

MORGAN STANLEY
Form 10-Q
May 06, 2014
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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, 2014

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 incorporation or organization)	New York, NY 10036 (Address of principal executive offices, including zip code)	(I.R.S. Employer Identification No.)	(Registrant's telephone number, including area 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

Accelerated Filer

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Non-Accelerated Filer

Smaller reporting company

(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, 2014, there were 1,971,294,604 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, 2014

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AVAILABLE INFORMATION

Morgan Stanley files annual, quarterly and current reports, proxy statements and other information with the U.S. 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; Operations and Technology Committee; 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 Activities;

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, 2014	December 31, 2013
Assets		
Cash and due from banks (\$546 and \$544 at March 31, 2014 and December 31, 2013, respectively, related to consolidated variable interest entities, generally not available to the Company)	\$ 13,785	\$ 16,602
Interest bearing deposits with banks	41,639	43,281
Cash deposited with clearing organizations or segregated under federal and other regulations or requirements (\$129 and \$117 at March 31, 2014 and December 31, 2013, respectively, related to consolidated variable interest entities, generally not available to the Company)	43,651	39,203
Trading assets, at fair value (approximately \$137,157 and \$151,078 were pledged to various parties at March 31, 2014 and December 31, 2013, respectively) (\$2,854 and \$2,825 at March 31, 2014 and December 31, 2013, respectively, related to consolidated variable interest entities, generally not available to the Company)	259,545	280,744
Securities available for sale, at fair value	58,886	53,430
Securities received as collateral, at fair value	21,613	20,508
Federal funds sold and securities purchased under agreements to resell (includes \$866 and \$866 at fair value at March 31, 2014 and December 31, 2013, respectively)	107,576	118,130
Securities borrowed	147,595	129,707
Customer and other receivables	60,506	57,104
Loans:		
Held for investment (net of allowances of \$124 and \$156 at March 31, 2014 and December 31, 2013, respectively)	41,575	36,545
Held for sale	4,730	6,329
Other investments (\$540 and \$561 at March 31, 2014 and December 31, 2013, respectively, related to consolidated variable interest entities, generally not available to the Company)	5,143	5,086
Premises, equipment and software costs (net of accumulated depreciation of \$6,253 and \$6,420 at March 31, 2014 and December 31, 2013, respectively) (\$199 and \$201 at March 31, 2014 and December 31, 2013, respectively, related to consolidated variable interest entities, generally not available to the Company)	5,778	6,019
Goodwill	6,601	6,595
Intangible assets (net of accumulated amortization of \$1,777 and \$1,703 at March 31, 2014 and December 31, 2013, respectively) (includes \$7 and \$8 at fair value at March 31, 2014 and December 31, 2013, respectively)	3,210	3,286
Other assets (\$24 and \$11 at March 31, 2014 and December 31, 2013, respectively, related to consolidated variable interest entities, generally not available to the Company)	9,548	10,133
Total assets	\$ 831,381	\$ 832,702
Liabilities		
Deposits (includes \$0 and \$185 at fair value at March 31, 2014 and December 31, 2013, respectively).	\$ 116,648	\$ 112,379
Commercial paper and other short-term borrowings (includes \$1,169 and \$1,347 at fair value at March 31, 2014 and December 31, 2013, respectively)	1,786	2,142
Trading liabilities, at fair value (\$46 and \$33 at March 31, 2014 and December 31, 2013, respectively, related to consolidated variable interest entities, generally non-recourse to the Company)	111,590	104,521
Obligation to return securities received as collateral, at fair value	27,565	24,568
Securities sold under agreements to repurchase (includes \$610 and \$561 at fair value at March 31, 2014 and December 31, 2013, respectively)	114,183	145,676
Securities loaned	32,370	32,799
	13,481	14,215

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Other secured financings (includes \$4,514 and \$5,206 at fair value at March 31, 2014 and December 31, 2013, respectively) (\$531 and \$543 at March 31, 2014 and December 31, 2013, respectively, related to consolidated variable interest entities, generally non-recourse to the Company)		
Customer and other payables	175,998	157,125
Other liabilities and accrued expenses (\$75 and \$76 at March 31, 2014 and December 31, 2013, respectively, related to consolidated variable interest entities, generally non-recourse to the Company)	14,118	16,672
Long-term borrowings (includes \$35,620 and \$35,637 at fair value at March 31, 2014 and December 31, 2013, respectively)	153,374	153,575
Total liabilities	761,113	763,672
Commitments and contingent liabilities (see Note 12)		
Equity		
Morgan Stanley shareholders' equity:		
Preferred stock (see Note 14)	3,220	3,220
Common stock, \$0.01 par value:		
Shares authorized: 3,500,000,000 at March 31, 2014 and December 31, 2013;		
Shares issued: 2,038,893,979 at March 31, 2014 and December 31, 2013;		
Shares outstanding: 1,971,686,139 at March 31, 2014 and 1,944,868,751 at December 31, 2013	20	20
Additional Paid-in capital	23,364	24,570
Retained earnings	43,522	42,172
Employee stock trusts	2,099	1,718
Accumulated other comprehensive loss	(968)	(1,093)
Common stock held in treasury, at cost, \$0.01 par value; 67,207,840 shares at March 31, 2014 and 94,025,228 shares at December 31, 2013	(2,087)	(2,968)
Common stock issued to employee stock trusts	(2,099)	(1,718)
Total Morgan Stanley shareholders' equity	67,071	65,921
Nonredeemable noncontrolling interests	3,197	3,109
Total equity	70,268	69,030
Total liabilities, redeemable noncontrolling interests and equity	\$ 831,381	\$ 832,702

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	
	2014	2013
	March 31,	
Revenues:		
Investment banking	\$ 1,308	\$ 1,224
Trading	2,962	2,694
Investments	359	338
Commissions and fees	1,216	1,167
Asset management, distribution and administration fees	2,549	2,346
Other	227	199
Total non-interest revenues	8,621	7,968
Interest income	1,343	1,388
Interest expense	1,035	1,206
Net interest	308	182
Net revenues	8,929	8,150
Non-interest expenses:		
Compensation and benefits	4,305	4,214
Occupancy and equipment	359	377
Brokerage, clearing and exchange fees	443	428
Information processing and communications	424	448
Marketing and business development	147	134
Professional services	452	440
Other	492	526
Total non-interest expenses	6,622	6,567
Income from continuing operations before income taxes	2,307	1,583
Provision for income taxes	762	333
Income from continuing operations	1,545	1,250
Discontinued operations:		
Income (loss) from discontinued operations before income taxes	44	(30)
Provision for (benefit from) income taxes	5	(11)
Income (loss) from discontinued operations	39	(19)
Net income	\$ 1,584	\$ 1,231
Net income applicable to redeemable noncontrolling interests		122
Net income applicable to nonredeemable noncontrolling interests	79	147
Net income applicable to Morgan Stanley	\$ 1,505	\$ 962
Preferred stock dividends	56	26

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Earnings applicable to Morgan Stanley common shareholders	\$	1,449		\$	936
Amounts applicable to Morgan Stanley:					
Income from continuing operations	\$	1,466		\$	981
Income (loss) from discontinued operations		39			(19)
Net income applicable to Morgan Stanley	\$	1,505		\$	962
Earnings per basic common share:					
Income from continuing operations	\$	0.73		\$	0.50
Income (loss) from discontinued operations		0.02			(0.01)
Earnings per basic common share	\$	0.75		\$	0.49
Earnings per diluted common share:					
Income from continuing operations	\$	0.72		\$	0.49
Income (loss) from discontinued operations		0.02			(0.01)
Earnings per diluted common share	\$	0.74		\$	0.48
Dividends declared per common share	\$	0.05		\$	0.05
Average common shares outstanding:					
Basic		1,924,270,160			1,901,204,729
Diluted		1,969,652,798			1,940,264,085

See Notes to Condensed Consolidated Financial Statements.

Table of Contents**MORGAN STANLEY****Condensed Consolidated Statements of Comprehensive Income****(dollars in millions)****(unaudited)**

	Three Months Ended March 31,	
	2014	2013
Net income	\$ 1,584	\$ 1,231
Other comprehensive income (loss), net of tax:		
Foreign currency translation adjustments(1)	\$ 66	\$ (245)
Amortization of cash flow hedges(2)	1	1
Change in net unrealized gains (losses) on securities available for sale(3)	74	(27)
Pension, postretirement and other related adjustments(4)	2	1
Total other comprehensive income (loss)	\$ 143	\$ (270)
Comprehensive income	\$ 1,727	\$ 961
Net income applicable to redeemable noncontrolling interests		122
Net income applicable to nonredeemable noncontrolling interests	79	147
Other comprehensive income (loss) applicable to nonredeemable noncontrolling interests	18	(92)
Comprehensive income applicable to Morgan Stanley	\$ 1,630	\$ 784

(1) Amounts are net of provision for (benefit from) income taxes of \$(56) million and \$165 million for the quarters ended March 31, 2014 and 2013, respectively.

(2) Amounts are net of provision for income taxes of \$1 million and \$1 million for the quarters ended March 31, 2014 and 2013, respectively.

(3) Amounts are net of provision for (benefit from) income taxes of \$51 million and \$(19) million for the quarters ended March 31, 2014 and 2013, respectively.

(4) Amounts are net of provision for income taxes of \$1 million and \$5 million for the quarters ended March 31, 2014 and 2013, 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,	
	2014	2013
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 1,584	\$ 1,231
Adjustments to reconcile net income to net cash provided by operating activities:		
Income on equity method investees	(38)	(64)
Compensation payable in common stock and options	311	265
Depreciation and amortization	326	360
Net (gain) loss on business dispositions	(66)	5
Net gain on sale of securities available for sale	(6)	(3)
Impairment charges	33	29
(Provision) release for credit losses on lending activities	10	(39)
Other non-cash adjustments to net income	(65)	(5)
Changes in assets and liabilities:		
Cash deposited with clearing organizations or segregated under federal and other regulations or requirements	(4,448)	(343)
Trading assets, net of Trading liabilities	31,336	13,284
Securities borrowed	(17,888)	(14,026)
Securities loaned	(429)	3,502
Customer and other receivables and other assets	(1,299)	2,730
Customer and other payables and other liabilities	16,904	6,976
Federal funds sold and securities purchased under agreements to resell	10,554	(6,003)
Securities sold under agreements to repurchase	(31,492)	(3,404)
Net cash provided by operating activities	5,327	4,495
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from (payments for):		
Premises, equipment and software	2	(263)
Business dispositions, net of cash disposed	135	481
Loans	(4,560)	(2,168)
Purchases of securities available for sale	(8,188)	(4,674)
Sales of securities available for sale	1,853	2,029
Maturities and redemptions of securities available for sale	981	1,351
Other investing activities	(41)	105
Net cash used for investing activities	(9,818)	(3,139)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net proceeds from (payments for):		
Commercial paper and other short-term borrowings	(356)	337
Noncontrolling interests	(9)	(8)
Other secured financings	(1,719)	501
Deposits	4,269	(2,643)
Proceeds from:		
Excess tax benefits associated with stock-based awards	84	12
Derivatives financing activities	150	279
Issuance of long-term borrowings	7,701	10,046
Payments for:		
Long-term borrowings	(8,786)	(12,018)
Derivatives financing activities		(243)

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Repurchases of common stock and employee tax withholdings	(672)	(306)
Cash dividends	(143)	(119)
Net cash provided by (used for) financing activities	519	(4,162)
Effect of exchange rate changes on cash and cash equivalents	59	(612)
Effect of cash and cash equivalents related to variable interest entities	(546)	(584)
Net decrease in cash and cash equivalents	(4,459)	(4,002)
Cash and cash equivalents, at beginning of period	59,883	46,904
 Cash and cash equivalents, at end of period	 \$ 55,424	 \$ 42,902
Cash and cash equivalents include:		
Cash and due from banks	\$ 13,785	\$ 17,773
Interest bearing deposits with banks	41,639	25,129
 Cash and cash equivalents, at end of period	 \$ 55,424	 \$ 42,902

SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION

Cash payments for interest were \$606 million and \$728 million for the quarters ended March 31, 2014 and 2013, respectively.

Cash payments for income taxes were \$128 million and \$139 million for the quarters ended March 31, 2014 and 2013, 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, 2014****(dollars in millions)****(unaudited)**

	Preferred Stock	Common Stock	Paid-in Capital	Retained Earnings	Employee Stock Trusts	Accumulated Other Comprehensive Income (Loss)	Common Stock Held in Treasury at Cost	Common Stock Issued to Employee Stock Trusts	Non- redeemable Non- controlling Interests	Total Equity
BALANCE AT DECEMBER 31, 2013	\$ 3,220	\$ 20	\$ 24,570	\$ 42,172	\$ 1,718	\$ (1,093)	\$ (2,968)	\$ (1,718)	\$ 3,109	\$ 69,030
Net income applicable to Morgan Stanley				1,505						1,505
Net income applicable to nonredeemable noncontrolling interests									79	79
Dividends				(155)						(155)
Shares issued under employee plans and related tax effects			(1,206)		381		1,553	(381)		347
Repurchases of common stock and employee tax withholdings							(672)			(672)
Net change in Accumulated other comprehensive income						125			18	143
Other net decreases									(9)	(9)
BALANCE AT MARCH 31, 2014	\$ 3,220	\$ 20	\$ 23,364	\$ 43,522	\$ 2,099	\$ (968)	\$ (2,087)	\$ (2,099)	\$ 3,197	\$ 70,268

See Notes to Condensed Consolidated Financial Statements.

Table of Contents**MORGAN STANLEY****Condensed Consolidated Statements of Changes in Total Equity (Continued)****Three Months Ended March 31, 2013****(dollars in millions)****(unaudited)**

	Preferred Stock	Common Stock	Paid-in Capital	Retained Earnings	Employee Stock Trusts	Accumulated Other Comprehensive Income (Loss)	Common Stock Held in Treasury at Cost	Common Stock Issued to Employee Stock Trusts	Non- Redeemable Non- controlling Interests	Total Equity
BALANCE AT DECEMBER 31, 2012	\$ 1,508	\$ 20	\$ 23,426	\$ 39,912	\$ 2,932	\$ (516)	\$ (2,241)	\$ (2,932)	\$ 3,319	\$ 65,428
Net income applicable to Morgan Stanley				962						962
Net income applicable to nonredeemable noncontrolling interests									147	147
Dividends				(124)						(124)
Shares issued under employee plans and related tax effects			235		(1,060)		6	1,060		241
Repurchases of common stock and employee tax withholdings							(306)			(306)
Net change in Accumulated other comprehensive income						(178)			(92)	(270)
Other net decreases									(6)	(6)
BALANCE AT MARCH 31, 2013	\$ 1,508	\$ 20	\$ 23,661	\$ 40,750	\$ 1,872	\$ (694)	\$ (2,541)	\$ (1,872)	\$ 3,368	\$ 66,072

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, Wealth Management and Investment 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 or the Company mean Morgan Stanley (the Parent) together with its consolidated subsidiaries.

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

Institutional Securities provides financial advisory and capital raising 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.

Wealth Management 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 engages in fixed income trading, which primarily facilitates clients trading or investments in such securities.

Investment 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.

Discontinued Operations. On March 27, 2014, the Company sold its Canadian terminal business (CanTerm) for approximately \$110 million, resulting in a gain of approximately \$45 million. Net revenues were \$49 million and \$5 million for the quarters ended March 31, 2014 and 2013, respectively. Net pre-tax income was \$45 million and \$0 million for the quarters ended March 31, 2014 and 2013, respectively. The results of CanTerm are reported as discontinued operations within the Institutional Securities business segment for all periods presented.

Remaining pre-tax loss amounts of \$(1) million and \$(30) million for the quarters ended March 31, 2014 and 2013, respectively, that are included in discontinued operations primarily related to the sale of Saxon and a principal investment.

Prior-period amounts have been recast for 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, allowance for credit losses 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. 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, 2013. The condensed consolidated financial statements reflect all adjustments of a normal

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

recurring nature 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 7). For 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 either Net income (loss) applicable to redeemable noncontrolling interests or Net income (loss) applicable to nonredeemable noncontrolling interests in the condensed consolidated statements of income. The portion of shareholders' equity of such subsidiaries that is redeemable would be presented as Redeemable noncontrolling interests outside of the equity section in the condensed consolidated statements of financial condition. The portion of shareholders' equity of such subsidiaries that is nonredeemable is presented as Nonredeemable noncontrolling interests, a component of total equity, in the condensed consolidated statements of financial condition.

For entities where (1) the total equity investment at risk is sufficient to enable the entity to finance its activities without additional subordinated financial 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, are 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 Investments revenues (see Note 4).

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 (MSSB LLC), Morgan Stanley & Co. International plc (MSIP), Morgan Stanley MUFG Securities Co., Ltd. (MSMS), Morgan Stanley Bank, N.A. (MSBNA) and Morgan Stanley Private Bank, National Association (MSPBNA).

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 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 in the Annual Report on Form 10-K for the year ended December 31, 2013.

During the quarter ended March 31, 2014, no updates were made to the Company's significant accounting policies.

Condensed Consolidated Statements of Cash Flows.

For purposes of the condensed consolidated statements of cash flows, cash and cash equivalents consist of Cash and due from banks and Interest bearing deposits with banks, which are highly liquid investments with original maturities of three months or less, held for investment purposes, and readily convertible to known amounts of cash.

The Company had no significant non-cash activities in the quarters ended March 31, 2014 and March 31, 2013.

Accounting Developments.

Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation Is Fixed at the Reporting Date. In February 2013, the Financial Accounting Standards Board (the FASB) issued an accounting update that requires an entity to measure obligations resulting from joint and several liability arrangements for which the total amount of the obligation is fixed at the reporting date, as the sum of the amount the reporting entity agreed to pay and any additional amount the reporting entity expects to pay on behalf of its co-obligors. This update also requires additional disclosures about those obligations. This guidance became effective for the Company retrospectively beginning on January 1, 2014. The adoption of this accounting guidance did not have a material impact on the Company's condensed consolidated financial statements.

Parent's Accounting for the Cumulative Translation Adjustment upon Derecognition of Certain Subsidiaries or Groups of Assets within a Foreign Entity or of an Investment in a Foreign Entity. In March 2013, the FASB issued an accounting update requiring the parent entity to release any related cumulative translation adjustment into net income when the parent ceases to have a controlling financial interest in a subsidiary that is a foreign entity. When the parent ceases to have a controlling financial interest in a subsidiary or group of assets that is a business within a foreign entity, the related cumulative translation adjustment would be released into net income only if the sale or transfer results in the complete or substantially complete liquidation of the foreign entity in which the subsidiary or group of assets had resided. This guidance became effective for the Company prospectively beginning on January 1, 2014. The adoption of this accounting guidance did not have a material impact on the Company's condensed consolidated financial statements.

Amendments to the Scope, Measurement, and Disclosure Requirements of an Investment Company. In June 2013, the FASB issued an accounting update that modifies the criteria used in defining an investment company under generally accepted accounting principles in the U.S. (U.S. GAAP) and sets forth certain measurement and disclosure requirements. This update requires an investment company to measure noncontrolling interests in another investment company at fair value and requires an entity to disclose the fact that it is an investment company, and provide information about changes, if any, in its status as an investment company. An entity will also need to include disclosures around financial support that has been provided or is contractually required to be provided to any of its investees. This guidance became effective for the Company prospectively beginning January 1, 2014. The adoption of this accounting guidance did not have a material impact on the Company's condensed consolidated financial statements.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists. In July 2013, the FASB issued an accounting update providing guidance on the financial statement presentation of an unrecognized tax benefit when a deferred tax asset from a net operating loss carryforward, similar tax loss, or tax credit carryforward exists. This guidance requires an unrecognized tax benefit, or a portion of an unrecognized tax benefit, to be presented in the financial statements as a reduction to such deferred tax asset if a settlement in such manner is expected in the event the uncertain tax position is disallowed. This guidance became effective for the Company beginning January 1, 2014. This guidance was applied prospectively to unrecognized tax benefits that existed at the effective date. The adoption of this accounting guidance did not have a material impact on the Company's condensed consolidated financial statements.

3. Wealth Management JV.

In 2009, the Company and Citigroup Inc. (Citi) consummated the combination of each institution's respective wealth management business. The combined businesses operated as the Wealth Management JV. Prior to September 2012, the Company owned 51% and Citi owned 49% of the Wealth Management JV. In September 2012, the Company purchased an additional 14% stake in the Wealth Management JV from Citi for \$1.89 billion, increasing the Company's interest from 51% to 65%. In June 2013, the Company purchased the remaining 35% stake in the Wealth Management JV for \$4.725 billion, increasing the Company's interest from 65% to 100%.

For the first quarter of 2014, no results were attributed to Citi since the Company owned 100% of the Wealth Management JV. For the first quarter of 2013, Citi's 35% interest was reported on the balance sheet as redeemable noncontrolling interest and the results related to its 35% interest were reported in net income (loss) applicable to redeemable noncontrolling interests in the condensed consolidated statement of income.

Concurrent with the acquisition of the remaining 35% stake in the Wealth Management JV, the deposit sweep agreement between Citi and the Company was terminated. During the quarter ended March 31, 2014, \$5 billion of deposits held by Citi relating to customer accounts were transferred to the Company's depository institutions. At March 31, 2014, approximately \$24 billion of additional deposits are scheduled to be transferred to the Company's depository institutions on an agreed-upon basis through June 2015.

4. 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.

Trading Assets and Trading Liabilities.

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

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market prices and trade data for identical or comparable securities. The fair value of agency mortgage

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pass-through pool securities is model-driven based on spreads of the comparable To-be-announced 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. These bonds are generally categorized in Level 1 of the fair value hierarchy. If the market is less active or prices are dispersed, these bonds are categorized in Level 2 of the fair value hierarchy. In instances where the inputs are unobservable, these bonds are categorized in Level 3 of the fair value hierarchy.

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, and/or applying discounted cash flow techniques. 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, and 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, credit default swap spreads, at the money volatility and/or volatility skew 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,

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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 and Loan Obligations. The Company holds cash collateralized debt obligations (CDOs)/collateralized loan obligations (CLOs) 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/loans (asset-backed CDOs/CLOs). 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/CLOs 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/CLO position is evaluated independently taking into consideration available comparable market levels, underlying collateral performance and pricing, and deal structures, as well as liquidity. Cash CDOs/CLOs 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/CLOs are categorized in Level 3 of the fair value hierarchy.

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.

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), which are floating rate instruments for which the rates reset through periodic auctions. SLARS are ABS backed by pools of

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student loans. MARS are municipal bonds often wrapped by municipal bond insurance. The fair value of ARS is primarily determined using recently executed transactions and market price quotations, obtained from independent external parties such as vendors and brokers, where available. The Company uses an internally developed methodology to discount for the lack of liquidity and non-performance risk where independent external market data are not available.

Inputs that impact the valuation of SLARS are independent external market data, recently executed transactions of comparable ARS, 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 recently executed transactions, the maximum rate, quality of underlying issuers/insurers and evidence of issuer calls/prepayment. 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.

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 that 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

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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 and basket credit default swaps, 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 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, 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 11.

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

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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.

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), CMBS, Federal Family Education Loan Program (FFELP) student loan asset-backed securities, auto loan asset-backed securities, corporate bonds, collateralized loan obligations, 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, CMBS, FFELP student loan asset-backed securities, auto loan asset-backed securities, corporate bonds and collateralized loan obligations are generally categorized in Level 2 of the fair value hierarchy. For further information on securities available for sale, see Note 5.

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 debt 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 to which the notes are linked, interest rate yield curves, option volatility and currency, and commodity or equity prices. Independent, external and traded prices for the notes are considered as well. 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.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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, 2014 and December 31, 2013.

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, 2014.**

	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, 2014
Assets at Fair Value					
Trading assets:					
U.S. government and agency securities:					
U.S. Treasury securities	\$ 25,473	\$ 3	\$	\$	\$ 25,476
U.S. agency securities	1,549	14,690			16,239
Total U.S. government and agency securities	27,022	14,693			41,715
Other sovereign government obligations	32,487	6,887	8		39,382
Corporate and other debt:					
State and municipal securities		1,591			1,591
Residential mortgage-backed securities		1,703	51		1,754
Commercial mortgage-backed securities		1,772	80		1,852
Asset-backed securities		853	146		999
Corporate bonds		16,083	538		16,621
Collateralized debt and loan obligations		473	1,293		1,766
Loans and lending commitments		8,411	4,988		13,399
Other debt		2,743	31		2,774
Total corporate and other debt		33,629	7,127		40,756
Corporate equities(1)	95,834	189	263		96,286
Derivative and other contracts:					
Interest rate contracts	590	433,871	2,533		436,994
Credit contracts		37,479	2,304		39,783
Foreign exchange contracts	27	49,712	162		49,901
Equity contracts	1,139	48,504	1,543		51,186
Commodity contracts	2,387	12,242	2,018		16,647
Other		114			114
Netting(2)	(3,815)	(499,521)	(4,627)	(56,075)	(564,038)
Total derivative and other contracts	328	82,401	3,933	(56,075)	30,587
Investments:					
Private equity funds			2,576		2,576
Real estate funds		6	1,643		1,649
Hedge funds		386	394		780
Principal investments	87	49	2,193		2,329
Other	181	57	521		759
Total investments	268	498	7,327		8,093
Physical commodities		2,726			2,726
Total trading assets	155,939	141,023	18,658	(56,075)	259,545

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Securities available for sale	29,264	29,622		58,886
Securities received as collateral	21,594	16	3	21,613
Federal funds sold and securities purchased under agreements to resell		866		866
Intangible assets(3)			7	7
Total assets measured at fair value	\$ 206,797	\$ 171,527	\$ 18,668	\$ (56,075) \$ 340,917

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)	Counterparty and Cash Collateral Netting	Balance at March 31, 2014
	(dollars in millions)				
Liabilities at Fair Value					
Commercial paper and other short-term borrowings	\$	\$ 1,169	\$	\$	\$ 1,169
Trading liabilities:					
U.S. government and agency securities:					
U.S. Treasury securities	14,509				14,509
U.S. agency securities	2,079	134			2,213
Total U.S. government and agency securities	16,588	134			16,722
Other sovereign government obligations	17,986	2,457			20,443
Corporate and other debt:					
State and municipal securities		2			2
Asset-backed securities		1			1
Corporate bonds		6,354	3		6,357
Collateralized debt and loan obligations		5			5
Unfunded lending commitments		39	6		45
Other debt		385	68		453
Total corporate and other debt		6,786	77		6,863
Corporate equities(1)	34,548	136	10		34,694
Derivative and other contracts:					
Interest rate contracts	556	411,966	2,654		415,176
Credit contracts		35,784	2,535		38,319
Foreign exchange contracts	5	50,088	110		50,203
Equity contracts	1,212	52,975	2,642		56,829
Commodity contracts	2,748	13,371	944		17,063
Other		46	1		47
Netting(2)	(3,815)	(499,521)	(4,627)	(36,806)	(544,769)
Total derivative and other contracts	706	64,709	4,259	(36,806)	32,868
Total trading liabilities	69,828	74,222	4,346	(36,806)	111,590
Obligation to return securities received as collateral	27,531	31	3		27,565
Securities sold under agreements to repurchase		456	154		610
Other secured financings		4,239	275		4,514
Long-term borrowings		33,742	1,878		35,620
Total liabilities measured at fair value	\$ 97,359	\$ 113,859	\$ 6,656	\$ (36,806)	\$ 181,068

(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 11.

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(3) Amount represents mortgage servicing rights (MSR) accounted for at fair value. See Note 7 for further information on MSRs.

Transfers Between Level 1 and Level 2 During the Quarter Ended March 31, 2014.

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.

In the quarter ended March 31, 2014, there were no material transfers between Level 1 and Level 2.

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, 2013.**

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Counterparty and Cash Collateral Netting	Balance at December 31, 2013
	(dollars in millions)				
Assets at Fair Value					
Trading assets:					
U.S. government and agency securities:					
U.S. Treasury securities	\$ 32,083	\$	\$	\$	\$ 32,083
U.S. agency securities	1,216	17,720			18,936
Total U.S. government and agency securities	33,299	17,720			51,019
Other sovereign government obligations	25,363	6,610	27		32,000
Corporate and other debt:					
State and municipal securities		1,615			1,615
Residential mortgage-backed securities		2,029	47		2,076
Commercial mortgage-backed securities		1,534	108		1,642
Asset-backed securities		878	103		981
Corporate bonds		16,592	522		17,114
Collateralized debt and loan obligations		802	1,468		2,270
Loans and lending commitments		7,483	5,129		12,612
Other debt		6,365	27		6,392
Total corporate and other debt		37,298	7,404		44,702
Corporate equities(1)	107,818	1,206	190		109,214
Derivative and other contracts:					
Interest rate contracts	750	526,127	2,475		529,352
Credit contracts		42,258	2,088		44,346
Foreign exchange contracts	52	61,570	179		61,801
Equity contracts	1,215	51,656	1,234		54,105
Commodity contracts	2,396	8,595	2,380		13,371
Other		43			43
Netting(2)	(3,836)	(606,878)	(4,931)	(54,906)	(670,551)
Total derivative and other contracts	577	83,371	3,425	(54,906)	32,467
Investments:					
Private equity funds			2,531		2,531
Real estate funds		6	1,637		1,643
Hedge funds		377	432		809
Principal investments	43	42	2,160		2,245
Other	202	45	538		785
Total investments	245	470	7,298		8,013
Physical commodities		3,329			3,329
Total trading assets	167,302	150,004	18,344	(54,906)	280,744
Securities available for sale	24,412	29,018			53,430

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Securities received as collateral	20,497	11			20,508
Federal funds sold and securities purchased under agreements to resell		866			866
Intangible assets(3)			8		8
Total assets measured at fair value	\$ 212,211	\$ 179,899	\$ 18,352	\$ (54,906)	\$ 355,556

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)	Counterparty and Cash Collateral Netting	Balance at December 31, 2013
(dollars in millions)					
Liabilities at Fair Value					
Deposits	\$	\$ 185	\$	\$	\$ 185
Commercial paper and other short-term borrowings		1,346	1		1,347
Trading liabilities:					
U.S. government and agency securities:					
U.S. Treasury securities	15,963				15,963
U.S. agency securities	2,593	116			2,709
Total U.S. government and agency securities	18,556	116			18,672
Other sovereign government obligations	14,717	2,473			17,190
Corporate and other debt:					
State and municipal securities		15			15
Corporate bonds		5,033	22		5,055
Collateralized debt and loan obligations		3			3
Unfunded lending commitments		127	2		129
Other debt		1,144	48		1,192
Total corporate and other debt		6,322	72		6,394
Corporate equities(1)	27,983	513	8		28,504
Derivative and other contracts:					
Interest rate contracts	675	504,292	2,362		507,329
Credit contracts		40,391	2,235		42,626
Foreign exchange contracts	23	61,925	111		62,059
Equity contracts	1,033	57,797	2,065		60,895
Commodity contracts	2,637	8,749	1,500		12,886
Other		72	4		76
Netting(2)	(3,836)	(606,878)	(4,931)	(36,465)	(652,110)
Total derivative and other contracts	532	66,348	3,346	(36,465)	33,761
Total trading liabilities	61,788	75,772	3,426	(36,465)	104,521
Obligation to return securities received as collateral	24,549	19			24,568
Securities sold under agreements to repurchase		407	154		561
Other secured financings		4,928	278		5,206
Long-term borrowings		33,750	1,887		35,637
Total liabilities measured at fair value	\$ 86,337	\$ 116,407	\$ 5,746	\$ (36,465)	\$ 172,025

(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 11.

(3) Amount represents MSRs accounted for at fair value. See Note 7 for further information on MSRs.

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Transfers Between Level 1 and Level 2 During the Quarter Ended March 31, 2013.

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.

In the quarter ended March 31, 2013, there were no material transfers between Level 1 and Level 2.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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, 2014 and 2013, 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.

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 Quarter Ended March 31, 2014.**

	Beginning Balance at December 31, 2013	Total Realized and Unrealized Gains (Losses)(1)	Purchases	Sales	Issuances	Settlements	Net Transfers	Ending Balance at March 31, 2014	Unrealized Gains (Losses) for Level 3 Assets/ Liabilities Outstanding at March 31, 2014(2)
	(dollars in millions)								
Assets at Fair Value									
Trading assets:									
Other sovereign government obligations	\$ 27	\$ 2	\$	\$ (20)	\$	\$	\$ (1)	\$ 8	\$ 1
Corporate and other debt:									
Residential mortgage-backed securities	47	5	2	(8)			5	51	4
Commercial mortgage-backed securities	108	8	45	(81)				80	
Asset-backed securities	103	17	7	(3)			22	146	17
Corporate bonds	522	20	183	(188)		(8)	9	538	21
Collateralized debt and loan obligations	1,468	52	283	(494)		(51)	35	1,293	12
Loans and lending commitments	5,129	(289)	670	(122)		(383)	(17)	4,988	(292)
Other debt	27	1	2	(3)			4	31	
Total corporate and other debt	7,404	(186)	1,192	(899)		(442)	58	7,127	(238)
Corporate equities	190	(1)	90	(21)			5	263	(3)
Net derivative and other contracts(3):									
Interest rate contracts	113	(133)	9		(7)	(51)	(52)	(121)	(150)
Credit contracts	(147)	(77)	39		(70)	36	(12)	(231)	67
Foreign exchange contracts	68	(7)				8	(17)	52	(6)
Equity contracts	(831)	49	144	(1)	(277)	(106)	(77)	(1,099)	10
Commodity contracts	880	163	56			(25)		1,074	152
Other	(4)	(1)				4		(1)	(1)
Total net derivative and other contracts	79	(6)	248	(1)	(354)	(134)	(158)	(326)	72
Investments:									
Private equity funds	2,531	171	75	(201)				2,576	90
Real estate funds	1,637	52	15	(61)				1,643	46
Hedge funds	432	13	18	(12)			(57)	394	13
Principal investments	2,160	61		(12)			(16)	2,193	47
Other	538	(14)	10	(11)			(2)	521	(14)
Total investments	7,298	283	118	(297)			(75)	7,327	182
Securities received as collateral							3	3	
Intangible assets	8					(1)		7	

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Liabilities at Fair Value																		
Commercial paper and other short-term borrowings	\$	1	\$		\$		\$	(1)	\$		\$							
Trading liabilities:																		
Corporate and other debt:																		
Corporate bonds		22		4		(46)		40				(9)		3		3		
Unfunded lending commitments		2		(4)										6		(4)		
Other debt		48				(5)							25		68			
Total corporate and other debt		72				(51)		40					16		77		(1)	
Corporate equities		8		1		(3)		2					4		10			
Obligation to return securities received as collateral													3		3			
Securities sold under agreements to repurchase		154													154			
Other secured financings		278		(4)				1				(8)		275		(4)		
Long-term borrowings		1,887		(25)				185				(176)		(43)		1,878		(27)

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

- (1) Total realized and unrealized gains (losses) are primarily included in Trading revenues in the condensed consolidated statements of income except for \$283 million related to Trading assets Investments, which is included in Investments revenues.
- (2) Amounts represent unrealized gains (losses) for the quarter ended March 31, 2014 related to assets and liabilities still outstanding at March 31, 2014.
- (3) Net derivative and other contracts represent Trading assets Derivative and other contracts net of Trading liabilities Derivative and other contracts. For further information on derivative instruments and hedging activities, see Note 11.
- In the quarter ended March 31, 2014, there were no material transfers from Level 2 to Level 3.

Changes in Level 3 Assets and Liabilities Measured at Fair Value on a Recurring Basis for the Quarter Ended March 31, 2013.

	Total Realized Beginning and Balance at December 31, 2012		Unrealized Gains (Losses) ⁽¹⁾		Purchases	Sales	Issuances	Settlements	Net Transfers	Ending Balance at March 31, 2013	Unrealized Gains (Losses) for Level 3 Assets/ Liabilities Outstanding at March 31, 2013 ⁽²⁾							
	(dollars in millions)																	
Assets at Fair Value																		
Trading assets:																		
Other sovereign government obligations	\$	6	\$		\$	1	\$	(3)	\$		\$	(1)	\$	3	\$			
Corporate and other debt:																		
Residential mortgage-backed securities		45		26		15		(42)				(25)		19		9		
Commercial mortgage-backed securities		232		15		6		(80)				1		174		7		
Asset-backed securities		109				1		(99)						11				
Corporate bonds		660		62		437		(247)				(12)		888		5		
Collateralized debt and loan obligations		1,951		191		314		(695)				(95)		1,666		63		
Loans and lending commitments		4,694		20		944		(149)				(738)		5,284		1		
Other debt		45		(8)		14		(49)				(1)		1		(1)		
Total corporate and other debt		7,736		306		1,731		(1,361)				(845)		476		84		
Corporate equities		288		(22)		85		(61)				(20)		270		5		
Net derivative and other contracts ⁽³⁾ :																		
Interest rate contracts		(82)		(106)		1		(1)				192		(26)		(22)	18	
Credit contracts		1,822		(452)		42		(15)				(4)		10		1,403	(418)	
Foreign exchange contracts		(359)		8								109		7		(235)	(2)	
Equity contracts		(1,144)		(140)		85		(1)				(93)		(76)		29	(1,340)	(125)
Commodity contracts		709		(10)		9		(4)				(8)		7		703	(30)	
Other		(7)		(2)								6				(3)	(2)	
Total net derivatives and other contracts		939		(702)		137		(1)				(113)		219		27	506	(559)
Investments:																		
Private equity funds		2,179		114		70		(72)								2,291	104	
Real estate funds		1,370		80		3		(83)								1,370	90	
Hedge funds		552		2		31		(34)						(6)		545	(3)	
Principal investments		2,833		63		35		(85)						9		2,855	78	