quarter ended March 31, 2012 were as follows:

	Institutional Securities	Global Wealth Management Group	Asset Management	Total
		(dollars in millions)		
Amortizable net intangible assets at December 31, 2011	\$ 229	\$ 3,641	\$ 2	\$ 3,872
Mortgage servicing rights (see Note 6)	122	11		133
Indefinite-lived intangible assets		280		280
Net intangible assets at December 31, 2011	\$ 351	\$ 3,932	\$ 2	\$ 4,285
Amortizable net intangible assets at December 31, 2011	\$ 229	\$ 3,641	\$ 2	\$ 3,872
Foreign currency translation adjustments and other	3			3
Amortization expense	(4)	(80)		(84)
Impairment losses(1)	(2)			(2)
Intangible assets acquired during the period	2			2
Amortizable net intangible assets at March 31, 2012	228	3,561	2	3,791
Mortgage servicing rights (see Note 6)	87	12		99
Indefinite-lived intangible assets		280		280
Net intangible assets at March 31, 2012	\$ 315	\$ 3,853	\$ 2	\$ 4,170

(1) Impairment losses are recorded within Other expenses.

9. Long-Term Borrowings and Other Secured Financings.

The Company's long-term borrowings included the following components:

	At March 31, 2012	At December 31, 2011
	(dollars in millions)	
Senior debt	\$ 167,986	\$ 175,471
Subordinated debt	3,899	3,910
Junior subordinated debentures	4,838	4,853
Total	\$ 176,723	\$ 184,234

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During the quarter ended March 31, 2012, the Company issued notes with a principal amount of approximately \$5 billion. During the quarter ended March 31, 2012, approximately \$16 billion of notes were matured or retired.

The weighted average maturity of the Company's long-term borrowings, based upon stated maturity dates, was approximately 5.3 years and 5.0 years at March 31, 2012 and December 31, 2011, respectively.

FDIC's Temporary Liquidity Guarantee Program.

At March 31, 2012 and December 31, 2011, the Company had long-term debt outstanding of \$4.7 billion and \$12.1 billion, respectively, under the Temporary Liquidity Guarantee Program (TLGP). The issuance of debt under the TLGP expired on December 31, 2010, but the existing long-term debt outstanding is guaranteed until June 30, 2012. These borrowings are senior unsecured debt obligations of the Company and guaranteed by the FDIC under the TLGP. The FDIC has concluded that the guarantee is backed by the full faith and credit of the U.S. government.

Other Secured Financings.

Other secured financings include the liabilities related to transfers of financial assets that are accounted for as financings rather than sales, consolidated VIEs where the Company is deemed to be the primary beneficiary, pledged commodities, certain equity-linked notes and other secured borrowings. See Note 6 for further information on other secured financings related to variable interest entities and securitization activities.

The Company's other secured financings consisted of the following:

	At March 31, 2012	At December 31, 2011
	(dollars in millions)	
Secured financings with original maturities greater than one year	\$ 19,883	\$ 18,696
Secured financings with original maturities one year or less	305	275
Failed sales(1)	1,247	1,748
Total(2)	\$ 21,435	\$ 20,719

(1) For more information on failed sales, see Note 6.

(2) Amounts include \$13,081 million and \$14,594 million at fair value at March 31, 2012 and December 31, 2011, respectively.

10. Derivative Instruments and Hedging Activities.

The Company trades, makes markets and takes proprietary positions globally in listed futures, OTC swaps, forwards, options and other derivatives referencing, among other things, interest rates, currencies, investment grade and non-investment grade corporate credits, loans, bonds, U.S. and other sovereign securities, emerging market bonds and loans, credit indices, asset-backed security indices, property indices, mortgage-related and other asset-backed securities, and real estate loan products. The Company uses these instruments for trading, foreign currency exposure management and asset and liability management.

The Company manages its trading positions by employing a variety of risk mitigation strategies. These strategies include diversification of risk exposures and hedging. Hedging activities consist of the purchase or sale of positions in related securities and financial instruments, including a

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variety of derivative products (*e.g.*, futures, forwards, swaps and options). The Company manages the market risk associated with its trading activities on a Company-wide basis, on a worldwide trading division level and on an individual product basis.

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The Company's derivative products consist of the following:

	At March 31, 2012		At December 31, 2011	
	Assets	Liabilities	Assets	Liabilities
	(dollars in millions)			
Exchange traded derivative products	\$ 3,882	\$ 6,071	\$ 4,103	\$ 4,969
OTC derivative products	36,134	36,694	43,961	41,484
Total	\$ 40,016	\$ 42,765	\$ 48,064	\$ 46,453

The Company incurs credit risk as a dealer in OTC derivatives. Credit risk with respect to derivative instruments arises from the failure of a counterparty to perform according to the terms of the contract. The Company's exposure to credit risk at any point in time is represented by the fair value of the derivative contracts reported as assets. The fair value of a derivative represents the amount at which the derivative could be exchanged in an orderly transaction between market participants and is further described in Notes 2 and 3.

In connection with its OTC derivative activities, the Company generally enters into master netting agreements and collateral arrangements with counterparties. These agreements provide the Company with the ability to offset a counterparty's rights and obligations, request additional collateral when necessary or liquidate the collateral in the event of counterparty default.

The tables below present a summary by counterparty credit rating and remaining contract maturity of the fair value of OTC derivatives in a gain position at March 31, 2012 and December 31, 2011, respectively. Fair value is presented in the final column, net of collateral received (principally cash and U.S. government and agency securities):

OTC Derivative Products Financial Instruments Owned at March 31, 2012(1)

Credit Rating(2)	Years to Maturity				Cross-Maturity and Cash Collateral Netting(3) (dollars in millions)	Net Exposure Post-Cash Collateral	Net Exposure Post-Collateral
	Less than 1	1 - 3	3 - 5	Over 5			
AAA	\$ 224	\$ 1,058	\$ 1,276	\$ 7,837	\$ (5,813)	\$ 4,582	\$ 4,408
AA	2,983	5,988	5,226	16,675	(22,926)	7,946	5,959
A	6,867	5,478	10,791	28,012	(41,189)	9,959	6,769
BBB	3,456	3,638	2,838	14,690	(16,673)	7,949	6,544
Non-investment grade	2,931	2,991	1,832	4,216	(6,272)	5,698	3,144
Total	\$ 16,461	\$ 19,153	\$ 21,963	\$ 71,430	\$ (92,873)	\$ 36,134	\$ 26,824

(1) Fair values shown represent the Company's net exposure to counterparties related to the Company's OTC derivative products. Amounts include centrally cleared derivatives. The table does not include listed derivatives and the effect of any related hedges utilized by the Company.

(2) Obligor credit ratings are determined by the Company's Credit Risk Management Department.

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- (3) Amounts represent the netting of receivable balances with payable balances for the same counterparty across maturity categories. Receivable and payable balances with the same counterparty in the same maturity category are netted within such maturity category, where appropriate. Cash collateral received is netted on a counterparty basis, provided legal right of offset exists.

Table of Contents**MORGAN STANLEY****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****OTC Derivative Products Financial Instruments Owned at December 31, 2011(1)**

Credit Rating(2)	Years to Maturity				Cross-Maturity and Cash Collateral Netting(3) (dollars in millions)	Net Exposure Post-Cash Collateral	Net Exposure Post-Collateral
	Less than 1	1 - 3	3 - 5	Over 5			
AAA	\$ 621	\$ 1,615	\$ 1,586	\$ 10,375	\$ (7,513)	\$ 6,684	\$ 6,389
AA	5,578	7,547	5,972	21,068	(31,074)	9,091	7,048
A	7,576	5,538	10,224	27,417	(41,608)	9,147	7,117
BBB	4,437	4,448	3,231	17,758	(17,932)	11,942	10,337
Non-investment grade	2,819	2,949	2,703	5,084	(6,458)	7,097	4,158
Total	\$ 21,031	\$ 22,097	\$ 23,716	\$ 81,702	\$ (104,585)	\$ 43,961	\$ 35,049

- (1) Fair values shown represent the Company's net exposure to counterparties related to the Company's OTC derivative products. Amounts include centrally cleared derivatives. The table does not include listed derivatives and the effect of any related hedges utilized by the Company.
- (2) Obligor credit ratings are determined by the Company's Credit Risk Management Department.
- (3) Amounts represent the netting of receivable balances with payable balances for the same counterparty across maturity categories. Receivable and payable balances with the same counterparty in the same maturity category are netted within such maturity category, where appropriate. Cash collateral received is netted on a counterparty basis, provided legal right of offset exists.

Hedge Accounting.

The Company applies hedge accounting using various derivative financial instruments to hedge interest rate and foreign exchange risk arising from assets and liabilities not held at fair value as part of asset and liability management and foreign currency exposure management.

The Company's hedges are designated and qualify for accounting purposes as one of the following types of hedges: hedges of exposure to changes in fair value of assets and liabilities being hedged (fair value hedges) and hedges of net investments in foreign operations whose functional currency is different from the reporting currency of the parent company (net investment hedges).

For all hedges where hedge accounting is being applied, effectiveness testing and other procedures to ensure the ongoing validity of the hedges are performed at least monthly.

Fair Value Hedges Interest Rate Risk. The Company's designated fair value hedges consisted primarily of interest rate swaps designated as fair value hedges of changes in the benchmark interest rate of fixed rate senior long-term borrowings. The Company uses regression analysis to perform an ongoing prospective and retrospective assessment of the effectiveness of these hedging relationships (*i.e.*, the Company applies the long-haul method of hedge accounting). A hedging relationship is deemed effective if the fair values of the hedging instrument (derivative) and the hedged item (debt liability) change inversely within a range of 80% to 125%. The Company considers the impact of valuation adjustments related to the Company's own credit spreads and counterparty credit spreads to determine whether they would cause the hedging relationship to be ineffective.

For qualifying fair value hedges of benchmark interest rates, the changes in the fair value of the derivative and the changes in the fair value of the hedged liability provide offset of one another and, together with any resulting ineffectiveness, are recorded in Interest expense. When a derivative is de-designated as a hedge, any basis adjustment remaining on the hedged liability is amortized to Interest expense over the remaining life of the liability using the effective interest method.

Table of Contents**MORGAN STANLEY****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Net Investment Hedges. The Company may utilize forward foreign exchange contracts to manage the currency exposure relating to its net investments in non-U.S. dollar functional currency operations. No hedge ineffectiveness is recognized in earnings since the notional amounts of the hedging instruments equal the portion of the investments being hedged and the currencies being exchanged are the functional currencies of the parent and investee. The gain or loss from revaluing hedges of net investments in foreign operations at the spot rate is deferred and reported within Accumulated other comprehensive income (loss) in Total Equity, net of tax effects. The forward points on the hedging instruments are recorded in Interest income.

The following tables summarize the fair value of derivative instruments designated as accounting hedges and the fair value of derivative instruments not designated as accounting hedges by type of derivative contract on a gross basis. Fair values of derivative contracts in an asset position are included in Financial instruments owned Derivative and other contracts. Fair values of derivative contracts in a liability position are reflected in Financial instruments sold, not yet purchased Derivative and other contracts.

	Assets at March 31, 2012		Liabilities at March 31, 2012	
	Fair Value	Notional (dollars in millions)	Fair Value	Notional
Derivatives designated as accounting hedges:				
Interest rate contracts	\$ 7,759	\$ 72,728	\$	\$
Foreign exchange contracts	392	12,845	148	9,692
Total derivatives designated as accounting hedges	8,151	85,573	148	9,692
Derivatives not designated as accounting hedges(1):				
Interest rate contracts	783,760	20,207,486	762,593	19,864,081
Credit contracts	99,996	2,382,764	93,766	2,331,035
Foreign exchange contracts	47,707	1,718,721	50,783	1,803,265
Equity contracts	46,538	673,987	51,149	689,748
Commodity contracts	40,116	430,298	40,506	385,031
Other	61	3,448	72	6,058
Total derivatives not designated as accounting hedges	1,018,178	25,416,704	998,869	25,079,218
Total derivatives	\$ 1,026,329	\$ 25,502,277	\$ 999,017	\$ 25,088,910
Cash collateral netting	(68,587)		(38,526)	
Counterparty netting	(917,726)		(917,726)	
Total derivatives	\$ 40,016	\$ 25,502,277	\$ 42,765	\$ 25,088,910

- (1) Notional amounts include net notionals related to long and short futures contracts of \$85 billion and \$75 billion, respectively. The variation margin on these futures contracts (excluded from the table above) of \$189 million and \$36 million is included in Receivables Brokers, dealers and clearing organizations and Payables Brokers, dealers and clearing organizations, respectively, on the condensed consolidated statements of financial condition.

Table of Contents**MORGAN STANLEY****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

	Assets at December 31, 2011		Liabilities at December 31, 2011	
	Fair Value	Notional	Fair Value	Notional
	(dollars in millions)			
Derivatives designated as accounting hedges:				
Interest rate contracts	\$ 8,151	\$ 71,706	\$	\$
Foreign exchange contracts	348	12,222	57	7,111
Total derivatives designated as accounting hedges	8,499	83,928	57	7,111
Derivatives not designated as accounting hedges(1):				
Interest rate contracts	904,725	21,099,876	880,027	21,005,733
Credit contracts	138,791	2,466,623	130,726	2,428,042
Foreign exchange contracts	61,995	1,582,364	64,691	1,604,493
Equity contracts	46,287	603,290	48,286	595,146
Commodity contracts	39,778	411,661	39,998	374,594
Other	598	11,662	2,275	24,905
Total derivatives not designated as accounting hedges	1,192,174	26,175,476	1,166,003	26,032,913
Total derivatives	\$ 1,200,673	\$ 26,259,404	\$ 1,166,060	\$ 26,040,024
Cash collateral netting	(77,938)		(44,936)	
Counterparty netting	(1,074,671)		(1,074,671)	
Total derivatives	\$ 48,064	\$ 26,259,404	\$ 46,453	\$ 26,040,024

(1) Notional amounts include net notionals related to long and short futures contracts of \$77 billion and \$66 billion, respectively. The variation margin on these futures contracts (excluded from the table above) of \$605 million and \$37 million is included in Receivables Brokers, dealers and clearing organizations and Payables Brokers, dealers and clearing organizations, respectively, on the condensed consolidated statements of financial condition.

The following tables summarize the gains or losses reported on derivative instruments designated and qualifying as accounting hedges for the quarters ended March 31, 2012 and 2011, respectively.

Derivatives Designated as Fair Value Hedges.

The following table presents gains (losses) reported on derivative instruments and the related hedge item as well as the hedge ineffectiveness included in Interest expense in the condensed consolidated statements of income from interest rate contracts:

Product Type	Gains (Losses) Recognized Three Months Ended March 31,	
	2012	2011
	(dollars in millions)	
Derivatives	\$ (546)	\$ (1,095)
Borrowings	698	1,258
Total	\$ 152	\$ 163

Table of Contents**MORGAN STANLEY****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)***Derivatives Designated as Net Investment Hedges.*

Product Type	Gains (Losses) Recognized in OCI (effective portion) Three Months Ended March 31, (dollars in millions)	
	2012	2011
Foreign exchange contracts(1)	\$ 21	\$ (126)
Total	\$ 21	\$ (126)

(1) Losses of \$66 million and \$47 million were recognized in income related to amounts excluded from hedge effectiveness testing during the quarters ended March 31, 2012 and 2011, respectively.

The table below summarizes gains (losses) on derivative instruments not designated as accounting hedges for the quarters ended March 31, 2012 and 2011, respectively:

Product Type	Gains (Losses) Recognized in Income(1)(2) Three Months Ended March 31, (dollars in millions)	
	2012	2011
Interest rate contracts	\$ 1,607	\$ 925
Credit contracts	(672)	(697)
Foreign exchange contracts	595	(339)
Equity contracts	(828)	(1,319)
Commodity contracts	(576)	(271)
Other contracts	55	208
Total derivative instruments	\$ 181	\$ (1,493)

(1) Gains (losses) on derivative contracts not designated as hedges are primarily included in Principal transactions Trading.

(2) Gains (losses) associated with certain derivative contracts that have physically settled are excluded from the table above. Gains (losses) on these contracts are reflected with the associated cash instruments, which are also included in Principal transactions Trading.

The Company also has certain embedded derivatives that have been bifurcated from the related structured borrowings. Such derivatives are classified in Long-term borrowings and had a net fair value of \$42 million and \$53 million at March 31, 2012 and December 31, 2011, respectively, and a notional value of \$3,299 million and \$3,312 million at March 31, 2012 and December 31, 2011, respectively. The Company recognized gains of \$7 million and losses of \$19 million related to changes in the fair value of its bifurcated embedded derivatives for the quarters ended March 31, 2012 and 2011, respectively.

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At March 31, 2012 and December 31, 2011, the amount of payables associated with cash collateral received that was netted against derivative assets was \$68.6 billion and \$77.9 billion, respectively, and the amount of receivables in respect of cash collateral paid that was netted against derivative liabilities was \$38.5 billion and \$44.9 billion, respectively. Cash collateral receivables and payables of \$276 million and \$32 million, respectively, at March 31, 2012 and \$268 million and \$9 million, respectively, at December 31, 2011, were not offset against certain contracts that did not meet the definition of a derivative.

Table of Contents**MORGAN STANLEY****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)*****Credit-Risk-Related Contingencies.***

In connection with certain OTC trading agreements, the Company may be required to provide additional collateral or immediately settle any outstanding liability balances with certain counterparties in the event of a credit ratings downgrade. At March 31, 2012, the aggregate fair value of OTC derivative contracts that contain credit-risk-related contingent features that are in a net liability position totaled \$34,669 million, for which the Company has posted collateral of \$28,717 million, in the normal course of business. The long-term credit ratings on the Company by Moody's Investors Service (Moody's) and Standard & Poor's Ratings Services (S&P) are currently at different levels (commonly referred to as split ratings). At March 31, 2012, the following are the amounts of additional collateral termination payments or other contractual amounts that could be called by counterparties under the terms of such agreements in the event of a downgrade of the Company's long-term credit rating under various scenarios: \$135 million (A3 Moody's/A- S&P) and \$3,432 million (Baa1 Moody's/BBB+ S&P). Of these amounts, \$2,883 million at March 31, 2012 related to bilateral arrangements between the Company and other parties where upon the downgrade of one party, the downgraded party must deliver incremental collateral to the other party. These bilateral downgrade arrangements are a risk management tool used extensively by the Company as credit exposures are reduced if counterparties are downgraded.

Credit Derivatives and Other Credit Contracts.

The Company enters into credit derivatives, principally through credit default swaps, under which it receives or provides protection against the risk of default on a set of debt obligations issued by a specified reference entity or entities. A majority of the Company's counterparties are banks, broker-dealers, insurance and other financial institutions, and monoline insurers.

The tables below summarize the notional and fair value of protection sold and protection purchased through credit default swaps at March 31, 2012 and December 31, 2011:

	At March 31, 2012			
	Maximum Potential Payout/Notional			
	Protection Sold			Protection Purchased
	Notional	Fair Value (Asset)/Liability (dollars in millions)	Notional	Fair Value (Asset)/Liability
Single name credit default swaps	\$ 1,285,767	\$ 21,182	\$ 1,266,956	\$ (20,328)
Index and basket credit default swaps	716,615	13,068	548,335	(11,560)
Tranched index and basket credit default swaps	349,543	8,100	546,583	(16,692)
Total	\$ 2,351,925	\$ 42,350	\$ 2,361,874	\$ (48,580)

	At December 31, 2011			
	Maximum Potential Payout/Notional			
	Protection Sold			Protection Purchased
	Notional	Fair Value (Asset)/Liability (dollars in millions)	Notional	Fair Value (Asset)/Liability
Single name credit default swaps	\$ 1,325,045	\$ 47,045	\$ 1,315,333	\$ (45,345)
Index and basket credit default swaps	787,228	29,475	601,452	(24,373)
Tranched index and basket credit default swaps	320,131	17,109	545,476	(31,976)
Total	\$ 2,432,404	\$ 93,629	\$ 2,462,261	\$ (101,694)

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The table below summarizes the credit ratings and maturities of protection sold through credit default swaps and other credit contracts at March 31, 2012:

Credit Ratings of the Reference Obligation	Protection Sold Maximum Potential Payout/Notional Years to Maturity					Fair Value (Asset)/ Liability(1)(2)
	Less than 1	1-3	3-5 (dollars in millions)	Over 5	Total	
Single name credit default swaps:						
AAA	\$ 1,733	\$ 5,488	\$ 16,458	\$ 10,828	\$ 34,507	\$ 673
AA	11,876	19,269	23,462	12,448	67,055	603
A	77,436	116,747	85,603	46,123	325,909	4,760
BBB	139,019	207,126	113,761	57,297	517,203	(2,771)
Non-investment grade	95,683	124,621	79,016	41,773	341,093	17,917
Total	325,747	473,251	318,300	168,469	1,285,767	21,182
Index and basket credit default swaps(3):						
AAA	49,836	68,416	48,295	26,424	192,971	(1,688)
AA	3,945	7,973	10,567	9,691	32,176	202
A	4,023	11,023	29,450	16,832	61,328	1,708
BBB	8,605	82,109	186,346	77,980	355,040	1,519
Non-investment grade	111,557	119,125	125,080	68,881	424,643	19,427
Total	177,966	288,646	399,738	199,808	1,066,158	21,168
Total credit default swaps sold	\$ 503,713	\$ 761,897	\$ 718,038	\$ 368,277	\$ 2,351,925	\$ 42,350
Other credit contracts(4)(5)	\$ 186	\$ 1,125	\$ 527	\$ 2,721	\$ 4,559	\$ (1,787)
Total credit derivatives and other credit contracts	\$ 503,899	\$ 763,022	\$ 718,565	\$ 370,998	\$ 2,356,484	\$ 40,563

(1) Fair value amounts are shown on a gross basis prior to cash collateral or counterparty netting.

(2) Fair value amounts of certain credit default swaps where the Company sold protection have an asset carrying value because credit spreads of the underlying reference entity or entities tightened during the terms of the contracts.

(3) Credit ratings are calculated internally.

(4) Other credit contracts include CLNs, CDOs and credit default swaps that are considered hybrid instruments.

(5) Fair value amount shown represents the fair value of the hybrid instruments.

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The table below summarizes the credit ratings and maturities of protection sold through credit default swaps and other credit contracts at December 31, 2011:

Credit Ratings of the Reference Obligation	Protection Sold Maximum Potential Payout/Notional Years to Maturity				Total	Fair Value (Asset)/ Liability(1)(2)
	Less than 1	1-3	3-5 (dollars in millions)	Over 5		
Single name credit default swaps:						
AAA	\$ 1,290	\$ 5,681	\$ 24,087	\$ 12,942	\$ 44,000	\$ 1,536
AA	12,416	22,043	23,341	10,986	68,786	1,597
A	67,344	124,445	85,543	47,640	324,972	8,683
BBB	131,588	218,262	115,320	64,347	529,517	4,789
Non-investment grade	94,105	133,867	82,163	47,635	357,770	30,440
Total	306,743	504,298	330,454	183,550	1,325,045	47,045
Index and basket credit default swaps(3):						
AAA	48,115	49,997	33,584	19,110	150,806	(907)
AA	6,584	15,349	9,498	15,745	47,176	1,053
A	5,202	18,996	17,396	12,286	53,880	2,470
BBB	8,525	99,004	235,888	32,057	375,474	8,365
Non-investment grade	112,451	141,042	160,537	65,993	480,023	35,603
Total	180,877	324,388	456,903	145,191	1,107,359	46,584
Total credit default swaps sold	\$ 487,620	\$ 828,686	\$ 787,357	\$ 328,741	\$ 2,432,404	\$ 93,629
Other credit contracts(4)(5)	\$ 65	\$ 2,356	\$ 717	\$ 2,469	\$ 5,607	\$ (1,146)
Total credit derivatives and other credit contracts	\$ 487,685	\$ 831,042	\$ 788,074	\$ 331,210	\$ 2,438,011	\$ 92,483

(1) Fair value amounts are shown on a gross basis prior to cash collateral or counterparty netting.

(2) Fair value amounts of certain credit default swaps where the Company sold protection have an asset carrying value because credit spreads of the underlying reference entity or entities tightened during the terms of the contracts.

(3) Credit ratings are calculated internally.

(4) Other credit contracts include CLNs, CDOs and credit default swaps that are considered hybrid instruments.

(5) Fair value amount shown represents the fair value of the hybrid instruments.

Single Name Credit Default Swaps. A credit default swap protects the buyer against the loss of principal on a bond or loan in case of a default by the issuer. The protection buyer pays a periodic premium (generally quarterly) over the life of the contract and is protected for the period. The Company in turn will have to perform under a credit default swap if a credit event as defined under the contract occurs. Typical credit events include bankruptcy, dissolution or insolvency of the referenced entity, failure to pay and restructuring of the obligations of the referenced entity. In order to provide an indication of the current payment status or performance risk of the credit default swaps, the external credit ratings of the underlying reference entity of the credit default swaps are disclosed.

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Index and Basket Credit Default Swaps. Index and basket credit default swaps are credit default swaps that reference multiple names through underlying baskets or portfolios of single name credit default swaps. Generally, in the event of a default on one of the underlying names, the Company will have to pay a pro rata portion of the total notional amount of the credit default index or basket contract. In order to provide an indication of the current payment status or performance risk of these credit default swaps, the weighted average external credit ratings of the underlying reference entities comprising the basket or index were calculated and disclosed.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Company also enters into index and basket credit default swaps where the credit protection provided is based upon the application of tranching techniques. In tranching transactions, the credit risk of an index or basket is separated into various portions of the capital structure, with different levels of subordination. The most junior tranches cover initial defaults, and once losses exceed the notional of the tranche, they are passed on to the next most senior tranche in the capital structure.

When external credit ratings are not available, credit ratings were determined based upon an internal methodology.

Credit Protection Sold through CLNs and CDOs. The Company has invested in CLNs and CDOs, which are hybrid instruments containing embedded derivatives, in which credit protection has been sold to the issuer of the note. If there is a credit event of a reference entity underlying the instrument, the principal balance of the note may not be repaid in full to the Company.

Purchased Credit Protection with Identical Underlying Reference Obligations. For single name credit default swaps and non-tranched index and basket credit default swaps, the Company has purchased protection with a notional amount of approximately \$2.0 trillion and \$1.9 trillion at March 31, 2012 and December 31, 2011, compared with a notional amount of approximately \$1.8 trillion and \$2.1 trillion, at March 31, 2012 and December 31, 2011, respectively, of credit protection sold with identical underlying reference obligations. In order to identify purchased protection with the same underlying reference obligations, the notional amount for individual reference obligations within non-tranched indices and baskets was determined on a pro rata basis and matched off against single name and non-tranched index and basket credit default swaps where credit protection was sold with identical underlying reference obligations.

The purchase of credit protection does not represent the sole manner in which the Company risk manages its exposure to credit derivatives. The Company manages its exposure to these derivative contracts through a variety of risk mitigation strategies, which include managing the credit and correlation risk across single name, non-tranched indices and baskets, tranched indices and baskets, and cash positions. Aggregate market risk limits have been established for credit derivatives, and market risk measures are routinely monitored against these limits. The Company may also recover amounts on the underlying reference obligation delivered to the Company under credit default swaps where credit protection was sold.

Table of Contents**MORGAN STANLEY****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****11. Commitments, Guarantees and Contingencies.****Commitments.**

The Company's commitments associated with outstanding letters of credit and other financial guarantees obtained to satisfy collateral requirements, investment activities, corporate lending and financing arrangements, mortgage lending and margin lending at March 31, 2012 are summarized below by period of expiration. Since commitments associated with these instruments may expire unused, the amounts shown do not necessarily reflect the actual future cash funding requirements:

	Less than 1	Years to Maturity			Total at March 31, 2012
		1-3	3-5	Over 5	
			(dollars in millions)		
Letters of credit and other financial guarantees obtained to satisfy collateral requirements	\$ 2,068	\$ 12	\$ 6	\$	\$ 2,086
Investment activities	1,160	238	44	274	1,716
Primary lending commitments investment grade(1)(2)	10,181	9,854	31,778	1,997	53,810
Primary lending commitments non-investment grade(2)	2,182	2,789	9,981	897	15,849
Secondary lending commitments(3)	56	203	20	112	391
Commitments for secured lending transactions	1,299	251	198		1,748
Forward starting reverse repurchase agreements and securities borrowing agreements(4)	74,317				74,317
Commercial and residential mortgage-related commitments	1,378	26	201	450	2,055
Other commitments	1,262	248	5	1	1,516
Total	\$ 93,903	\$ 13,621	\$ 42,233	\$ 3,731	\$ 153,488

- (1) This amount includes commitments to asset-backed commercial paper conduits of \$275 million at March 31, 2012, of which \$138 million have maturities of less than one year and \$137 million of which have maturities of one to three years.
- (2) This amount includes \$12.2 billion of investment grade and \$3.5 billion of non-investment grade unfunded commitments accounted for as held for investment and \$68 million of investment grade and \$191 million of non-investment grade unfunded commitments accounted for as held for sale at March 31, 2012. The remainder of these lending commitments are carried at fair value.
- (3) These commitments are recorded at fair value within Financial instruments owned and Financial instruments sold, not yet purchased in the condensed consolidated statements of financial condition (see Note 3).
- (4) The Company enters into forward starting reverse repurchase and securities borrowing agreements (agreements that have a trade date at or prior to March 31, 2012 and settle subsequent to period-end) that are primarily secured by collateral from U.S. government agency securities and other sovereign government obligations. These agreements primarily settle within three business days and of the amount at March 31, 2012, \$70.7 billion settled within three business days.

For further description of these commitments, refer to Note 13 to the consolidated financial statements for the year ended December 31, 2011 included in the Form 10-K.

The Company sponsors several non-consolidated investment funds for third-party investors where the Company typically acts as general partner of, and investment advisor to, these funds and typically commits to invest a minority of the capital of such funds, with subscribing third-party investors contributing the majority. The Company's employees, including its senior officers, as well as the Company's directors, may participate on the same terms and conditions as other investors in certain of these funds that the Company forms primarily for client investment, except that the Company may waive or lower applicable fees and charges for its employees. The Company has contractual capital commitments, guarantees, lending facilities and counterparty arrangements with respect to these investment funds.

Table of Contents**MORGAN STANLEY****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Guarantees.**

The table below summarizes certain information regarding the Company's obligations under guarantee arrangements at March 31, 2012:

Type of Guarantee	Maximum Potential Payout/Notional Years to Maturity				Total	Carrying Amount (Asset)/ Liability	Collateral/ Recourse
	Less than 1	1-3	3-5	Over 5 (dollars in millions)			
Credit derivative contracts(1)	\$ 503,713	\$ 761,897	\$ 718,038	\$ 368,277	\$ 2,351,925	\$ 42,350	\$
Other credit contracts	186	1,125	527	2,721	4,559	(1,787)	
Non-credit derivative contracts(1)	1,084,120	889,974	375,232	424,365	2,773,691	85,784	
Standby letters of credit and other financial guarantees issued(2)(3)	1,247	1,704	1,253	5,604	9,808	(141)	6,788
Market value guarantees		51	188	553	792	13	89
Liquidity facilities	4,827	305	37	67	5,236	(7)	6,552
Whole loan sales representations and warranties				24,366	24,366	79	
Securitization representations and warranties				78,029	78,029	35	
General partner guarantees	83	18	25	156	282	77	

(1) Carrying amounts of derivative contracts are shown on a gross basis prior to cash collateral or counterparty netting. For further information on derivative contracts, see Note 10.

(2) Approximately \$2.6 billion of standby letters of credit are also reflected in the Commitments table in primary and secondary lending commitments. Standby letters of credit are recorded at fair value within Financial instruments owned or Financial instruments sold, not yet purchased in the condensed consolidated statements of financial condition.

(3) Amounts include guarantees issued by consolidated real estate funds sponsored by the Company of approximately \$225 million. These guarantees relate to obligations of the fund's investee entities, including guarantees related to capital expenditures and principal and interest debt payments. Accrued losses under these guarantees of approximately \$7 million are reflected as a reduction of the carrying value of the related fund investments, which are reflected in Financial instruments owned Investments on the condensed consolidated statement of financial condition.

For further description of these guarantees, refer to Note 13 to the consolidated financial statements for the year ended December 31, 2011 included in the Form 10-K.

Table of Contents**MORGAN STANLEY****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The Company has obligations under certain guarantee arrangements, including contracts and indemnification agreements that contingently require a guarantor to make payments to the guaranteed party based on changes in an underlying measure (such as an interest or foreign exchange rate, security or commodity price, an index or the occurrence or non-occurrence of a specified event) related to an asset, liability or equity security of a guaranteed party. Also included as guarantees are contracts that contingently require the guarantor to make payments to the guaranteed party based on another entity's failure to perform under an agreement, as well as indirect guarantees of the indebtedness of others. The Company's use of guarantees is described below by type of guarantee:

Other Guarantees and Indemnities.

In the normal course of business, the Company provides guarantees and indemnifications in a variety of commercial transactions. These provisions generally are standard contractual terms. Certain of these guarantees and indemnifications are described below.

Trust Preferred Securities. The Company has established Morgan Stanley Capital Trusts for the limited purpose of issuing trust preferred securities to third parties and lending the proceeds to the Company in exchange for junior subordinated debentures. The Company has directly guaranteed the repayment of the trust preferred securities to the holders thereof to the extent that the Company has made payments to a Morgan Stanley Capital Trust on the junior subordinated debentures. In the event that the Company does not make payments to a Morgan Stanley Capital Trust, holders of such series of trust preferred securities would not be able to rely upon the guarantee for payment of those amounts. The Company has not recorded any liability in the condensed consolidated financial statements for these guarantees and believes that the occurrence of any events (*i.e.*, non-performance on the part of the paying agent) that would trigger payments under these contracts is remote. See Note 15 to the consolidated financial statements for the year ended December 31, 2011 included in the Form 10-K for details on the Company's junior subordinated debentures.

Indemnities. The Company provides standard indemnities to counterparties for certain contingent exposures and taxes, including U.S. and foreign withholding taxes, on interest and other payments made on derivatives, securities and stock lending transactions, certain annuity products and other financial arrangements. These indemnity payments could be required based on a change in the tax laws or change in interpretation of applicable tax rulings or a change in factual circumstances. Certain contracts contain provisions that enable the Company to terminate the agreement upon the occurrence of such events. The maximum potential amount of future payments that the Company could be required to make under these indemnifications cannot be estimated.

Exchange/Clearinghouse Member Guarantees. The Company is a member of various U.S. and non-U.S. exchanges and clearinghouses that trade and clear securities and/or derivative contracts. Associated with its membership, the Company may be required to pay a proportionate share of the financial obligations of another member who may default on its obligations to the exchange or the clearinghouse. While the rules governing different exchange or clearinghouse memberships vary, in general the Company's guarantee obligations would arise only if the exchange or clearinghouse had previously exhausted its resources. The maximum potential payout under these membership agreements cannot be estimated. The Company has not recorded any contingent liability in the condensed consolidated financial statements for these agreements and believes that any potential requirement to make payments under these agreements is remote.

Merger and Acquisition Guarantees. The Company may, from time to time, in its role as investment banking advisor be required to provide guarantees in connection with certain European merger and acquisition transactions. If required by the regulating authorities, the Company provides a guarantee that the acquirer in the merger and acquisition transaction has or will have sufficient funds to complete the transaction and would then be required to make the acquisition payments in the event the acquirer's funds are insufficient at the completion date of the transaction. These arrangements generally cover the time

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frame from the transaction offer date to its closing date and, therefore, are generally short term in nature. The maximum potential amount of future payments that the Company could be required to make cannot be estimated. The Company believes the likelihood of any payment by the Company under these arrangements is remote given the level of the Company's due diligence associated with its role as investment banking advisor.

Guarantees on Morgan Stanley Stable Value Program. On September 30, 2009, the Company entered into an agreement with the investment manager for the Stable Value Program ("SVP"), a fund within the Company's 401(k) plan, and certain other third parties. Under the agreement, the Company contributed \$20 million to the SVP on October 15, 2009 and recorded the contribution in Compensation and benefits expense. Additionally, the Company may have a future obligation to make a payment of \$40 million to the SVP following the third anniversary of the agreement, after which the SVP would be wound down over a period of time. The future obligation is contingent upon whether the market-to-book value ratio of the portion of the SVP that is subject to certain book-value stabilizing contracts has fallen below a specific threshold and the Company and the other parties to the agreement all decline to make payments to restore the SVP to such threshold as of the third anniversary of the agreement. The Company has not recorded a liability for this guarantee in the condensed consolidated financial statements.

In the ordinary course of business, the Company guarantees the debt and/or certain trading obligations (including obligations associated with derivatives, foreign exchange contracts and the settlement of physical commodities) of certain subsidiaries. These guarantees generally are entity or product specific and are required by investors or trading counterparties. The activities of the subsidiaries covered by these guarantees (including any related debt or trading obligations) are included in the Company's condensed consolidated financial statements.

Contingencies.

Legal. In the normal course of business, the Company has been named, from time to time, as a defendant in various legal actions, including arbitrations, class actions and other litigation, arising in connection with its activities as a global diversified financial services institution. Certain of the actual or threatened legal actions include claims for substantial compensatory and/or punitive damages or claims for indeterminate amounts of damages. In some cases, the entities that would otherwise be the primary defendants in such cases are bankrupt or are in financial distress. These actions have included, but are not limited to, residential mortgage and credit crisis related matters. Over the last several years, the level of litigation and investigatory activity focused on residential mortgage and credit crisis related matters has increased materially in the financial services industry. As a result, the Company expects that it may become the subject of increased claims for damages and other relief regarding residential mortgages and related securities in the future and, while the Company has identified below any individual proceedings where the Company believes a material loss to be reasonably possible and reasonably estimable, there can be no assurance that material losses will not be incurred from claims that have not yet been notified to the Company or are not yet determined to be probable or possible and reasonably estimable losses.

The Company is also involved, from time to time, in other reviews, investigations and proceedings (both formal and informal) by governmental and self-regulatory agencies regarding the Company's business, including, among other matters, accounting and operational matters, certain of which may result in adverse judgments, settlements, fines, penalties, injunctions or other relief.

The Company contests liability and/or the amount of damages as appropriate in each pending matter. Where available information indicates that it is probable a liability had been incurred at the date of the condensed consolidated financial statements and the Company can reasonably estimate the amount of that loss, the Company accrues the estimated loss by a charge to income. In many proceedings, however, it is inherently difficult to determine whether any loss is probable or even possible or to estimate the amount of any loss. In

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addition, even where loss is possible or an exposure to loss exists in excess of the liability already accrued with respect to a previously recognized loss contingency, it is not always possible to reasonably estimate the size of the possible loss or range of loss.

For certain legal proceedings, the Company cannot reasonably estimate such losses, particularly for proceedings that are in their early stages of development or where plaintiffs seek substantial or indeterminate damages. Numerous issues may need to be resolved, including through potentially lengthy discovery and determination of important factual matters, determination of issues related to class certification and the calculation of damages, and by addressing novel or unsettled legal questions relevant to the proceedings in question, before a loss or additional loss or range of loss or additional loss can be reasonably estimated for any proceeding.

For certain other legal proceedings, the Company can estimate reasonably possible losses, additional losses, ranges of loss or ranges of additional loss in excess of amounts accrued, but does not believe, based on current knowledge and after consultation with counsel, that such losses will have a material adverse effect on the Company's condensed consolidated financial statements as a whole, other than the matters referred to in the following paragraphs.

On September 25, 2009, the Company was named as a defendant in a lawsuit styled *Citibank, N.A. v. Morgan Stanley & Co. International, PLC*, which was pending in the United States District Court for the Southern District of New York (SDNY). The lawsuit relates to a credit default swap referencing the Capmark VI CDO (Capmark), which was structured by Citibank, N.A. (Citi N.A.). At issue is whether, as part of the swap agreement, Citi N.A. was obligated to obtain the Company's prior written consent before it exercised its rights to liquidate Capmark upon the occurrence of certain contractually-defined credit events. Citi N.A. is seeking approximately \$245 million in compensatory damages plus interest and costs. On October 8, 2010, the court issued an order denying Citi N.A.'s motion for judgment on the pleadings as to the Company's counterclaim for reformation and granting Citi N.A.'s motion for judgment on the pleadings as to the Company's counterclaim for estoppel. On May 25, 2011, the court issued an order denying the Company's motion for summary judgment and granting Citi N.A.'s cross motion for summary judgment. On June 27, 2011, the court entered a judgment in favor of Citi N.A. for \$269 million plus post-judgment interest and costs, and the Company filed a notice of appeal with the United States Court of Appeals for the Second Circuit, which appeal is now pending. Based on currently available information, the Company believes it could incur a loss of up to approximately \$269 million plus post-judgment interest.

On August 25, 2008, the Company and two ratings agencies were named as defendants in a purported class action related to securities issued by a structured investment vehicle called Cheyne Finance (the Cheyne SIV). The case is styled *Abu Dhabi Commercial Bank, et al. v. Morgan Stanley & Co. Inc., et al.* and is pending in the SDNY. The complaint alleges, among other things, that the ratings assigned to the securities issued by the Cheyne SIV were false and misleading because the ratings did not accurately reflect the risks associated with the subprime residential mortgage backed securities held by the Cheyne SIV. On September 2, 2009, the court dismissed all of the claims against the Company except for plaintiffs' claims for common law fraud. On June 15, 2010, the court denied plaintiffs' motion for class certification. On July 20, 2010, the court granted plaintiffs leave to replead their aiding and abetting common law fraud claims against the Company, and those claims were added in an amended complaint filed on August 5, 2010. On December 27, 2011, the court permitted plaintiffs to reinstate their causes of action for negligent misrepresentation and breach of fiduciary duty against the Company. The Company moved to dismiss these claims on January 10, 2012. On January 5, 2012, the court permitted plaintiffs to amend their Complaint and assert a negligence claim against the Company. The amended complaint was filed on January 9, 2012 and the Company moved to dismiss the negligence claim on January 17, 2012. On January 23, 2012, the Company moved for summary judgment with respect to the fraud and aiding and abetting fraud claims. There are 15 plaintiffs in this action asserting claims related to approximately \$983 million of securities issued by the Cheyne SIV. Plaintiffs have not alleged the amount of their alleged investments and are seeking, among other things, unspecified compensatory and punitive damages. Based on currently available

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information, the Company believes that the defendants could incur a loss up to the amount of plaintiffs' claimed compensatory damages, once specified, related to their alleged purchase of approximately \$983 million of securities issued by the Cheyne SIV plus pre- and post-judgment interest, fees and costs.

On July 15, 2010, China Development Industrial Bank (CDIB) filed a complaint against the Company, which is styled *China Development Industrial Bank v. Morgan Stanley & Co. Incorporated et al.* and is pending in the Supreme Court of the State of New York, New York County. The complaint relates to a \$275 million credit default swap referencing the super senior portion of the STACK 2006-1 CDO. The complaint asserts claims for common law fraud, fraudulent inducement and fraudulent concealment and alleges that the Company misrepresented the risks of the STACK 2006-1 CDO to CDIB, and that the Company knew that the assets backing the CDO were of poor quality when it entered into the credit default swap with CDIB. The complaint seeks compensatory damages related to the approximately \$228 million that CDIB alleges it has already lost under the credit default swap, rescission of CDIB's obligation to pay an additional \$12 million, punitive damages, equitable relief, fees and costs. On February 28, 2011, the court presiding over this action denied the Company's motion to dismiss the complaint. On March 21, 2011, the Company appealed the order denying its motion to dismiss the complaint. On July 7, 2011, the appellate court affirmed the lower court's decision denying the motion to dismiss. Based on currently available information, the Company believes it could incur a loss of up to approximately \$240 million plus pre- and post-judgment interest, fees and costs.

On March 15, 2010, the Federal Home Loan Bank of San Francisco filed two complaints against the Company and other defendants in the Superior Court of the State of California. These actions are styled *Federal Home Loan Bank of San Francisco v. Credit Suisse Securities (USA) LLC, et al.*, and *Federal Home Loan Bank of San Francisco v. Deutsche Bank Securities Inc. et al.*, respectively. Amended complaints were filed on June 10, 2010. The complaints allege that defendants made untrue statements and material omissions in connection with the sale to plaintiff of mortgage pass through certificates backed by securitization trusts containing residential mortgage loans. The original amount of the certificates allegedly sold to plaintiff by the Company in these cases was approximately \$980 million collectively. The complaints raise claims under both the federal securities laws and California law and seek, among other things, to rescind the plaintiff's purchase of such certificates. On July 29, 2011 and September 8, 2011, the court presiding over these cases dismissed the federal securities law claims against the Company, but denied the Company's motion to dismiss with respect to other claims. At March 31, 2012, the current unpaid balance of the mortgage pass through certificates at issue in these cases was approximately \$398 million and the certificates had not yet incurred losses. Based on currently available information, the Company believes it could incur a loss up to the difference between the \$398 million unpaid balance of these certificates and their fair market value at the time of a judgment against the Company, plus pre- and post-judgment interest, fees and costs. The Company may be entitled to be indemnified for some of these losses and would be entitled to an offset for interest received by the plaintiff prior to a judgment.

12. Regulatory Requirements.

Morgan Stanley. The Company is a financial holding company under the Bank Holding Company Act of 1956, as amended, and is subject to the regulation and oversight of the Board of Governors of the Federal Reserve System (the "Federal Reserve"). The Federal Reserve establishes capital requirements for the Company, including well-capitalized standards, and evaluates the Company's compliance with such capital requirements. The Office of the Comptroller of the Currency establishes similar capital requirements and standards for the Company's national bank subsidiaries.

The Company calculates its capital ratios and risk-weighted assets (RWA) in accordance with the capital adequacy standards for financial holding companies adopted by the Federal Reserve. These standards are based upon a framework described in the International Convergence of Capital Measurement and Capital Standards, July 1988, as amended, also referred to as Basel I. In December 2007, the U.S. banking regulators published final

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regulation incorporating the Basel II Accord, which requires internationally active banking organizations, as well as certain of their U.S. bank subsidiaries, to implement Basel II standards over the next several years. In July 2010, the Company began reporting its capital adequacy standards on a parallel basis to its regulators under Basel I and Basel II as part of a phased implementation of Basel II.

In June 2011, the U.S. banking regulators published final regulations implementing a provision of the Dodd-Frank Wall Street Reform and Consumer Protection Act requiring certain institutions supervised by the Federal Reserve, including the Company, be subject to capital requirements that are not less than the generally applicable risk-based capital requirements. As a result, the generally applicable capital standards, which are based on Basel I standards, but may themselves change over time, will serve as a permanent floor to minimum capital requirements calculated under the Basel II standards the Company is currently required to implement, as well as future capital standards.

In December 2009, the Basel Committee released proposals on risk-based capital, leverage and liquidity standards, known as Basel III. Basel III contains new capital standards that raise the quality of capital and strengthen counterparty credit risk capital requirements and introduces a leverage ratio as a supplemental measure to the risk-based ratio. Basel III includes a new capital conservation buffer, which imposes a common equity requirement above the new minimum that can be depleted under stress, subject to restrictions on capital actions, a new additional loss absorbency capital requirement for global systemically important banks (GSIB), such as the Company, and a new countercyclical buffer, which regulators can activate during periods of excessive credit growth in their jurisdiction. The Basel III proposals complement an earlier proposal for revisions to the market risk framework that increases capital requirements for securitizations within the Company's trading book. In 2011, the U.S. regulators issued proposed rules that are intended to implement certain aspects of the market risk framework proposals. While precise dates for the implementation of the new requirements in the U.S. have not been announced, the U.S. regulators will require implementation of Basel III subject to an extended phase-in period.

At March 31, 2012, the Company was in compliance with Basel I capital requirements with ratios of Tier 1 capital to RWAs of 16.8% and total capital to RWAs of 18.1% (6% and 10% being well-capitalized for regulatory purposes, respectively). In addition, financial holding companies are subject to a Tier 1 leverage ratio as defined by the Federal Reserve. The Company calculated its Tier 1 leverage ratio as Tier 1 capital divided by adjusted average total assets (which reflects adjustments for disallowed goodwill, certain intangible assets, deferred tax assets and financial and non-financial equity investments). The adjusted average total assets are derived using weekly balances for the year. At March 31, 2012, the Company was in compliance with this leverage restriction, with a Tier 1 leverage ratio of 7.0% (5% being well-capitalized for regulatory purposes).

At March 31, 2012, the Company calculated its RWAs in accordance with the regulatory capital requirements of the Federal Reserve, which is consistent with guidelines described under Basel I. RWAs reflect both on and off-balance sheet risk of the Company. The risk capital calculations will evolve over time as the Company enhances its risk management methodology and incorporates improvements in modeling techniques while maintaining compliance with the regulatory requirements and interpretations.

The following table summarizes the capital measures for the Company:

	March 31, 2012		December 31, 2011	
	Balance	Ratio	Balance	Ratio
	(dollars in millions)			
Tier 1 common capital(1)(2)	\$ 42,151	13.3%	\$ 39,785	12.7%
Tier 1 capital(2)	53,527	16.8%	51,114	16.3%
Total capital(2)	57,587	18.1%	54,956	17.5%
RWAs(2)	317,693		314,055	
Adjusted average assets(2)	760,071		769,578	
Tier 1 leverage(2)		7.0%		6.6%

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- (1) Tier 1 common capital ratio equals Tier 1 common capital divided by RWAs. On December 30, 2011, the Federal Reserve formalized regulatory definitions for Tier 1 common capital and Tier 1 common capital ratio. The Federal Reserve defined Tier 1 common capital as Tier 1 capital less non-common elements in Tier 1 capital, including perpetual preferred stock and related surplus, minority interest in subsidiaries, trust preferred securities and mandatory convertible preferred securities. Previously, the Company's definition of Tier 1 common capital included all of the items noted in the Federal Reserve's definition, but it also included an adjustment for the portion of goodwill and non-servicing intangible assets associated with MSSB's noncontrolling interests (i.e., Citigroup, Inc.'s (Citi) share of MSSB's goodwill and intangibles). The Company's conformance to the Federal Reserve's definition under the final rule reduced its Tier 1 common capital and Tier 1 common ratio by approximately \$4.2 billion and 132 basis points, respectively at December 31, 2011.
- (2) The December 31, 2011 deferred tax asset disallowance was adjusted by approximately \$1.2 billion, resulting in a reduction to the Company's Tier 1 common capital, Tier 1 capital, Total capital, RWAs and adjusted average assets by such amount, Tier 1 common capital ratio, Tier 1 capital ratio and Total capital ratio by approximately 30 basis points and Tier 1 leverage ratio by approximately 20 basis points.

Tier 1 capital ratio increased quarter-over-quarter due to an increase in capital. Tier 1 leverage ratio increased quarter-over-quarter due to a decrease in adjusted average assets.

The Company's U.S. Bank Operating Subsidiaries. The Company's domestic bank operating subsidiaries are subject to various regulatory capital requirements as administered by U.S. federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory, and possibly additional, discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's U.S. bank operating subsidiaries' financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company's U.S. bank operating subsidiaries must meet specific capital guidelines that involve quantitative measures of the Company's U.S. bank operating subsidiaries' assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices.

At March 31, 2012, the Company's U.S. bank operating subsidiaries met all capital adequacy requirements to which they are subject and exceeded all regulatory mandated and targeted minimum regulatory capital requirements to be well-capitalized. There are no conditions or events that management believes have changed the Company's U.S. bank operating subsidiaries' category.

The table below sets forth the capital information for the Company's U.S. bank operating subsidiaries, which are U.S. depository institutions:

	March 31, 2012		December 31, 2011	
	Amount	Ratio	Amount	Ratio
	(dollars in millions)			
<i>Total capital (to RWAs):</i>				
Morgan Stanley Bank, N.A.	\$ 10,496	17.4%	\$ 10,222	17.8%
Morgan Stanley Private Bank, National Association	\$ 1,298	27.8%	\$ 1,278	31.9%
<i>Tier I capital (to RWAs):</i>				
Morgan Stanley Bank, N.A.	\$ 8,980	14.9%	\$ 8,703	15.1%
Morgan Stanley Private Bank, National Association	\$ 1,295	27.7%	\$ 1,275	31.8%
<i>Leverage ratio:</i>				
Morgan Stanley Bank, N.A.	\$ 8,980	13.4%	\$ 8,703	13.2%
Morgan Stanley Private Bank, National Association	\$ 1,295	10.6%	\$ 1,275	10.2%

Under regulatory capital requirements adopted by the U.S. federal banking agencies, U.S. depository institutions, in order to be considered well-capitalized, must maintain a ratio of total capital to RWAs of 10%, a capital ratio of Tier 1 capital to RWAs of 6%, and a ratio of Tier 1 capital to average book assets (leverage ratio) of 5%. Each U.S. depository institution subsidiary of the Company must be well-capitalized in order for the Company to continue to qualify as a financial holding company and to continue to engage in the broadest range of financial activities permitted for financial holding companies. At March 31, 2012 and December 31, 2011, the

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Company's U.S. depository institutions maintained capital at levels in excess of the universally mandated well-capitalized levels. These subsidiary depository institutions maintain capital at levels sufficiently in excess of the well-capitalized requirements to address any additional capital needs and requirements identified by the federal banking regulators.

MS&Co. and Other Broker-Dealers. MS&Co. is a registered broker-dealer and registered futures commission merchant and, accordingly, is subject to the minimum net capital requirements of the U.S. Securities and Exchange Commission (SEC), the Financial Industry Regulatory Authority, Inc. and the U.S. Commodity Futures Trading Commission. MS&Co. has consistently operated with capital in excess of its regulatory capital requirements. MS&Co.'s net capital totaled \$7,842 million and \$8,249 million at March 31, 2012 and December 31, 2011, respectively, which exceeded the amount required by \$6,660 million and \$7,215 million, respectively. MS&Co. is required to hold tentative net capital in excess of \$1 billion and net capital in excess of \$500 million in accordance with the market and credit risk standards of Appendix E of SEC Rule 15c3-1. MS&Co. is also required to notify the SEC in the event that its tentative net capital is less than \$5 billion. At March 31, 2012, MS&Co. had tentative net capital in excess of the minimum and the notification requirements.

Morgan Stanley Smith Barney LLC is a registered broker-dealer and registered futures commission merchant and, accordingly, is subject to the minimum net capital requirements of the SEC, the Financial Industry Regulatory Authority, Inc. and the U.S. Commodity Futures Trading Commission. Morgan Stanley Smith Barney LLC has consistently operated with capital in excess of its regulatory capital requirements. Morgan Stanley Smith Barney LLC clears certain customer activity directly and introduces other business to MS&Co. and Citigroup, Inc. MSIP, a London-based broker-dealer subsidiary, is subject to the capital requirements of the Financial Services Authority, and MSMS, a Tokyo-based broker-dealer subsidiary, is subject to the capital requirements of the Financial Services Agency. MSIP and MSMS have consistently operated in excess of their respective regulatory capital requirements.

Other Regulated Subsidiaries. Certain other U.S. and non-U.S. subsidiaries are subject to various securities, commodities and banking regulations, and capital adequacy requirements promulgated by the regulatory and exchange authorities of the countries in which they operate. These subsidiaries have consistently operated in excess of their local capital adequacy requirements.

Morgan Stanley Derivative Products Inc. (MSDP), a derivative products subsidiary rated Aa3 by Moody's and AAA by S&P, maintains certain operating restrictions that have been reviewed by Moody's and S&P. MSDP is operated such that creditors of the Company should not expect to have any claims on the assets of MSDP, unless and until the obligations to its own creditors are satisfied in full. Creditors of MSDP should not expect to have any claims on the assets of the Company or any of its affiliates, other than the respective assets of MSDP.

13. Total Equity.

Morgan Stanley Shareholders' Equity.

During the quarters ended March 31, 2012 and 2011, the Company did not purchase any of its common stock as part of its share repurchase program. At March 31, 2012, the Company had approximately \$1.6 billion remaining under its current share repurchase authorization. Share repurchases by the Company are subject to regulatory approval.

Table of Contents**MORGAN STANLEY****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****14. Earnings per Common Share.**

Basic earnings per common share (EPS) is computed by dividing earnings (loss) available to Morgan Stanley common shareholders by the weighted average number of common shares outstanding for the period. Common shares outstanding include common stock and vested restricted stock units (RSUs) where recipients have satisfied either the explicit vesting terms or retirement eligibility requirements. Diluted EPS reflects the assumed conversion of all dilutive securities. The Company calculates EPS using the two-class method and determines whether instruments granted in share-based payment transactions are participating securities (see Note 2 to the consolidated financial statements for the year ended December 31, 2011 in the Form 10-K). The following table presents the calculation of basic and diluted EPS (in millions, except for per share data):

	Three Months Ended March 31,	
	2012	2011
Basic EPS:		
Income from continuing operations	\$ 149	\$ 1,145
Net gain (loss) from discontinued operations	(15)	(15)
Net income	134	1,130
Net income applicable to noncontrolling interests	228	162
Net income (loss) applicable to Morgan Stanley	(94)	968
Less: Preferred dividends (Series A Preferred Stock)	(11)	(11)
Less: Preferred dividends (Series B Preferred Stock)		(196)
Less: Preferred dividends (Series C Preferred Stock)	(13)	(13)
Less: Allocation of earnings to participating RSUs(1):		
From continuing operations	(1)	(12)
Earnings (loss) applicable to Morgan Stanley common shareholders	\$ (119)	\$ 736
Weighted average common shares outstanding	1,877	1,456
Earnings (loss) per basic common share:		
Income (loss) from continuing operations	\$ (0.05)	\$ 0.52
Net gain (loss) from discontinued operations	(0.01)	(0.01)
Earnings (loss) per basic common share	\$ (0.06)	\$ 0.51
Diluted EPS:		
Earnings (loss) applicable to Morgan Stanley common shareholders	\$ (119)	\$ 736
Weighted average common shares outstanding	1,877	1,456
Effect of dilutive securities:		
Stock options and RSUs(1)		16
Weighted average common shares outstanding and common stock equivalents	1,877	1,472
Earnings (loss) per diluted common share:		
Income (loss) from continuing operations	\$ (0.05)	\$ 0.51
Net income (loss) from discontinued operations	(0.01)	(0.01)

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Earnings (loss) per diluted common share	\$ (0.06)	\$ 0.50
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- (1) RSUs that are considered participating securities participate in all of the earnings of the Company in the computation of basic EPS, and therefore, such RSUs are not included as incremental shares in the diluted calculation.

Table of Contents**MORGAN STANLEY****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The following securities were considered antidilutive and, therefore, were excluded from the computation of diluted EPS:

Number of Antidilutive Securities Outstanding at End of Period:	Three Months Ended March 31,	
	2012	2011
	(shares in millions)	
RSUs and Performance-based stock units	103	26
Stock options	45	60
Series B Preferred Stock		311
Total	148	397

15. Interest Income and Interest Expense.

Details of Interest income and Interest expense were as follows:

	Three Months Ended March 31,	
	2012	2011
	(dollars in millions)	
Interest income(1):		
Financial instruments owned(2)	\$ 791	\$ 918
Securities available for sale	86	88
Loans	118	105
Interest bearing deposits with banks	27	35
Federal funds sold and securities purchased under agreements to resell and Securities borrowed	113	277
Other	407	436
Total Interest income	\$ 1,542	\$ 1,859
Interest expense(1):		
Deposits	\$ 45	\$ 66
Commercial paper and other short-term borrowings	13	8
Long-term debt	1,254	1,313
Securities sold under agreements to repurchase and Securities loaned	463	471
Other	(174)	(5)
Total Interest expense	\$ 1,601	\$ 1,853
Net interest	\$ (59)	\$ 6

(1)

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Interest income and expense are recorded within the condensed consolidated statements of income depending on the nature of the instrument and related market conventions. When interest is included as a component of the instrument's fair value, interest is included within Principal transactions Trading revenues or Principal transactions Investments revenues. Otherwise, it is included within Interest income or Interest expense.

- (2) Interest expense on Financial instruments sold, not yet purchased is reported as a reduction to Interest income on Financial instruments owned.

16. Employee Benefit Plans.

The Company sponsors various pension plans for the majority of its U.S. and non-U.S. employees. The Company provides certain other postretirement benefits, primarily health care and life insurance, to eligible U.S. employees. The Company also provides certain postemployment benefits to certain former employees or inactive employees prior to retirement.

Table of Contents**MORGAN STANLEY****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Effective January 1, 2011, the Morgan Stanley Employees Retirement Plan (the Pension Plan) for U.S. participants ceased accruals of benefits under the Pension Plan.

The components of the Company's net periodic benefit expense for its pension and postretirement plans were as follows:

	Three Months Ended March 31,	
	2012	2011
	(dollars in millions)	
Service cost, benefits earned during the period	\$ 8	\$ 8
Interest cost on projected benefit obligation	41	42
Expected return on plan assets	(28)	(33)
Net amortization of prior service costs	(3)	(4)
Net amortization of actuarial loss	7	5
Net periodic benefit expense	\$ 25	\$ 18

17. Income Taxes.

The Company is under continuous examination by the Internal Revenue Service (the IRS) and other tax authorities in certain countries, such as Japan and the U.K., and states in which the Company has significant business operations, such as New York. The Company is currently under examination by the IRS Appeals Office for the remaining issues covering tax years 1999–2005. Also, the Company is currently at various levels of field examination with respect to audits with the IRS, as well as New York State and New York City, for tax years 2006–2008 and 2007–2009, respectively. During 2012, the Company expects to reach a conclusion with U.K. tax authorities on substantially all issues through tax year 2009. Also during 2012, the Company expects to reach a conclusion with the Japanese tax authorities on substantially all issues covering tax years 2007–2008 and commence an audit covering tax years 2009–2010.

The Company believes that the resolution of tax matters will not have a material effect on the condensed consolidated statements of financial condition of the Company, although a resolution could have a material impact on the Company's condensed consolidated statements of income for a particular future period and on the Company's effective income tax rate for any period in which such resolution occurs. The Company has established a liability for unrecognized tax benefits that the Company believes is adequate in relation to the potential for additional assessments. Once established, the Company adjusts unrecognized tax benefits only when more information is available or when an event occurs necessitating a change.

It is reasonably possible that significant changes in the gross balance of unrecognized tax benefits may occur within the next 12 months. At this time, however, it is not possible to reasonably estimate the expected change to the total amount of unrecognized tax benefits and impact on the effective tax rate over the next 12 months.

The Company's effective tax rate from continuing operations for the quarter ended March 31, 2011 included a \$447 million net tax benefit from the remeasurement of a deferred tax asset and the reversal of a related valuation allowance. The deferred tax asset and valuation allowance were recognized in income from discontinued operations in 2010 in connection with the recognition of a \$1.2 billion loss due to writedowns and related costs following the Company's commitment to a plan to dispose of Revel Entertainment Group, LLC (Revel). The Company recorded the valuation allowance because the Company did not believe it was more likely than not that it would have sufficient future net capital gain to realize the benefit of the expected capital loss to be recognized upon the disposal of Revel. During the quarter ended March 31, 2011, the disposal of Revel was restructured as a

Table of Contents**MORGAN STANLEY****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

tax-free like kind exchange and the disposal was completed. The restructured transaction changed the character of the future taxable loss to ordinary. The Company reversed the valuation allowance because the Company believes it is more likely than not that it will have sufficient future ordinary taxable income to recognize the recorded deferred tax asset. In accordance with the applicable accounting literature, this reversal of a previously established valuation allowance due to a change in circumstances was recognized in income from continuing operations.

18. Segment and Geographic Information.***Segment Information.***

The Company structures its segments primarily based upon the nature of the financial products and services provided to customers and the Company's management organization. The Company provides a wide range of financial products and services to its customers in each of its business segments: Institutional Securities, Global Wealth Management Group and Asset Management. For further discussion of the Company's business segments, see Note 1.

Revenues and expenses directly associated with each respective segment are included in determining its operating results. Other revenues and expenses that are not directly attributable to a particular segment are allocated based upon the Company's allocation methodologies, generally based on each segment's respective net revenues, non-interest expenses or other relevant measures.

As a result of treating certain intersegment transactions as transactions with external parties, the Company includes an Intersegment Eliminations category to reconcile the business segment results to the Company's consolidated results. Intersegment eliminations also reflect the effect of fees paid by the Institutional Securities business segment to the Global Wealth Management Group business segment related to the bank deposit program.

Selected financial information for the Company's segments is presented below:

Three Months Ended March 31, 2012	Institutional Securities	Global Wealth Management Group	Asset Management (dollars in millions)	Intersegment Eliminations	Total
Total non-interest revenues	\$ 3,484	\$ 3,004	\$ 541	\$ (35)	\$ 6,994
Net interest	(461)	410	(8)		(59)
Net revenues(1)	\$ 3,023	\$ 3,414	\$ 533	\$ (35)	\$ 6,935
Income (loss) from continuing operations before income taxes	\$ (312)	\$ 387	\$ 128	\$	\$ 203
Provision for (benefit from) income taxes	(105)	121	38		54
Income (loss) from continuing operations	(207)	266	90		149
Discontinued operations(2):					
Gain from discontinued operations	24	2	1		27
Provision for income taxes	41	1			42
Net gain (loss) on discontinued operations	(17)	1	1		(15)

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Net income (loss)	(224)	267	91	134
Net income applicable to noncontrolling interests	89	74	65	228
Net income (loss) applicable to Morgan Stanley	\$ (313)	\$ 193	\$ 26	\$ (94)

Table of Contents**MORGAN STANLEY****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Three Months Ended March 31, 2011	Institutional Securities	Global Wealth Management Group	Asset Management (dollars in millions)	Intersegment Eliminations	Total
Total non-interest revenues	\$ 3,895	\$ 3,063	\$ 630	\$ (20)	\$ 7,568
Net interest	(327)	341	(8)		6
Net revenues(1)	\$ 3,568	\$ 3,404	\$ 622	\$ (20)	\$ 7,574
Income from continuing operations before income taxes	\$ 432	\$ 344	\$ 125	\$	\$ 901
Provision for (benefit from) income taxes	(363)	89	30		(244)
Income from continuing operations	795	255	95		1,145
Discontinued operations(2):					
Gain (loss) from discontinued operations	(38)	3	6	1	(28)
Provision for (benefit from) income taxes	(15)	1		1	(13)
Net gain (loss) on discontinued operations	(23)	2	6		(15)
Net income	772	257	101		1,130
Net income applicable to noncontrolling interests	61	74	27		162
Net income applicable to Morgan Stanley	\$ 711	\$ 183	\$ 74	\$	\$ 968

(1) In certain management fee arrangements, the Company is entitled to receive performance-based fees (also referred to as incentive fees) when the return on assets under management exceeds certain benchmark returns or other performance targets. In such arrangements, performance fee revenue is accrued (or reversed) quarterly based on measuring account fund performance to date versus the performance benchmark stated in the investment management agreement. The amount of performance-based fee revenue at risk of reversing if fund performance falls below stated investment management agreement benchmarks was approximately \$175 million at March 31, 2012 and approximately \$179 million at December 31, 2011 (see Note 2 to the consolidated financial statements for the year ended December 31, 2011 included in the Form 10-K).

(2) See Notes 1 and 20 for discussion of discontinued operations.

Net Interest	Institutional Securities	Global Wealth Management Group	Asset Management (dollars in millions)	Intersegment Eliminations	Total
Three Months Ended March 31 2012					
Interest income	\$ 1,145	\$ 490	\$ 3	\$ (96)	\$ 1,542
Interest expense	1,606	80	11	(96)	1,601
Net interest	\$ (461)	\$ 410	\$ (8)	\$	\$ (59)
Three Months Ended March 31 2011					
Interest income	\$ 1,486	\$ 453	\$ 4	\$ (84)	\$ 1,859
Interest expense	1,813	112	12	(84)	1,853

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Net interest	\$ (327)	\$ 341	\$ (8)	\$	\$ 6
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Total Assets(1)	Institutional Securities	Global Wealth Management Group (dollars in millions)	Asset Management	Total
At March 31, 2012	\$ 670,662	\$ 103,235	\$ 7,133	\$ 781,030
At December 31, 2011	\$ 641,456	\$ 101,427	\$ 7,015	\$ 749,898

(1) Corporate assets have been fully allocated to the Company's business segments.

Table of Contents**MORGAN STANLEY****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)*****Geographic Information.***

The Company operates in both U.S. and non-U.S. markets. The Company's non-U.S. business activities are principally conducted through European and Asian locations. The net revenues disclosed in the following table reflect the regional view of the Company's consolidated net revenues on a managed basis, based on the following methodology:

Institutional Securities: advisory and equity underwriting – client location, debt underwriting – revenue recording location, sales and trading – trading desk location.

Global Wealth Management Group: global representative coverage location.

Asset Management: client location, except for Merchant Banking and Real Estate Investing businesses, which are based on asset location.

Net Revenues	Three Months Ended March 31,	
	2012	2011
	(dollars in millions)	
Americas	\$ 4,790	\$ 5,466
Europe, Middle East, and Africa	1,154	1,667
Asia	991	441
Net revenues	\$ 6,935	\$ 7,574

19. Equity Method Investments.

The Company has investments accounted for under the equity method of accounting (see Note 1) of \$4,384 million and \$4,524 million at March 31, 2012 and December 31, 2011, respectively, included in Other investments in the condensed consolidated statements of financial condition. Losses from these investments were \$32 million and \$660 million for the quarters ended March 31, 2012 and 2011, respectively and are included in Other revenues in the condensed consolidated statements of income. The loss for 2011 included the loss related to the Company's 40% stake in MUMSS, as described below. See Note 24 to the consolidated financial statements for the year ended December 31, 2011 included in the Form 10-K for further information.

Japanese Securities Joint Venture

On May 1, 2010, the Company and Mitsubishi UFJ Financial Group, Inc. (MUFG) formed a joint venture in Japan of their respective investment banking and securities businesses. MUFG and the Company have integrated their respective Japanese securities companies by forming two joint venture companies. MUFG contributed the investment banking, wholesale and retail securities businesses conducted in Japan by Mitsubishi UFJ Securities Co., Ltd. into Mitsubishi UFJ Morgan Stanley Securities Co., Ltd. (MUMSS). The Company contributed the investment banking operations conducted in Japan by its subsidiary MSMS, formerly known as Morgan Stanley Japan Securities Co., Ltd., into MUMSS (MSMS, together with MUMSS, the Joint Venture). MSMS will continue its sales and trading and capital markets business conducted in Japan. Following the respective contributions to the Joint Venture and a cash payment of 23 billion yen (\$247 million), from MUFG to the Company, the Company owns a 40% economic interest in the Joint Venture and MUFG owns a 60% economic interest in the Joint Venture.

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The Company holds a 40% voting interest and MUFG holds a 60% voting interest in MUMSS, while the Company holds a 51% voting interest and MUFG holds a 49% voting interest in MSMS. The Company continues to consolidate MSMS in its consolidated financial statements and, commencing on May 1, 2010,

Table of Contents**MORGAN STANLEY****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

accounted for its interest in MUMSS as an equity method investment within the Institutional Securities business segment. During the quarters ended March 31, 2012 and 2011, the Company recorded a gain (loss) of \$27 million and \$(655) million, respectively, within Other revenues in the condensed consolidated statements of income, arising from the Company's 40% stake in MUMSS.

In order to enhance the risk management at MUMSS, during the quarter ended March 31, 2011, the Company entered into a transaction with MUMSS whereby the risk associated with the fixed income trading positions that previously caused the majority of the aforementioned MUMSS losses in 2011 was transferred to MSMS. In return for entering into the transaction, the Company received total consideration of \$659 million, which represented the estimated fair value of the fixed income trading positions transferred.

At March 31, 2012, the Company performed an impairment review of its equity method investment in MUMSS in view of the current financial performance of MUMSS and the current state of the Japanese economy. The Company recorded no other-than-temporary impairment loss at March 31, 2012. Adverse market or economic events, as well as further deterioration of economic performance, could result in impairment charges of this investment in future periods.

20. Discontinued Operations.

See Note 1 for a discussion of the Company's discontinued operations.

The table below provides information regarding amounts included in discontinued operations:

	Three Months Ended March 31,	
	2012	2011
	(dollars in millions)	
Net revenues(1):		
Saxon	\$ 76	\$ 24
Quilter	31	33
Other(2)		10
	\$ 107	\$ 67
Pre-tax gain (loss) on discontinued operations(1):		
Revel	\$	\$ (10)
Saxon(3)	25	(34)
Quilter	2	3
Other(2)		13
	\$ 27	\$ (28)

(1) Amounts included eliminations of intersegment activity.

(2) Amounts included in Other for the three months ended March 31, 2011 are related to CityMortgage Bank, Retail Asset Management and other.

(3) Amount included a pre-tax gain of approximately \$51 million primarily resulting from the subsequent increase in fair value of Saxon, which had incurred impairment losses of \$98 million in the quarter ended December 31, 2011, as well as approximately \$5 million of severance costs incurred in connection with the disposition of Saxon. See Note 21 for a further discussion of the disposition of Saxon.

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MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

21. Subsequent Events.

Common Dividend.

On April 19, 2012, the Company announced that its Board of Directors declared a quarterly dividend per common share of \$0.05. The dividend is payable on May 15, 2012 to common shareholders of record on April 30, 2012.

Long-Term Borrowings.

Subsequent to March 31, 2012 and through April 30, 2012, the Company's long-term borrowings (net of issuances) decreased by approximately \$1.6 billion.

Quilter.

On April 2, 2012, the Company closed the sale of Quilter, its retail wealth management business in the U.K. The Company has classified Quilter as held for sale within the Global Wealth Management Group business segment and the results of its operations are presented as discontinued operations for all periods presented.

Saxon.

On October 24, 2011, the Company announced that it had reached an agreement to sell Saxon, a provider of servicing and subservicing of residential mortgage loans, to Ocwen Financial Corporation. During the first quarter of 2012, the transaction was restructured as a sale of Saxon's assets, the first phase of which was completed in the second quarter of 2012. The remaining operations of Saxon are expected to be wound down within the year. The Company expects to incur incremental wind-down costs in future periods. The results of Saxon are reported as discontinued operations within the Institutional Securities business segment for all periods presented.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of Morgan Stanley:

We have reviewed the accompanying condensed consolidated statement of financial condition of Morgan Stanley and subsidiaries (the Company) as of March 31, 2012, and the related condensed consolidated statements of income, comprehensive income, cash flows and changes in total equity for the three-month periods ended March 31, 2012 and March 31, 2011. These condensed consolidated financial statements are the responsibility of the management of the Company.

We conducted our reviews in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to such condensed consolidated financial statements for them to be in conformity with accounting principles generally accepted in the United States of America.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated statement of financial condition of the Company as of December 31, 2011, and the related consolidated statements of income, comprehensive income, cash flows and changes in total equity for the year then ended (not presented herein) included in the Company's Annual Report on Form 10-K; and in our report dated February 27, 2012, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated statement of financial condition as of December 31, 2011 is fairly stated, in all material respects, in relation to the consolidated statement of financial condition from which it has been derived.

/s/ Deloitte & Touche LLP

New York, New York

May 7, 2012

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations. Introduction.

Morgan Stanley, a financial holding company, is a global financial services firm that maintains significant market positions in each of its business segments Institutional Securities, Global Wealth Management Group and Asset Management. The Company, through its subsidiaries and affiliates, provides a wide variety of products and services to a large and diversified group of clients and customers, including corporations, governments, financial institutions and individuals. Unless the context otherwise requires, the terms Morgan Stanley and the Company mean Morgan Stanley and its consolidated subsidiaries.

A summary of the activities of each of the Company's business segments is as follows:

Institutional Securities provides capital raising; financial advisory services, including advice on mergers and acquisitions, restructurings, real estate and project finance; corporate lending; sales, trading, financing and market-making activities in equity and fixed income securities and related products, including foreign exchange and commodities; and investment activities.

Global Wealth Management Group, which includes the Company's 51% interest in Morgan Stanley Smith Barney Holdings LLC (MSSB), provides brokerage and investment advisory services to individual investors and small-to-medium sized businesses and institutions covering various investment alternatives; financial and wealth planning services; annuity and other insurance products; credit and other lending products; cash management services; retirement services; and trust and fiduciary services and engages in fixed income principal trading, which primarily facilitates clients' trading or investments in such securities.

Asset Management provides a broad array of investment strategies that span the risk/return spectrum across geographies, asset classes and public and private markets to a diverse group of clients across the institutional and intermediary channels as well as high net worth clients.

See Notes 1 and 20 to the condensed consolidated financial statements for a discussion of the Company's discontinued operations.

The results of operations in the past have been, and in the future may continue to be, materially affected by many factors, including the effect of economic and political conditions and geopolitical events; the effect of market conditions, particularly in the global equity, fixed income, credit and commodities markets, including corporate and mortgage (commercial and residential) lending and commercial real estate markets; the impact of current, pending and future legislation (including the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act)), regulation (including capital, leverage and liquidity requirements), and legal actions in the United States of America (U.S.) and worldwide; the level and volatility of equity, fixed income, and commodity prices and interest rates, currency values and other market indices; the availability and cost of both credit and capital as well as the credit ratings assigned to the Company's unsecured short-term and long-term debt; investor sentiment and confidence in the financial markets; the performance of the Company's acquisitions, joint ventures, strategic alliances or other strategic arrangements (including MSSB and with Mitsubishi UFJ Financial Group, Inc. (MUFG)); the Company's reputation; inflation, natural disasters and acts of war or terrorism; the actions and initiatives of current and potential competitors as well as governments, regulators and self-regulatory organizations and technological changes; or a combination of these or other factors. In addition, legislative, legal and regulatory developments related to the Company's businesses are likely to increase costs, thereby affecting results of operations. These factors also may have an impact on the Company's ability to achieve its strategic objectives. For a further discussion of these and other important factors that could affect the Company's business, see Business Competition and Business Supervision and Regulation in Part I, Item 1 and Risk Factors in Part I, Item 1A of the Company's Annual Report on Form 10-K for the year ended December 31, 2011 (the Form 10-K) and Other Matters herein.

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The discussion of the Company's results of operations below may contain forward-looking statements. These statements, which reflect management's beliefs and expectations, are subject to risks and uncertainties that may cause actual results to differ materially. For a discussion of the risks and uncertainties that may affect the Company's future results, please see "Forward-Looking Statements" immediately preceding Part I, Item 1, "Competition and Supervision and Regulation" in Part I, Item 1, "Risk Factors" in Part I, Item 1A and "Executive Summary Significant Items" in Part II, Item 7 of the Form 10-K and "Other Matters" herein.

Executive Summary.

Financial Information and Statistical Data (dollars in millions, except where noted and per share amounts).

	Three Months Ended March 31,	
	2012	2011
Net revenues:		
Institutional Securities	\$ 3,023	\$ 3,568
Global Wealth Management Group	3,414	3,404
Asset Management	533	622
Intersegment Eliminations	(35)	(20)
Consolidated net revenues	\$ 6,935	\$ 7,574
Net income	\$ 134	\$ 1,130
Net income applicable to noncontrolling interests	228	162
Net income (loss) applicable to Morgan Stanley	\$ (94)	\$ 968
Income (loss) from continuing operations applicable to Morgan Stanley:		
Institutional Securities	\$ (296)	\$ 734
Global Wealth Management Group	193	182
Asset Management	25	68
Intersegment Eliminations		
Income (loss) from continuing operations applicable to Morgan Stanley	\$ (78)	\$ 984
Amounts applicable to Morgan Stanley:		
Income (loss) from continuing operations applicable to Morgan Stanley	\$ (78)	\$ 984
Net gain (loss) from discontinued operations applicable to Morgan Stanley(1)	(16)	(16)
Net income (loss) applicable to Morgan Stanley	\$ (94)	\$ 968
Earnings (loss) applicable to Morgan Stanley common shareholders	(119)	736
Earnings (loss) per basic common share:		
Income (loss) from continuing operations	\$ (0.05)	\$ 0.52
Net gain (loss) from discontinued operations(1)	(0.01)	(0.01)
Earnings (loss) per basic common share(2)	\$ (0.06)	\$ 0.51
Earnings (loss) per diluted common share:		
Income (loss) from continuing operations	\$ (0.05)	\$ 0.51
Net gain (loss) from discontinued operations(1)	(0.01)	(0.01)
Earnings (loss) per diluted common share(2)	\$ (0.06)	\$ 0.50

Regional net revenues(3):		
Americas	\$ 4,790	\$ 5,466
Europe, Middle East and Africa	1,154	1,667
Asia	991	441
Net revenues	\$ 6,935	\$ 7,574

Table of Contents*Financial Information and Statistical Data (dollars in millions, except where noted and per share amounts) (Continued).*

	Three Months Ended March 31,	
	2012	2011
Average common equity (dollars in billions)(4):		
Institutional Securities	\$ 29.5	\$ 33.2
Global Wealth Management Group	13.3	13.1
Asset Management	2.5	2.6
Parent capital	15.2	(0.8)
Total from continuing operations	60.5	48.1
Discontinued operations		
Consolidated average common equity	\$ 60.5	\$ 48.1
Return on average common equity(4)(5):		
Institutional Securities	N/M	7%
Global Wealth Management Group	6%	5%
Asset Management	4%	9%
Consolidated	N/M	6%
Book value per common share(6)	\$ 30.74	\$ 31.45
Tangible common equity(7)	\$ 54,156	\$ 41,673
Tangible book value per common share(8)	\$ 27.37	\$ 26.97
Effective income tax rate from continuing operations(9)	26.5%	(27.1)%
Worldwide employees	59,569	62,494
Average liquidity (dollars in billions)(10):		
Parent company liquidity	\$ 71	\$ 77
Bank and other subsidiaries liquidity	107	95
Total liquidity	\$ 178	\$ 172
Capital ratios at March 31, 2012 and 2011(11)(12):		
Total capital ratio	18.1%	16.1%
Tier 1 common capital ratio	13.3%	8.9%
Tier 1 capital ratio	16.8%	14.4%
Tier 1 leverage ratio	7.0%	6.1%
Consolidated assets under management or supervision (dollars in billions)(13):		
Asset Management(14)	\$ 304	\$ 276
Global Wealth Management Group	527	498
Total	\$ 831	\$ 774

Table of Contents*Financial Information and Statistical Data (dollars in millions, except where noted and per share amounts) (Continued).*

	Three Months Ended March 31,	
	2012	2011
Institutional Securities:		
Pre-tax profit margin(15)	N/M	12%
Global Wealth Management Group:		
Global representatives	17,193	18,124
Annualized revenues per global representative (dollars in thousands)(16)	\$ 787	\$ 747
Assets by client segment (dollars in billions):		
\$10 million or more	\$ 588	\$ 544
\$1 million to \$10 million	735	728
Subtotal \$1 million or more	1,323	1,272
\$100,000 to \$1 million	381	395
Less than \$100,000	40	39
Total client assets	\$ 1,744	\$ 1,706
Fee-based assets as a percentage of total client assets	30%	29%
Client assets per global representative(17)	\$ 101	\$ 94
Global fee-based asset flows (dollars in billions)	\$ 8.7	\$ 17.5
Bank deposits (dollars in billions)(18)	\$ 112	\$ 112
Global retail locations	743	820
Pre-tax profit margin(15)	11%	10%
Asset Management:		
Assets under management or supervision (dollars in billions)	\$ 304	\$ 276
Pre-tax profit margin(15)	24%	20%
Selective Management Financial Measures Non-GAAP(19):		
Net Revenues Non-GAAP	\$ 8,913	\$ 7,763
Income from continuing operations applicable to Morgan Stanley Non-GAAP	\$ 1,376	\$ 1,100
Income per diluted common share from continuing operations Non-GAAP	\$ 0.71	\$ 0.59
Return on average common equity from continuing operations Non-GAAP	9.2%	7.3%

N/M Not Meaningful.

N/A Not Applicable. Information is not comparable.

- (1) See Notes 1 and 20 to the condensed consolidated financial statements for information on discontinued operations.
- (2) For the calculation of basic and diluted earnings per share (EPS), see Note 14 to the condensed consolidated financial statements.
- (3) Regional net revenues include the impact of the fluctuation in the Company's credit spreads and other credit factors (Debt-Related Credit Spreads) on certain of the Company's long-term and short-term borrowings, primarily structured notes (Borrowings), that are accounted for at fair value.
- (4) Beginning in the quarter ended March 31, 2012, the Company and segment Required Capital is met by Tier 1 common capital. Prior to the current quarter, the Company's Required Capital was met by regulatory Tier 1 capital or Tier 1 common equity. Segment capital for prior periods has been recast under this framework.
- (5) The calculation of return on average common equity uses income from continuing operations applicable to Morgan Stanley less preferred dividends as a percentage of average common equity. The return on average common equity is a non-Generally Accepted Accounting Principle (GAAP) financial measure that the Company considers to be a useful measure to the Company and investors to assess operating performance. The computation of average common equity for each business segment is determined using the Company's Required Capital framework (Required Capital Framework), an internal capital adequacy measure (see Liquidity and Capital Resources Required Capital herein). The Required Capital Framework will evolve over time to respond to changes in the business and regulatory environment and to incorporate enhancements in modeling techniques (see Liquidity and Capital Resources Regulatory Requirements herein for further information on risk-based capital, leverage and liquidity standards, known as Basel III, which were proposed by the Basel Committee on Banking Supervision (the Basel Committee) in December 2009). The effective tax rates used in the computation of business segment return on average

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common equity were determined on a separate entity basis. Excluding the effects of the aggregate discrete tax benefit in the quarter ended March 31, 2011, the return on average common equity for the Institutional Securities business segment would have been 1% (see Executive Summary Overview of the Quarter Ended March 31, 2012 Financial Results herein).

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- (6) Book value per common share equals common shareholders' equity of \$60,816 million at March 31, 2012 and \$48,589 million at March 31, 2011 divided by common shares outstanding of 1,978 million at March 31, 2012 and 1,545 million at March 31, 2011.
- (7) Tangible common equity is a non-GAAP financial measure that the Company considers to be a useful measure that the Company and investors use to assess capital adequacy. For a discussion of tangible common equity, see [Liquidity and Capital Resources](#) [The Balance Sheet](#) herein.
- (8) Tangible book value per common share is a non-GAAP financial measure that the Company considers to be a useful measure that the Company and investors use to assess capital adequacy. Tangible book value per common share equals tangible common equity divided by period-end common shares outstanding.
- (9) For a discussion of the effective income tax rate, see [Executive Summary](#) [Overview of the Quarter Ended March 31, 2012 Financial Results](#) .
- (10) For a discussion of average liquidity, see [Liquidity and Capital Resources](#) [Liquidity and Trading Management](#) [Global Liquidity Reserve](#) herein.
- (11) On December 30, 2011, the Board of Governors of the Federal Reserve System (the [Federal Reserve](#)) formalized regulatory definitions for Tier 1 common capital and Tier 1 common capital ratio. The Company's Tier 1 common ratio at March 31, 2011 was recast to conform to this definition. The Company's Total capital ratio, Tier 1 common capital ratio and Tier 1 capital ratio at March 31, 2011 have also been adjusted based on revised guidance from the Federal Reserve about the Company's capital treatment for over-the-counter ([OTC](#)) derivative collateral. For a discussion of Total capital ratio, Tier 1 common capital ratio, Tier 1 capital ratio and Tier 1 leverage ratio, see [Liquidity and Capital Resources](#) [Regulatory Requirements](#) herein.
- (12) The December 31, 2011 deferred tax asset disallowance was adjusted by approximately \$1.2 billion, resulting in a reduction to the Company's Tier 1 common capital, Tier 1 capital and Total capital by such amount, Tier 1 common capital ratio, Tier 1 capital ratio and Total capital ratio by approximately 30 basis points and Tier 1 leverage ratio by approximately 20 basis points.
- (13) Revenues and expenses associated with these assets are included in the Company's Global Wealth Management Group and Asset Management business segments.
- (14) Amounts exclude the Asset Management business segment's proportionate share of assets managed by entities in which it owns a minority stake.
- (15) Pre-tax profit margin is a non-GAAP financial measure that the Company considers to be a useful measure that the Company and investors use to assess operating performance. Percentages represent income from continuing operations before income taxes as a percentage of net revenues.
- (16) Annualized net revenues per global representative for the quarters ended March 31, 2012 and 2011 equals Global Wealth Management Group's net revenues divided by the quarterly weighted average global representative headcount for the quarters ended March 31, 2012 and 2011, respectively.
- (17) Client assets per global representative equal total period-end client assets divided by period-end global representative headcount.
- (18) Approximately \$57 billion and \$54 billion of the bank deposit balances at March 31, 2012 and 2011, respectively, are held at Company-affiliated depositories with the remainder held at Citigroup, Inc. ([Citi](#)) affiliated depositories. These deposit balances are held at certain of the Company's Federal Deposit Insurance Corporation (the [FDIC](#)) insured depository institutions for the benefit of the Company's clients through their accounts. For additional information regarding the Company's deposits, see [Liquidity and Capital Resources](#) [Funding Management](#) [Deposits](#) herein.

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(19) From time to time, the Company may disclose certain non-GAAP financial measures in the course of its earnings releases, earnings conference calls, financial presentations and otherwise. For these purposes, GAAP refers to generally accepted accounting principles in the United States. The Securities and Exchange Commission (SEC) defines a non-GAAP financial measure as a numerical measure of historical or future financial performance, financial positions, or cash flows that excludes or includes amounts or is subject to adjustments that effectively exclude, or include, amounts from the most directly comparable measure calculated and presented in accordance with GAAP. Non-GAAP financial measures disclosed by the Company are provided as additional information to investors in order to provide them with further transparency about, or an alternative method for assessing, our financial condition and operating results. These measures are not in accordance with, or a substitute for, GAAP, and may be different from or inconsistent with non-GAAP financial measures used by other companies. Whenever the Company refers to a non-GAAP financial measure, the Company will also generally present the most directly comparable financial measure calculated and presented in accordance with GAAP, along with a reconciliation of the differences between the non-GAAP financial measure we reference with such comparable GAAP financial measure. The return on average common equity is calculated as annualized earnings applicable to Morgan Stanley common shareholders from continuing operations, prior to the allocation of income to participating restricted stock units, divided by average common equity. The return on average common equity excluding the impact of Debt-Related Credit Spreads on Borrowings is a non-GAAP financial measure that the Company considers to be a useful measure that the Company and investors use to assess operating performance. The table below presents a reconciliation of selective management financial measures from a non-GAAP to a GAAP basis:

	Three Months Ended March 31,	
	2012	2011
Reconciliation of Selective Management Financial Measures from a Non-GAAP to a GAAP Basis (dollars in millions, except per share amounts)		
Net Revenues		
Net Revenues Non-GAAP	\$ 8,913	\$ 7,763
Impact of Debt-Related Credit Spreads on Borrowings	(1,978)	(189)
Net Revenues GAAP	\$ 6,935	\$ 7,574
Income from continuing operations applicable to Morgan Stanley		
Income applicable to Morgan Stanley Non-GAAP	\$ 1,376	\$ 1,100
Impact of Debt-Related Credit Spreads on Borrowings (net of tax benefits of \$524 million and \$73 million for the three months ended March 31 2012 and 2011, respectively)	(1,454)	(116)
Income (loss) applicable to Morgan Stanley GAAP	\$ (78)	\$ 984
Earnings (loss) per diluted common share		
Income per diluted common share from continuing operations Non-GAAP	\$ 0.71	\$ 0.59
Impact of Debt-Related Credit Spreads on Borrowings	(0.76)	(0.08)
Income (loss) per common diluted share from continuing operations GAAP	\$ (0.05)	\$ 0.51
Average diluted shares Non-GAAP (in millions)	1,903	1,472
Impact of Debt-Related Credit Spreads on Borrowings (in millions)	(26)	
Average diluted shares GAAP (in millions)	1,877	1,472
Average common equity		
Income applicable to Morgan Stanley Non-GAAP	\$ 1,352	\$ 880
Impact of Debt-Related Credit Spreads on Borrowings (net of tax benefits of \$524 million and \$73 million for the three months ended March 31 2012 and 2011, respectively)	(1,454)	(116)
Income (loss) applicable to Morgan Stanley GAAP	\$ (102)	\$ 764
Average common equity Non-GAAP	\$ 59,033	\$ 48,171
Impact of inception to date Debt-Related Credit Spreads on Borrowings, net of tax	1,452	(44)
Average common equity GAAP	\$ 60,485	\$ 48,127

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Global Market and Economic Conditions.

During the first quarter of 2012, global market and economic conditions improved modestly from 2011 year-end. The U.S. economy expanded moderately and financial stresses in Europe lessened to some degree following a number of actions taken by European policymakers. Despite these improvements, global market and economic conditions continued to be challenged by concerns about the continuing European sovereign debt crisis, lack of robust economic recovery in the U.S., and slowing economic growth in emerging markets.

In the U.S., major equity market indices ended the first quarter of 2012 higher compared with the beginning of the year primarily due to improved investor confidence in the global economic recovery. U.S. economic activity continued to expand at a moderate pace in the first quarter of 2012. Conditions in the labor market continued to improve as the unemployment rate decreased to 8.2% at March 31, 2012 from 8.5% at December 31, 2011. However, certain sectors of the residential real estate market and investments in commercial real estate projects remained challenged in the first quarter of 2012. Consumer spending and business investments continued to improve and concerns about crude oil supplies contributed to a rise in oil prices during the quarter, although overall consumer price inflation was relatively subdued. The Federal Open Market Committee (FOMC) of the Federal Reserve kept key interest rates at historically low levels, and at March 31, 2012, the federal funds target rate was between zero and 0.25%, and the discount rate was 0.75%. In the first quarter of 2012, the FOMC announced that key interest rates will likely remain at historically low levels at least through late 2014.

In Europe, real gross domestic product growth stabilized in the first quarter of 2012. Major European equity market indices ended the quarter higher compared with the beginning of the year, as investors' concerns about the sovereign debt crisis, especially in Greece, Ireland, Italy, Portugal and Spain (the European Peripherals), and the sovereign debt exposures in the European banking system receded during the quarter. The euro area unemployment rate increased to 10.9% at March 31, 2012 from 10.6% at December 31, 2011. At March 31, 2012, the European Central Bank's (ECB) benchmark interest rate was 1.00%, and the Bank of England's (BOE) benchmark interest rate was 0.50%, both of which were unchanged from December 31, 2011. In the first quarter of 2012, the BOE increased the size of its quantitative easing program in order to inject further monetary stimulus into the economy in the United Kingdom (U.K.), and during the first quarter of 2012 the U.K. entered into a technical recession (two consecutive quarters of negative gross domestic product). During the first quarter of 2012, funding conditions for euro-area banks eased as the ECB conducted its second three-year refinancing operation and widened the pool of eligible collateral for refinancing operations. In February of 2012, European Union leaders agreed on a new bailout and debt-restructuring agreement designed to reduce Greece's debt. In the first four months of 2012, rating agencies downgraded the credit ratings for some European countries, and Spain joined other European countries by entering into a technical recession.

In Asia, major stock markets closed out the first quarter of 2012 higher compared with the beginning of the year. Japan's economic activity remained flat during the first quarter of 2012. To further stimulate its economy, in February and April of 2012, the Bank of Japan increased the size of its quantitative easing program twice. Japan's benchmark interest rate remained within a range of zero to 0.1% during the first quarter of 2012. China's gross domestic product growth continued to moderate during the first quarter of 2012 as import and export growth slowed sharply after domestic tightening measures and global economic turmoil impacted consumption. To stimulate the Chinese economy, the People's Bank of China cut its bank reserve requirement by 0.5% in February 2012.

Overview of the Quarter Ended March 31, 2012 Financial Results.

Consolidated Results. The Company recorded a net loss applicable to Morgan Stanley of \$94 million on net revenues of \$6,935 million during the quarter ended March 31, 2012 (current quarter), compared with net income applicable to Morgan Stanley of \$968 million on net revenues of \$7,574 million in the quarter ended March 31, 2011 (prior year period).

Net revenues in the current quarter included negative revenue of \$1,978 million, or \$(0.76) per diluted share, due to the impact of the tightening of the Company's Debt-Related Credit Spreads on Borrowings that are accounted

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for at fair value, compared with negative revenues of \$189 million in the prior year period. Non-interest expenses were relatively flat at \$6,732 million in the current quarter. Compensation expenses increased 3% in the current quarter compared to the prior year period, and included severance expense of \$138 million related to staff reductions. Non-compensation expenses decreased 4% in the current quarter.

Diluted EPS and diluted EPS from continuing operations were \$(0.06) and \$(0.05), respectively, in the current quarter compared with \$0.50 and \$0.51, respectively, in the prior year period.

Excluding the impact of the Company's Debt-Related Credit Spreads on Borrowings, in the current quarter, net revenues were \$8,913 million and diluted EPS from continuing operations was \$0.71 per share, compared to \$7,763 million and \$0.59 per share, respectively, in the prior year period.

The Company's effective tax rate from continuing operations was 26.5% and a benefit of (27.1)% for the quarter ended March 31, 2012 and March 31, 2011, respectively. The results for the quarter ended March 31, 2011 included a net tax benefit of \$447 million, or \$0.30 per diluted share, from the remeasurement of a deferred tax asset and the reversal of a related valuation allowance. Excluding this discrete tax benefit the annual effective tax rate in the quarter ended March 31, 2011 would have been 22.5%. The increase in the effective tax rate is primarily reflective of the geographic mix of earnings. For further discussion of the prior year discrete tax benefits, see Executive Summary Significant Items Income Tax Benefits herein.

During the current quarter, the Company announced that it reached an agreement to sell Quilter Holdings Ltd. (Quilter), its retail wealth management business in the U.K. This transaction, and the first phase of the previously announced disposition of Saxon, closed on April 2, 2012. The results of Quilter (reported in the Global Wealth Management Group business segment) and Saxon (reported in the Institutional Securities business segment) are presented as discontinued operations for all periods presented. Discontinued operations for the quarters ended March 31, 2012 and 2011 were a loss of \$15 million in both periods.

Institutional Securities. Income (loss) from continuing operations before taxes was \$(312) million in the current quarter, compared with \$432 million in the prior year period. Net revenues for the current quarter were \$3,023 million compared with \$3,568 million in the prior year period. The results in the current quarter included negative revenue of \$1,978 million (fixed income and commodities: \$1,597 million; equities: \$381 million) due to the impact of the tightening of the Company's Debt-Related Credit Spreads on Borrowings that were accounted for at fair value compared with negative revenue of \$189 million (fixed income and commodities: approximately \$159 million; equities: approximately \$30 million) in the prior year period. Investment banking revenues for the current quarter decreased 16% to \$851 million from the prior year period, reflecting lower revenues from equity underwriting transactions and lower advisory revenues, partially offset by higher revenues from fixed income underwriting transactions. The following sales and trading net revenues results exclude the impact of Debt-Related Credit Spreads on Borrowings that are accounted for at fair value. The presentation of net revenues excluding the impact of Debt-Related Credit Spreads on Borrowings that are accounted for at fair value is a non-GAAP financial measure that the Company considers useful for the Company and investors to allow further comparability of period to period operating performance. See Business Segments Institutional Securities Sales and Trading Net Revenues for more information. Excluding the impact of Debt-Related Credit Spreads on Borrowings that are accounted for at fair value, fixed income and commodities sales and trading net revenues of \$2,594 million increased 34% from a year ago, reflecting increased contributions from most products, with particular strength in interest rates, currency products, commodities and corporate credit, partially offset by lower revenues in securitized products. The results in the prior year period were negatively impacted by losses of \$318 million from Monoline Insurers (Monolines) (see Executive Summary Significant Items Monoline Insurers herein for further information). Equity sales and trading net revenues, excluding the impact of Debt-Related Credit Spreads on Borrowings that are accounted for at fair value, of \$1,833 million increased 6% from a year ago reflecting solid performance across all regions with higher revenues in the derivative business and notable growth in electronic and retail volumes. Other sales and trading net losses in the current quarter were \$286 million compared with losses of \$460 million in the prior year period. Results in both quarters primarily reflected losses on economic hedges related to the Company's long-term debt and costs

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related to the amount of liquidity held (negative carry). Other revenues in the current quarter were \$58 million compared with negative revenues of \$602 million in the prior year period. Results for the prior year period included a loss of \$655 million arising from the Company's 40% stake in Mitsubishi UFJ Morgan Stanley Securities Co., Ltd. (MUMSS) (see Executive Summary Significant Items Japanese Securities Joint Venture herein). Non-interest expenses increased 6% to \$3,335 million in the current quarter primarily due to higher Compensation and benefit expenses, which increased 10% to \$2,108 million.

Global Wealth Management Group. Income from continuing operations before taxes was \$387 million in the current quarter compared with \$344 million in the prior year period. Net revenues of \$3,414 million in the current quarter were essentially unchanged from a year ago as higher asset management and net interest revenues were mostly offset by lower commissions. In the current quarter, Non-interest expenses of \$3,027 million, including Compensation expenses of \$2,105 million, were essentially unchanged from the prior year period. Total client asset balances were \$1,744 billion at March 31, 2012 and client assets in fee-based accounts were \$531 billion, or 30% of total client assets. Global fee based asset flows for the current quarter were \$8.7 billion as compared with \$17.5 billion in the prior year period.

Asset Management. Income from continuing operations before taxes was \$128 million in the current quarter compared with \$125 million in the prior year period. Net revenues were \$533 million in the current quarter compared with \$622 million in the prior year period. The decrease in net revenues primarily reflected lower gains on principal investments in the Company's Merchant Banking business, including certain investments associated with the Company's employee deferred compensation and co-investment plans, partially offset by higher net investment gains associated with certain consolidated real estate funds sponsored by the Company. Asset management, distribution and administration fees increased 1% to \$411 million in the current quarter, primarily reflecting higher performance fees and higher fund management and administration fees, primarily due to higher average assets under management. This increase was partially offset by the absence of FrontPoint Partners LLC (FrontPoint) in the current quarter compared with two months of FrontPoint fees in the prior year period. Non-interest expenses decreased 19% to \$405 million in the current quarter, reflecting decreases in compensation expenses and non-compensation expenses.

Significant Items.

Corporate Lending. The Company recorded the following amounts primarily associated with the portion of the loans and lending commitment portfolio carried at fair value within the Institutional Securities business segment (see Business Segments Institutional Securities Sales and Trading Net Revenues herein):

	Three Months Ended	
	March 31,	
	2012(1)	2011(1)
	(dollars in millions)	
Gains on loans and lending commitments	\$ 770	\$ 209
Losses on hedges	(636)	(135)
Total gains	\$ 134	\$ 74

(1) Amounts include realized and unrealized gains (losses).

Japanese Securities Joint Venture. During the quarters ended March 31, 2012 and 2011, the Company recorded a gain (loss) of \$27 million and \$(655) million, respectively, within Other revenues in the condensed consolidated statements of income, arising from the Company's 40% stake in MUMSS (see Note 19 to the condensed consolidated financial statements).

Income Tax Benefit. The Company's effective tax rate from continuing operations for the quarter ended March 31, 2011 included a \$447 million net tax benefit from the remeasurement of a deferred tax asset and the reversal of a related valuation allowance. The deferred tax asset and valuation allowance were recognized in

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income from discontinued operations in 2010 in connection with the recognition of a \$1.2 billion loss due to writedowns and related costs following the Company's commitment to a plan to dispose of Revel Entertainment Group, LLC (Revel). The Company recorded the valuation allowance because the Company did not believe it was more likely than not that it would have sufficient future net capital gain to realize the benefit of the expected capital loss to be recognized upon the disposal of Revel. During the quarter ended March 31, 2011, the disposal of Revel was restructured as a tax-free like kind exchange and the disposal was completed. The restructured transaction changed the character of the future taxable loss to ordinary. The Company reversed the valuation allowance because the Company believes it is more likely than not that it will have sufficient future ordinary taxable income to recognize the recorded deferred tax asset. In accordance with the applicable accounting literature, this reversal of a previously established valuation allowance due to a change in circumstances was recognized in income from continuing operations.

Monoline Insurers. The results for the quarter ended March 31, 2011 included a loss of \$318 million related to the Company's counterparty credit exposures to Monolines, principally MBIA Insurance Corporation (MBIA).

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Business Segments.

Substantially all of the Company's operating revenues and operating expenses can be directly attributed to its business segments. Certain revenues and expenses have been allocated to each business segment, generally in proportion to its respective revenues or other relevant measures.

As a result of treating certain intersegment transactions as transactions with external parties, the Company includes an Intersegment Eliminations category to reconcile the business segment results to the Company's consolidated results. Intersegment Eliminations also reflect the effect of fees paid by the Institutional Securities business segment to the Global Wealth Management Group business segment related to the bank deposit program. The Company did not recognize any Intersegment Elimination gains or losses in the quarters ended March 31, 2012 and March 31, 2011.

Net Revenues.

Principal Transactions Trading. Principal transactions Trading revenues include revenues from customers' purchases and sales of financial instruments in which the Company acts as principal and gains and losses on the Company's positions, as well as proprietary trading activities for its own account. Principal transactions Trading revenues includes the realized gains and losses from sales of cash instruments and derivative settlements, unrealized gains and losses from ongoing fair value changes of the Company's positions related to market-making activities, and gains and losses related to investments associated with certain employee deferred compensation plans. In many markets, the realized and unrealized gains and losses from the purchase and sale transactions will include any spreads between bids and offers. Certain fees received on loans carried at fair value and dividends from equity securities are also recorded in this line item since they relate to market-making positions. Commissions received for purchasing and selling listed equity securities and options are recorded separately in the Commissions and fees line item. Other cash and derivative instruments typically do not have fees associated with them and fees for related services would be recorded in Commissions and fees.

Principal Transactions Investments. The Company's investments generally are held for long-term appreciation and generally are subject to significant sales restrictions. Estimates of the fair value of the investments may involve significant judgment and may fluctuate significantly over time in light of business, market, economic and financial conditions generally or in relation to specific transactions. In some cases, such investments are required or are a necessary part of offering other products. The revenues recorded are the result of realized gains and losses from sales and unrealized gains and losses from ongoing fair value changes of the Company's holdings as well as from investments associated with certain employee deferred compensation plans. Typically, there are no fee revenues from these investments. The sales restrictions on the investments relate primarily to redemption and withdrawal restrictions on investments in real estate funds, hedge funds, and private equity funds, which include investments made in connection with certain employee deferred compensation plans (see Note 3 to the condensed consolidated financial statements). Restrictions on interests in exchanges and clearinghouses generally include a requirement to hold those interests for the period of time that the Company is clearing trades on that exchange or clearinghouse. Additionally, there are certain principal investments related to assets held by consolidated real estate funds, which are primarily related to holders of noncontrolling interests.

Commissions and Fees. Commission and fee revenues primarily arise from agency transactions in listed and OTC equity securities, services related to sales and trading activities, and sales of mutual funds, futures, insurance products and options.

Asset Management, Distribution and Administration Fees. Asset management, distribution and administration fees include fees associated with the management and supervision of assets, account services and administration, performance-based fees relating to certain funds, separately managed accounts, shareholder servicing, and the distribution of certain open-ended mutual funds.

Asset management, distribution and administration fees in the Global Wealth Management Group business segment also include revenues from individual investors electing a fee-based pricing arrangement and fees for

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investment management. Mutual fund distribution fees in the Global Wealth Management Group business segment are based on either the average daily fund net asset balances or average daily aggregate net fund sales and are affected by changes in the overall level and mix of assets under management or supervision.

Asset management fees in the Asset Management business segment arise from investment management services the Company provides to investment vehicles pursuant to various contractual arrangements. The Company receives fees primarily based upon mutual fund daily average net assets or based on monthly or quarterly invested equity for other vehicles. Performance-based fees in the Asset Management business segment are earned on certain funds as a percentage of appreciation earned by those funds and, in certain cases, are based upon the achievement of performance criteria. These fees are normally earned annually and are recognized on a monthly or quarterly basis.

Net Interest. Interest income and Interest expense are a function of the level and mix of total assets and liabilities, including financial instruments owned and financial instruments sold, not yet purchased, securities available for sale, securities borrowed or purchased under agreements to resell, securities loaned or sold under agreements to repurchase, loans, deposits, commercial paper and other short-term borrowings, long-term borrowings, trading strategies, customer activity in the Company's prime brokerage business, and the prevailing level, term structure and volatility of interest rates. Certain Securities purchased under agreements to resell (reverse repurchase agreements) and Securities sold under agreements to repurchase (repurchase agreements) and Securities borrowed and Securities loaned transactions may be entered into with different customers using the same underlying securities, thereby generating a spread between the interest revenue on the reverse repurchase agreements or securities borrowed transactions and the interest expense on the repurchase agreements or securities loaned transactions.

Market Making.

As a market maker, the Company stands ready to buy, sell or otherwise transact with customers under a variety of market conditions and provide firm or indicative prices in response to customer requests. The Company's liquidity obligations can be explicit and obligatory in some cases, and in others, customers expect the Company to be willing to transact with them. In order to most effectively fulfill its market-making function, the Company engages in activities, across all of its trading businesses, that include, but are not limited to, (i) taking positions in anticipation of, and in response to customer demand to buy or sell, and depending on the liquidity of the relevant market and the size of the position holding those positions for a period of time; (ii) managing and assuming basis risk (risk associated with imperfect hedging) between customized customer risks and the standardized products available in the market to hedge those risks; (iii) building, maintaining, and re-balancing inventory, through trades with other market participants, and engaging in accumulation activities to accommodate anticipated customer demand; (iv) trading in the market to remain current on pricing and trends; and (v) engaging in other activities to provide efficiency and liquidity for markets. Interest income and expense are also impacted by market-making activities as debt securities held by the Company earn interest and securities are loaned, borrowed, sold with agreement to repurchase and purchased with agreement to resell.

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INSTITUTIONAL SECURITIES
INCOME STATEMENT INFORMATION

	Three Months Ended March 31,	
	2012	2011
	(dollars in millions)	
Revenues:		
Investment banking	\$ 851	\$ 1,008
Principal transactions:		
Trading	2,044	2,647
Investments	(49)	143
Commissions and fees	548	669
Asset management, distribution and administration fees	32	30
Other	58	(602)
Total non-interest revenues	3,484	3,895
Interest income	1,145	1,486
Interest expense	1,606	1,813
Net interest	(461)	(327)
Net revenues	3,023	3,568
Compensation and benefits	2,108	1,923
Non-compensation expenses	1,227	1,213
Total non-interest expenses	3,335	3,136
Income (loss) from continuing operations before income taxes	(312)	432
Benefit from income taxes	(105)	(363)
Income (loss) from continuing operations	(207)	795
Discontinued operations:		
Income (loss) from discontinued operations	24	(38)
Provision for (benefit from) income taxes	41	(15)
Net gains (losses) on discontinued operations	(17)	(23)
Net income (loss)	(224)	772
Net income applicable to noncontrolling interests	89	61
Net income (loss) applicable to Morgan Stanley	\$ (313)	\$ 711
Amounts applicable to Morgan Stanley:		
Income (loss) from continuing operations	\$ (296)	\$ 734
Net gains (losses) from discontinued operations	(17)	(23)

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Net income (loss) applicable to Morgan Stanley	\$ (313)	\$ 711
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Noncontrolling Interests. Noncontrolling interests primarily relate to Morgan Stanley MUFG Securities, Co., Ltd.

Discontinued Operations. On October 24, 2011, the Company announced that it had reached an agreement to sell Saxon, a provider of servicing and subservicing of residential mortgage loans, to Ocwen Financial Corporation. During the first quarter of 2012, the transaction was restructured as a sale of Saxon's assets, the first phase of which was completed in the second quarter of 2012. The remaining operations of Saxon are expected to be wound down within the year. The Company expects to incur incremental wind-down costs in future periods. The results of Saxon are reported as discontinued operations within the Institutional Securities business segment for all periods presented.

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On February 17, 2011, the Company completed the sale of Revel. The sale price approximated the carrying value of Revel at the time of disposal and, accordingly, the Company did not recognize any pre-tax gain or loss on the sale. The results of Revel are reported as discontinued operations within the Institutional Securities business segment for all periods presented through the date of sale. For further information on Revel, see Note 20 to the condensed consolidated financial statements.

Investment Banking. Investment banking revenues were as follows:

	Three Months Ended March 31,	
	2012	2011
	(dollars in millions)	
Advisory revenues	\$ 313	\$ 385
Underwriting revenues:		
Equity underwriting revenues	172	285
Fixed income underwriting revenues	366	338
Total underwriting revenues	538	623
Total investment banking revenues	\$ 851	\$ 1,008

The following table presents the Company's volumes of announced and completed mergers and acquisitions, equity and equity-related offerings, and fixed income offerings:

	Three Months Ended March 31,	
	2012(1)	2011(1)
	(dollars in billions)	
Announced mergers and acquisitions(2)	\$ 106	\$ 147
Completed mergers and acquisitions(2)	74	246
Equity and equity-related offerings(3)	12	13
Fixed income offerings(4)	70	65

- (1) Source: Thomson Reuters, data at April 11, 2012. Announced and completed mergers and acquisitions volumes are based on full credit to each of the advisors in a transaction. Equity and equity-related offerings and fixed income offerings are based on full credit for single book managers and equal credit for joint book managers. Transaction volumes may not be indicative of net revenues in a given period. In addition, transaction volumes for prior periods may vary from amounts previously reported due to the subsequent withdrawal or change in the value of a transaction.
- (2) Amounts include transactions of \$100 million or more and announced mergers and acquisitions exclude terminated transactions.
- (3) Amounts include Rule 144A and public common stock offerings, convertible offerings and rights offerings.
- (4) Amounts include non-convertible preferred stock, mortgage-backed securities, asset-backed securities and taxable municipal debt. Amounts also include publicly registered and Rule 144A issues. Amounts exclude leveraged loans and self-led issuances.

Investment banking revenues for the quarter ended March 31, 2012 decreased 16% from the comparable period in 2011, reflecting lower revenues from equity underwriting transactions and lower advisory revenues, partially offset by higher revenues from fixed income underwriting transactions. Overall, underwriting revenues of \$538 million decreased 14% from the quarter ended March 31, 2011. Equity underwriting revenues decreased 40% to \$172 million in the quarter ended March 31, 2012 reflecting lower levels of market activity across all regions. Fixed income underwriting revenues increased 8% to \$366 million in the quarter ended March 31, 2012, primarily reflecting growth in both bond issuance fees and loan syndication fees. Advisory revenues from merger, acquisition and restructuring transactions were \$313 million in the quarter ended March 31, 2012, a decrease of 19% from the comparable period of 2011, reflecting lower levels of market activity.

Sales and Trading Net Revenues. Sales and trading net revenues are composed of Principal transactions Trading revenues; Commissions and fees; Asset management, distribution and administration fees; and Net interest revenues (expenses). In assessing the profitability of its sales and trading activities, the Company views these net revenues in the aggregate. In addition, decisions relating to principal transactions are based on an overall review of aggregate revenues and costs associated with each transaction or series of transactions. This review includes, among other

things, an assessment of the potential gain or loss associated with a transaction,

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including any associated commissions and fees, dividends, the interest income or expense associated with financing or hedging the Company's positions, and other related expenses. See Note 10 to the condensed consolidated financial statements for further information related to gains (losses) on derivative instruments.

Total sales and trading net revenues decreased to \$2,163 million in the quarter ended March 31, 2012 from \$3,019 million in the quarter ended March 31, 2011, reflecting lower equity and fixed income and commodities sales and trading net revenues, partially offset by lower losses in other sales and trading net revenues.

Sales and trading net revenues were as follows:

	Three Months Ended March 31,	
	2012	2011(1)
	(dollars in millions)	
Principal transactions Trading	\$ 2,044	\$ 2,647
Commissions and fees	548	669
Asset management, distribution and administration fees	32	30
Net interest	(461)	(327)
Total sales and trading net revenues	\$ 2,163	\$ 3,019

(1) All prior-period amounts have been reclassified to conform to the current period's presentation.
Sales and trading net revenues by business were as follows:

	Three Months Ended March 31,	
	2012	2011(1)
	(dollars in millions)	
Equity	\$ 1,452	\$ 1,702
Fixed income and commodities	997	1,777
Other(2)	(286)	(460)
Total sales and trading net revenues	\$ 2,163	\$ 3,019

(1) All prior-period amounts have been reclassified to conform to the current period's presentation.

(2) Other sales and trading net revenues include net gains (losses) from certain loans and lending commitments and related hedges associated with the Company's lending activities. Other sales and trading net revenues also include gains (losses) on economic hedges related to the Company's long-term debt and net losses associated with costs related to the amount of liquidity held (negative carry).

The following sales and trading net revenues results exclude the impact of Debt-Related Credit Spreads on Borrowings that are accounted for at fair value(1). The reconciliation of sales and trading, including equity sales and trading and fixed income and commodities sales and trading net revenues from a non-GAAP to a GAAP basis is as follows:

Three Months Ended
March 31,
2012 2011
(dollars in millions)

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Total sales and trading net revenues non-GAAP(1)	\$ 4,141	\$ 3,208
Impact of Debt-Related Credit Spreads on Borrowings	(1,978)	(189)
Total sales and trading net revenues	\$ 2,163	\$ 3,019
Equity sales and trading net revenues non-GAAP(1)	\$ 1,833	\$ 1,732
Impact of Debt-Related Credit Spreads on Borrowings	(381)	(30)
Equity sales and trading net revenues	\$ 1,452	\$ 1,702
Fixed income and commodities sales and trading net revenues non-GAAP(1)	\$ 2,594	\$ 1,936
Impact of Debt-Related Credit Spreads on Borrowings	(1,597)	(159)
Fixed income and commodities sales and trading net revenues	\$ 997	\$ 1,777

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(1) Sales and trading net revenues, including fixed income and commodities and equity sales and trading net revenues that excluded the impact of Debt-Related Credit Spreads on Borrowings that are accounted for at fair value are non-GAAP financial measures that the Company considers useful for the Company and investors to allow further comparability of period to period operating performance.

Equity. Equity sales and trading net revenues decreased 15% to \$1,452 million in the quarter ended March 31, 2012 from the comparable period in 2011. The results in equity sales and trading net revenues also included negative revenue in the quarter ended March 31, 2012 of \$381 million due to the impact of the tightening of the Company's Debt-Related Credit Spreads on Borrowings that are accounted for at fair value compared with negative revenue of approximately \$30 million in the quarter ended March 31, 2011. Equity sales and trading net revenues, excluding the impact of the Company's Debt-Related Credit Spreads on Borrowings that are accounted for at fair value, in the quarter ended March 31, 2012 increased 6% over the comparable period in 2011, reflecting performance across all regions with higher revenues in the derivatives business and notable growth in electronic and retail volumes.

In the quarter ended March 31, 2012, equity sales and trading net revenues also reflected gains of \$44 million related to changes in the fair value of net derivative contracts attributable to the tightening of counterparties' credit default swap spreads and other credit factors compared with gains of \$12 million in the quarter ended March 31, 2011. The Company also recorded losses of \$72 million in the quarter ended March 31, 2012 related to changes in the fair value of net derivative contracts attributable to the tightening of the Company's credit default swap spreads and other credit factors compared with losses of \$40 million in the quarter ended March 31, 2011. The gains and losses on credit default swap spreads and other credit factors do not reflect any gains or losses on related hedging instruments.

Fixed Income and Commodities. Fixed income and commodities sales and trading net revenues decreased 44% to \$997 million in the quarter ended March 31, 2012 from \$1,777 million in the quarter ended March 31, 2011. Results in the quarter ended March 31, 2012 included negative revenue of \$1,597 million due to the impact of the tightening of the Company's Debt-Related Credit Spreads on Borrowings that are accounted for at fair value, compared with negative revenue of approximately \$159 million in the quarter ended March 31, 2011. Fixed income and commodities sales and trading net revenues, excluding the impact of the Company's Debt-Related Credit Spreads on Borrowings that are accounted for at fair value, in the quarter ended March 31, 2012 increased 34% over the comparable period in 2011. Fixed income net revenues, excluding the impact of the Company's Debt-Related Credit Spreads on Borrowings that are accounted for at fair value, in the quarter ended March 31, 2012 increased 31% over the comparable period in 2011. The results in fixed income in the quarter ended March 31, 2012 reflected higher revenues in interest rate and currency products and corporate credit products, partially offset by lower revenues in securitized products due to lower trading volumes. Results in the quarter ended March 31, 2011 also included losses of \$318 million from Monolines (see Executive Summary Significant Items Monoline Insurers herein for further information). Commodity net revenues, excluding the impact of the Company's Debt-Related Credit Spreads on Borrowings that are accounted for at fair value, increased 30% in the quarter ended March 31, 2012, primarily due to higher levels of client activity, including structured transactions.

In the quarter ended March 31, 2012, fixed income and commodities sales and trading net revenues reflected net gains of \$492 million related to changes in the fair value of net derivative contracts attributable to the tightening of counterparties' credit default swap spreads and other credit factors compared with gains of \$857 million in the quarter ended March 31, 2011. The Company also recorded losses of \$763 million in the quarter ended March 31, 2012 related to changes in the fair value of net derivative contracts attributable to the tightening of the Company's credit default swap spreads and other credit factors compared with losses of \$156 million in the quarter ended March 31, 2011. The gains and losses on credit default swap spreads and other credit factors do not reflect any gains or losses on related hedging instruments.

Other. In addition to the equity and fixed income and commodities sales and trading net revenues discussed above, sales and trading revenues included other trading revenues, consisting of certain activities associated with the Company's lending activities, gains (losses) on economic hedges related to the Company's long-term debt

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and negative carry. Other sales and trading net revenues reflected a net loss of \$286 million in the quarter ended March 31, 2012 compared with a net loss of \$460 million in the quarter ended March 31, 2011. The results in both quarters primarily reflected losses on economic hedges related to the Company's long-term debt and negative carry. Results in the quarter ended March 31, 2012 were partially offset by net gains of \$134 million associated with the portion of the loan and lending commitment portfolio carried at fair value (mark-to-market valuations and realized gains of \$770 million and losses on related hedges of \$636 million). Results in the prior year quarter were partially offset by net gains of approximately \$74 million associated with the portion of the loan and lending commitment portfolio carried at fair value (mark-to-market valuations and realized gains of approximately \$209 million offset by losses on related hedges of approximately \$135 million).

Effective April 1, 2012, the Company began accounting for all new relationship-driven and event-driven loans and lending commitments as either held for investment or held for sale. This corporate lending portfolio has grown and the Company expects this trend to continue. See

Quantitative and Qualitative Disclosures about Market Risk Credit Risk Institutional Securities Activities Credit Exposure Corporate Lending in Part I, Item 3, herein.

Net Interest. Net interest expense increased to \$461 million in the quarter ended March 31, 2012 from \$327 million in the quarter ended March 31, 2011 primarily due to lower interest revenues in reverse repurchase agreements and stock lending transactions.

Principal Transactions Investments. Principal transaction net investment losses of \$49 million were recognized in the quarter ended March 31, 2012 compared with net investment gains of \$143 million in the quarter ended March 31, 2011. Results in the quarter ended March 31, 2012 primarily included mark-to-market losses on principal investments. Results in the quarter ended March 31, 2011 reflected gains in principal investments in real estate funds and investments associated with certain employee deferred compensation plans and co-investment plans.

Other. Other gains of \$58 million were recognized in the quarter ended March 31, 2012 compared with other losses of \$602 million in the quarter ended March 31, 2011. The results in the quarters ended March 31, 2012 and 2011, primarily included a gain (loss) of \$27 million and \$(655) million, respectively, arising from the Company's 40% stake in MUMSS (see Executive Summary Significant Items Japanese Securities Joint Venture herein).

Non-interest Expenses. Non-interest expenses increased 6% in the quarter ended March 31, 2012. The increase was primarily due to higher compensation expenses. Compensation and benefits expenses increased 10% in the quarter ended March 31, 2012, primarily due to higher net revenues, excluding the impact of the Company's Debt Related Credit Spreads on Borrowings that are accounted for at fair value, and severance expense of \$108 million related to reductions in force in January 2012. Non-compensation expenses increased 1% in the quarter ended March 31, 2012 compared with the prior year period. Information processing and communications expense increased 12% in the quarter ended March 31, 2012, primarily due to ongoing investments in technology. Professional services expenses increased 21% in the quarter ended March 31, 2012, primarily due to higher consulting expenses. Other expenses decreased 27% in the quarter ended March 31, 2012, primarily due to lower litigation expenses.

Table of Contents**GLOBAL WEALTH MANAGEMENT GROUP****INCOME STATEMENT INFORMATION**

	Three Months Ended March 31,	
	2012	2011
	(dollars in millions)	
Revenues:		
Investment banking	\$ 205	\$ 204
Principal transactions:		
Trading	371	333
Investments	2	4
Commissions and fees	630	770
Asset management, distribution and administration fees	1,739	1,662
Other	57	90
Total non-interest revenues	3,004	3,063
Interest income	490	453
Interest expense	80	112
Net interest	410	341
Net revenues	3,414	3,404
Compensation and benefits	2,105	2,109
Non-compensation expenses	922	951
Total non-interest expenses	3,027	3,060
Income from continuing operations before income taxes	387	344
Provision for income taxes	121	89
Income from continuing operations	266	255
Discontinued operations:		
Income from discontinued operations	2	3
Provision for income taxes	1	1
Net gain on discontinued operations	1	2
Net income	267	257
Net income applicable to noncontrolling interests	74	74
Net income applicable to Morgan Stanley	\$ 193	\$ 183
Amounts applicable to Morgan Stanley:		
Income from continuing operations	\$ 193	\$ 182
Net gain from discontinued operations		1
Net income applicable to Morgan Stanley	\$ 193	\$ 183

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Net Revenues. Global Wealth Management Group's net revenues are composed of Transactional, Asset management, Net interest and Other revenues. Transactional revenues include Investment banking, Principal transactions Trading, and Commissions and fees. Asset management revenues include Asset management, distribution and administration fees and fees related to the bank deposit program. Net interest revenues include net interest revenues related to the bank deposit program, interest on securities available for sale and all other net interest revenues. Other revenues include revenues from available for sale securities, customer account services fees, other miscellaneous revenues and revenues from Principal transactions Investments.

	Three Months Ended March 31,	
	2012	2011
	(dollars in millions)	
Revenues:		
Transactional	\$ 1,206	\$ 1,307
Asset management	1,739	1,662
Net interest	410	341
Other	59	94
Net revenues	\$ 3,414	\$ 3,404

MSSB. On May 31, 2009, MSSB was formed (see Note 3 to the consolidated financial statements included in the 2011 Form 10-K). The Company owns 51% of MSSB, which is consolidated. Net income applicable to noncontrolling interests for all periods primarily represents Citi's interest in MSSB.

Quilter. On April 2, 2012, the Company closed the sale of Quilter, its retail wealth management business in the U.K. The Company has classified Quilter as held for sale within the Global Wealth Management Group business segment and the results of its operations are presented as discontinued operations for all periods presented.

Transactional.

Investment Banking. Investment banking revenues were \$205 million in the quarter ended March 31, 2012, essentially unchanged from the comparable period of 2011.

Principal Transactions Trading. Principal transactions Trading revenues increased 11% in the quarter ended March 31, 2012 from the comparable period of 2011, primarily due to gains related to investments associated with certain employee deferred compensation plans, higher revenues from corporate fixed income securities and unit investment trusts, partially offset by lower revenues from corporate equity securities, government securities, derivatives and structured products.

Commissions and Fees. Commissions and fees revenues decreased 18% in the quarter ended March 31, 2012 from the comparable period of 2011, primarily due to lower client activity.

Asset Management.

Asset Management, Distribution and Administration Fees. Asset management, distribution and administration fees increased 5% in the quarter ended March 31, 2012 from the comparable period of 2011, primarily due to higher fee-based revenues and higher revenues from the bank deposit program on balances held at Citi depositories. The referral fees for deposits placed with Citi affiliated depository institutions were \$82 million and \$65 million in the quarters ended March 31, 2012 and 2011, respectively.

Balances in the bank deposit program increased to \$112.0 billion at March 31, 2012 from \$111.5 billion at March 31, 2011. Deposits held by Company-affiliated FDIC-insured depository institutions were \$57 billion at March 31, 2012 and \$54 billion at March 31, 2011.

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Client assets in fee-based accounts increased to \$531 billion and represented 30% of total client assets at March 31, 2012, compared with \$490 billion and 29% at March 31, 2011, respectively. Total client asset balances increased to \$1,744 billion at March 31, 2012 from \$1,706 billion at March 31, 2011, primarily due to the impact of market conditions and net new asset inflows. Client asset balances in households with assets greater than \$1 million increased to \$1,323 billion at March 31, 2012 from \$1,272 billion at March 31, 2011. Global fee-based asset net inflows decreased to \$8.7 billion at March 31, 2012 from \$17.5 billion at March 31, 2011.

Net Interest.

Net interest increased 20% in the quarter ended March 31, 2012 from the comparable period of 2011, primarily resulting from an increase in Interest income from the securities available for sale portfolio and higher revenues from the bank deposit program.

Other.

Principal Transactions Investments. Principal transaction net investment gains were \$2 million in the quarter ended March 31, 2012 compared with net investment gains of \$4 million in the quarter ended March 31, 2011. The decrease primarily reflected losses related to investments associated with certain employee deferred compensation plans compared with such investments in the prior year.

Other. Other revenues were \$57 million in the quarter ended March 31, 2012, a decrease of 37% from the comparable period of 2011, primarily due to lower gains on sales of securities available for sale, lower proxy and other fees, lower credit card revenues and a higher allowance for loan losses.

Non-interest Expenses. Non-interest expenses decreased 1% in the quarter ended March 31, 2012 from the comparable period of 2011. Compensation and benefits expense was essentially unchanged in the quarter ended March 31, 2012 from the comparable period of 2011. Non-compensation expenses decreased 3% in the quarter ended March 31, 2012 from the comparable period of 2011. In the quarter ended March 31, 2012, marketing and business development expense increased 12% from the comparable period of 2011, primarily due to higher costs associated with conferences and seminars. Professional services expense decreased 10% in the quarter ended March 31, 2012 from the comparable period of 2011, primarily due to lower technology consulting costs.

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	Three Months Ended March 31, 2012 2011 (dollars in millions)	
Revenues:		
Investment banking	\$ 7	\$ 2
Principal transactions:		
Trading	(6)	(1)
Investments	132	182
Asset management, distribution and administration fees	411	405
Other	(3)	42
 Total non-interest revenues	 541	 630
 Interest income	 3	 4
Interest expense	11	12
 Net interest	 (8)	 (8)
 Net revenues	 533	 622
 Compensation and benefits	 218	 253
Non-compensation expenses	187	244
 Total non-interest expenses	 405	 497
 Income from continuing operations before income taxes	 128	 125
Provision for income taxes	38	30
 Income from continuing operations	 90	 95
 Discontinued operations:		
Gain from discontinued operations	1	6
Provision for (benefit from) income taxes		
 Net gain from discontinued operations	 1	 6
 Net income	 91	 101
Net income applicable to noncontrolling interests	65	27
 Net income applicable to Morgan Stanley	 \$ 26	 \$ 74
 Amounts applicable to Morgan Stanley:		
Income from continuing operations	\$ 25	\$ 68
Net gain from discontinued operations	1	6
 Net income applicable to Morgan Stanley	 \$ 26	 \$ 74

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Noncontrolling Interests. Noncontrolling interests are primarily related to the consolidation of certain real estate funds sponsored by the Company.

Discontinued Operations. Discontinued operations in the quarters ended March 31, 2012 and March 31, 2011 primarily include results of operations related to the sale of substantially all of its retail asset management business, including Van Kampen Investments Inc., to Invesco Ltd. See Note 20 for further information.

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The Asset Management business segment's period-end and average assets under management or supervision were as follows:

	At March 31,		Average For The Three Months Ended March 31,	
	2012	2011	2012	2011
	(dollars in billions)			
Assets under management or supervision by asset class:				
Traditional Asset Management:				
Equity	\$ 117	\$ 116	\$ 111	\$ 112
Fixed income	58	61	58	61
Liquidity	75	55	74	55
Alternatives(1)	26	18	25	18
Total Traditional Asset Management	276	250	268	246
Real Estate Investing	19	17	19	16
Merchant Banking:				
Private Equity	9	9	9	9
FrontPoint(2)				3
Total Merchant Banking	9	9	9	12
Total assets under management or supervision	\$ 304	\$ 276	\$ 296	\$ 274
Share of minority stake assets(2)(3)	\$ 6	\$ 8	\$ 5	\$ 7

- (1) The alternatives asset class includes a range of investment products such as funds of hedge funds, funds of private equity funds and funds of real estate funds.
- (2) On March 1, 2011, the Company and the principals of FrontPoint completed a transaction whereby FrontPoint senior management and portfolio managers own a majority equity stake in FrontPoint and the Company retains a minority stake. At March 31, 2011, the assets under management attributed to FrontPoint are represented within the share of minority stake assets.
- (3) Amounts represent the Asset Management business segment's proportional share of assets managed by entities in which it owns a minority stake.

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Activity in the Asset Management business segment's assets under management or supervision during the quarters ended March 31, 2012 and 2011 were as follows:

	Three Months Ended March 31,	
	2012	2011(1)
	(dollars in billions)	
Balance at beginning of period	\$ 287	\$ 272
Net flows by asset class:		
Traditional Asset Management:		
Equity	(1)	2
Fixed income	(1)	(1)
Liquidity	1	2
Alternatives(2)		
Total Traditional Asset Management	(1)	3
Real Estate Investing	1	
Merchant Banking:		
FrontPoint(3)		(2)
Total Merchant Banking		(2)
Total net flows		1
Net market appreciation	17	7
Decrease due to FrontPoint transaction		(4)
Total net increase	17	4
Balance at end of period	\$ 304	\$ 276

(1) All prior-period amounts have been reclassified to conform to the current period's presentation.

(2) The alternatives asset class includes a range of investment products such as funds of hedge funds, funds of private equity funds and funds of real estate funds.

(3) The amount for the quarter ended March 31, 2011 includes two months of net flows related to FrontPoint.

Principal Transactions Investments. The Company recorded principal transactions net investment gains of \$132 million in the quarter ended March 31, 2012 compared with net gains of \$182 million in the quarter ended March 31, 2011. The decrease in the quarter ended March 31, 2012 was primarily related to lower net investment gains in the Company's Merchant Banking business, including certain investments associated with the Company's employee deferred compensation and co-investment plans, partially offset by higher net investment gains associated with certain consolidated real estate funds sponsored by the Company.

Asset Management, Distribution and Administration Fees. Asset management, distribution and administration fees increased 1% in the quarter ended March 31, 2012 compared with the prior year period. The increase primarily reflected higher performance fees and higher fund management and administration fees, primarily due to higher average assets under management. The increase in revenues was partially offset by the absence of FrontPoint in the quarter ended March 31, 2012 compared with two months of FrontPoint fees in the quarter ended March 31, 2011.

The Company's assets under management increased \$28 billion from \$276 billion at March 31, 2011 to \$304 billion at March 31, 2012 reflecting net customer inflows primarily in the Company's liquidity funds. The Company recorded net customer inflows of \$0.2 billion in the quarter ended March 31, 2012 compared with net inflows of \$1.4 billion in the quarter ended March 31, 2011.

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Other. Other losses were \$3 million in the quarter ended March 31, 2012 as compared with gains of \$42 million in the quarter ended March 31, 2011. The decrease in the quarter ended March 31, 2012 primarily

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reflected lower revenues associated with the Company's minority stake investments in Avenue Capital Group, a New York based investment manager, and Lansdowne Partners, a London-based investment manager.

Non-interest Expenses. Non-interest expenses decreased 19% in the quarter ended March 31, 2012 compared with the quarter ended March 31, 2011, reflecting a decrease in compensation expenses and non-compensation expenses. Compensation and benefits expenses decreased 14% in the quarter ended March 31, 2012 compared with the prior year period primarily related to lower net revenues, including the absence of FrontPoint in the quarter ended March 31, 2012 compared with two months of FrontPoint expenses in the quarter ended March 31, 2011. Non-compensation expenses decreased 23% in the quarter ended March 31, 2012 compared with the prior year period, which included indemnification losses related to the FrontPoint transaction recognized in Other expenses.

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Other Matters.

Real Estate.

The Company acts as the general partner for various real estate funds and also invests in certain of these funds as a limited partner. The Company's real estate investments at March 31, 2012 and December 31, 2011 are described below. Such amounts exclude investments associated with certain employee deferred compensation and co-investment plans.

At March 31, 2012 and December 31, 2011, the condensed consolidated statements of financial condition included amounts representing real estate investment assets of condensed consolidated subsidiaries of approximately \$2.1 billion and \$2.0 billion, respectively, including noncontrolling interests of approximately \$1.7 billion and \$1.6 billion, respectively, for a net amount of \$0.4 billion in both periods. This net presentation is a non-GAAP financial measure that the Company considers to be a useful measure for the Company and investors to use in assessing the Company's net exposure. In addition, the Company has contractual capital commitments, guarantees, lending facilities and counterparty arrangements with respect to real estate investments of \$0.7 billion at March 31, 2012.

In addition to the Company's real estate investments, the Company engages in various real estate-related activities, including origination of loans secured by commercial and residential properties. The Company also securitizes and trades in a wide range of commercial and residential real estate and real estate-related whole loans, mortgages and other real estate. In connection with these activities, the Company has provided, or otherwise agreed to be responsible for, representations and warranties. Under certain circumstances, the Company may be required to repurchase such assets or make other payments related to such assets if such representations and warranties were breached. The Company continues to monitor its real estate-related activities in order to manage its exposures and potential liability from these markets and businesses. See "Legal Proceedings - Residential Mortgage and Credit Crisis Related Matters" in Part II, Item 1, herein and see Note 11 to the condensed consolidated financial statements.

See Note 11 to the condensed consolidated financial statements for further information.

Regulatory Outlook.

On July 21, 2010, President Obama signed the Dodd-Frank Act into law. While certain portions of the Dodd-Frank Act were effective immediately, other portions will be effective only following extended transition periods. Moreover, implementation of the Dodd-Frank Act will be accomplished through numerous rulemakings by multiple governmental agencies, only a portion of which have been completed. It remains difficult to assess fully the impact that the Dodd-Frank Act will have on the Company and on the financial services industry generally. In addition, various international developments, such as the adoption of risk-based capital, leverage and liquidity standards by the Basel Committee, known as Basel III, will impact the Company in the coming years.

It is likely that 2012 and subsequent years will see further material changes in the way major financial institutions are regulated in both the U.S. and other markets in which the Company operates, although it remains difficult to predict which further reform initiatives will become law, how such reforms will be implemented or the exact impact they will have on the Company's business, financial condition, results of operations and cash flows for a particular future period.

For a further discussion regarding the regulatory outlook for the Company, please refer to "Supervision and Regulation" in Part I, Item 1 included in the Form 10-K.

Activities Restrictions under the Volcker Rule. On April 19, 2012, the Federal Reserve issued guidance regarding when banking entities, such as the Company, must bring their activities, investments, relationships and transactions into compliance with the Volcker Rule. The guidance confirms that banking entities will have until July 21, 2014 to bring all of their activities and investments into conformance with the Volcker Rule, subject to possible extensions. Banking entities must act in good faith and develop a conformance plan that is as specific as possible about how they will fully conform all of their covered activities and investments by July 21, 2014, unless that period is extended by the Federal Reserve.

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Critical Accounting Policies.

The Company's condensed consolidated financial statements are prepared in accordance with accounting principles generally accepted in the U.S., which require the Company to make estimates and assumptions (see Note 1 to the condensed consolidated financial statements). The Company believes that of its significant accounting policies (see Note 2 to the consolidated financial statements for the year ended December 31, 2011 included in the Form 10-K and Note 2 to the condensed consolidated financial statements), the following policies involve a higher degree of judgment and complexity.

Fair Value.

Financial Instruments Measured at Fair Value. A significant number of the Company's financial instruments are carried at fair value. The Company makes estimates regarding valuation of assets and liabilities measured at fair value in preparing the condensed consolidated financial statements. These assets and liabilities include but are not limited to:

Financial instruments owned and Financial instruments sold, not yet purchased;

Securities available for sale;

Securities received as collateral and Obligation to return securities received as collateral;

Certain Securities purchased under agreements to resell;

Certain Deposits;

Certain Commercial paper and other short-term borrowings, primarily structured notes;

Certain Securities sold under agreements to repurchase;

Certain Other secured financings; and

Certain Long-term borrowings, primarily structured notes.

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (*i.e.*, the exit price) in an orderly transaction between market participants at the measurement date.

In determining fair value, the Company uses various valuation approaches. A hierarchy for inputs is used in measuring fair value that maximizes the use of observable prices and inputs and minimizes the use of unobservable prices and inputs by requiring that the relevant observable inputs be used when available. The hierarchy is broken down into three levels, wherein Level 1 uses observable prices in active markets, and Level 3 consists of valuation techniques that incorporate significant unobservable inputs and, therefore, require the greatest use of judgment. In periods of market disruption, the observability of prices and inputs may be reduced for many instruments. This condition could cause an instrument to be recategorized from Level 1 to Level 2 or Level 2 to Level 3. In addition, a downturn in market conditions could lead to declines in the valuation of many instruments. For further information on the valuation process, fair value definition, Level 1, Level 2, Level 3 and related valuation techniques, and quantitative information about and sensitivity of significant unobservable inputs used in Level 3 fair value measurements, see Notes 2 and 4 to the consolidated financial statements for the year ended December 31, 2011 included in the Form 10-K and Notes 2 and 3 to the

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condensed consolidated financial statements.

Level 3 Assets and Liabilities. The Company's Level 3 assets before the impact of cash collateral and counterparty netting across the levels of the fair value hierarchy were \$29.7 billion and \$32.5 billion at March 31, 2012 and December 31, 2011, respectively, and represented approximately 9% and 10% at March 31, 2012 and December 31, 2011, respectively, of the assets measured at fair value (approximately 4% of total assets at March 31, 2012 and December 31, 2011). Level 3 liabilities before the impact of cash collateral and counterparty netting across the levels of the fair value hierarchy were \$9.9 billion and \$11.2 billion at March 31, 2012 and December 31, 2011, respectively, and represented approximately 5% and 6%, respectively, of the Company's liabilities measured at fair value.

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Assets and Liabilities Measured at Fair Value on a Non-recurring Basis. At March 31, 2012, certain of the Company's assets were measured at fair value on a non-recurring basis, primarily relating to loans, other investments, premises, equipment and software costs, and intangible assets. The Company incurs losses or gains for any adjustments of these assets to fair value. A downturn in market conditions could result in impairment charges in future periods.

For assets and liabilities measured at fair value on a non-recurring basis, fair value is determined by using various valuation approaches. The same hierarchy as described above, which maximizes the use of observable inputs and minimizes the use of unobservable inputs by generally requiring that the observable inputs be used when available, is used in measuring fair value for these items.

For further information on assets and liabilities that are measured at fair value on a non-recurring basis, see Note 3 to the condensed consolidated financial statements.

Fair Value Control Processes. The Company employs control processes to validate the fair value of its financial instruments, including those derived from pricing models. These control processes are designed to ensure that the values used for financial reporting are based on observable inputs wherever possible. In the event that observable inputs are not available, the control processes are designed to assure that the valuation approach utilized is appropriate and consistently applied and that the assumptions are reasonable. For more information regarding the Company's valuation policies, processes and procedures, see Note 2 to the condensed consolidated financial statements.

Goodwill and Intangible Assets.

Goodwill. The Company tests goodwill for impairment on an annual basis on July 1 and on an interim basis when certain events or circumstances exist. The Company tests for impairment at the reporting unit level, which is generally at the level of or one level below its business segments. Goodwill no longer retains its association with a particular acquisition once it has been assigned to a reporting unit. As such, all of the activities of a reporting unit, whether acquired or organically developed, are available to support the value of the goodwill. For both the annual and interim tests, the Company has the option to first assess qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If after assessing the totality of events or circumstances, the Company determines it is more likely than not that the fair value of a reporting unit is greater than its carrying amount, then performing the two-step impairment test is not required. However, if the Company concludes otherwise, then it is required to perform the first step of the two-step impairment test. Goodwill impairment is determined by comparing the estimated fair value of a reporting unit with its respective carrying value. If the estimated fair value exceeds the carrying value, goodwill at the reporting unit level is not deemed to be impaired. If the estimated fair value is below carrying value, however, further analysis is required to determine the amount of the impairment. Additionally, if the carrying value of a reporting unit is zero or a negative value and it is determined that it is more likely than not the goodwill is impaired, further analysis is required. The estimated fair values of the reporting units are derived based on valuation techniques the Company believes market participants would use for each of the reporting units. The estimated fair values are generally determined utilizing methodologies that incorporate price-to-book, price-to-earnings and assets under management multiples of certain comparable companies. The Company also utilizes a discounted cash flow methodology for certain reporting units.

Intangible Assets. Amortizable intangible assets are amortized over their estimated useful lives and are reviewed for impairment on an interim basis when certain events or circumstances exist. For amortizable intangible assets, an impairment exists when the carrying amount of the intangible asset exceeds its fair value. An impairment loss will be recognized only if the carrying amount of the intangible asset is not recoverable and exceeds its fair value. The carrying amount of the intangible asset is not recoverable if it exceeds the sum of the expected undiscounted cash flows.

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Indefinite-lived intangible assets are not amortized but are reviewed annually (or more frequently when certain events or circumstances exist) for impairment. For indefinite-lived intangible assets, an impairment exists when the carrying amount exceeds its fair value.

For both goodwill and intangible assets, to the extent an impairment loss is recognized, the loss establishes the new cost basis of the asset. Subsequent reversal of impairment losses is not permitted. For amortizable intangible assets, the new cost basis is amortized over the remaining useful life of that asset. Adverse market or economic events could result in impairment charges in future periods.

See Notes 3 and 8 to the condensed consolidated financial statements for additional information about goodwill and intangible assets.

Legal, Regulatory and Tax Contingencies.

In the normal course of business, the Company has been named, from time to time, as a defendant in various legal actions, including arbitrations, class actions and other litigation, arising in connection with its activities as a global diversified financial services institution.

Certain of the actual or threatened legal actions include claims for substantial compensatory and/or punitive damages or claims for indeterminate amounts of damages. In some cases, the entities that would otherwise be the primary defendants in such cases are bankrupt or in financial distress.

The Company is also involved, from time to time, in other reviews, investigations and proceedings (both formal and informal) by governmental and self-regulatory agencies regarding the Company's business, including, among other matters, accounting and operational matters, certain of which may result in adverse judgments, settlements, fines, penalties, injunctions or other relief.

Accruals for litigation and regulatory proceedings are generally determined on a case-by-case basis. Where available information indicates that it is probable a liability had been incurred at the date of the condensed consolidated financial statements and the Company can reasonably estimate the amount of that loss, the Company accrues the estimated loss by a charge to income. In many proceedings, however, it is inherently difficult to determine whether any loss is probable or even possible or to estimate the amount of any loss. For certain legal proceedings, the Company can estimate possible losses, additional losses, ranges of loss or ranges of additional loss in excess of amounts accrued. For certain other legal proceedings, the Company cannot reasonably estimate such losses, particularly for proceedings that are in their early stages of development or where plaintiffs seek substantial or indeterminate damages. Numerous issues may need to be resolved, including through potentially lengthy discovery and determination of important factual matters, and by addressing novel or unsettled legal questions relevant to the proceedings in question, before a loss or additional loss or range of loss or additional loss can be reasonably estimated for any proceeding.

The Company is subject to the income and indirect tax laws of the U.S., its states and municipalities and those of the foreign jurisdictions in which the Company has significant business operations. These tax laws are complex and subject to different interpretations by the taxpayer and the relevant governmental taxing authorities. The Company must make judgments and interpretations about the application of these inherently complex tax laws when determining the provision for income taxes and the expense for indirect taxes and must also make estimates about when certain items affect taxable income in the various tax jurisdictions. Disputes over interpretations of the tax laws may be settled with the taxing authority upon examination or audit. The Company periodically evaluates the likelihood of assessments in each taxing jurisdiction resulting from current and subsequent years' examinations, and unrecognized tax benefits related to potential losses that may arise from tax audits are established in accordance with the guidance on accounting for unrecognized tax benefits. Once established, unrecognized tax benefits are adjusted when there is more information available or when an event occurs requiring a change.

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The income of certain foreign subsidiaries earned outside of the United States has previously been excluded from taxation in the U.S. as a result of a provision of U.S. tax law that defers the imposition of tax on certain active financial services income until such income is repatriated to the United States as a dividend. This provision, which expired for taxable years beginning on or after January 1, 2012, had previously been extended by Congress on several occasions, including the most recent extension which occurred during 2010. If this provision is extended again with respect to such income earned during 2012, the overall financial impact to the Company would depend upon the level, composition and geographic mix of earnings but could decrease the Company's 2012 annual effective tax rate and have a favorable impact on the Company's net income, but not its cash flows due to utilization of tax attributes carryforwards.

Significant judgment is required in making these estimates, and the actual cost of a legal claim, tax assessment or regulatory fine/penalty may ultimately be materially different from the recorded accruals and unrecognized tax benefits, if any. See Notes 11 and 17 to the condensed consolidated financial statements for additional information on legal proceedings and tax examinations.

Special Purpose Entities and Variable Interest Entities.

The Company's involvement with special purpose entities (SPE) consists primarily of the following:

Transferring financial assets into SPEs;

Acting as an underwriter of beneficial interests issued by securitization vehicles;

Holding one or more classes of securities issued by, or making loans to or investments in, SPEs that hold debt, equity, real estate or other assets;

Purchasing and selling (in both a market-making and a proprietary-trading capacity) securities issued by SPEs/variable interest entities (VIE), whether such vehicles are sponsored by the Company or not;

Entering into derivative transactions with SPEs (whether or not sponsored by the Company);

Providing warehouse financing to collateralized debt obligations and collateralized loan obligations;

Entering into derivative agreements with non-SPEs whose value is derived from securities issued by SPEs;

Servicing assets held by SPEs or holding servicing rights related to assets held by SPEs that are serviced by others under subservicing arrangements;

Serving as an asset manager to various investment funds that may invest in securities that are backed, in whole or in part, by SPEs; and

Structuring and/or investing in other structured transactions designed to provide enhanced, tax-efficient yields to the Company or its clients.

The Company engages in securitization activities related to commercial and residential mortgage loans, U.S. agency collateralized mortgage obligations, corporate bonds and loans, municipal bonds and other types of financial instruments. The Company's involvement with SPEs is discussed further in Note 6 to the condensed consolidated financial statements.

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In most cases, these SPEs are deemed for accounting purposes to be VIEs. The Company applies accounting guidance for consolidation of VIEs to certain entities in which equity investors do not have the characteristics of a controlling financial interest. Entities that previously met the criteria as qualifying SPEs that were not subject to consolidation prior to January 1, 2010 became subject to the consolidation requirements for VIEs on that date. Excluding entities subject to the Deferral (as defined in Note 2 to the condensed consolidated financial statements), effective January 1, 2010, the primary beneficiary of a VIE is the party that both (1) has the power to direct the activities of a VIE that most significantly affect the VIE's economic performance and (2) has an obligation to absorb losses or the right to receive benefits that in either case could potentially be significant to the VIE. The Company consolidates entities of which it is the primary beneficiary.

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The Company determines whether it is the primary beneficiary of a VIE upon its initial involvement with the VIE and reassesses whether it is the primary beneficiary on an ongoing basis as long as it has any continuing involvement with the VIE. This determination is based upon an analysis of the design of the VIE, including the VIE's structure and activities, the power to make significant economic decisions held by the Company and by other parties and the variable interests owned by the Company and other parties.

See Note 2 to the consolidated financial statements for the year ended December 31, 2011 included in the Form 10-K for information on accounting guidance adopted on January 1, 2010 for transfers of financial assets.

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Liquidity and Capital Resources.

The Company's senior management establishes the liquidity and capital policies of the Company. Through various risk and control committees, the Company's senior management reviews business performance relative to these policies, monitors the availability of alternative sources of financing, and oversees the liquidity and interest rate and currency sensitivity of the Company's asset and liability position. The Company's Treasury Department, Firm Risk Committee, Asset and Liability Management Committee and other control groups assist in evaluating, monitoring and controlling the impact that the Company's business activities have on its condensed consolidated statements of financial condition, liquidity and capital structure. Liquidity and capital matters are reported regularly to the Board's Risk Committee.

The Balance Sheet.

The Company actively monitors and evaluates the composition and size of its balance sheet. A substantial portion of the Company's total assets consists of liquid marketable securities and short-term receivables arising principally from sales and trading activities in the Institutional Securities business segment. The liquid nature of these assets provides the Company with flexibility in managing the size of its balance sheet. The Company's total assets increased to \$781,030 million at March 31, 2012 from \$749,898 million at December 31, 2011. The increase in total assets was primarily due to an increase in Securities borrowed, Financial instruments owned Corporate equities, Federal funds sold and securities purchased under agreements to resell and Securities received as collateral.

The Company's assets and liabilities are primarily related to transactions attributable to sales and trading and securities financing activities. At March 31, 2012, securities financing assets and liabilities were \$365 billion and \$284 billion, respectively. At December 31, 2011, securities financing assets and liabilities were \$332 billion and \$268 billion, respectively. Securities financing transactions include repurchase and resale agreements, securities borrowed and loaned transactions, securities received as collateral and obligation to return securities received. Securities borrowed or purchased under agreements to resell and securities loaned or sold under agreements to repurchase are treated as collateralized financings (see Note 2 to the consolidated financial statements for the year ended December 31, 2011 included in the Form 10-K and Note 5 to the condensed consolidated financial statements). Securities sold under agreements to repurchase and Securities loaned were \$142 billion at March 31, 2012 and averaged \$158 billion during the quarter ended March 31, 2012. Securities purchased under agreements to resell and Securities borrowed were \$278 billion at March 31, 2012 and averaged \$283 billion during the quarter ended March 31, 2012.

Securities financing assets and liabilities also include matched book transactions with minimal market, credit and/or liquidity risk. Matched book transactions accommodate customers, as well as obtain securities for the settlement and financing of inventory positions. The customer receivable portion of the securities financing transactions includes customer margin loans, collateralized by customer owned securities, and customer cash, which is segregated according to regulatory requirements. The customer payable portion of the securities financing transactions primarily includes customer payables to the Company's prime brokerage clients. The Company's risk exposure on these transactions is mitigated by collateral maintenance policies that limit the Company's credit exposure to customers. Included within securities financing assets were \$18 billion and \$12 billion at March 31, 2012 and December 31, 2011, respectively, recorded in accordance with accounting guidance for the transfer of financial assets that represented offsetting assets and liabilities for fully collateralized non-cash loan transactions.

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The following table sets forth the Company's tangible common equity at March 31, 2012 and December 31, 2011 and average balances during the quarter ended March 31, 2012:

	Balance at		Average Balance(1)
	March 31, 2012	December 31, 2011 (dollars in millions)	For the Three Months Ended March 31, 2012
Common equity	\$ 60,816	\$ 60,541	\$ 60,485
Preferred equity	1,508	1,508	1,508
Morgan Stanley shareholders' equity	62,324	62,049	61,993
Junior subordinated debentures issued to capital trusts	4,838	4,853	4,844
Less: Goodwill and net intangible assets(2)	(6,660)	(6,691)	(6,685)
Tangible Morgan Stanley shareholders' equity	\$ 60,502	\$ 60,211	\$ 60,152
Common equity	\$ 60,816	\$ 60,541	\$ 60,485
Less: Goodwill and net intangible assets(2)	(6,660)	(6,691)	(6,685)
Tangible common equity(3)	\$ 54,156	\$ 53,850	\$ 53,800

(1) The Company calculates its average balances based upon month-end balances.

(2) The goodwill and net intangible assets deduction exclude mortgage servicing rights (net of disallowable mortgage servicing rights) of \$90 million and \$120 million at March 31, 2012 and December 31, 2011, respectively, and include only the Company's share of MSSB's goodwill and intangible assets.

(3) Tangible common equity, a non-GAAP financial measure, equals common equity less goodwill and net intangible assets as defined above. The Company views tangible common equity as a useful measure to investors because it is a commonly utilized metric and reflects the common equity deployed in the Company's businesses.

Balance Sheet and Funding Activity for the Three Months Ended March 31, 2012.

During the quarter ended March 31, 2012, the Company issued notes with a principal amount of approximately \$5 billion. In connection with the note issuances, the Company generally enters into certain transactions to obtain floating interest rates based primarily on short-term London Inter-Bank Offer Rate (LIBOR) trading levels. The weighted average maturity of the Company's long-term borrowings, based upon stated maturity dates, was approximately 5.3 years at March 31, 2012. During the quarter ended March 31, 2012, approximately \$16 billion in aggregate long-term borrowings were matured or retired. Subsequent to March 31, 2012 and through April 30, 2012, the Company's long-term borrowings (net of issuances) decreased by approximately \$1.6 billion.

At March 31, 2012, the aggregate outstanding carrying amount of the Company's senior indebtedness was approximately \$166 billion (including guaranteed obligations of the indebtedness of subsidiaries) compared with \$176 billion at December 31, 2011. The decrease in the amount of senior indebtedness was primarily due to repayments of notes, net of new issuances in long-term and short-term borrowings.

Capital Management.

The Company's senior management views capital as an important source of financial strength. The Company actively manages its consolidated capital position based upon, among other things, business opportunities, risks, capital availability and rates of return together with internal capital policies, regulatory requirements and rating agency guidelines and, therefore, in the future may expand or contract its capital base to address the changing needs of its businesses. The Company attempts to maintain total capital, on a consolidated basis, at least equal to the sum of its operating subsidiaries' equity.

At March 31, 2012, the Company had approximately \$1.6 billion remaining under its current share repurchase program out of the \$6 billion authorized by the Board of Directors in December 2006. The share repurchase program is for capital management purposes and considers, among other things, business segment capital needs.

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as well as equity-based compensation and benefit plan requirements. Share repurchases by the Company are subject to regulatory approval. During the quarter ended March 31, 2012, the Company did not repurchase common stock as part of its capital management share repurchase program (see also Unregistered Sales of Equity Securities and Use of Proceeds in Part II, Item 2).

The Board of Directors determines the declaration and payment of dividends on a quarterly basis. In April 2012, the Company announced that its Board of Directors declared a quarterly dividend per common share of \$0.05. In March 2012, the Company also announced that the Board of Directors declared a quarterly dividend of \$252.78 per share of Series A Floating Rate Non-Cumulative Preferred Stock (represented by depositary shares, each representing 1/1,000th interest in a share of preferred stock and each having a dividend of \$0.25278) and a quarterly dividend of \$25.00 per share of Series C Non-Cumulative Non-Voting Perpetual Preferred Stock.

Required Capital.

The Company's capital estimation is based on the Required Capital Framework, an internal capital adequacy measure. This framework is a risk-based internal use of capital measure, which is compared with the Company's regulatory capital to help ensure the Company maintains an amount of risk-based going concern capital after absorbing potential losses from extreme stress events at a point in time. The difference between the Company's regulatory capital and aggregate Required Capital is the Company's Parent capital. Average Tier 1 common capital, aggregate Required Capital and Parent capital for the quarter ended March 31, 2012 were approximately \$40.9 billion, \$27.0 billion and \$13.9 billion, respectively. The Company generally holds Parent capital for prospective regulatory requirements, including Basel III, organic growth, acquisitions and other capital needs.

Tier 1 common capital and common equity attribution to the business segments is based on capital usage calculated by Required Capital Framework. In principle, each business segment is capitalized as if it were an independent operating entity with limited diversification benefit between the business segments. Required Capital is assessed at each business segment and further attributed to product lines. This process is intended to align capital with the risks in each business segment in order to allow senior management to evaluate returns on a risk-adjusted basis. The Required Capital Framework will evolve over time in response to changes in the business and regulatory environment and to incorporate enhancements in modeling techniques. During 2012, the Company will continue to evaluate the framework with respect to the impact of future regulatory requirements, as appropriate.

Beginning in the quarter ended March 31, 2012, the Company and segment Required Capital is met by Tier 1 common capital. Prior to the current quarter, the Company's Required Capital was met by regulatory Tier 1 capital or Tier 1 common equity. Segment capital for prior periods has been recast under this framework.

For a further discussion of the Company's Tier 1 common capital, see Regulatory Requirements herein.

The following table presents the Company's and business segments' average Tier 1 common capital and average common equity for the quarter ended March 31, 2012 and the quarter ended December 31, 2011.

	Three Months Ended March 31, 2012		Three Months Ended December 31, 2011	
	Average Tier 1 Common Capital	Average Common Equity (dollars in billions)	Average Tier 1 Common Capital	Average Common Equity
Institutional Securities	\$ 22.1	\$ 29.5	\$ 24.4	\$ 31.3
Global Wealth Management Group	3.6	13.3	3.3	13.0
Asset Management	1.3	2.5	1.3	2.5
Parent capital	13.9	15.2	11.6	13.8
Total	\$ 40.9	\$ 60.5	\$ 40.6	\$ 60.6

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Capital Covenants.

In October 2006 and April 2007, the Company executed replacement capital covenants in connection with offerings by Morgan Stanley Capital Trust VII and Morgan Stanley Capital Trust VIII (the "Capital Securities"), which become effective after the scheduled redemption date in 2046. Under the terms of the replacement capital covenants, the Company has agreed, for the benefit of certain specified holders of debt, to limitations on its ability to redeem or repurchase any of the Capital Securities for specified periods of time. For a complete description of the Capital Securities and the terms of the replacement capital covenants, see the Company's Current Reports on Form 8-K dated October 12, 2006 and April 26, 2007.

Liquidity Risk Management Framework.

The primary goal of the Company's liquidity risk management framework is to ensure that the Company has access to adequate funding across a wide range of market conditions. The framework is designed to enable the Company to fulfill its financial obligations and support the execution of the Company's business strategies.

The following principles guide the Company's liquidity risk management framework:

Sufficient liquid assets should be maintained to cover maturing liabilities;

Maturity profile of assets and liabilities should be aligned, with limited reliance on short-term funding;

Source, counterparty, currency, region, and term of funding should be diversified; and

Limited access to funding should be anticipated through the Contingency Funding Plan.

The core components of the Company's liquidity risk management framework are the Contingency Funding Plan ("CFP"), Liquidity Stress Tests and the Global Liquidity Reserve. These elements support the Company's target liquidity profile.

Contingency Funding Plan.

The Company maintains the CFP, which describes the data and information flows, limits and triggers, escalation procedures, roles and responsibilities, and available mitigating actions in the event of a liquidity stress. The CFP assesses current and future funding sources and uses and establishes a plan for monitoring and managing a potential liquidity stress event. A set of escalation triggers identifies early signs of stress and activates a response plan.

Liquidity Stress Tests.

The Company uses Liquidity Stress Tests to model liquidity outflows across multiple scenarios over a range of time horizons. These scenarios contain various combinations of idiosyncratic and systemic stress events.

The assumptions underpinning the Liquidity Stress Tests include, but are not limited to, the following:

No government support;

No access to equity and unsecured debt markets;

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Repayment of all unsecured debt maturing within one year;

Higher haircuts and significantly lower availability of secured funding;

Additional collateral that would be required by trading counterparties and certain exchanges and clearing organizations related to a multi-notch credit rating downgrade;

Additional collateral that would be required due to collateral substitutions, collateral disputes and uncalled collateral;

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Discretionary unsecured debt buybacks;

Drawdowns on unfunded commitments provided to third parties;

Client cash withdrawals and reduction in customer short positions that fund long positions;

Limited access to the foreign exchange swap markets;

Return of securities borrowed on an uncollateralized basis; and

Maturity roll-off of outstanding letters of credit with no further issuance.

The Liquidity Stress Tests are produced at the Parent company (Parent) and major operating subsidiary levels, as well as at major currency levels, to capture specific cash requirements and cash availability across the Company. The Liquidity Stress Tests assume that subsidiaries will use their own liquidity first to fund their obligations before drawing liquidity from the Parent. The Parent will support its subsidiaries and will not have access to subsidiaries' liquidity reserves that are subject to any regulatory, legal or tax constraints.

At March 31, 2012, the Company maintained sufficient liquidity to meet current and contingent funding obligations as modeled in its Liquidity Stress Tests.

Global Liquidity Reserve.

The Company maintains sufficient liquidity reserves (Global Liquidity Reserve) to cover daily funding needs and meet strategic liquidity targets sized by the CFP and Liquidity Stress Tests. These liquidity targets are based on the Company's risk tolerance, balance sheet level and composition, subsidiary funding needs, and upcoming debt maturities, which are subject to change dependent on market and firm-specific events.

The Global Liquidity Reserve is held within the Parent and operating subsidiaries. The Global Liquidity Reserve is comprised of highly liquid and diversified cash and cash equivalents and unencumbered securities. Eligible unencumbered securities include U.S. government securities, U.S. agency securities, U.S. agency mortgage-backed securities, FDIC-guaranteed corporate debt and non-U.S. government securities.

Global Liquidity Reserve by Type of Investment.

The table below summarizes the Company's Global Liquidity Reserve by type of investment:

	At March 31, 2012 (dollars in billions)
Cash deposits with banks	\$ 10
Cash deposits with central banks	24
Unencumbered highly liquid securities:	
U.S. Government obligations	81
U.S. agency and agency mortgage-backed securities	36
Non-U.S. sovereign obligations(1)	18
Investments in money market funds	
Other investment grade securities	10
Global Liquidity Reserve	\$ 179

(1) Non-U.S sovereign obligations are composed of unencumbered German, French, Dutch, U.K., Brazilian and Japanese government obligations. The ability to monetize assets during the start of a liquidity crisis is critical. The Company believes that the assets held in the Global Liquidity Reserve can be monetized within five business days in a stressed environment given the highly liquid and diversified nature of the reserves. The currency profile of the Global Liquidity Reserve is

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consistent with the CFP and Liquidity Stress Tests. In addition to the Global Liquidity Reserve, the Company has other cash and cash equivalents and other unencumbered assets that are available for monetization which are not included in the balances in the table above.

Global Liquidity Reserve Held by the Parent and Operating Subsidiaries.

The table below summarizes the Global Liquidity Reserve held by the Parent and operating subsidiaries:

	At March 31, 2012	At December 31, 2011	Average Balance(1) For the Three Months Ended March 31, 2012	For the Three Months Ended December 31, 2011
	(dollars in billions)			
Parent	\$ 72	\$ 75	\$ 71	\$ 76
Non-Bank Subsidiaries:				
Domestic	15	18	16	16
Foreign	27	26	28	24
Total Non-Bank Subsidiaries	42	44	44	40
Bank Subsidiaries:				
Domestic	56	56	56	56
Foreign	9	7	7	7
Total Bank Subsidiaries	65	63	63	63
Total	\$ 179	\$ 182	\$ 178	\$ 179

(1) The Company calculates the average Global Liquidity Reserve based upon daily amounts.

The Company is exposed to intra-day settlement risk in connection with liquidity provided to its major broker-dealer subsidiaries for intra-day clearing and settlement of its securities and financing activity.

As mentioned in Contingency Funding Plan, the CFP assumes that the Parent will support its subsidiaries and will not have access to subsidiaries' liquidity reserves that are subject to any regulatory, legal or tax constraints.

Funding Management.

The Company's funding management policies are designed to provide for financings that are executed in a manner that reduces the risk of disruption to the Company's operations. The Company pursues a strategy of diversification of secured and unsecured funding sources (by product, by investor and by region) and attempts to ensure that the tenor of the Company's liabilities equals or exceeds the expected holding period of the assets being financed.

The Company funds its balance sheet on a global basis through diverse sources. These sources may include the Company's equity capital, long-term debt, repurchase agreements, securities lending, deposits, commercial paper, letters of credit and lines of credit. The Company has active financing programs for both standard and structured products targeting global investors and currencies.

Secured Financing. A substantial portion of the Company's total assets consists of liquid marketable securities and short-term collateralized receivables arising principally from its Institutional Securities business segment's sales and trading activities. The liquid nature of these assets provides the Company with flexibility in funding these assets with secured financing. The Company's goal is to achieve an optimal mix of durable secured and unsecured funding. The Institutional Securities business segment actively sources term secured funding. Secured funding investors principally focus on the quality of the eligible collateral posted, which is why the Company

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actively manages its secured financing book based on the quality of the assets being funded. The ability to fund less liquid assets may be impaired in a stress environment. To mitigate this risk, the Company obtains longer-term secured financing for less liquid assets.

The Company utilizes shorter term secured funding only for highly liquid assets and has established longer tenor targets for less liquid asset classes, for which funding may be at risk in the event of a market disruption. The Company defines highly liquid collateral as that which is consistent with the standards of the Global Liquidity Reserve, and less liquid collateral as that which does not meet those standards. At March 31, 2012, the weighted average maturity of the Company's secured financing against less liquid collateral was greater than 120 days. To further minimize the refinancing risk of secured financing for less liquid collateral, the Company diversifies its investor base and limits the amount of monthly maturities for secured financing of less liquid collateral. Finally, in addition to the above risk management framework, the Company holds a portion of its Global Liquidity Reserve against the potential disruption to its secured financing capabilities.

Unsecured Financing. The Company views long-term debt and deposits as stable sources of funding for core inventories and less liquid assets. Unencumbered securities and non security assets are financed with a combination of long and short term debt and deposits. When appropriate, the Company may use derivative products to conduct asset and liability management and to make adjustments to the Company's interest rate risk profile (see Note 12 to the consolidated financial statements for the year ended December 31, 2011 included in the Form 10-K).

Temporary Liquidity Guarantee Program (TLGP). In October 2008, the Secretary of the U.S. Treasury invoked the systemic risk exception of the FDIC Improvement Act of 1991, and the FDIC announced the TLGP. Based on the Final Rule adopted on November 21, 2008, the TLGP provides a guarantee, through the earlier of maturity or June 30, 2012, of certain senior unsecured debt issued by participating Eligible Entities (including the Company) between October 14, 2008 and June 30, 2009. Of the \$23.8 billion issued by the Company under the TLGP, \$4.7 billion was still outstanding at March 31, 2012.

Short-Term Borrowings. The Company's unsecured short-term borrowings consist of commercial paper, bank loans, bank notes and structured notes with maturities of 12 months or less at issuance.

The table below summarizes the Company's short-term unsecured borrowings:

	At March 31, 2012	At December 31, 2011
	(dollars in millions)	
Commercial paper(1)	\$ 257	\$ 978
Other short-term borrowings	1,760	1,865
Total	\$ 2,017	\$ 2,843

(1) At December 31, 2011, the majority of the commercial paper balance was issued as part of client transactions and was not used for the Company's general funding purposes. During the quarter ended March 31, 2012, the client transactions matured and the remaining balance at March 31, 2012 was used for the Company's general funding purposes.

Deposits. The Company's bank subsidiaries' funding sources include bank deposits, repurchase agreements, federal funds purchased, certificates of deposit, money market deposit accounts, demand deposit accounts, commercial paper and Federal Home Loan Bank advances. The vast majority of deposits in Morgan Stanley Bank, N.A. and Morgan Stanley Private Bank, National Association (the Subsidiary Banks) are sourced from the Company's retail brokerage accounts and are considered to have stable, low cost funding characteristics.

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Deposits were as follows:

	At March 31, 2012(1)	At December 31, 2011(1)
	(dollars in millions)	
Savings and demand deposits(2)	\$ 63,950	\$ 63,029
Time deposits(3)	2,491	2,633
Total	\$ 66,441	\$ 65,662

(1) Total deposits subject to FDIC Insurance at March 31, 2012 and December 31, 2011 were \$53 billion and \$52 billion, respectively.

(2) Amounts include non-interest bearing deposits of \$1,280 million and \$1,270 million at March 31, 2012 and December 31, 2011, respectively.

(3) Certain time deposit accounts are carried at fair value under the fair value option (see Note 3 to the condensed consolidated financial statements).

With the passage of the Dodd-Frank Act, the statutory standard maximum deposit insurance amount was permanently increased to \$250,000 per depositor and is in effect for the Subsidiary Banks.

Long-Term Borrowings. The Company uses a variety of long-term debt funding sources to generate liquidity, taking CFP requirements into consideration. In addition, the issuance of long-term debt allows the Company to reduce reliance on short-term credit sensitive instruments (*e.g.*, commercial paper and other unsecured short-term borrowings). Long-term borrowings are generally structured to ensure staggered maturities, thereby mitigating refinancing risk, and to maximize investor diversification through sales to global institutional and retail clients. Availability and cost of financing to the Company can vary depending on market conditions, the volume of certain trading and lending activities, the Company's credit ratings and the overall availability of credit.

The Company may from time to time engage in various transactions in the credit markets (including, for example, debt retirements) that it believes are in the best interests of the Company and its investors.

Long-term borrowings at March 31, 2012 consisted of the following:

	Parent	Subsidiaries	Total
	(dollars in millions)		
Due in 2012	\$ 19,357	\$ 1,063	\$ 20,420
Due in 2013	24,697	479	25,176
Due in 2014	20,672	1,253	21,925
Due in 2015	18,448	4,128	22,576
Due in 2016	17,978	1,663	19,641
Thereafter	65,328	1,657	66,985
Total	\$ 166,480	\$ 10,243	\$ 176,723

Credit Ratings.

The Company relies on external sources to finance a significant portion of its day-to-day operations. The cost and availability of financing generally is impacted by the Company's credit ratings. In addition, the Company's credit ratings can have a significant impact on certain trading revenues, particularly in those businesses where longer term counterparty performance is critical, such as OTC derivative transactions, including credit derivatives and interest rate swaps. Issuer specific factors that are important to the determination of the Company's credit ratings include governance, the level and quality of earnings, capital adequacy, funding and liquidity, risk appetite and management, asset quality, strategic direction and business mix. Additionally, the agencies will look at other industry-wide factors such as regulatory or legislative changes, macro-economic environment, and perceived levels of government support.

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The rating agencies have stated that they currently incorporate various degrees of uplift from perceived government support in the credit ratings of systemically important banks, including the credit ratings of the Company. Rating agencies continue to monitor progress of U.S. financial reform legislation to assess whether the possibility of extraordinary government support for the financial system in any future financial crises is negatively impacted. Legislative outcomes may lead to reduced uplift assumptions for U.S. banks and thereby place downward pressure on credit ratings. At the same time, proposed U.S. financial reform legislation also has positive implications for credit ratings such as higher standards for capital and liquidity levels. The net result on credit ratings and the timing of any change in rating agency assumptions on support is currently uncertain.

At April 30, 2012, the Company's and Morgan Stanley Bank, N.A.'s senior unsecured ratings were as set forth below. The long-term credit ratings on the Company by Moody's Investor Services, Inc. (Moody's) and Standard & Poor's Ratings Services (S&P) are currently at different levels (commonly referred to as "split ratings").

	Company			Morgan Stanley Bank, N.A.		
	Short-Term Debt	Long-Term Debt	Rating Outlook	Short-Term Debt	Long-Term Debt	Rating Outlook
Dominion Bond Rating Service Limited	R-1 (middle)	A (high)	Negative			
Fitch Ratings	F1	A	Stable	F1	A	Stable
Moody's Investor Services, Inc.(1)	P-1	A2	Downgrade Review	P-1	A1	Downgrade Review
Rating and Investment Information, Inc.	a-1	A+	Negative			
Standard & Poor's	A-2	A-	Negative	A-1	A	Negative

(1) On February 15, 2012, Moody's placed the ratings of 17 banks on review for downgrade in the context of a broad review of global banks with capital markets operations. As part of this review, Moody's placed the Company's and Morgan Stanley Bank, N.A.'s A2/A1 long-term and P-1 short-term ratings on review for downgrade.

In connection with certain OTC trading agreements and certain other agreements associated with the Institutional Securities business segment, the Company may be required to provide additional collateral or immediately settle any outstanding liability balances with certain counterparties in the event of a credit rating downgrade. At March 31, 2012, the following are the amounts of additional collateral, termination payments or other contractual amounts (whether in a net asset or liability position) that could be called by counterparties under the terms of such agreements in the event of a downgrade of the Company's long-term credit rating under various scenarios: \$868 million (A3 Moody's/A- S&P); \$5,177 million (Baa1 Moody's/BBB+ S&P); and \$7,206 million (Baa2 Moody's/BBB S&P). Also, the Company is required to pledge additional collateral to certain exchanges and clearing organizations in the event of a credit rating downgrade. At March 31, 2012, the increased collateral requirement at certain exchanges and clearing organizations under various scenarios was \$160 million (A3 Moody's/A- S&P); \$1,600 million (Baa1 Moody's/BBB+ S&P); and \$2,400 million (Baa2 Moody's/BBB S&P).

While certain aspects of a credit ratings downgrade are quantifiable pursuant to contractual provisions, the impact it will have on the Company's business and results of operation in future periods is inherently uncertain and will depend on a number of inter-related factors, including, among others, the magnitude of the downgrade, individual client behavior and future mitigating actions the Company may take.

The liquidity impact of additional collateral requirements is fully considered for in the Company's CFP.

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Off-Balance Sheet Arrangements with Unconsolidated Entities.

The Company enters into various arrangements with unconsolidated entities, including VIEs, primarily in connection with its Institutional Securities and Global Wealth Management Group business segments. See Off-Balance Sheet Arrangements with Unconsolidated Entities included in Part II, Item 7, of the Form 10-K and Note 6 to the condensed consolidated financial statements for further information.

See Note 11 to the condensed consolidated financial statements for further information on guarantees.

Commitments.

The Company's commitments associated with outstanding letters of credit and other financial guarantees obtained to satisfy collateral requirements, investment activities, corporate lending and financing arrangements, mortgage lending and margin lending at March 31, 2012 are summarized below by period of expiration. Since commitments associated with these instruments may expire unused, the amounts shown do not necessarily reflect the actual future cash funding requirements:

	Years to Maturity				Total at March 31, 2012
	Less than 1	1-3	3-5 (dollars in millions)	Over 5	
Letters of credit and other financial guarantees obtained to satisfy collateral requirements	\$ 2,068	\$ 12	\$ 6	\$	\$ 2,086
Investment activities	1,160	238	44	274	1,716
Primary lending commitments investment grade(1)(2)	10,181	9,854	31,778	1,997	53,810
Primary lending commitments non-investment grade(2)	2,182	2,789	9,981	897	15,849
Secondary lending commitments(3)	56	203	20	112	391
Commitments for secured lending transactions	1,299	251	198		1,748
Forward starting reverse repurchase agreements and securities borrowing agreements(4)	74,317				74,317
Commercial and residential mortgage-related commitments	1,378	26	201	450	2,055
Other commitments	1,262	248	5	1	1,516
Total	\$ 93,903	\$ 13,621	\$ 42,233	\$ 3,731	\$ 153,488

- (1) This amount includes commitments to asset-backed commercial paper conduits of \$275 million at March 31, 2012, of which \$138 million have maturities of less than one year and \$137 million of which have maturities of one to three years.
- (2) This amount includes \$12.2 billion of investment grade and \$3.5 billion of non-investment grade unfunded commitments accounted for as held for investment and \$68 million of investment grade and \$191 million of non-investment grade unfunded commitments accounted for as held for sale at March 31, 2012. The remainder of these lending commitments are carried at fair value.
- (3) These commitments are recorded at fair value within Financial instruments owned and Financial instruments sold, not yet purchased in the condensed consolidated statements of financial condition (see Note 3 to the condensed consolidated financial statements).
- (4) The Company enters into forward starting reverse repurchase and securities borrowing agreements (agreements that have a trade date at or prior to March 31, 2012 and settle subsequent to period-end) that are primarily secured by collateral from U.S. government agency securities and other sovereign government obligations. These agreements primarily settle within three business days and of the amount at March 31, 2012, \$70.7 billion settled within three business days.

Regulatory Requirements.

Capital.

The Company is a financial holding company under the Bank Holding Company Act of 1956, as amended, and is subject to the regulation and oversight of the Federal Reserve. The Federal Reserve establishes capital requirements for the Company, including well-capitalized standards, and evaluates the Company's compliance

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with such capital requirements. The Office of the Comptroller of the Currency establishes similar capital requirements and standards for the Company's national bank subsidiaries (see "Other Matters Regulatory Outlook" herein).

The Company calculates its capital ratios and risk-weighted assets (RWA) in accordance with the capital adequacy standards for financial holding companies adopted by the Federal Reserve. These standards are based upon a framework described in the "International Convergence of Capital Measurement and Capital Standards," July 1988, as amended, also referred to as Basel I. In December 2007, the U.S. banking regulators published final regulations incorporating the Basel II Accord, which requires internationally active banking organizations, as well as certain of their U.S. bank subsidiaries, to implement Basel II standards over the next several years. In July 2010, the Company began reporting its capital adequacy standards on a parallel basis to its regulators under Basel I and Basel II as part of a phased implementation of Basel II.

In June 2011, the U.S. banking regulators published final regulations implementing a provision of the Dodd-Frank Act requiring that certain institutions supervised by the Federal Reserve, including the Company, be subject to capital requirements that are not less than the generally applicable risk-based capital requirements. As a result, the generally applicable capital requirements, which are based on Basel I standards, but may themselves change over time, will serve as a permanent floor to minimum capital requirements calculated under the Basel II standards the Company is currently required to implement, as well as future capital standards.

In December 2009, the Basel Committee released proposals on risk-based capital, leverage and liquidity standards, known as "Basel III." Basel III contains new capital standards that raise the quality of capital and strengthen counterparty credit risk capital requirements and introduce a leverage ratio as a supplemental measure to the risk-based ratio. Basel III includes a new capital conservation buffer, which imposes a common equity requirement above the new minimum that can be depleted under stress, subject to restrictions on capital actions, a new additional loss absorbency capital requirement for global systemically important banks (GSIB) such as the Company, and a new countercyclical buffer which regulators can activate during periods of excessive credit growth in their jurisdiction. The Basel III proposals complement an earlier proposal for revisions to the market risk framework. The earlier proposal, also referred to as Basel 2.5, increases capital requirements for securitizations and correlation trading within the Company's trading book. In 2011, the U.S. regulators issued proposed rules that are intended to implement certain aspects of the market risk framework proposals. While precise dates for the implementation of the new requirements in the U.S. have not been announced, the U.S. regulators will require implementation of Basel III subject to an extended phase-in period.

In December 2011, the Federal Reserve issued final rules on Capital Plans, which require large bank holding companies such as the Company to submit Capital Plans on an annual basis in order for the Federal Reserve to assess the companies' systems and processes that incorporate forward-looking projections of revenue and losses to monitor and maintain their internal capital adequacy. The rules also require that such companies receive no objection from the Federal Reserve before making a capital action. The Federal Reserve published the results of its 2012 Comprehensive Capital Analysis and Review in March 2012. The Company received no objection to its 2012 capital plan, including the potential acquisition of an additional 14% of MSSB and ongoing payment of current common and preferred dividends.

In accordance with the Federal Reserve's new Capital Plans final rule, Tier 1 common capital is calculated as Tier 1 capital less non-common elements in Tier 1 capital. Non-common elements include perpetual preferred stock and related surplus, minority interests in subsidiaries, trust preferred securities and mandatory convertible preferred securities. The Federal Reserve will work with the other federal banking agencies to implement Basel III and to propose a Basel III Tier 1 common capital ratio as a new minimum regulatory capital ratio. The existing supervisory definition of Tier 1 common capital will remain in force under the Capital Plans final rule until the Federal Reserve adopts the Basel III Tier 1 common ratio.

Pursuant to provisions of the Dodd-Frank Act, over time, trust preferred securities will no longer qualify as Tier 1 capital but will only qualify as Tier 2 capital. This change in regulatory capital treatment will be phased in

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incrementally during a transition period that will start on January 1, 2013 and end on January 1, 2016. This provision of the Dodd-Frank Act accelerates the phasing in of the disqualification of the trust preferred securities as provided for by Basel III.

At March 31, 2012, the Company was in compliance with Basel I capital requirements with ratios of Tier 1 capital to RWAs of 16.8% and total capital to RWAs of 18.1% (6% and 10% being well-capitalized for regulatory purposes, respectively). Also, the ratio of Tier 1 common capital to RWAs was 13.3% (5% being the minimum under the Federal Reserve's new capital plan framework). In addition, financial holding companies are also subject to a Tier 1 leverage ratio as defined by the Federal Reserve. The Company calculated its Tier 1 leverage ratio as Tier 1 capital divided by adjusted average total assets (which reflects adjustments for disallowed goodwill, certain intangible assets, deferred tax assets and financial and non-financial equity investments). The adjusted average total assets are derived using weekly balances for the year. At March 31, 2012, the Company was in compliance with this leverage restriction, with a Tier 1 leverage ratio of 7.0% (5% being well-capitalized for regulatory purposes).

The following table reconciles the Company's total shareholders' equity to Tier 1 common, Tier 1, Tier 2 and Total allowable capital as defined by the regulations issued by the Federal Reserve and presents the Company's consolidated capital ratios at March 31, 2012 and December 31, 2011:

	At March 31, 2012	At December 31, 2011
	(dollars in millions)	
Allowable capital		
Common shareholders' equity	\$ 60,816	\$ 60,541
Less: Goodwill	(6,700)	(6,686)
Less: Non-servicing intangible assets	(4,080)	(4,165)
Less: Net deferred tax assets(2)	(5,575)	(6,098)
Less: After-tax debt valuation adjustment	(842)	(2,296)
Other deductions	(1,468)	(1,511)
 Tier 1 common capital(1)(2)	 42,151	 39,785
Qualifying preferred stock	1,508	1,508
Qualifying restricted core capital elements	9,868	9,821
 Tier 1 capital(2)	 53,527	 51,114
Qualifying subordinated debt and restricted core capital elements	4,721	4,546
Other qualifying amounts	25	17
Other deductions	(686)	(721)
 Tier 2 capital	 4,060	 3,842
 Total allowable capital(2)	 \$ 57,587	 \$ 54,956
 Total risk weighted assets(2)	 \$ 317,693	 \$ 314,055
 Capital ratios		
Total capital ratio(2)	18.1%	17.5%
 Tier 1 common capital ratio(1)(2)	 13.3%	 12.7%
 Tier 1 capital ratio(2)	 16.8%	 16.3%
 Tier 1 leverage ratio(2)	 7.0%	 6.6%

- (1) Tier 1 common capital ratio equals Tier 1 common capital divided by RWAs. On December 30, 2011, the Federal Reserve formalized regulatory definitions for Tier 1 common capital and Tier 1 common capital ratio. The Federal Reserve defined Tier 1 common capital as Tier 1 capital less non-common elements in Tier 1 capital, including perpetual preferred stock and related surplus, minority interest in

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subsidiaries, trust preferred securities and mandatory convertible preferred securities. Previously, the Company's definition of Tier 1 common capital included all of the items noted in the Federal Reserve's definition, but it also included an adjustment for the portion of goodwill and non-servicing intangible assets associated with MSSB's noncontrolling interests (i.e., Citi's share of MSSB's goodwill and intangibles). The Company's conformance to the Federal Reserve's definition under the final rule reduced its Tier 1 common capital and Tier 1 common ratio by approximately \$4.2 billion and 132 basis points, respectively at December 31, 2011.

- (2) The December 31, 2011 deferred tax asset disallowance was adjusted by approximately \$1.2 billion, resulting in a reduction to the Company's Tier 1 common capital, Tier 1 capital, Total capital and RWAs by such amount, Tier 1 common capital ratio, Tier 1 capital ratio and Total capital ratio by approximately 30 basis points and Tier 1 leverage ratio by approximately 20 basis points.

Total allowable capital is composed of Tier 1 capital, which includes Tier 1 common capital, and Tier 2 capital. Tier 1 common capital is defined as Tier 1 capital less non-common elements in Tier 1 capital, including qualifying perpetual stock and qualifying restricted core capital elements, as per the Capital Plans final rule. Tier 1 capital consists predominately of common shareholders' equity as well as qualifying preferred stock and qualifying restricted core capital elements (trust preferred securities and noncontrolling interests) less goodwill, non-servicing intangible assets (excluding allowable mortgage servicing rights), net deferred tax assets (recoverable in excess of one year), an after-tax debt valuation adjustment and certain other deductions, including equity investments. The debt valuation adjustment in the above table represents the cumulative change in fair value of certain long-term and short-term borrowings that was attributable to the Company's own instrument-specific credit spreads and is included in retained earnings. For a further discussion of fair value, see Note 3 to the condensed consolidated financial statements.

At March 31, 2012, the Company calculated its RWAs in accordance with the regulatory capital requirements of the Federal Reserve, which is consistent with guidelines described under Basel I. RWAs reflect both on and off-balance sheet risk of the Company. The risk capital calculations will evolve over time as the Company enhances its risk management methodology and incorporates improvements in modeling techniques while maintaining compliance with the regulatory requirements and interpretations.

Market RWAs reflect capital charges attributable to the risk of loss resulting from adverse changes in market prices and other factors. For a further discussion of the Company's market risks and Value-at-Risk (VaR) model, see Quantitative and Qualitative Disclosures about Market Risk in Part II, Item 7A, of the Form 10-K and in Part I, Item 3 herein. Market RWAs incorporate two components: systematic risk and specific risk. Systematic and specific risk charges are computed using either the Company's VaR model or Standardized Approach in accordance with regulatory requirements.

Credit RWAs reflect capital charges attributable to the risk of loss arising from a borrower or counterparty failing to meet its financial obligations. For a further discussion of the Company's credit risks, see Quantitative and Qualitative Disclosures about Market Risk in Part II, Item 7A, of the Form 10-K and in Part I, Item 3 herein.

Under the Basel Committee's proposed framework, based on a preliminary analysis of the guidelines published to date and other factors, the Company estimates its pro forma Tier 1 common capital ratio under Basel III will be in a range between 8% and 10% by the end of 2012. This is a preliminary estimate and may change based on guidelines for implementation to be issued by the Federal Reserve. The pro forma Tier 1 common capital ratio under Basel III is a non-GAAP financial measure that the Company considers to be a useful measure to the Company and investors to gauge future regulatory capital requirements. The pro forma Tier 1 common capital ratio estimate is based on shareholders' equity, Tier 1 common capital and RWAs at March 31, 2012, adjusted for analysts' consensus of earnings for the remainder of 2012, and various passive mitigation efforts. This preliminary estimate is forward-looking, is subject to risks and uncertainties that may cause actual results to differ materially and should not be taken as a projection of what our capital ratios, RWAs, earnings or other results will actually be at these future dates. For a discussion of risks and uncertainties that may affect the future results of the Company, please see Risk Factors in Part I, Item 1A of the Form 10-K.

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Liquidity.

The Basel Committee has developed two standards for supervisors to use in liquidity risk supervision. The first standard's objective is to promote the short-term resilience of the liquidity risk profile of banks and bank holding companies. The Basel Committee developed the Liquidity Coverage Ratio (LCR) to ensure banks have sufficient high-quality liquid assets to cover net outflows arising from significant stress lasting 30 calendar days. The standard requires that the value of the ratio be no lower than 100%. The second standard's objective is to promote resilience over a longer time horizon. The Net Stable Funding Ratio (NSFR) has a time horizon of one year and builds on traditional net liquid asset and cash capital methodologies used widely by internationally active banking organizations to provide a sustainable maturity structure of assets and liabilities. The NSFR is defined as the amount of available stable funding to the amount of required stable funding. This ratio must be greater than 100%. After an observation period beginning in 2011, the LCR, including any revisions, will be introduced on January 1, 2015. The NSFR, including any revisions, will move to a minimum standard by January 1, 2018. The Company will continue to monitor the development and the potential impact of these standards.

In addition, in December 2011, the Federal Reserve issued proposed rules to implement certain requirements of the systemic risk regime, including with respect to liquidity. The proposed rules would require systemically important financial institutions, such as the Company, to maintain a sufficient quantity of highly liquid assets to survive a projected 30-day liquidity stress event, to conduct regular liquidity stress tests, and to implement various liquidity risk management requirements.

Effects of Inflation and Changes in Foreign Exchange Rates.

The Company's assets to a large extent are liquid in nature and, therefore, are not significantly affected by inflation, although inflation may result in increases in the Company's expenses, which may not be readily recoverable in the price of services offered. To the extent inflation results in rising interest rates and has other adverse effects upon the securities markets and upon the value of financial instruments, it may adversely affect the Company's financial position and profitability.

A significant portion of the Company's business is conducted in currencies other than the U.S. dollar, and changes in foreign exchange rates relative to the U.S. dollar can therefore affect the value of non-U.S. dollar net assets, revenues and expenses. Potential exposures as a result of these fluctuations in currencies are closely monitored, and, where cost-justified, strategies are adopted that are designed to reduce the impact of these fluctuations on the Company's financial performance. These strategies may include the financing of non-U.S. dollar assets with direct or swap-based borrowings in the same currency and the use of currency forward contracts or the spot market in various hedging transactions related to net assets, revenues, expenses or cash flows.

Table of Contents**Item 3. Quantitative and Qualitative Disclosures about Market Risk.****Market Risk.**

Market risk refers to the exposure of the Company to adverse changes in the values of its portfolios and financial instruments due to changes in market prices or rates. Generally, the Company is exposed to market risk as a result of trading, investing and client facilitation activities, mainly within the Institutional Securities business segment where the substantial majority of the Company's Value-at-Risk (VaR) for market risk exposures is generated. In addition, the Company incurs trading related market risk within the Global Wealth Management Group business segment. The Asset Management business segment incurs mainly non-trading market risk primarily from capital investments in real estate funds and investments in private equity vehicles. Regarding sales and trading and related activities, the Company is exposed to concentration risk in certain of its OTC derivatives portfolios related to the additional cost of closing out particularly large risk positions. For a further discussion of the Company's Market Risk, see Quantitative and Qualitative Disclosures about Market Risk Risk Management in Part II, Item 7A of the Form 10-K.

VaR.

The Company uses VaR as one of a range of risk management tools. VaR methodology has various strengths and limitations, which include, but are not limited to: use of historical changes in market risk factors, which may not be accurate predictors of future market conditions, and may not fully incorporate the risk of extreme market events that are outsized relative to observed historical market behavior or reflect the historical distribution of results beyond the 95% confidence interval; and reporting of losses in a single day, which does not reflect the risk of positions that cannot be liquidated or hedged in one day. A small proportion of market risk generated by trading positions is not included in VaR. The modeling of the risk characteristics of some positions relies on approximations that, under certain circumstances, could produce significantly different results from those produced using more precise measures.

The Company's VaR model evolves over time in response to changes in the composition of trading portfolios and to improvements in modeling techniques and systems capabilities. The Company is committed to continuous review and enhancement of VaR methodologies and assumptions in order to capture evolving risks associated with changes in market structure and dynamics. As part of regular process improvement, additional systematic and name-specific risk factors may be added to improve the VaR model's ability to more accurately estimate risks to specific asset classes or industry sectors. Additionally, the Company continues to evaluate enhancements to the VaR model to make it more responsive to recent market conditions, while maintaining a longer-term perspective.

The Company also performs routine stress testing to more comprehensively monitor the risks in the portfolio. The Company utilizes Stress VaR (S-VaR), which is a proprietary methodology that seeks to measure both the Company's market and credit risks, while adjusting for the different liquidity characteristics of the underlying risks (in contrast to traditional VaR measures which are typically calculated using the same liquidity horizon for all risks). S-VaR is an important risk metric used in establishing the Company's risk tolerance and its capital allocation framework. Further information on S-VaR can be found in Quantitative and Qualitative Disclosures about Market Risk Risk Management in Part II, Item 7A of the Form 10-K.

Since the reported VaR statistics are estimates based on historical data, VaR should not be viewed as predictive of the Company's future revenues or financial performance or of its ability to monitor and manage risk. There can be no assurance that the Company's actual losses on a particular day will not exceed the VaR amounts indicated below or that such losses will not occur more than five times in 100 trading days for a 95%/one-day VaR. VaR does not predict the magnitude of losses which, should they occur, may be significantly greater than the VaR amount.

The Credit Portfolio VaR has been disclosed as a separate category from the Primary Risk Categories. The Credit Portfolio VaR includes the mark-to-market relationship lending exposures and associated hedges as well as counterparty credit valuation adjustments and related hedges.

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The table below presents VaR for the Company's Trading portfolio, on a quarter-end, quarterly average and quarterly high and low basis (see Table 1 below). The VaR that would result if the Company were to adopt alternative parameters for its calculations, such as a higher confidence level for the VaR statistic (99% rather than 95%) or a shorter historical time series of market data (one year rather than four years), are also disclosed (see Table 2 below).

Trading Risks.

The table below presents the Company's 95%/one-day Trading VaR:

Market Risk Category	95%/One-Day VaR for the Quarter Ended March 31, 2012				95%/One-Day VaR for the Quarter Ended December 31, 2011			
	Period End	Average	High	Low (dollars in millions)	Period End	Average	High	Low
Interest rate and credit spread	\$ 56	\$ 57	\$ 75	\$ 46	\$ 66	\$ 57	\$ 71	\$ 49
Equity price	38	33	42	24	25	29	48	21
Foreign exchange rate	13	16	25	9	18	12	18	8
Commodity price	32	31	36	25	28	28	33	23
Less: Diversification benefit(1)(2)	(70)	(65)	N/A	N/A	(67)	(60)	N/A	N/A
Primary Risk Categories	\$ 69	\$ 72	\$ 84	\$ 65	\$ 70	\$ 66	\$ 76	\$ 60
Credit Portfolio	33	40	52	33	52	103	122	49
Less: Diversification benefit(1)(2)	(24)	(28)	N/A	N/A	(35)	(46)	N/A	N/A
Total Trading VaR	\$ 78	\$ 84	\$ 93	\$ 76	\$ 87	\$ 123	\$ 145	\$ 83

(1) Diversification benefit equals the difference between the total VaR and the sum of the component VaRs. This benefit arises because the simulated one-day losses for each of the components occur on different days; similar diversification benefits also are taken into account within each component.

(2) N/A Not Applicable. The minimum and maximum VaR values for the total VaR and each of the component VaRs might have occurred on different days during the quarter and therefore the diversification benefit is not an applicable measure.

The Company's average VaR for the Primary Risk Categories for the quarter ended March 31, 2012 was \$72 million compared with \$66 million for the quarter ended December 31, 2011. This increase was driven by elevated risk in equity, foreign exchange and commodity asset classes.

The average Credit Portfolio VaR for the quarter ended March 31, 2012 was \$40 million compared with \$103 million for the quarter ended December 31, 2011. This reduction primarily reflects the settlement with MBIA in December of 2011.

The average Total Trading VaR for the quarter ended March 31, 2012 was \$84 million compared with \$123 million for the quarter ended December 31, 2011. This reduction is principally the result of settlement with MBIA.

VaR Statistics under Varying Assumptions.

VaR statistics are not readily comparable across firms because of differences in the breadth of products included in each firm's VaR model, in the statistical assumptions made when simulating changes in market risk factors, and in the methods used to approximate portfolio revaluations under the simulated market conditions. These differences can result in materially different VaR estimates for similar portfolios. The impact varies depending on the factor history assumptions, the frequency with which the factor history is updated, and the confidence level. As a result, VaR statistics are more reliable and relevant when used as indicators of trends in risk taking rather than as a basis for inferring differences in risk taking across firms.

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Table 2 presents the VaR statistics that would result if the Company were to adopt alternative parameters for its calculations, such as the reported confidence level (95% versus 99%) for the VaR statistic or a shorter historical time series (four-year versus one-year) for market data upon which it bases its simulations. The four-year VaR measure continues to reflect the high market volatilities experienced through 2008, while the one-year VaR is no longer affected by these phenomena.

Table 2: 95% and 99% Average Trading VaR with Four-Year / One-Year Historical Time Series	95% Average One-Day VaR for the Quarter Ended March 31, 2012		99% Average One-Day VaR for the Quarter Ended March 31, 2012	
	Four-Year Risk Factor History	One-Year Risk Factor History	Four-Year Risk Factor History	One-Year Risk Factor History
Market Risk Category	(dollars in millions)			
Interest rate and credit spread	\$ 57	\$ 46	\$ 99	\$ 78
Equity price	33	28	48	41
Foreign exchange rate	16	14	26	21
Commodity price	31	29	52	45
Less: Diversification benefit(1)	(65)	(57)	(114)	(97)
Primary Risk Categories	\$ 72	\$ 60	\$ 111	\$ 88
Credit Portfolio	40	31	83	53
Less: Diversification benefit(1)	(28)	(23)	(55)	(37)
Total Trading VaR	\$ 84	\$ 68	\$ 139	\$ 104

(1) Diversification benefit equals the difference between the total VaR and the sum of the component VaRs. This benefit arises because the simulated one-day losses for each of the components occur on different days; similar diversification benefits also are taken into account within each component.

Distribution of VaR Statistics and Net Revenues for the quarter ended March 31, 2012.

One method of evaluating the reasonableness of the Company's VaR model as a measure of the Company's potential volatility of net revenue is to compare the VaR with actual trading revenue. Assuming no intra-day trading, for a 95%/one-day VaR, the expected number of times that trading losses should exceed VaR during the year is 13, and, in general, if trading losses were to exceed VaR more than 21 times in a year, the adequacy of the VaR model could be questioned. Differences between recent market volatility and the historical volatility used in the VaR model may result in the number of days in which trading losses exceed VaR to be higher or lower than statistically expected. The Company evaluates the reasonableness of its VaR model by comparing the potential declines in portfolio values generated by the model with actual trading results for both the Company as well as individual business units. For days where losses exceed the 95% or 99% VaR statistic, the Company examines the drivers of trading losses to evaluate the VaR model's accuracy relative to realized trading results.

In line with the enhanced transparency of the Company's traded market risk displayed in Tables 1 and 2, the distribution of VaR Statistics and Net Revenues will be presented for both the Primary Risk Categories and the Total Trading populations.

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Primary Risk Categories.

As shown in Table 1, the Company's average 95%/one-day Primary Risk Categories VaR for the quarter ended March 31, 2012 was \$72 million. The histogram below presents the distribution of the Company's daily 95%/one-day Primary Risk Categories VaR for the quarter ended March 31, 2012. The most frequently occurring value was between \$70 million and \$75 million, while for approximately 75% of trading days during the quarter the Primary Risk Categories VaR ranged between \$65 million and \$75 million.

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The histogram below shows the distribution of daily net trading revenue for the Company's businesses that comprise the Primary Risk Categories for the quarter ended March 31, 2012. This excludes non-trading revenues of these businesses and revenue associated with the Company's own credit risk. During the quarter ended March 31, 2012, the Company's businesses that comprise the Primary Risk Categories experienced net trading losses on four days, of which zero days were in excess of the 95%/one-day Primary Risk Categories VaR.

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Total Trading including the Primary Risk Categories and the Credit Portfolio.

As shown in Table 1, the Company's average 95%/one-day Total Trading VaR, which includes the Primary Risk Categories and the Credit Portfolio, for the quarter ended March 31, 2012 was \$84 million. The histogram below presents the distribution of the Company's daily 95%/one-day Total Trading VaR for the quarter ended March 31, 2012. The most frequently occurring value was between \$85 million and \$90 million, while for approximately 65% of trading days during the quarter the Total Trading VaR ranged between \$80 million and \$90 million.

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The histogram below shows the distribution of daily net trading revenue for the Company's Trading businesses for the quarter ended March 31, 2012. This excludes non-trading revenues of these businesses and revenue associated with the Company's own credit risk. During the quarter ended March 31, 2012, the Company experienced net trading losses on four days, of which zero days were in excess of the 95%/one-day Trading VaR.

Non-Trading Risks.

The Company believes that sensitivity analysis is an appropriate representation of the Company's non-trading risks. Reflected below is this analysis, which covers substantially all of the non-trading risk in the Company's portfolio.

Counterparty Exposure Related to the Company's Own Spread.

The credit spread risk relating to the Company's own mark-to-market derivative counterparty exposure is managed separately from VaR. The credit spread risk sensitivity of this exposure corresponds to an increase in value of approximately \$6 million for each 1 basis point widening in the Company's credit spread level for both March 31, 2012 and December 31, 2011.

Funding Liabilities.

The credit spread risk sensitivity of the Company's mark-to-market funding liabilities corresponded to an increase in value of approximately \$12 million for each 1 basis point widening in the Company's credit spread level for both March 31, 2012 and December 31, 2011.

Table of Contents**Interest Rate Risk Sensitivity on Income from Continuing Operations.**

The Company measures the interest rate risk of certain assets and liabilities by calculating the hypothetical sensitivity of net interest income to potential changes in the level of interest rates over the next twelve months. This sensitivity analysis includes positions that are mark-to-market as well as positions that are accounted for on an accrual basis. For interest rate derivatives that are perfect economic hedges to non-mark-to-market assets or liabilities, the disclosed sensitivities include only the impact of the coupon accrual mismatch. This treatment mitigates the effects caused by the measurement basis differences between the economic hedge and the corresponding hedged instrument.

Given the currently low interest rate environment, the Company uses the following two interest rate scenarios to quantify the Company's sensitivity: instantaneous parallel shocks of 100 and 200 basis point increases to all points on all yield curves simultaneously.

The hypothetical model does not assume any growth, change in business focus, asset pricing philosophy or asset/liability funding mix and does not capture how the Company would respond to significant changes in market conditions. Furthermore, the model does not reflect the Company's expectations regarding the movement of interest rates in the near term, nor the actual effect on income from continuing operations before income taxes if such changes were to occur.

	March 31, 2012		December 31, 2011	
	+100 Basis Points	+200 Basis Points	+100 Basis Points	+200 Basis Points
	(dollars in millions)			
Impact on income from continuing operations before income taxes	\$ 614	\$ 1,019	\$ 600	\$ 1,080
Impact on income from continuing operations before income taxes excluding Citi's share of MSSB(1)	384	650	370	672

(1) Reflects the exclusion of the portion of income from continuing operations before taxes associated with MSSB's noncontrolling interest in the joint venture.

Principal Investments.

The Company makes investments in both public and private companies. These investments are predominantly equity positions with long investment horizons, the majority of which are for business facilitation purposes. The market risk related to these investments is measured by estimating the potential reduction in net revenues associated with a 10% decline in investment values.

Investments	10% Sensitivity	
	March 31, 2012	December 31, 2011
	(dollars in millions)	
Investments related to Asset Management activities:		
Hedge fund investments	\$ 134	\$ 141
Private equity and infrastructure funds	115	108
Real estate funds	132	133
Other investments:		
Mitsubishi UFJ Morgan Stanley Securities Co., Ltd.	137	144
Other Company investments	292	297

Credit Risk.

For a further discussion of the Company's credit risks, see Quantitative and Qualitative Disclosures about Market Risk Risk Management Credit Risk in Part II, Item 7A of the Form 10-K. See Notes 7 and 11 to the condensed consolidated financial statements for additional information about the Company's financing receivables and lending commitments, respectively.

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Institutional Securities Activities.

Credit Exposure Corporate Lending. In connection with certain of its Institutional Securities business segment activities, the Company provides loans or lending commitments (including bridge financing) to selected corporate clients. Such loans and lending commitments can generally be classified as either relationship-driven or event-driven. These loans and lending commitments have varying terms, may be senior or subordinated, may be secured or unsecured, are generally contingent upon representations, warranties and contractual conditions applicable to the borrower, and may be syndicated, traded or hedged by the Company.

Relationship-driven loans and lending commitments refer to loans and lending commitments used for general corporate purposes, working capital and liquidity purposes. Commitments associated with relationship-driven activities may not be indicative of the Company's actual funding requirements, as the commitment may expire unused or the borrower may not fully utilize the commitment. The Company may hedge its exposures in connection with relationship-driven transactions. Additionally, the Company may mitigate credit risk by requiring borrowers to pledge collateral and include financial covenants in lending commitments. The Company's relationship-driven loans and lending commitments typically consist of revolving lines of credit, letter of credit facilities and certain term loans. These loans are carried either at fair value with changes in fair value recorded in earnings or amortized cost in the condensed consolidated statements of financial condition.

Event-driven loans and lending commitments refer to activities associated with a particular event or transaction, such as to support client merger, acquisition or recapitalization activities. Commitments associated with these event-driven activities may not be indicative of the Company's actual funding requirements since funding is contingent upon a proposed transaction being completed. In addition, the borrower may not fully utilize the commitment or the Company's portion of the commitment may be reduced through the syndication or sales process. The event-driven loans are typically syndicated or sold to third party institutional investors. The Company may have a custodial relationship with these institutional investors, such as prime brokerage clients. The borrower's ability to draw on the commitment is also subject to certain terms and conditions, among other factors. The Company risk manages its exposures in connection with event-driven transactions through various means, including syndication, distribution and/or hedging. The Company's event-driven loans and lending commitments typically consist of term loans and bridge loans. These loans are carried either at fair value with changes in fair value recorded in earnings or amortized cost in the condensed consolidated statements of financial condition.

During 2011, the Company accounted for certain new relationship-driven and event-driven loans and lending commitments as held for investment. Effective April 1, 2012, the Company began accounting for all new relationship-driven and event-driven loans and lending commitments as either held for investment or held for sale.

The table below presents the Company's credit exposure from its corporate lending positions and lending commitments, which is measured in accordance with the Company's internal risk management standards at March 31, 2012. The total corporate lending exposure column includes both lending commitments and funded loans. Lending commitments represent legally binding obligations to provide funding to clients at March 31, 2012 for both relationship-driven and event-driven lending transactions. Since commitments associated with these business activities may expire unused, they do not necessarily reflect the actual future cash funding requirements.

Table of Contents**Corporate Lending Commitments and Funded Loans at March 31, 2012**

Credit Rating(1)	Years to Maturity				Total Corporate Lending Exposure(2) (dollars in millions)	Corporate Lending Exposure at Carrying Value	Corporate Lending Commitments(3)
	Less than 1	1-3	3-5	Over 5			
AAA	\$ 786	\$ 85	\$ 140	\$	\$ 1,011	\$	\$ 1,011
AA	3,883	2,056	4,503	280	10,722	1,008	9,714
A	4,266	5,415	9,492	543	19,716	2,962	16,754
BBB	3,378	6,361	18,989	1,274	30,002	3,671	26,331
Investment grade	12,313	13,917	33,124	2,097	61,451	7,641	53,810
Non-investment grade	3,497	4,194	14,988	1,320	23,999	8,150	15,849
Total	\$ 15,810	\$ 18,111	\$ 48,112	\$ 3,417	\$ 85,450	\$ 15,791	\$ 69,659

(1) Obligor credit ratings are determined by the Credit Risk Management Department.

(2) Total corporate lending exposure represents the Company's potential loss assuming the market price of funded loans and lending commitments was zero.

(3) Amounts represent the notional amount of unfunded lending commitments less the amount of commitments reflected in the Company's condensed consolidated statements of financial condition. For syndications led by the Company, lending commitments accepted by the borrower but not yet closed are net of the amounts agreed to by counterparties that will participate in the syndication. For syndications that the Company participates in and does not lead, lending commitments accepted by the borrower but not yet closed include only the amount that the Company expects it will be allocated from the lead syndicate bank.

At March 31, 2012, the aggregate amount of investment grade loans was \$7.6 billion and the aggregate amount of non-investment grade loans was \$8.2 billion. In connection with these corporate lending activities (which include corporate funded loans and lending commitments), the Company had hedges (which include single name, sector and index hedges) with a notional amount of \$33.8 billion related to the total corporate lending exposure of \$85.5 billion at March 31, 2012.

At March 31, 2012, the Company's corporate lending exposure carried at fair value includes \$14.1 billion of funded loans and \$0.9 billion of lending commitments recorded in Financial instruments owned and Financial instruments sold, not yet purchased, respectively, in the consolidated statements of financial condition. The Company's corporate lending exposure accounted for as held for investment includes \$2.4 billion of funded loans recorded in Loans, with an allowance for loan losses of \$15 million, and \$15.7 billion of unfunded commitments with an allowance for credit losses of \$12 million recorded in Other liabilities in the consolidated statements of financial condition at March 31, 2012. The Company's corporate lending exposure accounted for as held for sale includes \$235 million of funded loans and \$259 million of unfunded commitments at March 31, 2012. See Notes 7 and 11 to the condensed consolidated financial statements for information on corporate loans and corporate lending commitments, respectively.

Event-Driven Loans and Lending Commitments at March 31, 2012.

Included in the total corporate lending exposure amounts in the table above at March 31, 2012 were event-driven exposure of \$6.7 billion composed of funded loans of \$1.9 billion and lending commitments of \$4.8 billion. Included in the event-driven exposure at March 31, 2012 were \$3.8 billion of loans and lending commitments to non-investment grade borrowers. The maturity profile of the event-driven loans and lending commitments at March 31, 2012 was as follows: 71% will mature in less than 1 year, 5% will mature within 1 to 3 years, 15% will mature within 3 to 5 years, and 9% will mature in over 5 years.

At March 31, 2012, \$291 million of the Company's event-driven loans were on a non-accrual basis. These loans primarily are those the Company originated prior to the financial crisis in 2008 and was unable to sell or syndicate. For loans carried at fair value that are on non-accrual status, interest income is recognized on a cash basis.

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Activity associated with the corporate event-driven lending exposure for the quarter ended March 31, 2012 was as follows (dollars in millions):

Event-driven lending exposures at December 31, 2011	\$ 7,157
Closed commitments	3,948
Net reductions, primarily through syndication or sales	(4,384)
Mark-to-market adjustments	(34)
Event-driven lending exposures at March 31, 2012	\$ 6,687

Other Institutional Securities Lending Activities.

In addition to the primary corporate lending activity described above, the Institutional Securities business segment engages in other lending activity. At March 31, 2012, \$8.3 billion of funded loans and \$67 million of unfunded lending commitments carried at fair value were recorded in Financial instruments owned and Financial instruments sold, not yet purchased, respectively, in the condensed consolidated statements of financial condition. These loans include corporate loans purchased in the secondary market, commercial and residential mortgage loans, and financing extended to equities and commodities customers. At March 31, 2012, \$1.6 billion of funded loans accounted for as held for investment are recorded in Loans with an allowance for loan losses of \$6 million in the condensed consolidated statements of financial condition. These loans are primarily asset-backed lending.

Credit Exposure Derivatives. For credit exposure information on the Company's OTC derivative products, see Note 10 to the condensed consolidated financial statements.

Credit Derivatives.

A credit derivative is a contract between a seller (guarantor) and buyer (beneficiary) of protection against the risk of a credit event occurring on a set of debt obligations issued by a specified reference entity. The beneficiary pays a periodic premium (typically quarterly) over the life of the contract and is protected for the period. If a credit event occurs, the guarantor is required to make payment to the beneficiary based on the terms of the credit derivative contract. Credit events include bankruptcy, dissolution or insolvency of the referenced entity, failure to pay, obligation acceleration, repudiation and payment moratorium. Debt restructurings are also considered a credit event in some cases. In certain transactions referenced to a portfolio of referenced entities or asset-backed securities, deductibles and caps may limit the guarantor's obligations.

The Company trades in a variety of credit derivatives and may either purchase or write protection on a single name or portfolio of referenced entities. The Company is an active market maker in the credit derivatives markets. As a market maker, the Company works to earn a bid-offer spread on client flow business and manage any residual credit or correlation risk on a portfolio basis. Further, the Company uses credit derivatives to manage its exposure to residential and commercial mortgage loans and corporate lending exposures during the periods presented.

The Company actively monitors its counterparty credit risk related to credit derivatives. A majority of the Company's counterparties are banks, broker-dealers, insurance and other financial institutions. Contracts with these counterparties do not include ratings-based termination events but do include provisions related to counterparty rating downgrades, which may result in additional collateral being required by the Company. As with all derivative contracts, the Company considers counterparty credit risk in the valuation of its positions and recognizes credit valuation adjustments as appropriate within Principal transactions Trading.

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The following table summarizes the key characteristics of the Company's credit derivative portfolio by counterparty at March 31, 2012. The fair values shown are before the application of any counterparty or cash collateral netting.

	At March 31, 2012				
	Receivable	Fair Values(1) Payable	Net	Beneficiary	Notionals Guarantor
	(dollars in millions)				
Banks and securities firms	\$ 89,613	\$ 84,630	\$ 4,983	\$ 2,010,818	\$ 1,951,216
Insurance and other financial institutions	9,297	8,963	334	318,326	395,237
Monolines(2)	191	2	189	17,975	
Non-financial entities	895	171	724	14,755	5,472
Total	\$ 99,996	\$ 93,766	\$ 6,230	\$ 2,361,874	\$ 2,351,925

(1) The Company's credit default swaps are classified in both Level 2 and Level 3 of the fair value hierarchy. Approximately 10% of receivable fair values and 6% of payable fair values represent Level 3 amounts.

(2) Credit derivatives used to hedge the Company's credit exposure to Monolines (including derivative counterparty exposure) are included in the table based on the counterparties writing such hedges. None of these hedges are written by other Monolines.

See Note 10 to the condensed consolidated financial statements for further information on credit derivatives.

Country Risk Exposure. Country risk exposure is the risk that events within a country, such as currency crises, regulatory changes and other political events, will adversely affect the ability of the sovereign government and/or obligors within the country to honor their obligations to the Company. Country risk exposure is measured in accordance with the Company's internal risk management standards and includes obligations from sovereign governments, corporations, clearinghouses and financial institutions. The Company actively manages country risk exposure through a comprehensive risk management framework that combines credit and market fundamentals as well as scenario analysis, and allows the Company to effectively identify, monitor and limit country risk. Country risk exposure before and after hedges are monitored and managed, with stress testing and scenario analysis conducted on a continuous basis, to identify exposure concentrations, wrong way risk and the impact of idiosyncratic events. In addition, indirect exposures are captured and monitored through regular stress testing and counterparty, market and systemic vulnerability analysis. The Company reduces its country risk exposure through the effect of risk mitigants, such as netting agreements with counterparties that permit the Company to offset receivables and payables with such counterparties, obtaining collateral from counterparties, and by hedging. For a further discussion of the Company's country risk exposure, see Quantitative and Qualitative Disclosures about Market Risk Risk Management Credit Risk Country Risk Exposure in Part II, Item 7A of the Form 10-K.

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The Company's sovereign exposures consist of financial instruments entered into with sovereign and local governments. Its non-sovereign exposures comprise exposures to corporations and financial institutions. The following table shows the Company's significant non-U.S. country risk exposure, except for select European countries (see "Country Risk Exposure - Select European Countries" herein), at March 31, 2012.

Country	Net Inventory(1)	Net Counterparty Exposure(2)	Funded Lending	Unfunded Commitments (dollars in millions)	Exposure Before Hedges	Hedges(3)	Net Exposure(4)
United Kingdom:							
Sovereigns	\$ (462)	\$ 75	\$	\$	\$ (387)	\$ (285)	\$ (672)
Non-sovereigns	663	13,784	3,413	4,505	22,365	(4,005)	18,360
Sub-total	\$ 201	\$ 13,859	\$ 3,413	\$ 4,505	\$ 21,978	\$ (4,290)	\$ 17,688
Germany:							
Sovereigns	\$ 1,760	\$ 650	\$	\$	\$ 2,410	\$ (1,455)	\$ 955
Non-sovereigns	272	3,107	560	4,147	8,086	(3,089)	4,997
Sub-total	\$ 2,032	\$ 3,757	\$ 560	\$ 4,147	\$ 10,496	\$ (4,544)	\$ 5,952
Brazil:							
Sovereigns	\$ 4,209	\$	\$	\$	\$ 4,209	\$	\$ 4,209
Non-sovereigns	85	322	348	282	1,037	(89)	948
Sub-total	\$ 4,294	\$ 322	\$ 348	\$ 282	\$ 5,246	\$ (89)	\$ 5,157
Canada:							
Sovereigns	\$ 564	\$ 243	\$	\$	\$ 807	\$	\$ 807
Non-sovereigns	891	1,080	230	1,403	3,604	(584)	3,020
Sub-total	\$ 1,455	\$ 1,323	\$ 230	\$ 1,403	\$ 4,411	\$ (584)	\$ 3,827
China:							
Sovereigns	\$ 172	\$ 132	\$	\$	\$ 304	\$	\$ 304
Non-sovereigns	1,562	324	425	15	2,326	(88)	2,238
Sub-total	\$ 1,734	\$ 456	\$ 425	\$ 15	\$ 2,630	\$ (88)	\$ 2,542

(1) Net inventory representing exposure to both long and short single name and index positions (*i.e.*, bonds and equities at fair value and CDS based on notional amount assuming zero recovery adjusted for any fair value receivable or payable).

(2) Net counterparty exposure (*i.e.*, repurchase transactions, securities lending and OTC derivatives) taking into consideration legally enforceable master netting agreements and collateral.

(3) Represents CDS hedges on net counterparty exposure and funded lending. Based on the CDS notional amount assuming zero recovery adjusted for any fair value receivable or payable.

(4) In addition, at March 31, 2012, the Company had exposure to these countries for overnight deposits with banks of approximately \$4.9 billion.

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Country Risk Exposure Select European Countries. In connection with certain of its Institutional Securities business segment activities, the Company has country risk exposure to many foreign countries. During the quarter ended March 31, 2012, certain European countries, which include Greece, Ireland, Italy, Portugal and Spain (the "European Peripherals") and France, experienced varying degrees of credit deterioration due to weaknesses in their economic and fiscal situations. The following table shows the Company's country risk exposure to European Peripherals and France at March 31, 2012. Such country risk exposure is measured in accordance with the Company's internal risk management standards and includes obligations from sovereign and non-sovereigns, which includes governments, corporations, clearinghouses and financial institutions.

Country	Net Inventory(1)	Net Counterparty Exposure(2)	Funded Lending	Unfunded Commitments (dollars in millions)	CDS Adjustment(3)	Exposure Before Hedges	Hedges(4)	Net Exposure
Greece:								
Sovereigns	\$ 18	\$ 17	\$	\$	\$	\$ 35	\$	\$ 35
Non-sovereigns	40	6	78			124	(64)	60
Sub-total	\$ 58	\$ 23	\$ 78	\$	\$	\$ 159	\$ (64)	\$ 95
Ireland:								
Sovereigns	\$ 33	\$ 3	\$	\$	\$ 4	\$ 40	\$ (2)	\$ 38
Non-sovereigns	130	23	68	8	17	246	(20)	226
Sub-total	\$ 163	\$ 26	\$ 68	\$ 8	\$ 21	\$ 286	\$ (22)	\$ 264
Italy:								
Sovereigns	\$ (829)	\$ 521	\$	\$	\$ 470	\$ 162	\$ (338)	\$ (176)
Non-sovereigns	267	551	336	387	186	1,727	(678)	1,049
Sub-total	\$ (562)	\$ 1,072	\$ 336	\$ 387	\$ 656	\$ 1,889	\$ (1,016)	\$ 873
Spain:								
Sovereigns	\$ (653)	\$ 5	\$	\$	\$ 509	\$ (139)	\$ (16)	\$ (155)
Non-sovereigns	160	459	68	833	240	1,760	(290)	1,470
Sub-total	\$ (493)	\$ 464	\$ 68	\$ 833	\$ 749	\$ 1,621	\$ (306)	\$ 1,315
Portugal:								
Sovereigns	\$ (416)	\$ 132	\$	\$	\$ 24	\$ (260)	\$ (100)	\$ (360)
Non-sovereigns	76	52	132		55	315	(92)	223
Sub-total	\$ (340)	\$ 184	\$ 132	\$	\$ 79	\$ 55	\$ (192)	\$ (137)
Sovereigns	\$ (1,847)	\$ 678	\$	\$	\$ 1,007	\$ (162)	\$ (456)	\$ (618)
Non-sovereigns	673	1,091	682	1,228	498	4,172	(1,144)	3,028
Total								
European Peripherals(5)	\$ (1,174)	\$ 1,769	\$ 682	\$ 1,228	\$ 1,505	\$ 4,010	\$ (1,600)	\$ 2,410
France(5):								
Sovereigns	\$ 555	\$ 252	\$	\$	\$ 13	\$ 820	\$ (278)	\$ 542
Non-sovereigns	(2)	2,728	457	1,577	410	5,170	(1,571)	3,599

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Sub-total(5)	\$	553	\$	2,980	\$	457	\$	1,577	\$	423	\$	5,990	\$	(1,849)	\$	4,141
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- (1) Net inventory representing exposure to both long and short single name and index positions (*i.e.*, bonds and equities at fair value and CDS based on notional amount assuming zero recovery adjusted for any fair value receivable or payable).
- (2) Net counterparty exposure (*i.e.*, repurchase transactions, securities lending and OTC derivatives) taking into consideration legally enforceable master netting agreements and collateral.
- (3) CDS adjustment represents credit protection purchased from European peripheral banks on European peripheral sovereign and financial institution risk, or French banks on French sovereign and financial institution risk. Based on the CDS notional amount assuming zero recovery adjusted for any fair value receivable or payable.

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- (4) Represents CDS hedges on net counterparty exposure and funded lending. Based on the CDS notional amount assuming zero recovery adjusted for any fair value receivable or payable.
- (5) In addition, at March 31, 2012, the Company had European Peripherals and French exposure for overnight deposits with banks of approximately \$222 million and \$23 million, respectively.

Industry Exposure Corporate Lending and OTC Derivative Products. The Company also monitors its credit exposure to individual industries for credit exposure arising from corporate loans and lending commitments as discussed above and current exposure arising from the Company's OTC derivative contracts.

The following tables show the Company's credit exposure from its primary corporate loans and lending commitments and OTC derivative products by industry at March 31, 2012:

Industry	Corporate Lending Exposure (dollars in millions)
Utilities	\$ 9,976
Energy	8,969
Funds, exchanges and other financial services(1)	7,692
Telecommunications services	5,547
Chemicals, metals, mining and other materials	5,185
Capital goods	4,288
Food, beverage and tobacco	4,089
Technology software and services	4,069
Media-related entities	3,985
Other	31,650
Total	\$ 85,450

Industry	OTC Derivative Products(2) (dollars in millions)
Banks	\$ 4,929
Special purpose vehicles	4,857
Funds, exchanges and other financial services(1)	4,652
Utilities	4,294
Regional governments	2,301
Sovereign governments	2,066
Other	3,725
Total	\$ 26,824

(1) Includes mutual funds, pension funds, private equity and real estate funds, exchanges and clearinghouses and diversified financial services.

(2) For further information on derivative instruments and hedging activities, see Note 10 to the condensed consolidated financial statements.

Global Wealth Management Group Activities.

The principal Global Wealth Management Group activities that result in credit risk to the Company include margin lending, non-purpose lending, and residential mortgage lending. At March 31, 2012, Global Wealth Management Group had \$12.3 billion of loans held for investment with an allowance for loan losses of \$5 million and \$138 million of loans held for sale classified in Loans in the condensed consolidated statements of financial condition. For a further discussion of the Company's credit risks associated with Global Wealth Management Group, see Quantitative and Qualitative Disclosures about Market Risk Risk Management Credit Risk Global Wealth Management Group Activities in Part

II, Item 7A of the Form 10-K.

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Item 4. Controls and Procedures.

Under the supervision and with the participation of the Company's management, including our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of the effectiveness of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) of the Securities Exchange Act of 1934, as amended (the "Exchange Act")). Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this report.

No change in the Company's internal control over financial reporting (as defined in Rule 13a-15(f) of the Exchange Act) occurred during the period covered by this report that materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

Table of Contents**FINANCIAL DATA SUPPLEMENT (Unaudited)****Average Balances and Interest Rates and Net Interest Income**

	Three Months Ended March 31, 2012		
	Average Weekly Balance	Interest (dollars in millions)	Annualized Average Rate
Assets			
Interest earning assets:			
Financial instruments owned(1):			
U.S.	\$ 130,147	\$ 631	2.0%
Non-U.S.	88,710	160	0.7
Securities available for sale:			
U.S.	31,508	86	1.1
Loans:			
U.S.	15,931	112	2.9
Non-U.S.	189	6	12.9
Interest bearing deposits with banks:			
U.S.	28,789	5	0.1
Non-U.S.	12,474	22	0.7
Federal funds sold and securities purchased under agreements to resell and			
Securities borrowed:			
U.S.	180,579	(37)	(0.1)
Non-U.S.	102,382	150	0.6
Other:			
U.S.	50,398	232	1.9
Non-U.S.	14,127	175	5.0
Total	\$ 655,234	\$ 1,542	1.0%
Non-interest earning assets	130,446		
Total assets	\$ 785,680		
Liabilities and Equity			
Interest bearing liabilities:			
Deposits:			
U.S.	\$ 65,638	\$ 45	0.3%
Non-U.S.	84		
Commercial paper and other short-term borrowings:			
U.S.	629	2	1.3
Non-U.S.	2,377	11	1.9
Long-term debt:			
U.S.	173,389	1,240	2.9
Non-U.S.	6,809	14	0.8
Financial instruments sold, not yet purchased(1):			
U.S.	28,779		
Non-U.S.	54,457		
Securities sold under agreements to repurchase and Securities loaned:			
U.S.	94,878	171	0.7
Non-U.S.	63,601	292	1.9
Other:			
U.S.	80,264	(384)	(1.9)

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Non-U.S.	34,655	210	2.5
Total	\$ 605,560	\$ 1,601	1.1
Non-interest bearing liabilities and equity	180,120		
Total liabilities and equity	\$ 785,680		
Net interest income and net interest rate spread		\$ (59)	(0.1)%

(1) Interest expense on Financial instruments sold, not yet purchased is reported as a reduction of Interest income on Financial instruments owned.

Table of Contents**FINANCIAL DATA SUPPLEMENT (Unaudited) (Continued)****Average Balances and Interest Rates and Net Interest Income**

	Three Months Ended March 31, 2011		
	Average Weekly Balance	Interest (dollars in millions)	Annualized Average Rate
Assets			
Interest earning assets:			
Financial instruments owned(1):			
U.S.	\$ 121,713	\$ 730	2.4%
Non-U.S.	120,291	188	0.6
Securities available for sale:			
U.S.	27,123	88	1.3
Loans:			
U.S.	10,966	100	3.7
Non-U.S.	193	5	10.5
Interest bearing deposits with banks:			
U.S.	48,102	12	0.1
Non-U.S.	14,983	23	0.6
Federal funds sold and securities purchased under agreements to resell and Securities borrowed:			
U.S.	199,619	55	0.1
Non-U.S.	98,941	222	0.9
Other:			
U.S.	40,899	248	2.5
Non-U.S.	17,328	188	4.4
Total	\$ 700,158	\$ 1,859	1.1%
Non-interest earning assets	135,698		
Total assets	\$ 835,856		
Liabilities and Equity			
Interest bearing liabilities:			
Deposits:			
U.S.	\$ 63,216	\$ 66	0.4%
Non-U.S.	65		
Commercial paper and other short-term borrowings:			
U.S.	1,476	3	0.8
Non-U.S.	1,644	5	1.2
Long-term debt:			
U.S.	186,108	1,304	2.8
Non-U.S.	6,676	9	0.5
Financial instruments sold, not yet purchased(1):			
U.S.	23,080		
Non-U.S.	62,115		
Securities sold under agreements to repurchase and Securities loaned:			
U.S.	105,383	185	0.7
Non-U.S.	93,514	286	1.2
Other:			
U.S.	85,962	(182)	(0.9)

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Non-U.S.	34,037	177	2.1
Total	\$ 663,276	\$ 1,853	1.1
Non-interest bearing liabilities and equity	172,580		
Total liabilities and equity	\$ 835,856		
Net interest income and net interest rate spread		\$ 6	%

(1) Interest expense on Financial instruments sold, not yet purchased is reported as a reduction of Interest income on Financial instruments owned.

Table of Contents**FINANCIAL DATA SUPPLEMENT (Unaudited) (Continued)****Rate/Volume Analysis**

The following tables set forth an analysis of the effect on net interest income of volume and rate changes:

	Three Months Ended March 31, 2012 versus Three Months Ended March 31, 2011		
	Increase (decrease) due to change in:		Net Change
	Volume	Rate (dollars in millions)	
Interest earning assets			
Financial instruments owned:			
U.S.	\$ 51	\$ (150)	\$ (99)
Non-U.S.	(49)	21	(28)
Securities available for sale:			
U.S.	14	(16)	(2)
Loans:			
U.S.	45	(33)	12
Non-U.S.		1	1
Interest bearing deposits with banks:			
U.S.	(5)	(2)	(7)
Non-U.S.	(4)	3	(1)
Federal funds sold and securities purchased under agreements to resell and			
Securities borrowed:			
U.S.	(5)	(87)	(92)
Non-U.S.	8	(80)	(72)
Other:			
U.S.	57	(73)	(16)
Non-U.S.	(35)	22	(13)
Change in interest income	\$ 77	\$ (394)	\$ (317)
Interest bearing liabilities			
Deposits:			
U.S.	\$ 3	\$ (24)	\$ (21)
Commercial paper and other short-term borrowings:			
U.S.	(2)	1	(1)
Non-U.S.	2	4	6
Long-term debt:			
U.S.	(89)	25	(64)
Non-U.S.		5	5
Securities sold under agreements to repurchase and Securities loaned:			
U.S.	(18)	4	(14)
Non-U.S.	(91)	97	6
Other:			
U.S.	11	(213)	(202)
Non-U.S.	3	30	33
Change in interest expense	\$ (181)	\$ (71)	\$ (252)
Change in net interest income	\$ 258	\$ (323)	\$ (65)

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Part II Other Information.

Item 1. Legal Proceedings.

In addition to the matters described in the Company's Annual Report on Form 10-K for the year ended December 31, 2011 (the "Form 10-K"), and those described below, in the normal course of business, the Company has been named, from time to time, as a defendant in various legal actions, including arbitrations, class actions and other litigation, arising in connection with its activities as a global diversified financial services institution. Certain of the actual or threatened legal actions include claims for substantial compensatory and/or punitive damages or claims for indeterminate amounts of damages. In some cases, the entities that would otherwise be the primary defendants in such cases are bankrupt or in financial distress.

The Company is also involved, from time to time, in other reviews, investigations and proceedings (both formal and informal) by governmental and self-regulatory agencies regarding the Company's business, including, among other matters, accounting and operational matters, certain of which may result in adverse judgments, settlements, fines, penalties, injunctions or other relief.

The Company contests liability and/or the amount of damages as appropriate in each pending matter. Where available information indicates that it is probable a liability had been incurred at the date of the condensed consolidated financial statements and the Company can reasonably estimate the amount of that loss, the Company accrues the estimated loss by a charge to income.

In many proceedings, however, it is inherently difficult to determine whether any loss is probable or even possible or to estimate the amount of any loss. The Company cannot predict with certainty if, how or when such proceedings will be resolved or what the eventual settlement, fine, penalty or other relief, if any, may be, particularly for proceedings that are in their early stages of development or where plaintiffs seek substantial or indeterminate damages. Numerous issues may need to be resolved, including through potentially lengthy discovery and determination of important factual matters, determination of issues related to class certification and the calculation of damages, and by addressing novel or unsettled legal questions relevant to the proceedings in question, before a loss or additional loss or range of loss or additional loss can be reasonably estimated for any proceeding. Subject to the foregoing, the Company believes, based on current knowledge and after consultation with counsel, that the outcome of such proceedings will not have a material adverse effect on the consolidated financial condition of the Company, although the outcome of such proceedings could be material to the Company's operating results and cash flows for a particular period depending on, among other things, the level of the Company's revenues or income for such period.

Over the last several years, the level of litigation and investigatory activity focused on residential mortgage and credit crisis related matters has increased materially in the financial services industry. As a result, the Company expects that it may become the subject of increased claims for damages and other relief regarding residential mortgages and related securities in the future and, while the Company has identified below certain proceedings that the Company believes to be material, individually or collectively, there can be no assurance that additional material losses will not be incurred from residential mortgage claims that have not yet been notified to the Company or are not yet determined to be material.

The following developments have occurred with respect to certain matters previously reported in the Form 10-K or concern new actions that have been filed since December 31, 2011:

Residential Mortgage and Credit Crisis Related Matters.

Class Actions.

On March 26, 2012, defendants filed a renewed motion to dismiss the complaint in *In re Morgan Stanley ERISA Litigation*.

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On April 24, 2012, the court presiding in *In re Morgan Stanley Pass-Through Certificate Litigation* denied defendants' motion for reconsideration of its denial-in-part of defendants' motion to dismiss the second amended complaint.

Other Litigation.

On February 29, 2012, U.S. Bank National Association, in its capacity as Trustee ("U.S. Bank"), filed a summons with notice on behalf of Morgan Stanley Mortgage Loan Trust 2006-4SL and Mortgage Pass-Through Certificates, Series 2006-4SL (together, the "Trust") against the Company. The summons with notice is styled *Morgan Stanley Mortgage Loan Trust 2006-4SL, et al. v. Morgan Stanley Mortgage Capital Inc.* and is pending in New York Supreme Court, New York County. The notice asserts claims for breach of contract and alleges, among other things, that the loans in the Trust, which had an original principal balance of approximately \$303 million, breached various representations and warranties. The notice seeks, among other relief, an order requiring the Company to comply with the loan breach remedy procedures in the transaction documents, unspecified damages, and interest.

On March 5, 2012, the plaintiff in *The Charles Schwab Corp. v. BNP Paribas Securities Corp., et al.* filed a second amended complaint. On April 10, 2012, the Company filed a demurrer to certain causes of action in the amended complaint.

On March 12, 2012, the court presiding in *Cambridge Place Investment Management Inc. v. Morgan Stanley & Co., Inc. et al.* denied defendants' motion to dismiss with respect to plaintiff's standing to bring suit. Defendants sought interlocutory appeal from that decision on April 11, 2012. On April 26, 2012, defendants filed a second motion to dismiss for failure to state a claim upon which relief can be granted.

On March 9, 2012, in *Federal Home Loan Bank of Boston v. Ally Financial, Inc. F/K/A GMAC LLC et al.*, the United States District Court for the District of Massachusetts denied plaintiff's motion to remand the case to state court.

On March 20, 2012, the Company filed answers to the complaints in both cases styled *Federal Deposit Insurance Corporation, as Receiver for Franklin Bank S.S.B v. Morgan Stanley & Company LLC F/K/A Morgan Stanley & Co. Inc.*, denying their allegations.

On April 25, 2012, The Prudential Insurance Company of America and certain affiliates filed a complaint against the Company and certain affiliates in the Superior Court of the State of New Jersey styled *The Prudential Insurance Company of America, et al. v. Morgan Stanley, et al.* The complaint alleges that defendants made untrue statements and material omissions in connection with the sale to plaintiffs of certain mortgage pass through certificates backed by securitization trusts containing residential mortgage loans. The total amount of certificates allegedly sponsored, underwritten and/or sold by the Company was approximately \$1 billion. The complaint raises claims under the New Jersey Uniform Securities Law, as well as common law claims of negligent misrepresentation, fraud and tortious interference with contract and seeks, among other things, compensatory damages, punitive damages, rescission and rescissory damages associated with plaintiffs' purchases of such certificates.

On April 25, 2012, Metropolitan Life Insurance Company and certain affiliates filed a complaint against the Company and certain affiliates in the Supreme Court of the State of New York styled *Metropolitan Life Insurance Company, et al. v. Morgan Stanley, et al.* The complaint alleges that defendants made untrue statements and material omissions in the sale to plaintiffs of certain mortgage pass through certificates backed by securitization trusts containing residential mortgage loans. The total amount of certificates allegedly sponsored, underwritten and/or sold by the Company was approximately \$757 million. The complaint raises common law claims of fraud, fraudulent inducement, aiding and abetting fraud and negligent misrepresentation and seeks, among other things, rescission, compensatory and/or rescissory damages, as well as punitive damages, associated with plaintiffs' purchases of such certificates.

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On May 1, 2012, Asset Management Fund d/b/a AMF Funds and certain of its affiliated funds filed a summons with notice against the Company in the Supreme Court of the State of New York, styled *Asset Management Fund d/b/a AMF Funds et al v. Morgan Stanley et al*. The notice alleges that defendants made material misrepresentations and omissions in the sale to plaintiffs of certain mortgage pass through certificates backed by securitization trusts containing residential mortgage loans. The total amount of certificates allegedly sponsored, underwritten and/or sold by the Company to plaintiffs was approximately \$122 million. The notice identifies causes of action against the Company for, among other things, common-law fraud, fraudulent inducement, aiding and abetting fraud, and negligent misrepresentation. The notice identifies the relief sought to include, among other things, monetary damages, punitive damages and rescission.

Other Matters.

On April 2, 2012, the Company entered into a Consent Order (Order) with the Board of Governors of the Federal Reserve System (Federal Reserve Board) relating to the servicing of residential mortgage loans. The terms of the Order are substantially similar and, in many respects, identical to the orders entered into with the Federal Reserve Board by other large U.S. financial institutions. The Order, which is available on the Federal Reserve Board's website, sets forth various allegations of improper conduct in servicing by Saxon, requires that the Company and its affiliates cease and desist such conduct, and requires that the Company, and its Board of Directors and affiliates, take various affirmative steps. The Order requires (i) the Company to engage an independent third-party consultant to conduct a review of certain foreclosure actions or proceedings that occurred or were pending between January 1, 2009 and December 31, 2010; (ii) the adoption of policies and procedures related to management of third parties used to outsource residential mortgage servicing, loss mitigation or foreclosure; (iii) a validation report from an independent third-party consultant regarding compliance with the Order for the first year; and (iv) submission of quarterly progress reports as to compliance with the Order by the Company's Board of Directors. The Order also provides that the Company will be responsible for the payment of any civil money penalties or compensatory payments assessed by the Federal Reserve Board related to such alleged conduct, which penalties or payments have not yet been determined.

Shareholder Derivative Matter.

On March 22, 2012, the Appellate Division of the Supreme Court of the State of New York affirmed the dismissal of the complaint in *Security, Police and Fire Professionals of America Retirement Fund, et al. v. John J. Mack et al*.

China Matter.

As disclosed in February 2009, the Company uncovered actions initiated by an employee based in China in an overseas real estate subsidiary that appeared to have violated the Foreign Corrupt Practices Act. The Company terminated the employee, reported the activity to appropriate authorities and cooperated with the investigations by the United States Department of Justice (DOJ) and the United States Securities and Exchange Commission (SEC). On April 25, 2012, the DOJ announced that the former employee had pled guilty to certain criminal charges, and the SEC announced that it had brought certain civil charges against the former employee, which have been settled. On the same day, the DOJ and SEC announced that they will not take any action against the Company in connection with this matter.

Table of Contents**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.**

The table below sets forth the information with respect to purchases made by or on behalf of the Company of its common stock during the quarterly period ended March 31, 2012.

Issuer Purchases of Equity Securities

(dollars in millions, except per share amounts)

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased As Part of Publicly Announced Plans or Programs(C)	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs
Month #1 (January 1, 2012 – January 31, 2012)				
Share Repurchase Program(A)				\$ 1,560
Employee Transactions(B)	9,735,096	\$ 17.83		
Month #2 (February 1, 2012 – February 29, 2012)				
Share Repurchase Program(A)				\$ 1,560
Employee Transactions(B)	363,505	\$ 19.69		
Month #3 (March 1, 2012 – March 31, 2012)				
Share Repurchase Program(A)				\$ 1,560
Employee Transactions(B)	96,101	\$ 19.06		
Total				
Share Repurchase Program(A)				\$ 1,560
Employee Transactions(B)	10,194,702	\$ 17.91		

(A) On December 19, 2006, the Company announced that its Board of Directors authorized the repurchase of up to \$6 billion of the Company's outstanding stock under a share repurchase program (the "Share Repurchase Program"). The Share Repurchase Program is a program for capital management purposes that considers, among other things, business segment capital needs, as well as equity-based compensation and benefit plan requirements. The Share Repurchase Program has no set expiration or termination date. Share repurchases by the Company are subject to regulatory approval.

(B) Includes: (1) shares delivered or attested in satisfaction of the exercise price and/or tax withholding obligations by holders of employee and director stock options (granted under employee and director stock compensation plans) who exercised options; (2) shares withheld, delivered or attested (under the terms of grants under employee and director stock compensation plans) to offset tax withholding obligations that occur upon vesting and release of restricted shares; (3) shares withheld, delivered and attested (under the terms of grants under employee and director stock compensation plans) to offset tax withholding obligations that occur upon the delivery of outstanding shares underlying restricted stock units, and (4) shares withheld, delivered and attested (under the terms of grants under employee and director stock compensation plans) to offset the cash payment for fractional shares. The Company's employee and director stock compensation plans provide that the value of the shares withheld, delivered or attested shall be valued using the fair market value of the Company's common stock on the date the relevant transaction occurs, using a valuation methodology established by the Company.

(C) Share purchases under publicly announced programs are made pursuant to open-market purchases, Rule 10b5-1 plans or privately negotiated transactions (including with employee benefit plans) as market conditions warrant and at prices the Company deems appropriate.

Item 6. Exhibits.

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An exhibit index has been filed as part of this Report on Page E-1.

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SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

MORGAN STANLEY

(Registrant)

By: */s/ RUTH PORAT*
Ruth Porat

Executive Vice President and

Chief Financial Officer

By: */s/ PAUL C. WIRTH*
Paul C. Wirth

Deputy Chief Financial Officer

Date: May 7, 2012

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EXHIBIT INDEX

MORGAN STANLEY

Quarter Ended March 31, 2012

Exhibit No.	Description
10.1	Form of Award Certificate for Discretionary Retention Awards of Stock Units.
10.2	Form of Award Certificate for Discretionary Retention Awards under the Morgan Stanley Compensation Incentive Plan Deferred Bonus Program.
10.3	Form of Award Certificate for Performance Stock Units.
10.4	Memorandum to Colm Kelleher Regarding Repatriation to London.
10.5	Morgan Stanley U.S. Tax Equalization Program.
10.6	Amendment to Morgan Stanley 401(k) Savings Plan, dated as of February 28, 2012.
12	Statement Re: Computation of Ratio of Earnings to Fixed Charges and Computation of Earnings to Fixed Charges and Preferred Stock Dividends.
15	Letter of awareness from Deloitte & Touche LLP, dated May 7, 2012, concerning unaudited interim financial information.
31.1	Rule 13a-14(a) Certification of Chief Executive Officer.
31.2	Rule 13a-14(a) Certification of Chief Financial Officer.
32.1	Section 1350 Certification of Chief Executive Officer.
32.2	Section 1350 Certification of Chief Financial Officer.
101	Interactive data files pursuant to Rule 405 of Regulation S-T: (i) the Condensed Consolidated Statements of Financial Condition March 31, 2012 and December 31, 2011, (ii) the Condensed Consolidated Statements of Income Three Months Ended March 31, 2012 and 2011, (iii) the Condensed Consolidated Statements of Comprehensive Income Three Months Ended March 31, 2012 and 2011, (iv) the Condensed Consolidated Statements of Cash Flows Three Months Ended March 31, 2012 and 2011, (v) the Condensed Consolidated Statements of Changes in Total Equity Three Months Ended March 31, 2012 and 2011, and (vi) Notes to Condensed Consolidated Financial Statements (unaudited)