

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 June 30, 2013*

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934

Commission File Number 1-11758

# Morgan Stanley

(Exact Name of Registrant as specified in its charter)

**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**1585 Broadway**  
**New York, NY 10036**  
(Address of principal executive  
offices, including zip code)

**36-3145972**  
(I.R.S. Employer Identification No.)

**(212) 761-4000**  
(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

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 July 31, 2013, there were 1,958,539,144 shares of the Registrant's Common Stock, par value \$0.01 per share, outstanding.



Morgan Stanley

QUARTERLY REPORT ON FORM 10-Q

For the quarter ended June 30, 2013

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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](http://www.sec.gov).

Morgan Stanley’s internet site is [www.morganstanley.com](http://www.morganstanley.com). You can access Morgan Stanley’s Investor Relations webpage at [www.morganstanley.com/about/ir](http://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](http://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 Contributions;
- Policy Regarding Shareholder Rights Plan;
- Code of Ethics and Business Conduct;
- Code of Conduct; and
- 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.

**Part I—Financial Information.**

**Item 1. Financial Statements.**

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

	<b>June 30, 2013</b>	<b>December 31, 2012</b>
<b>Assets</b>		
Cash and due from banks (\$380 and \$526 at June 30, 2013 and December 31, 2012, respectively, related to consolidated variable interest entities generally not available to the Company) . . . . .	\$ 16,295	\$ 20,878
Interest bearing deposits with banks . . . . .	30,904	26,026
Cash deposited with clearing organizations or segregated under federal and other regulations or requirements . . . . .	35,363	30,970
Trading assets, at fair value (approximately \$145,191 and \$147,348 were pledged to various parties at June 30, 2013 and December 31, 2012, respectively; \$3,128 and \$3,505 related to consolidated variable interest entities, generally not available to the Company at June 30, 2013 and December 31, 2012, respectively) . . . . .	260,038	267,603
Securities available for sale, at fair value . . . . .	42,858	39,869
Securities received as collateral, at fair value . . . . .	14,749	14,278
Federal funds sold and securities purchased under agreements to resell (includes \$869 and \$621 at fair value at June 30, 2013 and December 31, 2012, respectively) . . . . .	142,494	134,412
Securities borrowed . . . . .	129,114	121,701
Customer and other receivables . . . . .	64,473	64,288
Loans (net of allowances of \$125 and \$106 at June 30, 2013 and December 31, 2012, respectively) . . . . .	34,571	29,046
Other investments . . . . .	4,869	4,999
Premises, equipment and software costs (net of accumulated depreciation of \$5,987 and \$5,525 at June 30, 2013 and December 31, 2012, respectively) (\$215 and \$224 at June 30, 2013 and December 31, 2012, respectively, related to consolidated variable interest entities, generally not available to the Company) . . . . .	5,966	5,946
Goodwill . . . . .	6,600	6,650
Intangible assets (net of accumulated amortization of \$1,420 and \$1,250 at June 30, 2013 and December 31, 2012, respectively) (includes \$9 and \$7 at fair value at June 30, 2013 and December 31, 2012, respectively) . . . . .	3,602	3,783
Other assets (\$547 and \$593 at June 30, 2013 and December 31, 2012, respectively, related to consolidated variable interest entities, generally not available to the Company) . . . . .	10,795	10,511
<b>Total assets</b> . . . . .	<b>\$802,691</b>	<b>\$780,960</b>
<b>Liabilities</b>		
Deposits (includes \$1,425 and \$1,485 at fair value at June 30, 2013 and December 31, 2012, respectively) . . . . .	\$ 81,514	\$ 83,266
Commercial paper and other short-term borrowings (includes \$1,590 and \$725 at fair value at June 30, 2013 and December 31, 2012, respectively) . . . . .	2,366	2,138
Trading liabilities, at fair value . . . . .	128,085	120,122
Obligation to return securities received as collateral, at fair value . . . . .	19,154	18,226
Securities sold under agreements to repurchase (includes \$552 and \$363 at fair value at June 30, 2013 and December 31, 2012, respectively) . . . . .	133,582	122,674
Securities loaned . . . . .	36,135	36,849
Other secured financings (includes \$6,452 and \$9,466 at fair value at June 30, 2013 and December 31, 2012, respectively) (\$610 and \$976 at June 30, 2013 and December 31, 2012, respectively, related to consolidated variable entities and are non-recourse to the Company) . . . . .	13,671	15,727
Customer and other payables . . . . .	145,555	127,722
Other liabilities and accrued expenses (\$117 at both June 30, 2013 and December 31, 2012, related to consolidated variable interest entities and are non-recourse to the Company) . . . . .	15,417	14,928
Long-term borrowings (includes \$40,819 and \$44,044 at fair value at June 30, 2013 and December 31, 2012, respectively) . . . . .	161,098	169,571
	736,577	711,223
Commitments and contingent liabilities (see Note 12)		
<b>Redeemable noncontrolling interests (see Notes 3 and 14)</b> . . . . .	—	4,309
<b>Equity</b>		
Morgan Stanley shareholders' equity:		
Preferred stock . . . . .	1,508	1,508
Common stock, \$0.01 par value:		
Shares authorized: 3,500,000,000 at June 30, 2013 and December 31, 2012;		
Shares issued: 2,038,893,979 at June 30, 2013 and 2,038,893,979 at December 31, 2012;		
Shares outstanding: 1,959,326,270 at June 30, 2013 and 1,974,042,123 at December 31, 2012 . . . . .	20	20
Additional Paid-in capital . . . . .	23,933	23,426
Retained earnings . . . . .	41,455	39,912
Employee stock trust . . . . .	1,821	2,932
Accumulated other comprehensive loss . . . . .	(1,169)	(516)
Common stock held in treasury, at cost, \$0.01 par value; 79,567,709 shares at June 30, 2013 and 64,851,856 shares at December 31, 2012 . . . . .	(2,566)	(2,241)
Common stock issued to employee trust . . . . .	(1,821)	(2,932)
Total Morgan Stanley shareholders' equity . . . . .	63,181	62,109
Nonredeemable noncontrolling interests . . . . .	2,933	3,319
Total equity . . . . .	66,114	65,428
<b>Total liabilities, redeemable noncontrolling interests and equity</b> . . . . .	<b>\$802,691</b>	<b>\$780,960</b>

See Notes to Condensed Consolidated Financial Statements.

**MORGAN STANLEY**

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
<b>Revenues:</b>				
Investment banking .....	\$ 1,303	\$ 1,104	\$ 2,527	\$ 2,167
Trading .....	2,894	2,469	5,588	4,871
Investments .....	188	63	526	148
Commissions and fees .....	1,217	1,040	2,385	2,217
Asset management, distribution and administration fees .....	2,404	2,268	4,750	4,420
Other .....	293	158	496	262
Total non-interest revenues .....	<u>8,299</u>	<u>7,102</u>	<u>16,272</u>	<u>14,085</u>
Interest income .....	1,422	1,323	2,820	2,865
Interest expense .....	1,218	1,483	2,431	3,084
Net interest .....	<u>204</u>	<u>(160)</u>	<u>389</u>	<u>(219)</u>
Net revenues .....	<u>8,503</u>	<u>6,942</u>	<u>16,661</u>	<u>13,866</u>
<b>Non-interest expenses:</b>				
Compensation and benefits .....	4,105	3,631	8,321	8,061
Occupancy and equipment .....	377	378	756	766
Brokerage, clearing and exchange fees .....	456	405	884	808
Information processing and communications .....	470	487	918	946
Marketing and business development .....	163	155	297	301
Professional services .....	458	477	898	889
Other .....	699	472	1,230	956
Total non-interest expenses .....	<u>6,728</u>	<u>6,005</u>	<u>13,304</u>	<u>12,727</u>
Income from continuing operations before income taxes .....	1,775	937	3,357	1,139
Provision for income taxes .....	555	224	887	278
Income from continuing operations .....	<u>1,220</u>	<u>713</u>	<u>2,470</u>	<u>861</u>
<b>Discontinued operations:</b>				
Gain (loss) from discontinued operations .....	(42)	52	(71)	80
Provision for (benefit from) income taxes .....	(13)	15	(23)	57
Net gain (loss) from discontinued operations .....	<u>(29)</u>	<u>37</u>	<u>(48)</u>	<u>23</u>
Net income .....	\$ 1,191	\$ 750	\$ 2,422	\$ 884
Net income applicable to redeemable noncontrolling interests ..	100	—	222	—
Net income applicable to non redeemable noncontrolling interests .....	111	159	258	387
Net income applicable to Morgan Stanley .....	<u>\$ 980</u>	<u>\$ 591</u>	<u>\$ 1,942</u>	<u>\$ 497</u>
Earnings applicable to Morgan Stanley common shareholders .....	<u>\$ 803</u>	<u>\$ 564</u>	<u>\$ 1,739</u>	<u>\$ 446</u>
<b>Amounts applicable to Morgan Stanley:</b>				
Income from continuing operations .....	\$ 1,009	\$ 562	\$ 1,990	\$ 483
Net gain (loss) from discontinued operations .....	(29)	29	(48)	14
Net income applicable to Morgan Stanley .....	<u>\$ 980</u>	<u>\$ 591</u>	<u>\$ 1,942</u>	<u>\$ 497</u>
<b>Earnings per basic common share:</b>				
Income from continuing operations .....	\$ 0.44	\$ 0.28	\$ 0.94	\$ 0.23
Net gain (loss) from discontinued operations .....	(0.02)	0.02	(0.03)	0.01
Earnings per basic common share .....	<u>\$ 0.42</u>	<u>\$ 0.30</u>	<u>\$ 0.91</u>	<u>\$ 0.24</u>
<b>Earnings per diluted common share:</b>				
Income from continuing operations .....	\$ 0.43	\$ 0.28	\$ 0.92	\$ 0.23
Net gain (loss) from discontinued operations .....	(0.02)	0.01	(0.03)	—
Earnings per diluted common share .....	<u>\$ 0.41</u>	<u>\$ 0.29</u>	<u>\$ 0.89</u>	<u>\$ 0.23</u>
Dividends declared per common share .....	\$ 0.05	\$ 0.05	\$ 0.10	\$ 0.10
<b>Average common shares outstanding:</b>				
Basic .....	<u>1,907,737,175</u>	<u>1,885,179,182</u>	<u>1,904,470,952</u>	<u>1,881,070,509</u>
Diluted .....	<u>1,951,362,736</u>	<u>1,911,709,377</u>	<u>1,945,813,411</u>	<u>1,907,107,639</u>

See Notes to Condensed Consolidated Financial Statements.

**MORGAN STANLEY**

**Condensed Consolidated Statements of Comprehensive Income**  
**(dollars in millions)**  
**(unaudited)**

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Net income .....	\$1,191	\$ 750	\$2,422	\$ 884
Other comprehensive income (loss), net of tax:				
Foreign currency translation adjustments(1) .....	\$ (201)	\$(151)	\$ (446)	\$(131)
Amortization of cash flow hedges(2) .....	1	1	2	3
Change in net unrealized losses on securities available for sale(3) .....	(342)	41	(369)	22
Pension, postretirement and other related adjustments(4) .....	10	17	11	19
Total other comprehensive loss .....	<u>\$ (532)</u>	<u>\$ (92)</u>	<u>\$ (802)</u>	<u>\$ (87)</u>
Comprehensive income .....	\$ 659	\$ 658	\$1,620	\$ 797
Net income applicable to redeemable noncontrolling interests . . . .	100	—	222	—
Net income applicable to non redeemable noncontrolling interests .....	111	159	258	387
Other comprehensive income applicable to redeemable noncontrolling interests .....	—	—	—	—
Other comprehensive income (loss) applicable to nonredeemable noncontrolling interests .....	<u>(57)</u>	<u>68</u>	<u>(149)</u>	<u>(24)</u>
Comprehensive income applicable to Morgan Stanley .....	<u>\$ 505</u>	<u>\$ 431</u>	<u>\$1,289</u>	<u>\$ 434</u>

- (1) Amounts are net of provision for income taxes of \$135 million and \$172 million for the quarters ended June 30, 2013 and 2012, respectively, and \$300 million and \$176 million for the six months ended June 30, 2013 and 2012, respectively.
- (2) Amounts are net of provision for income taxes of \$1 million and \$1 million for the quarters ended June 30, 2013 and 2012, respectively, and \$2 million and \$2 million for the six months ended June 30, 2013 and 2012, respectively.
- (3) Amounts are net of provision for (benefit from) income taxes of \$(234) million and \$30 million for the quarters ended June 30, 2013 and 2012, respectively, and \$(253) million and \$17 million for the six months ended June 30, 2013 and 2012, respectively.
- (4) Amounts are net of provision for income taxes of \$6 million and \$8 million for the quarters ended June 30, 2013 and 2012, respectively, and \$11 million and \$10 million for the six months ended June 30, 2013 and 2012, respectively.

See Notes to Condensed Consolidated Financial Statements.

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

	<b>Six Months Ended June 30,</b>	
	<b>2013</b>	<b>2012</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income	\$ 2,422	\$ 884
Adjustments to reconcile net income to net cash provided by operating activities:		
(Income) loss on equity method investees	(191)	20
Compensation payable in common stock and options	559	618
Depreciation and amortization	716	793
Gain on business dispositions	(30)	(108)
Gain on sale of securities available for sale	(38)	(23)
Impairment charges	112	33
Provision for credit losses on lending activities	63	62
Other non-cash adjustments to net income	13	(6)
Changes in assets and liabilities:		
Cash deposited with clearing organizations or segregated under federal and other regulations or requirements	(4,393)	36
Trading assets, net of Trading liabilities	12,075	38,656
Securities borrowed	(7,413)	(7,189)
Securities loaned	(714)	300
Customer and other receivables and other assets	(883)	(10,972)
Customer and other payables and other liabilities	13,278	5,310
Federal funds sold and securities purchased under agreements to resell	(8,082)	(17,833)
Securities sold under agreements to repurchase	10,908	6,885
Net cash provided by operating activities	18,402	17,466
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Proceeds from (payments for):		
Premises, equipment and software costs	(583)	(436)
Business dispositions, net of cash disposed	530	1,536
Loans, net	(3,441)	(1,670)
Purchases of securities available for sale	(14,335)	(6,418)
Sales, maturities and redemptions of securities available for sale	11,040	5,439
Other investing activities	186	70
Net cash used for investing activities	(6,603)	(1,479)
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Net proceeds from (payments for):		
Commercial paper and other short-term borrowings	228	(855)
Noncontrolling interests	(540)	(178)
Other secured financings	(1,761)	(4,822)
Deposits	(1,752)	2,590
Proceeds from:		
Excess tax benefits associated with stock-based awards	13	42
Derivatives financing activities	459	241
Issuance of long-term borrowings	21,698	9,422
Payments for:		
Long-term borrowings	(22,958)	(26,445)
Derivatives financing activities	(498)	(113)
Repurchases of common stock for employee tax withholding	(314)	(191)
Purchase of additional stake in Morgan Stanley Smith Barney Holdings LLC	(4,725)	—
Cash dividends	(239)	(230)
Net cash used for financing activities	(10,389)	(20,539)
Effect of exchange rate changes on cash and cash equivalents	(735)	(307)
Effect of cash and cash equivalents related to variable interest entities	(380)	(447)
Net increase (decrease) in cash and cash equivalents	295	(5,306)
Cash and cash equivalents, at beginning of period	46,904	47,312
Cash and cash equivalents, at end of period	\$ 47,199	\$ 42,006
Cash and cash equivalents include:		
Cash and due from banks	\$ 16,295	\$ 12,408
Interest bearing deposits with banks	30,904	29,598
Cash and cash equivalents, at end of period	\$ 47,199	\$ 42,006

**SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION**

Cash payments for interest were \$2,177 million and \$2,404 million for the six months ended June 30, 2013 and 2012, respectively.  
Cash payments for income taxes were \$537 million and \$220 million for the six months ended June 30, 2013 and 2012, respectively.

See Notes to Condensed Consolidated Financial Statements.



**MORGAN STANLEY**

**Condensed Consolidated Statements of Changes in Total Equity**  
**Six Months Ended June 30, 2013**  
(dollars in millions)  
(unaudited)

	Preferred Stock	Common Stock	Additional 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- redeemable Non- controlling Interests	Total Equity
<b>BALANCE AT DECEMBER 31, 2012</b> .....	\$1,508	\$ 20	\$23,426	\$39,912	\$ 2,932	\$ (516)	\$(2,241)	\$(2,932)	\$3,319	\$65,428
Net income applicable to Morgan Stanley .....	—	—	—	1,942	—	—	—	—	—	1,942
Net income applicable to nonredeemable noncontrolling interests .....	—	—	—	—	—	—	—	—	258	258
Dividends .....	—	—	—	(248)	—	—	—	—	—	(248)
Shares issued under employee plans and related tax effects .....	—	—	507	—	(1,111)	—	(11)	1,111	—	496
Repurchases of common stock .....	—	—	—	—	—	—	(314)	—	—	(314)
Foreign currency translation adjustments .....	—	—	—	—	—	(297)	—	—	(149)	(446)
Net change in cash flow hedges .....	—	—	—	—	—	2	—	—	—	2
Change in net unrealized losses on securities available for sale .....	—	—	—	—	—	(369)	—	—	—	(369)
Pension, postretirement and other related adjustments .....	—	—	—	—	—	11	—	—	—	11
Morgan Stanley Smith Barney Holdings LLC redemption value adjustment .....	—	—	—	(151)	—	—	—	—	—	(151)
Other net decreases .....	—	—	—	—	—	—	—	—	(495)	(495)
<b>BALANCE AT JUNE 30, 2013</b> .....	<u>\$1,508</u>	<u>\$ 20</u>	<u>\$23,933</u>	<u>\$41,455</u>	<u>\$ 1,821</u>	<u>\$(1,169)</u>	<u>\$(2,566)</u>	<u>\$(1,821)</u>	<u>\$2,933</u>	<u>\$66,114</u>

See Notes to Condensed Consolidated Financial Statements.

MORGAN STANLEY

Condensed Consolidated Statements of Changes in Total Equity—(Continued)  
Six Months Ended June 30, 2012  
(dollars in millions)  
(unaudited)

	Preferred Stock	Common Stock	Additional 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- Redeemable Non- controlling Interests	Total Equity
<b>BALANCE AT DECEMBER 31, 2011</b> .....	\$1,508	\$ 20	\$22,836	\$40,341	\$3,166	\$(157)	\$(2,499)	\$(3,166)	\$8,029	\$70,078
Net income applicable to Morgan Stanley .....	—	—	—	497	—	—	—	—	—	497
Net income applicable to nonredeemable noncontrolling interests .....	—	—	—	—	—	—	—	—	387	387
Dividends .....	—	—	—	(252)	—	—	—	—	—	(252)
Shares issued under employee plans and related tax effects .....	—	—	315	—	32	—	486	(32)	—	801
Repurchases of common stock .....	—	—	—	—	—	—	(191)	—	—	(191)
Foreign currency translation adjustments .....	—	—	—	—	—	(102)	—	—	(29)	(131)
Net change in cash flow hedges .....	—	—	—	—	—	3	—	—	—	3
Change in net unrealized gains on securities available for sale .....	—	—	—	—	—	22	—	—	—	22
Pension, postretirement and other related adjustments .....	—	—	—	—	—	14	—	—	5	19
Other net increases .....	—	—	—	—	—	—	—	—	404	404
<b>BALANCE AT JUNE 30, 2012</b> ....	<u>\$1,508</u>	<u>\$ 20</u>	<u>\$23,151</u>	<u>\$40,586</u>	<u>\$3,198</u>	<u>\$(220)</u>	<u>\$(2,204)</u>	<u>\$(3,198)</u>	<u>\$8,796</u>	<u>\$71,637</u>

See Notes to Condensed Consolidated Financial Statements.

## MORGAN STANLEY

### 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.

Effective with the quarter ended June 30, 2013, the Global Wealth Management Group and Asset Management business segments were re-titled Wealth Management and Investment Management, respectively.

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* (formerly known as Global Wealth Management Group), 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 trading, which primarily facilitates clients’ trading or investments in such securities.

*Investment Management* (formerly known as 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.

#### **Discontinued Operations.**

*Quilter.* On April 2, 2012, the Company completed the sale of Quilter & Co. Ltd. (“Quilter”), its retail wealth management business in the United Kingdom (“U.K.”). The results of Quilter are reported as discontinued operations within the Wealth Management business segment 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. The transaction, which was restructured as a sale of Saxon’s assets during the first quarter of 2012, was substantially completed in the second quarter of 2012. The results of Saxon are reported as discontinued operations within the Institutional Securities business segment for all periods presented.

Prior period amounts have been recast for discontinued operations. See Note 21 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.

## MORGAN STANLEY

### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Intercompany balances and transactions have been eliminated.

In the quarter ended March 31, 2013, the Company renamed “Principal transactions—Trading” revenues as “Trading” revenues and “Principal transactions—Investments” revenues as “Investments” revenues in the condensed consolidated statements of income, and “Financial instruments owned” as “Trading assets,” “Financial instruments sold, not yet purchased” as “Trading liabilities,” “Receivables” as “Customer and other receivables” and “Payables” as “Customer and other payables” in the condensed consolidated statements of financial condition.

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, 2012 (the “Form 10-K”). The condensed consolidated financial statements reflect all adjustments of a normal 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 the shareholders’ equity of such subsidiaries that is redeemable is presented as Redeemable noncontrolling interests outside of the equity section in the condensed consolidated statements of financial condition. The portion of the 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 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 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

## MORGAN STANLEY

### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(“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.

#### **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, 2012 included in the Form 10-K.

During the six months ended June 30, 2013, 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.

In the six months ended June 30, 2012, the Company’s significant non-cash activities included approximately \$0.6 billion of net assets received from Citigroup, Inc. (“Citi”) related to Citi’s required equity contribution in connection with the Morgan Stanley Smith Barney Holdings LLC (“Wealth Management JV”) platform integration (see Notes 3 and 14).

During the third quarter of 2012, the Company identified that activities related to certain loans had been reported as cash flows from operating activities that should have been presented as investing activities. The Company corrected the previously presented cash flows for these loans and in doing so, the condensed consolidated statements of cash flows for the six months ended June 30, 2012 has been adjusted to increase net cash flows from operating activities by \$1.7 billion, with the corresponding decrease in net cash flows from investing activities. The Company has evaluated the effect of the incorrect presentation, both qualitatively and quantitatively, and concluded that it did not have a material impact on, nor require amendment of, any previously filed annual or quarterly consolidated financial statements.

#### **Accounting Developments.**

***Disclosures about Offsetting Assets and Liabilities.*** In January 2013, the Financial Accounting Standards Board (the “FASB”) issued an accounting update that clarified the intended scope of the new balance sheet offsetting disclosures to derivatives, repurchase agreements, and securities lending transactions to the extent that they are either offset in the financial statements or subject to an enforceable master netting arrangement or similar agreement. These disclosure requirements became effective for the Company beginning on January 1, 2013. Since these amended principles require only additional disclosures concerning offsetting and related arrangements, adoption has not affected the Company’s condensed consolidated statements of income or financial condition (see Notes 6 and 11).

## MORGAN STANLEY

### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

*Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income.* In February 2013, the FASB issued an accounting update that created new disclosure requirements requiring entities to report the effect of significant reclassifications out of accumulated other comprehensive income on the respective line items in net income if the amount being reclassified is required under U.S. generally accepted accounting principles (“GAAP”) to be reclassified in its entirety to net income. The disclosure requirements became effective for the Company beginning on January 1, 2013. Since these amended principles require only additional disclosures concerning amounts reclassified out of accumulated other comprehensive income, adoption has not affected the Company’s condensed consolidated statements of comprehensive income or notes to the condensed consolidated financial statements (see Note 14).

#### **3. Morgan Stanley Smith Barney Holdings LLC.**

On May 31, 2009, the Company and Citi consummated the combination of each institution’s respective wealth management business. The combined businesses operated as the Wealth Management JV through June 28, 2013.

Prior to September 2012, the Company owned 51% and Citi owned 49% of the Wealth Management JV. On September 17, 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 addition, in September 2012, the terms of the Wealth Management JV agreement regarding the purchase of the remaining 35% interest were amended, which resulted in a reclassification of approximately \$4.3 billion from nonredeemable noncontrolling interests to redeemable noncontrolling interests during the third quarter of 2012. Prior to September 17, 2012, Citi’s results related to its 49% interest were reported in net income (loss) applicable to nonredeemable noncontrolling interests in the condensed consolidated statements of income. Subsequent to the purchase of the additional 14% stake, Citi’s results related to the 35% interest were reported in net income (loss) applicable to redeemable noncontrolling interests in the condensed consolidated statements of income. In connection with the Company’s acquisition of the additional 14% stake in the Wealth Management JV and pursuant to an amended deposit sweep agreement between Citi and the Company, in October 2012 \$5.4 billion of deposits held by Citi relating to customer accounts were transferred to the Company’s depository institutions at no premium based on a valuation agreement reached between Citi and the Company, and as such were no longer swept to Citi.

In June 2013, the Company received all regulatory approvals to acquire the remaining 35% stake in the Wealth Management JV. On June 28, 2013, the Company purchased the remaining 35% interest for \$4.725 billion, increasing the Company’s interest from 65% to 100%. The Company recorded a negative adjustment to retained earnings of approximately \$151 million (net of tax) to reflect the difference between the purchase price for the 35% interest in the Wealth Management JV and its carrying value. This adjustment negatively impacted the calculation of basic and diluted earnings per share for the quarter and six months ended June 30, 2013 (see Note 15). 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. As a result of the termination of the deposit sweep agreement, approximately \$57 billion of deposits will no longer be swept to Citi but will instead be transferred to the Company’s depository institutions on an agreed upon basis over the next 24 months (*i.e.*, through June 1, 2015) (see Note 22).

Additionally, in conjunction with the purchase of the remaining 35% interest, the Company redeemed all of the Class A Preferred Interests in the Wealth Management JV owned by Citi and its affiliates for approximately \$2.028 billion and repaid to Citi \$880 million in senior debt.

## MORGAN STANLEY

### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

#### 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 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. 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.

###### *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, default and prepayment rates for each asset category. Valuation



## MORGAN STANLEY

### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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 Obligation (“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, and 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.
- 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



## MORGAN STANLEY

### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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 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 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

## MORGAN STANLEY

### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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 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

## MORGAN STANLEY

### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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 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 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 and corporate bonds 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.

## MORGAN STANLEY

### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

#### *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, 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.

#### *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 June 30, 2013 and December 31, 2012.

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Assets and Liabilities Measured at Fair Value on a Recurring Basis at June 30, 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 June 30, 2013
(dollars in millions)					
<b>Assets at Fair Value</b>					
Trading assets:					
U.S. government and agency securities:					
U.S. Treasury securities	\$ 25,543	\$ —	\$ —	\$ —	\$ 25,543
U.S. agency securities	1,694	23,321	—	—	25,015
Total U.S. government and agency securities	27,237	23,321	—	—	50,558
Other sovereign government obligations	25,894	7,632	4	—	33,530
Corporate and other debt:					
State and municipal securities	—	1,585	—	—	1,585
Residential mortgage-backed securities	—	3,500	19	—	3,519
Commercial mortgage-backed securities	—	1,536	181	—	1,717
Asset-backed securities	—	875	108	—	983
Corporate bonds	—	15,962	509	—	16,471
Collateralized debt obligations	—	403	1,333	—	1,736
Loans and lending commitments	—	8,988	5,243	—	14,231
Other debt	—	8,099	12	—	8,111
Total corporate and other debt	—	40,948	7,405	—	48,353
Corporate equities(1)	74,239	1,293	256	—	75,788
Derivative and other contracts:					
Interest rate contracts	3,159	590,334	2,980	—	596,473
Credit contracts	—	51,847	3,094	—	54,941
Foreign exchange contracts	27	59,958	125	—	60,110
Equity contracts	900	49,982	989	—	51,871
Commodity contracts	3,154	15,710	2,432	—	21,296
Other	—	189	—	—	189
Netting(2)	(5,645)	(670,281)	(6,697)	(63,496)	(746,119)
Total derivative and other contracts	1,595	97,739	2,923	(63,496)	38,761
Investments:					
Private equity funds	—	—	2,286	—	2,286
Real estate funds	—	6	1,422	—	1,428
Hedge funds	—	447	407	—	854
Principal investments	20	2	2,822	—	2,844
Other	181	141	385	—	707
Total investments	201	596	7,322	—	8,119
Physical commodities	—	4,929	—	—	4,929
Total trading assets	129,166	176,458	17,910	(63,496)	260,038
Securities available for sale	15,718	27,140	—	—	42,858
Securities received as collateral	14,674	75	—	—	14,749
Federal funds sold and securities purchased under agreements to resell	—	869	—	—	869
Intangible assets(3)	—	—	9	—	9
Total assets measured at fair value	<u>\$159,558</u>	<u>\$ 204,542</u>	<u>\$17,919</u>	<u>\$(63,496)</u>	<u>\$ 318,523</u>

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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 June 30, 2013
(dollars in millions)					
<b>Liabilities at Fair Value</b>					
Deposits	\$ —	\$ 1,425	\$ —	\$ —	\$ 1,425
Commercial paper and other short-term borrowings	—	1,590	—	—	1,590
Trading liabilities:					
U.S. government and agency securities:					
U.S. Treasury securities	19,741	—	—	—	19,741
U.S. agency securities	2,766	79	—	—	2,845
Total U.S. government and agency securities	22,507	79	—	—	22,586
Other sovereign government obligations	25,035	2,308	—	—	27,343
Corporate and other debt:					
State and municipal securities	—	36	—	—	36
Residential mortgage-backed securities	—	—	4	—	4
Corporate bonds	—	6,813	42	—	6,855
Collateralized debt obligations	—	16	—	—	16
Unfunded lending commitments	—	216	8	—	224
Other debt	—	246	11	—	257
Total corporate and other debt	—	7,327	65	—	7,392
Corporate equities(1)	28,256	792	16	—	29,064
Derivative and other contracts:					
Interest rate contracts	3,293	566,567	2,964	—	572,824
Credit contracts	—	49,712	2,409	—	52,121
Foreign exchange contracts	8	59,554	221	—	59,783
Equity contracts	598	54,666	2,273	—	57,537
Commodity contracts	3,776	15,234	1,651	—	20,661
Other	—	178	6	—	184
Netting(2)	(5,645)	(670,281)	(6,697)	(38,787)	(721,410)
Total derivative and other contracts	2,030	75,630	2,827	(38,787)	41,700
Total trading liabilities	77,828	86,136	2,908	(38,787)	128,085
Obligation to return securities received as collateral	19,062	92	—	—	19,154
Securities sold under agreements to repurchase	—	404	148	—	552
Other secured financings	—	6,196	256	—	6,452
Long-term borrowings	—	38,114	2,705	—	40,819
Total liabilities measured at fair value	<u>\$96,890</u>	<u>\$ 133,957</u>	<u>\$ 6,017</u>	<u>\$(38,787)</u>	<u>\$ 198,077</u>

- (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 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 and Six Months Ended June 30, 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 and six months ended June 30, 2013, there were no material transfers between Level 1 and Level 2.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Assets and Liabilities Measured at Fair Value on a Recurring Basis at December 31, 2012.

	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, 2012
(dollars in millions)					
<b>Assets at Fair Value</b>					
Trading assets:					
U.S. government and agency securities:					
U.S. Treasury securities	\$ 24,662	\$ 14	\$ —	\$ —	\$ 24,676
U.S. agency securities	1,451	27,888	—	—	29,339
Total U.S. government and agency securities	26,113	27,902	—	—	54,015
Other sovereign government obligations	37,669	5,487	6	—	43,162
Corporate and other debt:					
State and municipal securities	—	1,558	—	—	1,558
Residential mortgage-backed securities	—	1,439	45	—	1,484
Commercial mortgage-backed securities	—	1,347	232	—	1,579
Asset-backed securities	—	915	109	—	1,024
Corporate bonds	—	18,403	660	—	19,063
Collateralized debt obligations	—	685	1,951	—	2,636
Loans and lending commitments	—	12,617	4,694	—	17,311
Other debt	—	4,457	45	—	4,502
Total corporate and other debt	—	41,421	7,736	—	49,157
Corporate equities(1)	68,072	1,067	288	—	69,427
Derivative and other contracts:					
Interest rate contracts	446	819,581	3,774	—	823,801
Credit contracts	—	63,234	5,033	—	68,267
Foreign exchange contracts	34	52,729	31	—	52,794
Equity contracts	760	37,074	766	—	38,600
Commodity contracts	4,082	14,256	2,308	—	20,646
Other	—	143	—	—	143
Netting(2)	(4,740)	(883,733)	(6,947)	(72,634)	(968,054)
Total derivative and other contracts	582	103,284	4,965	(72,634)	36,197
Investments:					
Private equity funds	—	—	2,179	—	2,179
Real estate funds	—	6	1,370	—	1,376
Hedge funds	—	382	552	—	934
Principal investments	185	83	2,833	—	3,101
Other	199	71	486	—	756
Total investments	384	542	7,420	—	8,346
Physical commodities	—	7,299	—	—	7,299
Total trading assets	132,820	187,002	20,415	(72,634)	267,603
Securities available for sale	14,466	25,403	—	—	39,869
Securities received as collateral	14,232	46	—	—	14,278
Federal funds sold and securities purchased under agreements to resell					
	—	621	—	—	621
Intangible assets(3)	—	—	7	—	7
Total assets measured at fair value	\$161,518	\$ 213,072	\$20,422	\$(72,634)	\$ 322,378



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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, 2012
(dollars in millions)					
<b>Liabilities at Fair Value</b>					
Deposits	\$ —	\$ 1,485	\$ —	\$ —	\$ 1,485
Commercial paper and other short-term borrowings	—	706	19	—	725
Trading liabilities:					
U.S. government and agency securities:					
U.S. Treasury securities	20,098	21	—	—	20,119
U.S. agency securities	1,394	107	—	—	1,501
Total U.S. government and agency securities	21,492	128	—	—	21,620
Other sovereign government obligations	27,583	2,031	—	—	29,614
Corporate and other debt:					
State and municipal securities	—	47	—	—	47
Residential mortgage-backed securities	—	—	4	—	4
Corporate bonds	—	3,942	177	—	4,119
Collateralized debt obligations	—	328	—	—	328
Unfunded lending commitments	—	305	46	—	351
Other debt	—	156	49	—	205
Total corporate and other debt	—	4,778	276	—	5,054
Corporate equities(1)	25,216	1,655	5	—	26,876
Derivative and other contracts:					
Interest rate contracts	533	789,715	3,856	—	794,104
Credit contracts	—	61,283	3,211	—	64,494
Foreign exchange contracts	2	56,021	390	—	56,413
Equity contracts	748	39,212	1,910	—	41,870
Commodity contracts	4,530	15,702	1,599	—	21,831
Other	—	54	7	—	61
Netting(2)	(4,740)	(883,733)	(6,947)	(46,395)	(941,815)
Total derivative and other contracts	1,073	78,254	4,026	(46,395)	36,958
Total trading liabilities	75,364	86,846	4,307	(46,395)	120,122
Obligation to return securities received as collateral	18,179	47	—	—	18,226
Securities sold under agreements to repurchase	—	212	151	—	363
Other secured financings	—	9,060	406	—	9,466
Long-term borrowings	—	41,255	2,789	—	44,044
Total liabilities measured at fair value	\$93,543	\$ 139,611	\$ 7,672	\$(46,395)	\$ 194,431

- (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.

**Transfers Between Level 1 and Level 2 During the Quarter Ended June 30, 2012.**

*Trading assets—Derivative and other contracts and Trading liabilities—Derivative and other contracts.* During the quarter ended June 30, 2012, the Company reclassified approximately \$1.5 billion of derivative assets and approximately \$1.7 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 June 30, 2012, the Company reclassified approximately \$0.5 billion of derivative assets and approximately \$0.7 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.



## MORGAN STANLEY

### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

#### **Transfers Between Level 1 and Level 2 During the Six Months Ended June 30, 2012.**

*Trading assets—Derivative and other contracts and Trading liabilities—Derivative and other contracts.* During the six months ended June 30, 2012, the Company reclassified approximately \$2.0 billion of derivative assets and approximately \$1.8 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. Also during the six months ended June 30, 2012, the Company reclassified approximately \$0.4 billion 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.

#### **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 and six months ended June 30, 2013 and 2012, 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.

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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 June 30, 2013.

	Beginning Balance at March 31, 2013	Total Realized and Unrealized Gains (Losses)(1)	Purchases	Sales	Issuances	Settlements	Net Transfers	Ending Balance at June 30, 2013	Unrealized Gains (Losses) for Level 3 Assets/Liabilities Outstanding at June 30, 2013(2)
(dollars in millions)									
<b>Assets at Fair Value</b>									
Trading assets:									
Other sovereign government obligations	\$ 3	\$ —	\$ 7	(6)	\$ —	\$ —	\$ —	\$ 4	\$ —
Corporate and other debt:									
Residential mortgage-backed securities	19	—	15	(5)	—	—	(10)	19	(1)
Commercial mortgage-backed securities	174	—	26	(19)	—	—	—	181	21
Asset-backed securities	11	1	107	(11)	—	—	—	108	—
Corporate bonds	888	(11)	183	(402)	—	—	(149)	509	2
Collateralized debt obligations	1,666	36	302	(596)	—	(87)	12	1,333	20
Loans and lending commitments	5,284	(55)	1,086	(190)	—	(850)	(32)	5,243	8
Other debt	1	7	4	—	—	—	—	12	7
Total corporate and other debt	8,043	(22)	1,723	(1,223)	—	(937)	(179)	7,405	57
Corporate equities	270	(24)	20	(13)	—	—	3	256	(12)
Net derivative and other contracts(3):									
Interest rate contracts	(22)	(43)	3	—	(24)	40	62	16	63
Credit contracts	1,403	(472)	130	—	(221)	(130)	(25)	685	(369)
Foreign exchange contracts	(235)	95	—	—	—	58	(14)	(96)	95
Equity contracts	(1,340)	18	7	—	(35)	(1)	67	(1,284)	(79)
Commodity contracts	703	81	26	—	(13)	(13)	(3)	781	58
Other	(3)	(2)	—	—	—	(1)	—	(6)	(2)
Total net derivative and other contracts	506	(323)	166	—	(293)	(47)	87	96	(234)
Investments:									
Private equity funds	2,291	104	20	(129)	—	—	—	2,286	97
Real estate funds	1,370	47	41	(36)	—	—	—	1,422	87
Hedge funds	545	(2)	10	(104)	—	—	(42)	407	(16)
Principal investments	2,855	(18)	60	(75)	—	—	—	2,822	82
Other	496	5	4	(30)	—	—	(90)	385	6
Total investments	7,557	136	135	(374)	—	—	(132)	7,322	256
Intangible assets	8	3	—	—	—	(2)	—	9	2
<b>Liabilities at Fair Value</b>									
Commercial paper and other short-term borrowings									
	\$ 5	\$ —	\$ —	\$ —	\$ —	\$ (2)	\$ (3)	\$ —	\$ —
Trading liabilities:									
Corporate and other debt:									
Residential mortgage-backed securities	4	—	—	—	—	—	—	4	—
Corporate bonds	424	4	(248)	36	—	—	(166)	42	(1)
Unfunded lending commitments	25	17	—	—	—	—	—	8	17
Other debt	11	1	(4)	2	—	—	3	11	—
Total corporate and other debt	464	22	(252)	38	—	—	(163)	65	16
Corporate equities	4	3	(8)	17	—	—	6	16	2
Obligation to return securities									
Securities sold under agreements to repurchase	155	7	—	—	—	—	—	148	7
Other secured financings	275	16	—	—	—	(3)	—	256	16
Long-term borrowings	2,784	68	—	—	466	(457)	(20)	2,705	65

(1) Total realized and unrealized gains (losses) are primarily included in Trading in the condensed consolidated statements of income except for \$136 million related to Trading assets—Investments, which is included in Investments revenues.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

- (2) Amounts represent unrealized gains (losses) for the quarter ended June 30, 2013 related to assets and liabilities still outstanding at June 30, 2013.
- (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.

Changes in Level 3 Assets and Liabilities Measured at Fair Value on a Recurring Basis for the Six Months Ended June 30, 2013.

	Beginning Balance at December 31, 2012	Total Realized and Unrealized Gains (Losses)(1)	Purchases	Sales	Issuances	Settlements	Net Transfers	Ending Balance at June 30, 2013	Unrealized Gains (Losses) for Level 3 Assets/ Liabilities Outstanding at June 30, 2013(2)
(dollars in millions)									
<b>Assets at Fair Value</b>									
Trading assets:									
Other sovereign government obligations .....	\$ 6	\$ —	\$ 8	\$ (8)	\$ —	\$ —	\$ (2)	\$ 4	\$ —
Corporate and other debt:									
Residential mortgage-backed securities .....	45	27	16	(44)	—	—	(25)	19	10
Commercial mortgage-backed securities .....	232	17	25	(93)	—	—	—	181	30
Asset-backed securities .....	109	1	6	(8)	—	—	—	108	—
Corporate bonds .....	660	2	193	(296)	—	(12)	(38)	509	(19)
Collateralized debt obligations .....	1,951	284	429	(1,314)	—	(15)	(2)	1,333	(54)
Loans and lending commitments .....	4,694	(55)	1,616	(294)	—	(1,050)	332	5,243	(16)
Other debt .....	45	(2)	20	(50)	—	—	(1)	12	(1)
Total corporate and other debt .....	7,736	274	2,305	(2,099)	—	(1,077)	266	7,405	(50)
Corporate equities .....	288	(9)	37	(41)	—	—	(19)	256	(24)
Net derivative and other contracts(3):									
Interest rate contracts .....	(82)	(193)	6	—	(30)	179	136	16	(76)
Credit contracts .....	1,822	(937)	169	—	(235)	(127)	(7)	685	(789)
Foreign exchange contracts .....	(359)	114	—	—	—	140	9	(96)	79
Equity contracts .....	(1,144)	48	74	(1)	(116)	(236)	91	(1,284)	(5)
Commodity contracts .....	709	46	36	—	(17)	9	(2)	781	38
Other .....	(7)	(4)	—	—	—	5	—	(6)	(4)
Total net derivative and other contracts .....	939	(926)	285	(1)	(398)	(30)	227	96	(757)
Investments:									
Private equity funds .....	2,179	218	88	(199)	—	—	—	2,286	194
Real estate funds .....	1,370	128	42	(119)	—	—	1	1,422	207
Hedge funds .....	552	—	38	(136)	—	—	(47)	407	(19)
Principal investments .....	2,833	45	95	(160)	—	—	9	2,822	143
Other .....	486	21	16	(47)	—	—	(91)	385	22
Total investments .....	7,420	412	279	(661)	—	—	(128)	7,322	547
Intangible assets .....	7	7	—	—	—	(5)	—	9	3

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

	Beginning Balance at December 31, 2012	Total Realized and Unrealized Gains (Losses)(1)	Purchases	Sales	Issuances	Settlements	Net Transfers	Ending Balance at June 30, 2013	Unrealized Gains (Losses) for Level 3 Assets/ Liabilities Outstanding at June 30, 2013(2)
(dollars in millions)									
<b>Liabilities at Fair Value</b>									
Commercial paper and other short-term borrowings . . . .	\$ 19	\$ —	\$ —	\$ —	\$ —	\$ (2)	\$ (17)	\$ —	\$ —
Trading liabilities:									
Corporate and other debt:									
Residential mortgage- backed securities . . . .	4	—	—	—	—	—	—	4	—
Corporate bonds . . . . .	177	(7)	(437)	83	—	—	212	42	9
Unfunded lending commitments . . . . .	46	38	—	—	—	—	—	8	38
Other debt . . . . .	49	13	(33)	5	—	—	3	11	10
Total corporate and other debt . . . . .	276	44	(470)	88	—	—	215	65	57
Corporate equities . . . . .	5	5	(13)	29	—	—	—	16	5
Securities sold under agreements to repurchase . . . . .									
Other secured financings . . . .	151	3	—	—	—	—	—	148	3
Long-term borrowings . . . . .	406	29	—	—	14	(135)	—	256	21
	2,789	24	—	—	955	(361)	(654)	2,705	16

- (1) Total realized and unrealized gains (losses) are primarily included in Trading in the condensed consolidated statements of income except for \$412 million related to Trading assets—Investments, which is included in Investments revenues.
- (2) Amounts represent unrealized gains (losses) for the six months ended June 30, 2013 related to assets and liabilities still outstanding at June 30, 2013.
- (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.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Changes in Level 3 Assets and Liabilities Measured at Fair Value on a Recurring Basis for Quarter Ended June 30, 2012.

	Beginning Balance at March 31, 2012	Total Realized and Unrealized Gains (Losses)(1)	Purchases	Sales	Issuances	Settlements	Net Transfers	Ending Balance at June 30, 2012	Unrealized Gains (Losses) for Level 3 Assets/Liabilities Outstanding at June 30, 2012(2)
(dollars in millions)									
<b>Assets at Fair Value</b>									
Trading assets:									
U.S. agency securities . . . . .	\$ 23	\$ —	\$ —	\$ (23)	\$ —	\$ —	\$ —	\$ —	\$ —
Other sovereign government obligations . . . . .	8	—	1	(1)	—	—	(7)	1	—
Corporate and other debt:									
State and municipal securities . . . . .	3	1	—	(1)	—	—	—	3	—
Residential mortgage-backed securities . . . . .	43	(6)	17	(33)	—	—	3	24	(23)
Commercial mortgage-backed securities . . . . .	127	(3)	146	(12)	—	—	(2)	256	1
Asset-backed securities . . . . .	3	(1)	8	(1)	—	—	—	9	(1)
Corporate bonds . . . . .	899	(39)	277	(428)	—	—	36	745	(27)
Collateralized debt obligations . . . . .	1,165	20	509	(241)	—	—	4	1,457	(10)
Loans and lending commitments . . . . .	8,597	(126)	326	(1,320)	—	(580)	897	7,794	(173)
Other debt . . . . .	57	(2)	14	(56)	—	—	—	13	(5)
Total corporate and other debt . . . . .	10,894	(156)	1,297	(2,092)	—	(580)	938	10,301	(238)
Corporate equities . . . . .	554	34	(14)	(45)	—	—	(47)	482	2
Net derivative and other contracts(3):									
Interest rate contracts . . . . .	22	(35)	158	—	(235)	59	(141)	(172)	17
Credit contracts . . . . .	4,381	340	19	—	(401)	(272)	(225)	3,842	181
Foreign exchange contracts . . . . .	66	(103)	—	—	—	(187)	—	(224)	(147)
Equity contracts . . . . .	(1,442)	218	31	(2)	(33)	15	40	(1,173)	213
Commodity contracts . . . . .	803	142	—	—	—	(9)	1	937	89
Other . . . . .	(23)	—	—	—	—	(4)	—	(27)	—
Total net derivative and other contracts . . . . .	3,807	562	208	(2)	(669)	(398)	(325)	3,183	353
Investments:									
Private equity funds . . . . .	1,994	15	50	(54)	—	—	—	2,005	7
Real estate funds . . . . .	1,338	12	30	(54)	—	—	—	1,326	10
Hedge funds . . . . .	623	(23)	6	(25)	—	—	(48)	533	(23)
Principal investments . . . . .	3,194	(9)	51	(80)	—	—	(109)	3,047	(22)
Other . . . . .	527	23	19	(23)	—	—	(3)	543	21
Total investments . . . . .	7,676	18	156	(236)	—	—	(160)	7,454	(7)
Intangible assets . . . . .	99	(5)	—	(84)	—	(2)	—	8	(4)

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

	Beginning Balance at March 31, 2012	Total Realized and Unrealized Gains (Losses)(1)	Purchases	Sales	Issuances	Settlements	Net Transfers	Ending Balance at June 30, 2012	Unrealized Gains (Losses) for Level 3 Assets/Liabilities Outstanding at June 30, 2012(2)
(dollars in millions)									
<b>Liabilities at Fair Value</b>									
Commercial paper and other short-term borrowings . . . . .	\$ 15	\$ —	\$ —	\$ —	\$ —	\$ (13)	\$—	\$ 2	\$—
Trading liabilities:									
Other sovereign government obligations . . . . .	1	—	(1)	—	—	—	—	—	—
Corporate and other debt:									
Residential mortgage-backed securities . . . . .	61	57	—	—	—	—	—	4	57
Corporate bonds . . . . .	193	32	(164)	139	—	—	(9)	127	59
Collateralized debt obligations . . . . .	—	—	(1)	2	—	—	—	1	—
Unfunded lending commitments . . . . .	60	9	—	—	—	—	—	51	9
Other debt . . . . .	33	16	(2)	48	—	—	—	63	16
Total corporate and other debt . . . . .	347	114	(167)	189	—	—	(9)	246	141
Corporate equities . . . . .	2	(27)	(13)	25	—	—	6	47	(26)
Securities sold under agreements to repurchase . . . . .	186	1	—	—	—	—	—	185	1
Other secured financings . . . . .	594	(4)	—	—	41	(152)	(17)	470	(4)
Long-term borrowings . . . . .	2,143	(59)	—	—	315	(284)	(23)	2,210	(146)

- (1) Total realized and unrealized gains (losses) are primarily included in Trading in the condensed consolidated statements of income except for \$18 million related to Trading assets—Investments, which is included in Investments revenues.
- (2) Amounts represent unrealized gains (losses) for the quarter ended June 30, 2012 related to assets and liabilities still outstanding at June 30, 2012.
- (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.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Changes in Level 3 Assets and Liabilities Measured at Fair Value on a Recurring Basis for the Six Months Ended June 30, 2012.

	Beginning Balance at December 31, 2011	Total Realized and Unrealized Gains (Losses)(1)	Purchases	Sales	Issuances	Settlements	Net Transfers	Ending Balance at June 30, 2012	Unrealized Gains (Losses) for Level 3 Assets/ Liabilities Outstanding at June 30, 2012(2)
(dollars in millions)									
<b>Assets at Fair Value</b>									
Trading assets:									
U.S. agency securities . . . . .	\$ 8	\$ —	\$ —	\$ (7)	\$ —	\$ —	\$(1)	\$ —	\$ —
Other sovereign government obligations . . . . .	119	—	1	(118)	—	—	(1)	1	—
Corporate and other debt:									
State and municipal securities . . . . .	—	1	—	(1)	—	—	3	3	1
Residential mortgage-backed securities . . . . .	494	(27)	3	(265)	—	—	(181)	24	(61)
Commercial mortgage-backed securities . . . . .	134	25	138	(37)	—	(1)	(3)	256	23
Asset-backed securities . . . . .	31	—	8	(29)	—	—	(1)	9	(1)
Corporate bonds . . . . .	675	6	331	(391)	—	—	124	745	(8)
Collateralized debt obligations . . . . .	980	137	725	(335)	—	—	(50)	1,457	52
Loans and lending commitments . . . . .	9,590	(168)	1,410	(2,269)	—	(695)	(74)	7,794	(312)
Other debt . . . . .	128	(7)	32	(158)	—	—	18	13	(12)
Total corporate and other debt . . . . .	12,032	(33)	2,647	(3,485)	—	(696)	(164)	10,301	(318)
Corporate equities . . . . .	417	(13)	215	(149)	—	—	12	482	(20)
Net derivative and other contracts(3):									
Interest rate contracts . . . . .	420	(28)	164	—	(240)	37	(525)	(172)	62
Credit contracts . . . . .	5,814	(1,083)	81	—	(411)	(267)	(292)	3,842	(1,539)
Foreign exchange contracts . . . . .									
Equity contracts . . . . .	43	(40)	—	—	—	(207)	(20)	(224)	(102)
Commodity contracts . . . . .	(1,234)	117	211	(1)	(74)	(244)	52	(1,173)	102
Other . . . . .	570	320	5	—	(4)	34	12	937	338
	(1,090)	59	—	—	—	264	740	(27)	57
Total net derivative and other contracts . . . . .	4,523	(655)	461	(1)	(729)	(383)	(33)	3,183	(1,082)
Investments:									
Private equity funds . . . . .	1,936	15	143	(89)	—	—	—	2,005	(5)
Real estate funds . . . . .	1,213	64	117	(68)	—	—	—	1,326	148
Hedge funds . . . . .	696	(1)	24	(58)	—	—	(128)	533	1
Principal investments . . . . .	2,937	24	230	(144)	—	—	—	3,047	(17)
Other . . . . .	501	(12)	52	(24)	—	—	26	543	(18)
Total investments . . . . .	7,283	90	566	(383)	—	—	(102)	7,454	109
Physical commodities . . . . .	46	—	—	—	—	(46)	—	—	—
Intangible assets . . . . .	133	(39)	—	(84)	—	(2)	—	8	(8)

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

	Beginning Balance at December 31, 2011	Total Realized and Unrealized Gains (Losses)(1)	Purchases	Sales	Issuances	Settlements	Net Transfers	Ending Balance at June 30, 2012	Unrealized Gains (Losses) for Level 3 Assets/ Liabilities Outstanding at June 30, 2012(2)
(dollars in millions)									
<b>Liabilities at Fair Value</b>									
Commercial paper and other short-term borrowings . . . . .	\$ 2	\$ —	\$ —	\$ —	\$ —	\$ —	—	\$ 2	\$ —
Trading liabilities:									
Other sovereign government obligations . . . . .	8	—	(8)	1	—	—	(1)	—	—
Corporate and other debt:									
Residential mortgage- backed securities . . . . .	355	(4)	(355)	—	—	—	—	4	(4)
Corporate bonds . . . . .	219	(25)	(203)	111	—	—	(25)	127	49
Collateralized debt obligations . . . . .	—	—	—	—	—	—	1	1	—
Unfunded lending commitments . . . . .	85	34	—	—	—	—	—	51	34
Other debt . . . . .	73	11	(1)	46	—	(55)	11	63	13
Total corporate and other debt . . . . .	732	16	(559)	157	—	(55)	(13)	246	92
Corporate equities . . . . .	1	(21)	—	27	—	—	(2)	47	(53)
Securities sold under agreements to repurchase . . .	340	3	—	—	—	—	(152)	185	3
Other secured financings . . . . .	570	(19)	—	—	52	(149)	(22)	470	(19)
Long-term borrowings . . . . .	1,603	(190)	—	—	444	(102)	75	2,210	(214)

- (1) Total realized and unrealized gains (losses) are primarily included in Trading in the condensed consolidated statements of income except for \$90 million related to Trading assets—Investments, which is included in Investments revenues.
- (2) Amounts represent unrealized gains (losses) for the six months ended June 30, 2012 related to assets and liabilities still outstanding at June 30, 2012.
- (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.



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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 June 30, 2013 and December 31, 2012.**

The disclosures below provide information on the valuation techniques, significant unobservable inputs and their ranges and averages 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 following disclosures also include qualitative information on the sensitivity of the fair value measurements to changes in the significant unobservable inputs.

At June 30, 2013.

	Balance at June 30, 2013 (dollars in millions)	Valuation Technique(s)	Significant Unobservable Input(s) / Sensitivity of the Fair Value to Changes in the Unobservable Inputs	Range(1)	Averages(2)
<b>Assets</b>					
Trading assets:					
Corporate and other debt:					
Commercial mortgage-backed securities	\$ 181	Comparable pricing	Comparable bond price / (A)	57 to 100 points	80 points
Asset-backed securities	108	Discounted cash flow	Discount rate / (C)	25%	25%
Corporate bonds	509	Comparable pricing	Comparable bond price / (A)	2 to 147 points	82 points
Collateralized debt obligations	1,333	Comparable pricing(6) Correlation model	Comparable bond price / (A) Credit correlation / (B)	17 to 94 points 38 to 50%	63 points 47%
Loans and lending commitments	5,243	Corporate loan model  Comparable pricing Margin loan model  Option model Comparable pricing(6)	Credit spread / (C)  Comparable bond price / (A) Credit spread / (C)(D)  Volatility skew / (C)(D) At the money volatility / (A) Comparable loan price / (A)	15 to 894 basis points 80 to 120 points 30 to 306 basis points -2 to 0% 31 to 42% 24 to 101 points	194 basis points 101 points 195 basis points -2% 34% 86 points
Corporate equities(3)	256	Net asset value(6) Comparable pricing Comparable pricing Market approach	Discount to net asset value / (C) Comparable equity price / (A) Comparable price / (A) EBITDA multiple / (A)	0 to 50% 0 to 100% 8 to 100 points 7 times	19% 43% 58 points 7 times
Net derivative and other contracts:					
Interest rate contracts	16	Option model	Interest rate volatility concentration liquidity multiple / (C)(D)  Comparable bond price / (A)(D) Interest rate - Foreign exchange correlation / (A)(D) Interest rate volatility skew / (A)(D) Interest rate quanto correlation / (A)(D) Interest rate curve correlation / (A)(D) Inflation volatility / (A)(D)	0 to 8 times  5 to 98 points 2 to 63% 25 to 55% -53 to 33% 35 to 88% 77 to 83%	2 times 51 points / 51 points(4) 32% / 38%(4) 43% / 35%(4) -5% / -9%(4) 67% / 70%(4) 79% / 78%(4)
Credit contracts	685	Comparable pricing  Correlation model(6)	Cash synthetic basis / (C)(D) Comparable bond price / (C)(D) Credit correlation / (B)	2 to 10 points 0 to 84 points 34 to 90%	4 points 27 points 54%
Foreign exchange contracts(5)	(96)	Option model	Comparable bond price / (A)(D) Interest rate quanto correlation / (A)(D) Interest rate - Credit spread correlation / (A)(D) Interest rate curve correlation / (A)(D) Interest rate - Foreign exchange correlation / (A)(D) Interest rate volatility skew / (A)(D) Interest rate curve / (A)(D)	5 to 98 points -53 to 33% -59 to 47% 35 to 88% 2 to 63% 25 to 55% 0 to 2%	51 points / 51 points(4) -5% / -9%(4) -5% / -3%(4) 67% / 70%(4) 32% / 38%(4) 43% / 35%(4) 1% / 1%(4)

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

	Balance at June 30, 2013 (dollars in millions)	Valuation Technique(s)	Significant Unobservable Input(s) / Sensitivity of the Fair Value to Changes in the Unobservable Inputs	Range(1) Averages(2)	
				Range(1)	Averages(2)
Equity contracts(5)	(1,284)	Option model	At the money volatility / (A)(D) Volatility skew / (A)(D) Equity - Equity correlation / (C)(D) Equity - Foreign exchange correlation / (C)(D) Equity - Interest rate correlation / (C)(D)	18 to 38 % -1 to 1 % 40 to 99% -70 to 9% 5 to 68%	34% -1% 71% -22% 38% /34%(4)
Commodity contracts	781	Option model	Forward power price / (C)(D)  Commodity volatility / (A)(D) Cross commodity correlation / (C)(D)	\$10 to \$113 per Megawatt hour 12 to 58% 43 to 98%	\$39 per Megawatt hour 12% 97%
Investments(3):					
Principal investments	2,822	Discounted cash flow	Implied weighted average cost of capital / (C)(D) Exit multiple / (A)(D)	10 to 12% 7 to 10 times	10% 9 times
		Discounted cash flow(6)	Capitalization rate / (C)(D) Equity discount rate / (C)(D)	6 to 9% 10 to 35%	7% 22%
		Market approach	EBITDA multiple / (A)	5 to 15 times	9 times
Other	385	Discounted cash flow	Implied weighted average cost of capital / (C)(D) Exit multiple / (A)(D)	10 to 12% 5 to 7 times	10% 6 times
		Market approach(6)	EBITDA multiple / (A)	7 to 8 times	8 times
<b>Liabilities</b>					
Trading liabilities:					
Securities sold under agreements to repurchase	\$ 148	Discounted cash flow	Funding spread / (A)	157 basis points	157 basis points
Other secured financings	256	Comparable pricing(6)	Comparable bond price / (A)	96 to 100 points	96 points
		Discounted cash flow	Funding spread / (A)	157 basis points	157 basis points
Long-term borrowings	2,705	Option model	At the money volatility / (A)(D) Volatility skew / (A)(D) Equity - Equity correlation / (A)(D) Equity - Foreign exchange correlation / (A)(D)	25 to 33% -1 to 0% 50 to 90% -70 to 9%	28% -1% 73% -33%

EBITDA—Earnings before interest, taxes, depreciation and amortization

- (1) The ranges of significant unobservable inputs are represented in points, percentages, basis points, times or megawatt hours. Points are a percentage of par; for example, 100 points would be 100% of par. A basis point equals 1/100th of 1%; for example, 894 basis points would equal 8.94%.
- (2) Amounts represent weighted averages except where simple averages and the median of the inputs are provided (see footnote 4 below). Weighted averages are calculated by weighting each input by the fair value of the respective financial instruments except for long-term borrowings and derivative instruments where inputs are weighted by risk.
- (3) Investments in funds measured using an unadjusted NAV are excluded.
- (4) The data structure of the significant unobservable inputs used in valuing Interest rate contracts, Foreign exchange contracts and certain Equity contracts may be in a multi-dimensional form, such as a curve or surface, with risk distributed across the structure. Therefore, a simple average and median, together with the range of data inputs, may be more appropriate measurements than a single point weighted average.
- (5) Includes derivative contracts with multiple risks (*i.e.*, hybrid products).
- (6) This is the predominant valuation technique for this major asset or liability class.

**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.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

At December 31, 2012.

	Balance at December 31, 2012 (dollars in millions)	Valuation Technique(s)	Significant Unobservable Input(s) / Sensitivity of the Fair Value to Changes in the Unobservable Inputs	Range(1)	Weighted Average
<b>Assets</b>					
Trading assets:					
Corporate and other debt:					
Commercial mortgage-backed securities	\$ 232	Comparable pricing	Comparable bond price / (A)	46 to 100 points	76 points
Asset-backed securities	109	Discounted cash flow	Discount rate / (C)	21%	21%
Corporate bonds	660	Comparable pricing	Comparable bond price / (A)	0 to 143 points	24 points
Collateralized debt obligations	1,951	Comparable pricing Correlation model	Comparable bond price / (A) Credit correlation / (B)	15 to 88 points 15 to 45%	59 points 40%
Loans and lending commitments	4,694	Corporate loan model  Comparable pricing Comparable pricing	Credit spread / (C)  Comparable bond price / (A) Comparable loan price / (A)	17 to 1,004 basis points 80 to 120 points 55 to 100 points	281 basis points 104 points 88 points
Corporate equities(2)	288	Net asset value Comparable pricing  Market approach	Discount to net asset value / (C) Discount to comparable equity price / (C)  EBITDA multiple / (A)	0 to 37% 0 to 27 points 6 times	8% 14 points 6 times
Net derivative and other contracts:					
Interest rate contracts	(82)	Option model       Discounted cash flow	Interest rate volatility concentration liquidity multiple / (C)(D) Comparable bond price / (A)(D) Interest rate - Foreign exchange correlation / (A)(D) Interest rate volatility skew / (A)(D) Interest rate quanto correlation / (A)(D) Interest rate curve correlation / (A)(D) Inflation volatility / (A)(D) Forward commercial paper rate-LIBOR basis / (A)	0 to 8 times 5 to 98 points 2 to 63% 9 to 95% -53 to 33% 48 to 99% 49 to 100% -18 to 95 basis points	See(3)
Credit contracts	1,822	Comparable pricing  Correlation model	Cash synthetic basis / (C) Comparable bond price / (C) Credit correlation / (B)	2 to 14 points 0 to 80 points 14 to 94%	See(4)
Foreign exchange contracts(5)	(359)	Option model	Comparable bond price / (A)(D) Interest rate quanto correlation / (A)(D) Interest rate - Credit spread correlation / (A)(D) Interest rate - Foreign exchange correlation / (A)(D) Interest rate volatility skew / (A)(D)	5 to 98 points -53 to 33% -59 to 65% 2 to 63% 9 to 95%	See(6)
Equity contracts(5)	(1,144)	Option model	At the money volatility / (C)(D) Volatility skew / (C)(D) Equity - Equity correlation / (C)(D) Equity - Foreign exchange correlation / (C)(D) Equity - Interest rate correlation / (C)(D)	7 to 24% -2 to 0% 40 to 96% -70 to 38% 18 to 65%	See(7)
Commodity contracts	709	Option model	Forward power price / (C)(D)  Commodity volatility / (A)(D) Cross commodity correlation / (C)(D)	\$28 to \$84 per Megawatt hour 17 to 29% 43 to 97%	
Investments(2):					
Principal investments	2,833	Discounted cash flow  Discounted cash flow  Market approach	Implied weighted average cost of capital / (C)(D) Exit multiple / (A)(D) Capitalization rate / (C)(D) Equity discount rate / (C)(D) EBITDA multiple / (A)	8 to 15% 5 to 10 times 6 to 10% 15 to 35% 3 to 17 times	9% 9 times 7% 23% 10 times

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

	Balance at December 31, 2012 (dollars in millions)	Valuation Technique(s)	Significant Unobservable Input(s) / Sensitivity of the Fair Value to Changes in the Unobservable Inputs	Range(1)	Weighted Average
Other	486	Discounted cash flow	Implied weighted average cost of capital / (C)(D)	11%	11%
		Market approach	Exit multiple / (A)(D) EBITDA multiple / (A)	6 times 6 to 8 times	6 times 7 times
<b>Liabilities</b>					
Trading liabilities:					
Corporate and other debt:					
Corporate bonds	\$ 177	Comparable pricing	Comparable bond price / (A)	0 to 150 points	50 points
Securities sold under agreements to repurchase	151	Discounted cash flow	Funding spread / (A)	110 to 184 basis points	166 basis points
Other secured financings	406	Comparable pricing Discounted cash flow	Comparable bond price / (A) Funding spread / (A)	55 to 139 points 183 to 186 basis points	102 points 184 basis points
Long-term borrowings	2,789	Option model	At the money volatility / (A)(D) Volatility skew / (A)(D) Equity - Equity correlation / (A)(D) Equity - Foreign exchange correlation / (A)(D)	20 to 24% -1 to 0% 50 to 90% -70 to 36%	24% 0% 77% -15%

LIBOR—London Interbank Offered Rate

- (1) The ranges of significant unobservable inputs are represented in points, percentages, basis points, times or megawatt hours. Points are a percentage of par; for example, 100 points would be 100% of par. A basis point equals 1/100th of 1%; for example, 1,004 basis points would equal 10.04%.
- (2) Investments in funds measured using an unadjusted NAV are excluded.
- (3) See Note 4 to the consolidated financial statements for the year ended December 31, 2012 included in the Form 10-K for a qualitative discussion of the wide unobservable input ranges for comparable bond prices, interest rate volatility skew, interest rate quanto correlation and forward commercial paper rate—LIBOR basis.
- (4) See Note 4 to the consolidated financial statements for the year ended December 31, 2012 included in the Form 10-K for a qualitative discussion of the wide unobservable input ranges for comparable bond prices and credit correlation.
- (5) Includes derivative contracts with multiple risks (*i.e.*, hybrid products).
- (6) See Note 4 to the consolidated financial statements for the year ended December 31, 2012 included in the Form 10-K for a qualitative discussion of the wide unobservable input ranges for comparable bond prices, interest rate quanto correlation, interest rate-credit spread correlation and interest rate volatility skew.
- (7) See Note 4 to the consolidated financial statements for the year ended December 31, 2012 included in the Form 10-K for a qualitative discussion of the wide unobservable input range for equity-foreign exchange correlation.

**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.

The following provides a description of significant unobservable inputs included in the June 30, 2013 and December 31, 2012 tables above for all major categories of assets and liabilities:

- *Comparable bond price*—a pricing input used when prices for the identical instrument are not available. Significant subjectivity may be involved when fair value is determined using pricing data available for comparable instruments. Valuation using comparable instruments can be done by calculating an implied yield (or spread over a liquid benchmark) from the price of a comparable bond, then adjusting that yield (or spread) to derive a value for the bond. The adjustment to yield (or spread) should account for relevant differences in the bonds such as maturity or credit quality. Alternatively, a price-to-price basis can be

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### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

assumed between the comparable instrument and bond being valued in order to establish the value of the bond. Additionally, as the probability of default increases for a given bond (*i.e.*, as the bond becomes more distressed), the valuation of that bond will increasingly reflect its expected recovery level assuming default. The decision to use price-to-price or yield/spread comparisons largely reflects trading market convention for the financial instruments in question. Price-to-price comparisons are primarily employed for CMBS, CDOs, mortgage loans and distressed corporate bonds. Implied yield (or spread over a liquid benchmark) is utilized predominately for non-distressed corporate bonds, loans and credit contracts.

- *Correlation*—a pricing input where the payoff is driven by more than one underlying risk. Correlation is a measure of the relationship between the movements of two variables (*i.e.*, how the change in one variable influences a change in the other variable). Credit correlation, for example, is the factor that describes the relationship between the probability of individual entities to default on obligations and the joint probability of multiple entities to default on obligations.
- *Credit spread*—the difference in yield between different securities due to differences in credit quality. The credit spread reflects the additional net yield an investor can earn from a security with more credit risk relative to one with less credit risk. The credit spread of a particular security is often quoted in relation to the yield on a credit risk-free benchmark security or reference rate, typically either U.S. Treasury or LIBOR.
- *Volatility skew*—the measure of the difference in implied volatility for options with identical underliers and expiry dates but with different strikes. The implied volatility for an option with a strike price that is above or below the current price of an underlying asset will typically deviate from the implied volatility for an option with a strike price equal to the current price of that same underlying asset.
- *Volatility*—the measure of the variability in possible returns for an instrument given how much that instrument changes in value over time. Volatility is a pricing input for options and, generally, the lower the volatility, the less risky the option. The level of volatility used in the valuation of a particular option depends on a number of factors, including the nature of the risk underlying that option (*e.g.*, the volatility of a particular underlying equity security may be significantly different from that of a particular underlying commodity index), the tenor and the strike price of the option.
- *EBITDA multiple / Exit multiple*—is the Enterprise Value to EBITDA ratio, where the Enterprise Value is the aggregate value of equity and debt minus cash and cash equivalents. The EBITDA multiple reflects the value of the company in terms of its full-year EBITDA, whereas the exit multiple reflects the value of the company in terms of its full year expected EBITDA at exit. Either multiple allows comparison between companies from an operational perspective as the effect of capital structure, taxation and depreciation/amortization is excluded.
- *Forward commercial paper rate–LIBOR basis*—the basis added to the LIBOR rate when the commercial paper yield is expressed as a spread over the LIBOR rate. The basis to LIBOR is dependent on a number of factors, including, but not limited to, collateralization of the commercial paper, credit rating of the issuer, and the supply of commercial paper. The basis may become negative, *i.e.*, the return for highly-rated commercial paper, such as asset-backed commercial paper, may be less than LIBOR.
- *Cash synthetic basis*—the measure of the price differential between cash financial instruments (“cash instruments”) and their synthetic derivative-based equivalents (“synthetic instruments”). The range disclosed in the table above signifies the number of points by which the synthetic bond equivalent price is higher than the quoted price of the underlying cash bonds.
- *Implied weighted average cost of capital (“WACC”)*—the WACC implied by the current value of equity in a discounted cash flow model. The model assumes that the cash flow assumptions, including

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**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

projections, are fully reflected in the current equity value while the debt to equity ratio is held constant. The WACC theoretically represents the required rate of return to debt and equity investors, respectively.

- *Capitalization rate*—the ratio between net operating income produced by an asset and its market value at the projected disposition date.
- *Funding spread*—the difference between the general collateral rate (which refers to the rate applicable to a broad class of U.S. Treasury issuances) and the specific collateral rate (which refers to the rate applicable to a specific type of security pledged as collateral, such as a municipal bond). Repurchase agreements are discounted based on collateral curves. The curves are constructed as spreads over the corresponding overnight index swap (“OIS”)/ LIBOR curves, with the short end of the curve representing spreads over the corresponding OIS curves and the long end of the curve representing spreads over LIBOR.

***Fair Value of Investments that Calculate Net Asset Value.***

The Company’s Investments measured at fair value were \$8,119 million and \$8,346 million at June 30, 2013 and December 31, 2012, 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 NAV at June 30, 2013 and December 31, 2012, respectively.

	At June 30, 2013		At December 31, 2012	
	Fair Value	Unfunded Commitment	Fair Value	Unfunded Commitment
	(dollars in millions)			
Private equity funds . . . . .	\$2,286	\$594	\$2,179	\$644
Real estate funds . . . . .	1,428	174	1,376	221
Hedge funds(1):				
Long-short equity hedge funds . . . . .	486	—	475	—
Fixed income/credit-related hedge funds . . . . .	75	—	86	—
Event-driven hedge funds . . . . .	41	—	52	—
Multi-strategy hedge funds . . . . .	252	3	321	3
Total . . . . .	\$4,568	\$771	\$4,489	\$868

(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 June 30, 2013, approximately 41% of the fair value amount of long-short equity hedge funds is redeemable at least quarterly, 39% is redeemable every six months and 20% of these funds have a redemption frequency of greater than six months. The notice period for long-short equity hedge funds at June 30, 2013 is primarily greater than six months. At December 31, 2012, approximately 36% of the fair value amount of long-short equity hedge funds is redeemable at least quarterly, 38% is redeemable every six months and 26% of these funds have a redemption frequency of greater than six months. The notice period for long-short equity hedge funds at December 31, 2012 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 June 30, 2013, it is estimated that 9% of the fair value of the funds will be liquidated in the next five years, another 60% of the fair value of the funds will be liquidated between five to 10 years and the remaining 31% of the fair value of the funds have a remaining life of greater than 10 years.



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### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

*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 June 30, 2013, it is estimated that 3% of the fair value of the funds will be liquidated within the next five years, another 52% of the fair value of the funds will be liquidated between five to 10 years and the remaining 45% 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.

- *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 7% 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 June 30, 2013. Investments representing approximately 6% 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 less than one year at June 30, 2013.
- *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 June 30, 2013, there were no restrictions on redemptions.
- *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, with the expectation to profit from the spread between the current market price and the ultimate purchase price of the target company. At June 30, 2013, 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 June 30, 2013, investments representing approximately 35% 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 June 30, 2013. Investments representing approximately 9% of the fair value of the investments in multi-strategy 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 indefinite at June 30, 2013.

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**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

***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 and six months ended June 30, 2013 and 2012, respectively:

	<b>Trading</b>	<b>Interest Income (Expense)</b>	<b>Gains (Losses) Included in Net Revenues</b>
	<b>(dollars in millions)</b>		
<i>Three Months Ended June 30, 2013</i>			
Federal funds sold and securities purchased under agreements to resell . . . . .	\$ (2)	\$ 2	\$ —
Deposits . . . . .	16	(16)	—
Commercial paper and other short-term borrowings(1) . . . . .	117	(1)	116
Securities sold under agreements to repurchase . . . . .	9	(2)	7
Long-term borrowings(1) . . . . .	1,116	(231)	885
<i>Six Months Ended June 30, 2013</i>			
Federal funds sold and securities purchased under agreements to resell . . . . .	\$ (1)	\$ 3	\$ 2
Deposits . . . . .	30	(33)	(3)
Commercial paper and other short-term borrowings(1) . . . . .	180	(2)	178
Securities sold under agreements to repurchase . . . . .	5	(3)	2
Long-term borrowings(1) . . . . .	1,207	(528)	679
<i>Three Months Ended June 30, 2012</i>			
Federal funds sold and securities purchased under agreements to resell . . . . .	\$ 12	\$ 1	\$ 13
Deposits . . . . .	15	(22)	(7)
Commercial paper and other short-term borrowings(2) . . . . .	211	—	211
Securities sold under agreements to repurchase . . . . .	5	(1)	4
Long-term borrowings(2) . . . . .	1,300	(325)	975
<i>Six Months Ended June 30, 2012</i>			
Federal funds sold and securities purchased under agreements to resell . . . . .	\$ 8	\$ 2	\$ 10
Deposits . . . . .	25	(44)	(19)
Commercial paper and other short-term borrowings(2) . . . . .	82	—	82
Securities sold under agreements to repurchase . . . . .	3	(2)	1
Long-term borrowings(2) . . . . .	(1,651)	(669)	(2,320)

- (1) Of the total gains (losses) recorded in Trading for short-term and long-term borrowings for the quarter and six months ended June 30, 2013, \$175 million and \$(142) million, respectively, are attributable to changes in the credit quality of the Company, and the respective remainder is attributable to changes in foreign currency rates or interest rates or movements in the reference price or index for structured notes before the impact of related hedges.
- (2) Of the total gains (losses) recorded in Trading for short-term and long-term borrowings for the quarter and six months ended June 30, 2012, \$350 million and \$(1,628) million, respectively, are attributable to changes in the credit quality of the Company, and the respective remainder is attributable to changes in foreign currency rates or interest rates or movements in the reference price or index for structured notes before the impact of related hedges.

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, 2012 included in the Form 10-K, all of the instruments within Trading assets or



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**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

Trading liabilities 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 Company hedges the economics of market risk for short-term and long-term borrowings (*i.e.*, risks other than that related to the credit quality of the Company) as part of its overall trading strategy and manages the market risks embedded within the issuance by the related business unit as part of the business unit's portfolio. The gains and losses on related economic hedges are recorded in Trading and largely offset the gains and losses on short-term and long-term borrowings attributable to market risk.

At June 30, 2013 and December 31, 2012, a breakdown of the short-term and long-term borrowings by business unit responsible for risk-managing each borrowing is shown in the table below:

<u>Business Unit</u>	<b>Short-term and Long-term Borrowings</b>	
	<u>At June 30, 2013</u>	<u>At December 31, 2012</u>
	(dollars in millions)	
Interest rates . . . . .	\$19,643	\$23,330
Equity . . . . .	19,387	17,326
Credit and foreign exchange . . . . .	2,680	3,337
Commodities . . . . .	699	776
Total . . . . .	<u>\$42,409</u>	<u>\$44,769</u>

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.**

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<u>2013</u>	<u>2012</u>	<u>2013</u>	<u>2012</u>
	(dollars in millions)			
Short-term and long-term borrowings(1) . . . . .	\$175	\$ 350	\$(142)	\$(1,628)
Loans(2) . . . . .	55	(119)	115	174
Unfunded lending commitments(3) . . . . .	81	78	215	485

- (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.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Net Difference between Contractual Principal Amount and Fair Value.

	Contractual Principal Amount Exceeds Fair Value	
	At June 30, 2013	At December 31, 2012
	(dollars in millions)	
Short-term and long-term borrowings(1)	\$ (821)	\$ (436)
Loans(2)	18,653	25,249
Loans 90 or more days past due and/or on non-accrual status(2)(3)	15,766	20,456

- (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) The aggregate fair value of loans that were in non-accrual status, which includes all loans 90 or more days past due, was \$1,523 million and \$1,360 million at June 30, 2013 and December 31, 2012, respectively. The aggregate fair value of loans that were 90 or more days past due was \$785 million and \$840 million at June 30, 2013 and December 31, 2012, 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.

*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, other investments, premises, equipment and software costs, and intangible assets.

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 and six months ended June 30, 2013 and 2012, respectively.

*Three and Six Months Ended June 30, 2013.*

	Fair Value Measurements Using:				Total Gains (Losses) for the Three Months Ended June 30, 2013(2)	Total Gains (Losses) for the Six Months Ended June 30, 2013(2)
	Carrying Value at June 30, 2013(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(3)	\$1,511	\$—	\$1,254	\$257	\$(51)	\$ (77)
Other investments(4)	64	—	—	64	(5)	(20)
Premises, equipment and software costs(4)	—	—	—	—	(6)	(6)
Intangible assets(4)	25	—	—	25	(8)	(9)
Total	<u>\$1,600</u>	<u>\$—</u>	<u>\$1,254</u>	<u>\$346</u>	<u>\$(70)</u>	<u>\$(112)</u>

- (1) Carrying values relate only to those assets that had fair value adjustments during the quarter ended June 30, 2013. These amounts do not include assets that had fair value adjustments during the six months ended June 30, 2013, unless the assets also had a fair value adjustment during the quarter ended June 30, 2013.

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**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

- (2) Losses are recorded within Other expenses in the condensed consolidated statements of income except for fair value adjustments related to Loans and losses related to Other investments, which are included in Other revenues.
- (3) 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.
- (4) Losses recorded were determined primarily using discounted cash flow models.

There were no liabilities measured at fair value on a non-recurring basis during the quarter and six months ended June 30, 2013.

*Three and Six Months Ended June 30, 2012.*

	<u>Fair Value Measurements Using:</u>				Total Gains (Losses) for the Three Months Ended June 30, 2012(2)	Total Gains (Losses) for the Six Months Ended June 30, 2012(2)
	Carrying Value at June 30, 2012(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(3) . . . . .	\$762	\$—	\$146	\$616	\$(13)	\$(19)
Other investments(4) . . . . .	86	—	—	86	(7)	(8)
Premises, equipment and software costs(4) . . . . .	1	—	—	1	—	(2)
Intangible assets(4) . . . . .	—	—	—	—	(2)	(4)
Total . . . . .	<u>\$849</u>	<u>\$—</u>	<u>\$146</u>	<u>\$703</u>	<u>\$(22)</u>	<u>\$(33)</u>

- (1) Carrying values relate only to those assets that had fair value adjustments during the quarter ended June 30, 2012. These amounts do not include assets that had fair value adjustments during the six months ended June 30, 2012, unless the assets also had a fair value adjustment during the quarter ended June 30, 2012.
- (2) Losses are recorded within Other expenses in the condensed consolidated statements of income except for fair value adjustments related to Loans and losses related to Other investments, which are included in Other revenues.
- (3) 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.
- (4) Losses recorded were determined primarily using discounted cash flow models.

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 six months ended June 30, 2012 in connection with the disposition of Saxon (see Notes 1 and 21). This pre-tax gain was primarily due to the subsequent increase in the 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 and six months ended June 30, 2012.

***Financial Instruments Not Measured at Fair Value.***

The tables below present 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 tables below exclude 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.

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### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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 Customer and other receivables and Customer and other payables arising in the ordinary course of business, 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.

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

For consumer and residential real estate loans where position-specific external price data are 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.

The fair value of long-term borrowings is generally determined based on transactional data or third party pricing for identical or comparable instruments, when available. Where position-specific external prices are not observable, fair value is determined based on current interest rates and credit spreads for debt instruments with similar terms and maturity.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Financial Instruments Not Measured at Fair Value at June 30, 2013 and December 31, 2012.

At June 30, 2013.

	At June 30, 2013		Fair Value Measurements Using:		
	Carrying Value	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
(dollars in millions)					
<b>Financial Assets:</b>					
Cash and due from banks	\$ 16,295	\$ 16,295	\$ 16,295	\$ —	\$ —
Interest bearing deposits with banks	30,904	30,904	30,904	—	—
Cash deposited with clearing organizations or segregated under federal and other regulations or requirements	35,363	35,363	35,363	—	—
Federal funds sold and securities purchased under agreements to resell	141,625	141,642	—	140,915	727
Securities borrowed	129,114	129,119	—	128,924	195
Customer and other receivables(1)	59,647	59,444	—	53,942	5,502
Loans(2)	34,571	34,797	—	7,458	27,339
<b>Financial Liabilities:</b>					
Deposits	\$ 80,089	\$ 80,089	\$ —	\$ 80,089	\$ —
Commercial paper and other short-term borrowings	776	776	—	651	125
Securities sold under agreements to repurchase	133,030	132,996	—	123,861	9,135
Securities loaned	36,135	36,195	—	34,544	1,651
Other secured financings	7,219	7,236	—	4,453	2,783
Customer and other payables(1)	142,215	142,215	—	142,215	—
Long-term borrowings	120,279	122,168	—	114,176	7,992

(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.

The fair value of the Company's unfunded lending commitments, primarily related to corporate lending in the Institutional Securities business segment, that are not carried at fair value at June 30, 2013 was \$986 million, of which \$706 million and \$280 million would be categorized in Level 2 and Level 3 of the fair value hierarchy, respectively. The carrying value of these commitments, if fully funded, would be \$68.6 billion.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

At December 31, 2012.

	At December 31, 2012		Fair Value Measurements Using:		
	Carrying Value	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	(dollars in millions)				
<b>Financial Assets:</b>					
Cash and due from banks	\$ 20,878	\$ 20,878	\$20,878	\$ —	\$ —
Interest bearing deposits with banks	26,026	26,026	26,026	—	—
Cash deposited with clearing organizations or segregated under federal and other regulations or requirements	30,970	30,970	30,970	—	—
Federal funds sold and securities purchased under agreements to resell	133,791	133,792	—	133,035	757
Securities borrowed	121,701	121,705	—	121,691	14
Customer and other receivables(1)	59,702	59,634	—	53,532	6,102
Loans(2)	29,046	27,263	—	5,307	21,956
<b>Financial Liabilities:</b>					
Deposits	\$ 81,781	\$ 81,781	\$ —	\$ 81,781	\$ —
Commercial paper and other short-term borrowings	1,413	1,413	—	1,107	306
Securities sold under agreements to repurchase	122,311	122,389	—	111,722	10,667
Securities loaned	36,849	37,163	—	35,978	1,185
Other secured financings	6,261	6,276	—	3,649	2,627
Customer and other payables(1)	125,037	125,037	—	125,037	—
Long-term borrowings	125,527	126,683	—	116,511	10,172

(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.

The fair value of the Company's unfunded lending commitments, primarily related to corporate lending in the Institutional Securities business segment, that are not carried at fair value at December 31, 2012 was \$755 million, of which \$543 million and \$212 million would be categorized in Level 2 and Level 3 of the fair value hierarchy, respectively. The carrying value of these commitments, if fully funded, would be \$50.0 billion.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

5. Securities Available for Sale.

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

	At June 30, 2013				Fair Value
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Other-than-Temporary Impairment	
	(dollars in millions)				
Debt securities available for sale:					
U.S. government and agency securities:					
U.S. Treasury securities	\$15,772	\$ 46	\$110	\$—	\$15,708
U.S. agency securities	14,364	30	166	—	14,228
Total U.S. government and agency securities	30,136	76	276	—	29,936
Corporate and other debt:					
Commercial mortgage-backed securities:					
Agency	2,426	—	64	—	2,362
Non-Agency	913	—	24	—	889
Auto loan asset-backed securities	2,056	1	7	—	2,050
Corporate bonds	3,679	2	67	—	3,614
Collateralized debt and loan obligations	1,087	—	8	—	1,079
FFELP student loan asset-backed securities(1)	2,911	14	7	—	2,918
Total Corporate and other debt	13,072	17	177	—	12,912
Total debt securities available for sale	43,208	93	453	—	42,848
Equity securities available for sale	15	—	5	—	10
Total	\$43,223	\$ 93	\$458	\$—	\$42,858

	At December 31, 2012				Fair Value
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Other-than-Temporary Impairment	
	(dollars in millions)				
Debt securities available for sale:					
U.S. government and agency securities:					
U.S. Treasury securities	\$14,351	\$109	\$ 2	\$—	\$14,458
U.S. agency securities	15,330	122	3	—	15,449
Total U.S. government and agency securities	29,681	231	5	—	29,907
Corporate and other debt:					
Commercial mortgage-backed securities:					
Agency	2,197	6	4	—	2,199
Non-Agency	160	—	—	—	160
Auto loan asset-backed securities	1,993	4	1	—	1,996
Corporate bonds	2,891	13	3	—	2,901
FFELP student loan asset-backed securities(1)	2,675	23	—	—	2,698
Total Corporate and other debt	9,916	46	8	—	9,954
Total debt securities available for sale	39,597	277	13	—	39,861
Equity securities available for sale	15	—	7	—	8
Total	\$39,612	\$277	\$ 20	\$—	\$39,869

(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.

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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

At June 30, 2013	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
	(dollars in millions)					
Debt securities available for sale:						
U.S. government and agency securities:						
U.S. Treasury securities	\$ 6,428	\$110	\$—	\$—	\$ 6,428	\$110
U.S. agency securities	7,108	166	8	—	7,116	166
Total U.S. government and agency securities	13,536	276	8	—	13,544	276
Corporate and other debt:						
Commercial mortgage-backed securities:						
Agency	2,362	64	—	—	2,362	64
Non-Agency	889	24	—	—	889	24
Auto loan asset-backed securities	1,288	7	—	—	1,288	7
Corporate bonds	3,080	67	—	—	3,080	67
Collateralized debt and loan obligations	1,079	8	—	—	1,079	8
FFELP student loan asset-backed securities	1,359	7	—	—	1,359	7
Total Corporate and other debt	10,057	177	—	—	10,057	177
Total debt securities available for sale	23,593	453	8	—	23,601	453
Equity securities available for sale	—	—	10	5	10	5
Total	\$23,593	\$453	\$ 18	\$ 5	\$23,611	\$458

At December 31, 2012	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
	(dollars in millions)					
Debt securities available for sale:						
U.S. government and agency securities:						
U.S. Treasury securities	\$ 1,012	\$ 2	\$—	\$—	\$ 1,012	\$ 2
U.S. agency securities	1,534	3	27	—	1,561	3
Total U.S. government and agency securities	2,546	5	27	—	2,573	5
Corporate and other debt:						
Commercial mortgage-backed securities:						
Agency	1,057	4	—	—	1,057	4
Auto loan asset-backed securities	710	1	—	—	710	1
Corporate bonds	934	3	—	—	934	3
Total Corporate and other debt	2,701	8	—	—	2,701	8
Total debt securities available for sale	5,247	13	27	—	5,274	13
Equity securities available for sale	8	7	—	—	8	7
Total	\$ 5,255	\$ 20	\$ 27	\$—	\$ 5,282	\$ 20



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**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

Gross unrealized gains and losses are recorded in Accumulated other comprehensive income.

The unrealized losses reported above on debt securities available for sale are due to rising interest rates during the quarter ended June 30, 2013. 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 June 30, 2013.

For equity securities available for sale in an unrealized loss position, 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 June 30, 2013.

The following table presents the amortized cost and fair value of debt securities available for sale by contractual maturity dates at June 30, 2013.

<u>At June 30, 2013</u>	<u>Amortized Cost</u>	<u>Fair Value</u>	<u>Annualized Average Yield</u>
	(dollars in millions)		
U.S. government and agency securities:			
U.S. Treasury securities:			
Due within 1 year . . . . .	\$ 449	\$ 455	2.1%
After 1 year through 5 years . . . . .	15,131	15,060	0.7%
After 5 years through 10 years . . . . .	192	193	2.0%
Total . . . . .	<u>15,772</u>	<u>15,708</u>	
U.S. agency securities:			
After 5 years through 10 years . . . . .	2,061	2,053	1.1%
After 10 years . . . . .	12,303	12,175	1.2%
Total . . . . .	<u>14,364</u>	<u>14,228</u>	
Total U.S. government and agency securities . . . . .	<u>30,136</u>	<u>29,936</u>	1.0%
Corporate and other debt:			
Commercial mortgage-backed securities:			
Agency:			
After 1 year through 5 years . . . . .	542	533	0.9%
After 5 years through 10 years . . . . .	555	544	0.9%
After 10 years . . . . .	1,329	1,285	1.5%
Total . . . . .	<u>2,426</u>	<u>2,362</u>	
Non-Agency:			
After 1 year through 5 years . . . . .	116	113	1.1%
After 5 years through 10 years . . . . .	38	37	0.8%
After 10 years . . . . .	759	739	1.5%
Total . . . . .	<u>913</u>	<u>889</u>	
Auto loan asset-backed securities:			
After 1 year through 5 years . . . . .	1,933	1,929	0.7%
After 5 years through 10 years . . . . .	123	121	0.7%
Total . . . . .	<u>2,056</u>	<u>2,050</u>	

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**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

<u>At June 30, 2013</u>	<u>Amortized Cost</u>	<u>Fair Value</u>	<u>Annualized Average Yield</u>
	(dollars in millions)		
Corporate bonds:			
Due within 1 year . . . . .	208	208	0.5%
After 1 year through 5 years . . . . .	2,735	2,697	1.2%
After 5 years through 10 years . . . . .	736	709	2.1%
Total . . . . .	<u>3,679</u>	<u>3,614</u>	
Collateralized debt and loan obligations:			
After 1 year through 5 years . . . . .	50	50	1.7%
After 10 years . . . . .	1,037	1,029	1.5%
Total . . . . .	<u>1,087</u>	<u>1,079</u>	
FFELP student loan asset-backed securities:			
After 1 year through 5 years . . . . .	110	110	0.7%
After 5 years through 10 years . . . . .	474	476	1.0%
After 10 years . . . . .	2,327	2,332	1.0%
Total . . . . .	<u>2,911</u>	<u>2,918</u>	
Total Corporate and other debt . . . . .	<u>13,072</u>	<u>12,912</u>	1.1%
Total debt securities available for sale . . . . .	<u>\$43,208</u>	<u>\$42,848</u>	1.0%

See Note 7 for additional information on securities issued by VIEs, including U.S. agency mortgage-backed securities, auto loan asset-backed securities, FFELP student loan asset-backed securities and collateralized debt and loan obligations.

The following table presents information pertaining to sales of securities available for sale during the three and six months ended June 30, 2013 and 2012:

	<u>Three Months Ended June 30,</u>		<u>Six Months Ended June 30,</u>	
	<u>2013</u>	<u>2012</u>	<u>2013</u>	<u>2012</u>
	(dollars in millions)			
Gross realized gains . . . . .	<u>\$35</u>	<u>\$24</u>	<u>\$41</u>	<u>\$25</u>
Gross realized losses . . . . .	<u>\$ 1</u>	<u>\$ 2</u>	<u>\$ 3</u>	<u>\$ 2</u>

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

**6. 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 manages credit exposure arising from such transactions by, in appropriate circumstances, entering into master netting agreements and collateral agreements with counterparties that provide the Company, in the event of a counterparty default (such as bankruptcy or a counterparty's failure to pay or perform), the right to net a counterparty's rights and obligations under such agreement and liquidate and setoff collateral against the net amount owed by the counterparty. The Company's policy is generally to take possession of securities purchased under agreements to resell and securities borrowed, and to receive securities and cash posted as collateral (with rights of rehypothecation), although in certain

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**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

cases the Company may agree for such collateral to be posted to a third party custodian under a tri-party arrangement that enables the Company to take control of such collateral in the event of a counterparty default. 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 as provided under the applicable agreement to ensure such transactions are adequately collateralized. The following tables present information about the offsetting of these instruments and related collateral amounts. For information related to offsetting of derivatives, see Note 11.

At June 30, 2013					
<u>Gross Amounts(1)</u>	<u>Amounts Offset in the Condensed Consolidated Statements of Financial Condition(2)</u>	<u>Net Amounts Presented in the Condensed Consolidated Statements of Financial Condition</u>	<u>Financial Instruments Not Offset in the Condensed Consolidated Statements of Financial Condition(3)</u>	<u>Net Exposure</u>	
(dollars in millions)					
<b>Assets</b>					
Federal funds sold and securities purchased under agreements to resell . . . . .	\$224,457	\$(81,963)	\$142,494	\$(134,752)	\$ 7,742
Securities borrowed . . . . .	135,398	(6,284)	129,114	(112,776)	16,338
<b>Liabilities</b>					
Securities sold under agreements to repurchase . . . . .	\$215,545	\$(81,963)	\$133,582	\$(102,451)	\$31,131
Securities loaned . . . . .	42,419	(6,284)	36,135	(33,965)	2,170

- (1) Amounts include \$7.4 billion of Federal funds sold and securities purchased under agreements to resell, \$13.2 billion of Securities borrowed, \$29.6 billion of Securities sold under agreements to repurchase and \$2.0 billion of Securities loaned which are either not subject to master netting agreements or collateral agreements or are subject to such agreements but the Company has not determined the agreements to be legally enforceable.
- (2) Amounts relate to master netting agreements and collateral agreements which have been determined by the Company to be legally enforceable in the event of default and where certain other criteria are met in accordance with applicable offsetting accounting guidance.
- (3) Amounts relate to master netting agreements and collateral agreements which have been determined by the Company to be legally enforceable in the event of default but where certain other criteria are not met in accordance with applicable offsetting accounting guidance.

At December 31, 2012					
<u>Gross Amounts(1)</u>	<u>Amounts Offset in the Condensed Consolidated Statements of Financial Condition(2)</u>	<u>Net Amounts Presented in the Condensed Consolidated Statements of Financial Condition</u>	<u>Financial Instruments Not Offset in the Condensed Consolidated Statements of Financial Condition(3)</u>	<u>Net Exposure</u>	
(dollars in millions)					
<b>Assets</b>					
Federal funds sold and securities purchased under agreements to resell . . . . .	\$203,448	\$(69,036)	\$134,412	\$(126,303)	\$ 8,109
Securities borrowed . . . . .	127,002	(5,301)	121,701	(105,849)	15,852
<b>Liabilities</b>					
Securities sold under agreements to repurchase . . . . .	\$191,710	\$(69,036)	\$122,674	\$(103,521)	\$19,153
Securities loaned . . . . .	42,150	(5,301)	36,849	(30,395)	6,454

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**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

- (1) Amounts include \$7.4 billion of Federal funds sold and securities purchased under agreements to resell, \$8.6 billion of Securities borrowed, \$17.5 billion of Securities sold under agreements to repurchase and \$0.6 billion of Securities loaned which are either not subject to master netting agreements or collateral agreements or are subject to such agreements but the Company has not determined the agreements to be legally enforceable.
- (2) Amounts relate to master netting agreements and collateral agreements which have been determined by the Company to be legally enforceable in the event of default and where certain other criteria are met in accordance with applicable offsetting accounting guidance.
- (3) Amounts relate to master netting agreements and collateral agreements which have been determined by the Company to be legally enforceable in the event of default but where certain other criteria are not met in accordance with applicable offsetting accounting guidance.

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 June 30, 2013 and December 31, 2012, there were approximately \$21.3 billion and \$24.0 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 Trading assets (see Notes 7 and 10).

The Company pledges its trading assets to collateralize repurchase agreements and other securities financings. Pledged financial instruments that can be sold or repledged by the secured party are identified as Trading assets (pledged to various parties) in the condensed consolidated statements of financial condition. The carrying value and classification of Trading assets 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:

	<u>At June 30, 2013</u>	<u>At December 31, 2012</u>
<u>(dollars in millions)</u>		
Trading assets:		
U.S. government and agency securities . . . . .	\$ 9,350	\$15,273
Other sovereign government obligations . . . . .	4,001	3,278
Corporate and other debt . . . . .	14,913	11,980
Corporate equities . . . . .	<u>9,788</u>	<u>26,377</u>
Total . . . . .	<u>\$38,052</u>	<u>\$56,908</u>

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**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

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 condensed consolidated statements of financial condition. At June 30, 2013 and December 31, 2012, the fair value of financial instruments received as collateral where the Company is permitted to sell or repledge the securities was \$602 billion and \$560 billion, respectively, and the fair value of the portion that had been sold or repledged was \$443 billion and \$397 billion, respectively.

At June 30, 2013 and December 31, 2012, cash and securities deposited with clearing organizations or segregated under federal and other regulations or requirements were as follows:

	At June 30, 2013	At December 31, 2013
	(dollars in millions)	
Cash deposited with clearing organizations or segregated under federal and other regulations or requirements .....	\$35,363	\$30,970
Securities(1) .....	14,555	13,424
Total .....	\$49,918	\$44,394

(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 Trading assets in the condensed consolidated statements of financial condition.

**7. Variable Interest Entities and Securitization Activities.**

The Company is involved with various special purpose entities (“SPE”) in the normal course of business. In most cases, these entities are deemed 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. Except for certain asset management entities, 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 of residential and commercial mortgage loans held by VIEs.
- Loans made to and investments in VIEs that hold debt, equity, real estate or other assets.

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### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

- 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 is 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 (*i.e.*, investors in most subordinated bond classes) 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.

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 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 Trading assets 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 Trading assets 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.

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**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

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.

As part of the Company's Institutional Securities business segment's securitization and related activities, 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 12).

The following tables present information at June 30, 2013 and December 31, 2012 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:

	<b>At June 30, 2013</b>				
	<b>Mortgage and Asset-Backed Securitizations</b>	<b>Collateralized Debt Obligations</b>	<b>Managed Real Estate Partnerships</b>	<b>Other Structured Financings</b>	<b>Other</b>
	(dollars in millions)				
VIE assets . . . . .	\$753	\$—	\$2,235	\$1,226	\$1,387
VIE liabilities . . . . .	\$448	\$—	\$ 107	\$ 65	\$ 162

	<b>At December 31, 2012</b>				
	<b>Mortgage and Asset-Backed Securitizations</b>	<b>Collateralized Debt Obligations</b>	<b>Managed Real Estate Partnerships</b>	<b>Other Structured Financings</b>	<b>Other</b>
	(dollars in millions)				
VIE assets . . . . .	\$978	\$52	\$2,394	\$983	\$1,676
VIE liabilities . . . . .	\$646	\$16	\$ 83	\$ 65	\$ 313

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 June 30, 2013 and December 31, 2012, managed real estate partnerships reflected nonredeemable noncontrolling interests in the Company's condensed consolidated financial statements of \$1,679 million and \$1,804 million, respectively. The Company also had additional maximum exposure to losses of approximately \$62 million and \$58 million at June 30, 2013 and December 31, 2012, 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.



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**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

The following tables present information about certain non-consolidated VIEs in which the Company had variable interests at June 30, 2013 and December 31, 2012. 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 and securities held in its available for sale portfolio (see Note 5):

	At June 30, 2013				
	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) . . . . .	\$279,227	\$22,003	\$3,247	\$1,759	\$9,631
Maximum exposure to loss:					
Debt and equity interests(2) . . . . .	\$ 22,707	\$ 1,978	\$ 79	\$1,061	\$2,788
Derivative and other contracts . . . . .	119	24	1,999	—	231
Commitments, guarantees and other . . . . .	—	278	—	661	539
Total maximum exposure to loss . . . . .	<u>\$ 22,826</u>	<u>\$ 2,280</u>	<u>\$2,078</u>	<u>\$1,722</u>	<u>\$3,558</u>
Carrying value of exposure to loss—Assets:					
Debt and equity interests(2) . . . . .	\$ 22,707	\$ 1,978	\$ 79	\$ 670	\$2,788
Derivative and other contracts . . . . .	119	5	4	—	83
Total carrying value of exposure to loss—Assets . . . . .	<u>\$ 22,826</u>	<u>\$ 1,983</u>	<u>\$ 83</u>	<u>\$ 670</u>	<u>\$2,871</u>
Carrying value of exposure to loss—Liabilities:					
Derivative and other contracts . . . . .	\$ —	\$ 2	\$ —	\$ —	\$ 54
Commitments, guarantees and other . . . . .	—	—	—	10	—
Total carrying value of exposure to loss—Liabilities . . . . .	<u>\$ —</u>	<u>\$ 2</u>	<u>\$ —</u>	<u>\$ 10</u>	<u>\$ 54</u>

(1) Mortgage and asset-backed securitizations include VIE assets as follows: \$26.9 billion of residential mortgages; \$62.4 billion of commercial mortgages; \$132.2 billion of U.S. agency collateralized mortgage obligations; and \$57.7 billion of other consumer or commercial loans.

(2) Mortgage and asset-backed securitizations include VIE debt and equity interests as follows: \$2.5 billion of residential mortgages; \$1.6 billion of commercial mortgages; \$13.7 billion of U.S. agency collateralized mortgage obligations; and \$4.9 billion of other consumer or commercial loans.



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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

	At December 31, 2012				
	<u>Mortgage and Asset-Backed Securizations</u>	<u>Collateralized Debt Obligations</u>	<u>Municipal Tender Option Bonds</u>	<u>Other Structured Financings</u>	<u>Other</u>
	(dollars in millions)				
VIE assets that the Company does not consolidate (unpaid principal balance)(1) . . . . .	\$251,689	\$13,178	\$3,390	\$1,811	\$14,029
Maximum exposure to loss:					
Debt and equity interests(2) . . . . .	\$ 22,280	\$ 1,173	\$ —	\$1,053	\$ 3,387
Derivative and other contracts . . . . .	154	51	2,158	—	562
Commitments, guarantees and other . . . . .	66	—	—	679	384
Total maximum exposure to loss . . . . .	<u>\$ 22,500</u>	<u>\$ 1,224</u>	<u>\$2,158</u>	<u>\$1,732</u>	<u>\$ 4,333</u>
Carrying value of exposure to loss—Assets:					
Debt and equity interests(2) . . . . .	\$ 22,280	\$ 1,173	\$ —	\$ 663	\$ 3,387
Derivative and other contracts . . . . .	156	8	4	—	174
Total carrying value of exposure to loss—Assets . . . . .	<u>\$ 22,436</u>	<u>\$ 1,181</u>	<u>\$ 4</u>	<u>\$ 663</u>	<u>\$ 3,561</u>
Carrying value of exposure to loss—Liabilities:					
Derivative and other contracts . . . . .	\$ 11	\$ 2	\$ —	\$ —	\$ 172
Commitments, guarantees and other . . . . .	—	—	—	12	—
Total carrying value of exposure to loss—Liabilities . . . . .	<u>\$ 11</u>	<u>\$ 2</u>	<u>\$ —</u>	<u>\$ 12</u>	<u>\$ 172</u>

(1) Mortgage and asset-backed securitizations include VIE assets as follows: \$18.3 billion of residential mortgages; \$53.8 billion of commercial mortgages; \$126.3 billion of U.S. agency collateralized mortgage obligations; and \$53.3 billion of other consumer or commercial loans.

(2) Mortgage and asset-backed securitizations include VIE debt and equity interests as follows: \$1.0 billion of residential mortgages; \$1.5 billion of commercial mortgages; \$14.8 billion of U.S. agency collateralized mortgage obligations; and \$5.0 billion of other consumer or commercial loans.

The Company's maximum exposure to loss often differs from the carrying value of the variable interests held by the Company. 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 \$4.5 billion at June 30, 2013. 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 (see Note 5). Securities issued by

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**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

securitization SPEs consist of \$1.7 billion of securities backed primarily by residential mortgage loans, \$0.4 billion of securities backed by U.S. agency collateralized mortgage obligations, \$1.0 billion of securities backed by commercial mortgage loans, \$0.5 billion of securities backed by collateralized debt obligations or collateralized loan obligations and \$0.9 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 Trading assets—Corporate and other debt or Securities available for sale and are measured at fair value (see Note 4). 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, 2012 included in the Form 10-K.

***Transfers of Assets with Continuing Involvement.***

The following tables present information at June 30, 2013 regarding transactions with SPEs in which the Company, acting as principal, transferred financial assets with continuing involvement and received sales treatment:

	<b>At June 30, 2013</b>			
	<b>Residential Mortgage Loans</b>	<b>Commercial Mortgage Loans</b>	<b>U.S. Agency Collateralized Mortgage Obligations</b>	<b>Credit- Linked Notes and Other</b>
	(dollars in millions)			
SPE assets (unpaid principal balance)(1) . . . . .	\$33,747	\$53,754	\$15,893	\$12,870
Retained interests (fair value):				
Investment grade . . . . .	\$ 1	\$ 55	\$ 1,953	\$ —
Non-investment grade . . . . .	51	114	—	1,327
Total retained interests (fair value) . . . . .	<u>\$ 52</u>	<u>\$ 169</u>	<u>\$ 1,953</u>	<u>\$ 1,327</u>
Interests purchased in the secondary market (fair value):				
Investment grade . . . . .	\$ 22	\$ 67	\$ 11	\$ 361
Non-investment grade . . . . .	80	25	—	61
Total interests purchased in the secondary market (fair value) . . . . .	<u>\$ 102</u>	<u>\$ 92</u>	<u>\$ 11</u>	<u>\$ 422</u>
Derivative assets (fair value) . . . . .	\$ —	\$ 776	\$ —	\$ 176
Derivative liabilities (fair value) . . . . .	\$ 2	\$ 1	\$ —	\$ 189

(1) Amounts include assets transferred by unrelated transferors.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

	At June 30, 2013			
	Level 1	Level 2	Level 3	Total
	(dollars in millions)			
Retained interests (fair value):				
Investment grade	\$—	\$1,971	\$ 38	\$2,009
Non-investment grade	—	94	1,398	1,492
Total retained interests (fair value)	\$—	\$2,065	\$1,436	\$3,501
Interests purchased in the secondary market (fair value):				
Investment grade	\$—	\$ 438	\$ 23	\$ 461
Non-investment grade	—	145	21	166
Total interests purchased in the secondary market (fair value)	\$—	\$ 583	\$ 44	\$ 627
Derivative assets (fair value)	\$—	\$ 694	\$ 258	\$ 952
Derivative liabilities (fair value)	\$—	\$ 172	\$ 20	\$ 192

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

	At December 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)	\$36,750	\$70,824	\$17,787	\$14,701
Retained interests (fair value):				
Investment grade	\$ 1	\$ 77	\$ 1,468	\$ —
Non-investment grade	54	109	—	1,503
Total retained interests (fair value)	\$ 55	\$ 186	\$ 1,468	\$ 1,503
Interests purchased in the secondary market (fair value):				
Investment grade	\$ 11	\$ 124	\$ 99	\$ 389
Non-investment grade	113	34	—	31
Total interests purchased in the secondary market (fair value)	\$ 124	\$ 158	\$ 99	\$ 420
Derivative assets (fair value)	\$ 2	\$ 948	\$ —	\$ 177
Derivative liabilities (fair value)	\$ 22	\$ —	\$ —	\$ 303

(1) Amounts include assets transferred by unrelated transferors.

	At December 31, 2012			
	Level 1	Level 2	Level 3	Total
	(dollars in millions)			
Retained interests (fair value):				
Investment grade	\$—	\$1,476	\$ 70	\$1,546
Non-investment grade	—	84	1,582	1,666
Total retained interests (fair value)	\$—	\$1,560	\$1,652	\$3,212
Interests purchased in the secondary market (fair value):				
Investment grade	\$—	\$ 617	\$ 6	\$ 623
Non-investment grade	—	139	39	178
Total interests purchased in the secondary market (fair value)	\$—	\$ 756	\$ 45	\$ 801
Derivative assets (fair value)	\$—	\$ 774	\$ 353	\$1,127
Derivative liabilities (fair value)	\$—	\$ 295	\$ 30	\$ 325

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**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

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 six months ended June 30, 2013 and 2012.

During the six months ended June 30, 2013 and 2012, the Company received proceeds from new securitization transactions of \$13.0 billion and \$9.2 billion, respectively. During the six months ended June 30, 2013 and 2012, the Company received proceeds from cash flows from retained interests in securitization transactions of \$2.2 billion and \$1.7 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 12).

***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 for transfers to VIEs and securitizations, the Company continues to recognize the assets in Trading assets, 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.

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:

	<u>At June 30, 2013</u>		<u>At December 31, 2012</u>	
	<u>Carrying Value of</u>		<u>Carrying Value of</u>	
	<u>Assets</u>	<u>Liabilities</u>	<u>Assets</u>	<u>Liabilities</u>
	(dollars in millions)			
Credit-linked notes . . . . .	\$147	\$141	\$283	\$222
Equity-linked transactions . . . . .	35	31	422	405
Other . . . . .	228	227	29	28

***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 \$9 million and \$7 million at June 30, 2013 and December 31, 2012, respectively, and are included within Intangible assets and carried at fair value in the condensed consolidated statements of financial condition.

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**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

*SPE Mortgage Servicing Activities.* The Company services residential mortgage loans in the U.S. and in Europe 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 June 30, 2013 and December 31, 2012 totaled approximately \$68 million and \$49 million, respectively. There were no allowances at June 30, 2013 and December 31, 2012.

The following tables present information about the Company's mortgage servicing activities for SPEs to which the Company transferred loans at June 30, 2013 and December 31, 2012:

	At June 30, 2013		
	Residential Mortgage Unconsolidated SPEs	Residential Mortgage Consolidated SPEs	Commercial Mortgage Unconsolidated SPEs
	(dollars in millions)		
Assets serviced (unpaid principal balance) . . . . .	\$741	\$863	\$4,301
Amounts past due 90 days or greater (unpaid principal balance)(1) . . . . .	\$ 72	\$ 48	\$ —
Percentage of amounts past due 90 days or greater(1) . . . . .	9.7%	5.5%	—
Credit losses . . . . .	\$ 1	\$ 3	\$ —

(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.

	At December 31, 2012		
	Residential Mortgage Unconsolidated SPEs	Residential Mortgage Consolidated SPEs	Commercial Mortgage Unconsolidated SPEs
	(dollars in millions)		
Assets serviced (unpaid principal balance) . . . . .	\$ 821	\$1,141	\$4,760
Amounts past due 90 days or greater (unpaid principal balance)(1) . . . . .	\$ 86	\$ 43	\$ —
Percentage of amounts past due 90 days or greater(1) . . . . .	10.4%	3.8%	—
Credit losses . . . . .	\$ 3	\$ 2	\$ —

(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.

**8. Financing Receivables and Allowance for Credit Losses.**

*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.

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**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

The Company’s loans held for investment at June 30, 2013 and December 31, 2012 included the following:

	At June 30, 2013	At December 31, 2012
(dollars in millions)		
Commercial and industrial .....	\$11,170	\$ 9,449
Consumer loans .....	9,452	7,618
Residential real estate loans .....	7,602	6,630
Wholesale real estate loans .....	863	326
Total loans held for investment, gross of allowance for loan losses .....	29,087	24,023
Allowance for loan losses .....	(125)	(106)
Total loans held for investment, net of allowance for loan losses .....	\$28,962	\$23,917

The above table does not include loans held for sale of \$5,609 million and \$5,129 million at June 30, 2013 and December 31, 2012, respectively.

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 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.

Commercial and industrial loans of approximately \$4 million and wholesale real estate loans of approximately \$10 million were impaired at June 30, 2013. Approximately 99% of the Company’s loan portfolio was current at June 30, 2013. Commercial and industrial loans of approximately \$19 million and residential real estate loans of approximately \$1 million were impaired at December 31, 2012. Approximately 99% of the Company’s loan portfolio was current at December 31, 2012.

The Company assigned an internal grade of “doubtful” to certain commercial asset-backed and wholesale real estate loans totaling \$11 million and \$25 million at June 30, 2013 and December 31, 2012, 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, 2012 included in the Form 10-K.

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**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

The table below summarizes information about the allowance for loan losses, loans by impairment methodology, the allowance for lending-related commitments and lending-related commitments by impairment methodology.

	<u>Commercial and Industrial</u>	<u>Consumer</u>	<u>Residential Real Estate</u>	<u>Wholesale Real Estate</u>	<u>Total</u>
	(dollars in millions)				
Allowance for loan losses:					
Balance at December 31, 2012 . . . . .	\$ 96	\$ 3	\$ 5	\$ 2	\$ 106
Gross charge-offs . . . . .	(12)	—	(1)	(2)	(15)
Net charge-offs . . . . .	(12)	—	(1)	(2)	(15)
Provision for loan losses(1)(4) . . . . .	31	(2)	—	5	34
Balance at June 30, 2013 . . . . .	<u>\$ 115</u>	<u>\$ 1</u>	<u>\$ 4</u>	<u>\$ 5</u>	<u>\$ 125</u>
Allowance for loan losses by impairment methodology:					
Collectively evaluated for impairment . . . . .	\$ 113	\$ 1	\$ 4	\$ 4	\$ 122
Individually evaluated for impairment . . . . .	2	—	—	1	3
Total allowance for loan losses at June 30, 2013 . . . . .	<u>\$ 115</u>	<u>\$ 1</u>	<u>\$ 4</u>	<u>\$ 5</u>	<u>\$ 125</u>
Loans evaluated by impairment methodology(2):					
Collectively evaluated for impairment . . . . .	\$11,154	\$9,452	\$7,594	\$853	\$29,053
Individually evaluated for impairment . . . . .	16	—	8	10	34
Total loan evaluated at June 30, 2013 . . . . .	<u>\$11,170</u>	<u>\$9,452</u>	<u>\$7,602</u>	<u>\$863</u>	<u>\$29,087</u>
Allowance for lending-related commitments:					
Balance at December 31, 2012 . . . . .	\$ 90	\$ —	\$ —	\$ 1	\$ 91
Provision for lending-related commitments(3)(4) . . . . .	29	—	—	—	29
Other . . . . .	(10)	—	—	—	(10)
Balance at June 30, 2013 . . . . .	<u>\$ 109</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 1</u>	<u>\$ 110</u>
Allowance for lending-related commitments by impairment methodology:					
Collectively evaluated for impairment . . . . .	\$ 109	\$ —	\$ —	\$ 1	\$ 110
Individually evaluated for impairment . . . . .	—	—	—	—	—
Total allowance for lending-related commitments at June 30, 2013 . . . . .	<u>\$ 109</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 1</u>	<u>\$ 110</u>
Lending-related commitments evaluated by impairment methodology:					
Collectively evaluated for impairment . . . . .	\$52,245	\$1,657	\$2,093	\$258	\$56,253
Individually evaluated for impairment . . . . .	—	—	—	—	—
Total lending-related commitments evaluated at June 30, 2013 . . . . .	<u>\$52,245</u>	<u>\$1,657</u>	<u>\$2,093</u>	<u>\$258</u>	<u>\$56,253</u>

(1) The Company records charges to the provisions for loan losses within Other revenues.

(2) Balances are gross of the allowance and represent recorded investment in the loans.



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**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

- (3) The Company records charges to the provisions for lending-related commitments within Other non-interest expenses.  
 (4) The Company's provision for loan losses and provision for lending-related commitments for the quarter ended June 30, 2013 were \$7 million and \$17 million, respectively.

	<b>Commercial and Industrial</b>	<b>Consumer</b>	<b>Residential Real Estate</b>	<b>Wholesale Real Estate</b>	<b>Total</b>
	(dollars in millions)				
Allowance for loan losses:					
Balance at December 31, 2011 .....	\$ 14	\$ 1	\$ 1	\$ 1	\$ 17
Gross charge-offs .....	(2)	—	—	—	(2)
Gross recoveries .....	—	—	—	8	8
Net charge-offs .....	(2)	—	—	8	6
Provision for loan losses(1)(4) .....	53	5	3	(7)	54
Balance at June 30, 2012 .....	<u>\$ 65</u>	<u>\$ 6</u>	<u>\$ 4</u>	<u>\$ 2</u>	<u>\$ 77</u>
Allowance for loan losses by impairment methodology:					
Collectively evaluated for impairment .....	\$ 94	\$ 3	\$ 5	\$ 2	\$ 104
Individually evaluated for impairment .....	2	—	—	—	2
Total allowance for loan losses at December 31, 2012 .....	<u>\$ 96</u>	<u>\$ 3</u>	<u>\$ 5</u>	<u>\$ 2</u>	<u>\$ 106</u>
Loans evaluated by impairment methodology(2):					
Collectively evaluated for impairment .....	\$ 9,419	\$7,618	\$6,629	\$326	\$23,992
Individually evaluated for impairment .....	30	—	1	—	31
Total loan evaluated at December 31, 2012 .....	<u>\$ 9,449</u>	<u>\$7,618</u>	<u>\$6,630</u>	<u>\$326</u>	<u>\$24,023</u>
Allowance for lending-related commitments:					
Balance at December 31, 2011 .....	\$ 19	\$ 3	\$ —	\$ 2	\$ 24
Provision for lending-related commitments(3)(4) .....	9	(1)	—	—	8
Balance at June 30, 2012 .....	<u>\$ 28</u>	<u>\$ 2</u>	<u>\$ —</u>	<u>\$ 2</u>	<u>\$ 32</u>
Allowance for lending-related commitments by impairment methodology:					
Collectively evaluated for impairment .....	\$ 86	\$ —	\$ —	\$ 1	\$ 87
Individually evaluated for impairment .....	4	—	—	—	4
Total allowance for lending-related commitments at December 31, 2012 .....	<u>\$ 90</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 1</u>	<u>\$ 91</u>
Lending-related commitments evaluated by impairment methodology:					
Collectively evaluated for impairment .....	\$44,079	\$1,406	\$ 712	\$101	\$46,298
Individually evaluated for impairment .....	47	—	—	—	47
Total lending-related commitments evaluated at December 31, 2012 .....	<u>\$44,126</u>	<u>\$1,406</u>	<u>\$ 712</u>	<u>\$101</u>	<u>\$46,345</u>

- (1) The Company records charges to the provisions for loan losses within Other revenues.  
 (2) Balances are gross of the allowance and represent recorded investment in the loans.  
 (3) The Company records charges to the provisions for lending-related commitments within Other non-interest expenses.  
 (4) The Company's provision for loan losses and provision for lending-related commitments for the quarter ended June 30, 2012 were \$44 million and \$12 million, respectively.



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### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

#### *Employee Loans.*

Employee loans are granted primarily in conjunction with a program established in the Wealth Management business segment to retain and recruit certain employees. These loans are recorded in Customer and other receivables in the condensed 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, which is recorded in Compensation and benefits expense. At June 30, 2013, the Company had \$5,550 million of employee loans, net of an allowance of approximately \$131 million. At December 31, 2012, the Company had \$5,998 million of employee loans, net of an allowance of approximately \$131 million.

The Company has also granted loans to other employees primarily in conjunction with certain after-tax leveraged investment arrangements. At June 30, 2013, the balance of these loans was \$155 million, net of an allowance of approximately \$103 million. At December 31, 2012, the balance of these loans was \$172 million, net of an allowance of approximately \$108 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 6).

#### *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 7).

### **9. 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.

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**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

The estimated fair values 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, 2012. The Company's testing did not indicate any goodwill impairment as each of the Company's reporting units with goodwill had a fair value that was substantially in excess of its carrying value. Adverse market or economic events could result in impairment charges in future periods. At December 31, 2012, each of the Company's reporting units with goodwill had a fair value that was substantially in excess of its carrying value.

**Goodwill.**

Changes in the carrying amount of the Company's goodwill, net of accumulated impairment losses for the six months ended June 30, 2013, were as follows:

	<u>Institutional Securities(1)</u>	<u>Wealth Management(1)</u>	<u>Investment Management</u>	<u>Total</u>
	(dollars in millions)			
<b>Goodwill at December 31, 2012(2)</b> .....	\$337	\$5,573	\$740	\$6,650
Foreign currency translation adjustments and other .....	(22)	—	—	(22)
Goodwill disposed of during the period(3)(4) .....	(17)	(11)	—	(28)
<b>Goodwill at June 30, 2013(2)</b> .....	<u>\$298</u>	<u>\$5,562</u>	<u>\$740</u>	<u>\$6,600</u>

- (1) On January 1, 2013, the International Wealth Management business was transferred from the Wealth Management business segment to the Equity division within the Institutional Securities business segment. Accordingly, prior period amounts have been recast to reflect the International Wealth Management business as part of the Institutional Securities business segment.
- (2) 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 Investment Management business segment, was \$7,300 million and \$7,350 million at June 30, 2013 and December 31, 2012, respectively.
- (3) In 2011, the Company announced that it had reached an agreement with the employees of its in-house quantitative proprietary trading unit, Process Driven Trading ("PDT"), within the Institutional Securities business segment, whereby PDT employees will acquire certain assets from the Company and launch an independent advisory firm. This transaction closed on January 1, 2013.
- (4) The Wealth Management business segment sold the U.K. operations of Global Stock Plan Services business to Computershare Limited. This transaction closed on May 31, 2013.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

*Net Intangible Assets.*

Changes in the carrying amount of the Company's intangible assets for the six months ended June 30, 2013 were as follows:

	Institutional Securities	Wealth Management	Investment Management	Total
	(dollars in millions)			
<b>Amortizable net intangible assets at December 31, 2012</b> . . . .	\$175	\$3,600	\$ 1	\$3,776
Mortgage servicing rights (see Note 7) . . . . .	—	7	—	7
<b>Net intangible assets at December 31, 2012</b> . . . . .	<u>\$175</u>	<u>\$3,607</u>	<u>\$ 1</u>	<u>\$3,783</u>
<b>Amortizable net intangible assets at December 31, 2012</b> . . . .	\$175	\$3,600	\$ 1	\$3,776
Foreign currency translation adjustments and other . . . . .	(4)	—	—	(4)
Amortization expense . . . . .	(6)	(164)	—	(170)
Impairment losses(1) . . . . .	(2)	(7)	—	(9)
<b>Amortizable net intangible assets at June 30, 2013</b> . . . . .	163	3,429	1	3,593
Mortgage servicing rights (see Note 7) . . . . .	—	9	—	9
<b>Net intangible assets at June 30, 2013</b> . . . . .	<u>\$163</u>	<u>\$3,438</u>	<u>\$ 1</u>	<u>\$3,602</u>

(1) Impairment losses are recorded within Other expenses.

**10. Long-Term Borrowings and Other Secured Financings.**

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

	At June 30, 2013	At December 31, 2012
	(dollars in millions)	
Senior debt . . . . .	\$148,763	\$158,899
Subordinated debt . . . . .	7,510	5,845
Junior subordinated debentures . . . . .	4,825	4,827
Total . . . . .	<u>\$161,098</u>	<u>\$169,571</u>

During the six months ended June 30, 2013, the Company issued and reissued notes with a principal amount of approximately \$22 billion. This amount included the Company's issuances of \$2.0 billion in 10 year subordinated debt on May 21, 2013, \$3.7 billion in senior unsecured debt on April 25, 2013 and \$4.5 billion in senior unsecured debt on February 25, 2013. During the six months ended June 30, 2013, approximately \$23 billion in aggregate long-term borrowings matured or were retired.

The weighted average maturity of the Company's long-term borrowings, based upon stated maturity dates, was approximately 5.4 years and 5.3 years at June 30, 2013 and December 31, 2012, respectively.

**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 7 for further information on other secured financings related to VIEs and securitization activities.

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**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

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

	<b>At June 30, 2013</b>	<b>At December 31, 2012</b>
	<b>(dollars in millions)</b>	
Secured financings with original maturities greater than one year . . . . .	\$ 9,824	\$14,431
Secured financings with original maturities one year or less . . . . .	3,448	641
Failed sales(1) . . . . .	399	655
Total(2) . . . . .	\$13,671	\$15,727

(1) For more information on failed sales, see Note 7.

(2) Amounts include \$6,452 million and \$9,466 million at fair value at June 30, 2013 and December 31, 2012, respectively.

**11. 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 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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**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

In connection with its derivative activities, the Company generally enters into master netting agreements and collateral agreements with its counterparties. These agreements provide the Company with the right, in the event of a default by the counterparty (such as bankruptcy or a failure to pay or perform), to net a counterparty's rights and obligations under the agreement and to liquidate and setoff collateral against any net amount owed by the counterparty. However, in certain circumstances: the Company may not have such an agreement in place; the relevant insolvency regime (which is based on the type of counterparty entity and the jurisdiction of organization of the counterparty) may not support the enforceability of the agreement; or the Company may not have sought legal advice to support the enforceability of the agreement. In cases where the Company has not determined an agreement to be enforceable, the related amounts are not offset in the tabular disclosures. The Company's policy is generally to receive securities and cash posted as collateral (with rights of rehypothecation), irrespective of the enforceability determination regarding the master netting and collateral agreement. In certain cases the Company may agree for such collateral to be posted to a third party custodian under a control agreement that enables the Company to take control of such collateral in the event of a counterparty default. The enforceability of the master netting agreement is taken into account in the Company's risk management practices and application of counterparty credit limits. The following tables present information about the offsetting of derivative instruments and related collateral amounts. See information related to offsetting of certain collateralized transactions in Note 6.

At June 30, 2013						
	Gross Amounts(1)	Amounts Offset in the Condensed Consolidated Statements of Financial Condition(2)	Net Amounts Presented in the Condensed Consolidated Statements of Financial Condition	Amounts Not Offset in the Condensed Consolidated Statements of Financial Condition(3)		Net Exposure
				Financial Instruments Collateral	Other Cash Collateral	
	(dollars in millions)					
<b>Derivative assets</b>						
Bilateral OTC . . . . .	\$486,776	\$(455,736)	\$31,040	\$(7,335)	\$(107)	\$23,598
Cleared OTC(4) . . . . .	265,254	(264,443)	811	—	—	811
Exchange traded . . . . .	32,850	(25,940)	6,910	—	—	6,910
Total derivative assets . . . . .	\$784,880	\$(746,119)	\$38,761	\$(7,335)	\$(107)	\$31,319
<b>Derivative liabilities</b>						
Bilateral OTC . . . . .	\$459,815	\$(429,459)	\$30,356	\$(5,984)	\$(122)	\$24,250
Cleared OTC(4) . . . . .	267,009	(266,011)	998	—	(32)	966
Exchange traded . . . . .	36,286	(25,940)	10,346	(2,525)	—	7,821
Total derivative liabilities . . . . .	\$763,110	\$(721,410)	\$41,700	\$(8,509)	\$(154)	\$33,037

- (1) Amounts include \$13.1 billion of derivative assets and \$10.7 billion of derivative liabilities which are either not subject to master netting agreements or collateral agreements or are subject to such agreements but the Company has not determined the agreements to be legally enforceable. See also "Fair Value and Notional of Derivative Instruments" for additional disclosure about gross fair values and notionals for derivative instruments by risk type.
- (2) Amounts relate to master netting agreements and collateral agreements which have been determined by the Company to be legally enforceable in the event of default and where certain other criteria are met in accordance with applicable offsetting accounting guidance.
- (3) Amounts relate to master netting agreements and collateral agreements which have been determined by the Company to be legally enforceable in the event of default but where certain other criteria are not met in accordance with applicable offsetting accounting guidance.
- (4) Includes OTC derivatives that are centrally cleared in accordance with certain regulatory requirements.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

At December 31, 2012

	Gross Amounts(1)	Amounts Offset in the Condensed Consolidated Statements of Financial Condition(2)	Net Amounts Presented in the Condensed Consolidated Statements of Financial Condition	Amounts Not Offset in the Condensed Consolidated Statements of Financial Condition(3)		Net Exposure
				Financial Instruments Collateral	Other Cash Collateral	
(dollars in millions)						
<b>Derivative assets</b>						
Bilateral OTC . . . . .	\$ 604,713	\$(573,844)	\$30,869	\$(7,691)	\$(232)	\$22,946
Cleared OTC(4) . . . . .	375,233	(374,546)	687	—	—	687
Exchange traded . . . . .	24,305	(19,664)	4,641	—	—	4,641
Total derivative assets . . . . .	<u>\$1,004,251</u>	<u>\$(968,054)</u>	<u>\$36,197</u>	<u>\$(7,691)</u>	<u>\$(232)</u>	<u>\$28,274</u>
<b>Derivative Liabilities</b>						
Bilateral OTC . . . . .	\$ 578,018	\$(547,285)	\$30,733	\$(7,871)	\$(64)	\$22,798
Cleared OTC(4) . . . . .	374,960	(374,866)	94	—	(23)	71
Exchange traded . . . . .	25,795	(19,664)	6,131	(1,028)	—	5,103
Total derivative liabilities . . . . .	<u>\$ 978,773</u>	<u>\$(941,815)</u>	<u>\$36,958</u>	<u>\$(8,899)</u>	<u>\$(87)</u>	<u>\$27,972</u>

- (1) Amounts include \$7.2 billion of derivative assets and \$7.3 billion of derivative liabilities which are either not subject to master netting agreements or collateral agreements or are subject to such agreements but the Company has not determined the agreements to be legally enforceable. See also “Fair Value and Notional of Derivative Instruments” for additional disclosure about gross fair values and notionals for derivative instruments by risk type.
- (2) Amounts relate to master netting agreements and collateral agreements which have been determined by the Company to be legally enforceable in the event of default and where certain other criteria are met in accordance with applicable offsetting accounting guidance.
- (3) Amounts relate to master netting agreements and collateral agreements which have been determined by the Company to be legally enforceable in the event of default but where certain other criteria are not met in accordance with applicable offsetting accounting guidance.
- (4) Includes OTC derivatives that are centrally cleared in accordance with certain regulatory requirements.

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 Note 2 to the consolidated financial statements for the year ended December 31, 2012 included in the Form 10-K and Note 4.

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**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

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 June 30, 2013 and December 31, 2012, 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—Trading Assets at June 30, 2013(1)**

Credit Rating(2)	Years to Maturity				Cross-Maturity and Cash Collateral Netting(3)	Net Exposure Post-Cash Collateral	Net Exposure Post-Collateral
	Less than 1	1-3	3-5	Over 5			
	(dollars in millions)						
AAA .....	\$ 428	\$ 597	\$ 1,429	\$ 4,653	\$ (4,570)	\$ 2,537	\$ 2,106
AA .....	3,311	1,846	1,976	9,579	(10,337)	6,375	4,417
A .....	10,049	9,456	11,120	23,417	(43,619)	10,423	8,858
BBB .....	3,216	3,665	3,176	15,686	(18,035)	7,708	6,040
Non-investment grade .....	2,270	2,823	1,298	3,241	(4,931)	4,701	2,988
Total .....	<u>\$19,274</u>	<u>\$18,387</u>	<u>\$18,999</u>	<u>\$56,576</u>	<u>\$(81,492)</u>	<u>\$31,744</u>	<u>\$24,409</u>

- (1) Fair values shown represent the Company's net exposure to counterparties related to the Company's OTC derivative products. Amounts include centrally cleared OTC derivatives. The table does not include exchange-traded 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.

**OTC Derivative Products—Trading Assets at December 31, 2012(1)**

Credit Rating(2)	Years to Maturity				Cross-Maturity and Cash Collateral Netting(3)	Net Exposure Post-Cash Collateral	Net Exposure Post-Collateral
	Less than 1	1-3	3-5	Over 5			
	(dollars in millions)						
AAA .....	\$ 353	\$ 551	\$ 1,299	\$ 6,121	\$ (4,851)	\$ 3,473	\$ 3,088
AA .....	2,125	3,635	2,958	10,270	(12,761)	6,227	4,428
A .....	6,643	9,596	14,228	29,729	(50,722)	9,474	7,638
BBB .....	2,673	3,970	3,704	18,586	(21,713)	7,220	5,754
Non-investment grade .....	2,091	2,855	2,142	4,538	(6,696)	4,930	2,725
Total .....	<u>\$13,885</u>	<u>\$20,607</u>	<u>\$24,331</u>	<u>\$69,244</u>	<u>\$(96,743)</u>	<u>\$31,324</u>	<u>\$23,633</u>

- (1) Fair values shown represent the Company's net exposure to counterparties related to the Company's OTC derivative products. Amounts include centrally cleared OTC derivatives. The table does not include exchange-traded 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.



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### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

#### ***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.

***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 Company recognized an out of period pre-tax gain of approximately \$300 million in the Institutional Securities business segment's Other sales and trading net revenues for the quarter ended June 30, 2012, related to the reversal of amounts recorded in cumulative other comprehensive income due to the incorrect application of hedge accounting on certain derivative contracts previously designated as net investment hedges of certain foreign, non-U.S. dollar denominated subsidiaries. This amount included a pre-tax gain of approximately \$191 million related to the quarter ended March 31, 2012, with the remainder impacting prior periods. The Company evaluated the effects of the incorrect application of hedge accounting, both qualitatively and quantitatively, and concluded that it did not have a material impact on any prior annual or quarterly consolidated results. In addition, the Company recognized a partially offsetting pre-tax loss of approximately \$224 million for the quarter ended June 30, 2012 resulting from fair value changes within the quarter of the related derivative positions not qualifying for net investment hedge accounting. Subsequent to the identification of the incorrect application of net investment hedge accounting, and during the quarter ended June 30, 2012, the Company appropriately redesignated the forward foreign exchange contracts and reapplied hedge accounting.



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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

**Fair Value and Notional of Derivative Instruments.** 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 and the platform on which these instruments are traded or cleared on a gross basis. Fair values of derivative contracts in an asset position are included in Trading assets and fair values of derivative contracts in a liability position are reflected in Trading liabilities in the condensed consolidated statements of financial condition (see Note 4):

	Derivative Assets At June 30, 2013							
	Fair Value				Notional			
	Bilateral OTC	Cleared OTC(2)	Exchange Traded	Total	Bilateral OTC	Cleared OTC(2)	Exchange Traded	Total
	(dollars in millions)							
Derivatives designated as hedging instruments:								
Interest rate contracts . . . . .	\$ 5,829	\$ 149	\$ —	\$ 5,978	\$ 63,071	\$ 5,457	\$ —	\$ 68,528
Foreign exchange contracts . . . . .	541	—	—	541	10,423	100	—	10,523
Total derivatives designated as hedging instruments . . . . .	6,370	149	—	6,519	73,494	5,557	—	79,051
Derivatives not designated as hedges(1):								
Interest rate contracts . . . . .	328,549	261,592	354	590,495	7,322,458	11,488,922	959,708	19,771,088
Credit contracts . . . . .	51,546	3,395	—	54,941	1,562,941	228,753	—	1,791,694
Foreign exchange contracts . . . . .	59,424	118	27	59,569	2,110,099	5,603	7,617	2,123,319
Equity contracts . . . . .	24,174	—	27,697	51,871	314,370	—	461,446	775,816
Commodity contracts . . . . .	16,524	—	4,772	21,296	203,156	—	174,677	377,833
Other . . . . .	189	—	—	189	3,418	—	—	3,418
Total derivatives not designated as hedges . . . . .	480,406	265,105	32,850	778,361	11,516,442	11,723,278	1,603,448	24,843,168
Total derivatives . . . . .	\$ 486,776	\$ 265,254	\$ 32,850	\$ 784,880	\$11,589,936	\$11,728,835	\$1,603,448	\$24,922,219
Cash collateral netting . . . . .	(59,341)	(1,424)	—	(60,765)	—	—	—	—
Counterparty netting . . . . .	(396,395)	(263,019)	(25,940)	(685,354)	—	—	—	—
Total derivative assets . . . . .	\$ 31,040	\$ 811	\$ 6,910	\$ 38,761	\$11,589,936	\$11,728,835	\$1,603,448	\$24,922,219

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

	Derivative Liabilities At June 30, 2013							
	Fair Value				Notional			
	Bilateral OTC	Cleared OTC(2)	Exchange Traded	Total	Bilateral OTC	Cleared OTC(2)	Exchange Traded	Total
	(dollars in millions)							
Derivatives designated as hedging instruments:								
Interest rate contracts . . . . .	\$ 423	\$ 449	\$ —	\$ 872	\$ 3,004	\$ 14,604	\$ —	\$ 17,608
Foreign exchange contracts . . . . .	47	1	—	48	5,022	229	—	5,251
Total derivatives designated as hedging instruments . . . . .	470	450	—	920	8,026	14,833	—	22,859
Derivatives not designated as hedges(1):								
Interest rate contracts . . . . .	308,861	262,603	488	571,952	7,022,729	11,323,486	1,593,220	19,939,435
Credit contracts . . . . .	48,247	3,874	—	52,121	1,436,811	223,801	—	1,660,612
Foreign exchange contracts . . . . .	59,645	82	8	59,735	2,038,154	4,451	2,011	2,044,616
Equity contracts . . . . .	27,059	—	30,478	57,537	320,717	—	456,502	777,219
Commodity contracts . . . . .	15,349	—	5,312	20,661	185,304	—	147,719	333,023
Other . . . . .	184	—	—	184	5,243	—	—	5,243
Total derivatives not designated as hedges . . . . .	459,345	266,559	36,286	762,190	11,008,958	11,551,738	2,199,452	24,760,148
Total derivatives . . . . .	\$ 459,815	\$ 267,009	\$ 36,286	\$ 763,110	\$ 11,016,984	\$ 11,566,571	\$ 2,199,452	\$ 24,783,007
Cash collateral netting . . . . .	(33,064)	(2,992)	—	(36,056)	—	—	—	—
Counterparty netting . . . . .	(396,395)	(263,019)	(25,940)	(685,354)	—	—	—	—
Total derivative liabilities . . . . .	\$ 30,356	\$ 998	\$ 10,346	\$ 41,700	\$ 11,016,984	\$ 11,566,571	\$ 2,199,452	\$ 24,783,007

- (1) Notional amounts include gross notionals related to open long and short futures contracts of \$444 billion and \$898 billion, respectively. The unsettled fair value on these futures contracts (excluded from the table above) of \$505 million and \$169 million is included in Customer and other receivables and Customer and other payables, respectively, on the condensed consolidated statements of financial condition.
- (2) Includes OTC derivatives that are centrally cleared in accordance with certain regulatory requirements.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

	Derivative Assets At December 31, 2012							
	Fair Value				Notional			
	Bilateral OTC	Cleared OTC(2)	Exchange Traded	Total	Bilateral OTC	Cleared OTC(2)	Exchange Traded	Total
	(dollars in millions)							
Derivatives designated as hedging instruments:								
Interest rate contracts . . . . .	\$ 8,046	\$ 301	\$ —	\$ 8,347	\$ 66,916	\$ 8,199	\$ —	\$ 75,115
Foreign exchange contracts . . . . .	367	—	—	367	10,291	—	—	10,291
Total derivatives designated as hedging instruments . . . . .	8,413	301	—	8,714	77,207	8,199	—	85,406
Derivatives not designated as hedges(1):								
Interest rate contracts . . . . .	443,523	371,789	142	815,454	8,029,510	10,096,252	776,130	18,901,892
Credit contracts . . . . .	65,168	3,099	—	68,267	1,734,907	197,879	—	1,932,786
Foreign exchange contracts . . . . .	52,349	44	34	52,427	1,831,385	3,834	5,967	1,841,186
Equity contracts . . . . .	19,916	—	18,684	38,600	258,484	—	329,216	587,700
Commodity contracts . . . . .	15,201	—	5,445	20,646	164,842	—	176,714	341,556
Other . . . . .	143	—	—	143	4,908	—	—	4,908
Total derivatives not designated as hedges . . . . .	596,300	374,932	24,305	995,537	12,024,036	10,297,965	1,288,027	23,610,028
Total derivatives . . . . .	\$ 604,713	\$ 375,233	\$ 24,305	\$ 1,004,251	\$ 12,101,243	\$ 10,306,164	\$ 1,288,027	\$ 23,695,434
Cash collateral netting . . . . .	(68,024)	(1,224)	—	(69,248)	—	—	—	—
Counterparty netting . . . . .	(505,820)	(373,322)	(19,664)	(898,806)	—	—	—	—
Total derivative assets . . . . .	\$ 30,869	\$ 687	\$ 4,641	\$ 36,197	\$ 12,101,243	\$ 10,306,164	\$ 1,288,027	\$ 23,695,434

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

	Derivative Liabilities At December 31, 2012							
	Fair Value				Notional			
	Bilateral OTC	Cleared OTC(2)	Exchange Traded	Total	Bilateral OTC	Cleared OTC(2)	Exchange Traded	Total
	(dollars in millions)							
Derivatives designated as hedging instruments:								
Interest rate contracts . . . . .	\$ 167	\$ 1	\$ —	\$ 168	\$ 2,000	\$ 660	\$ —	\$ 2,660
Foreign exchange contracts . . . . .	319	—	—	319	17,156	—	—	17,156
Total derivatives designated as hedging instruments . . . . .	486	1	—	487	19,156	660	—	19,816
Derivatives not designated as hedges(1):								
Interest rate contracts . . . . .	422,864	370,856	216	793,936	7,726,241	9,945,979	1,994,947	19,667,167
Credit contracts . . . . .	60,420	4,074	—	64,494	1,645,464	222,343	—	1,867,807
Foreign exchange contracts . . . . .	56,062	29	3	56,094	1,878,597	3,473	4,003	1,886,073
Equity contracts . . . . .	22,239	—	19,631	41,870	257,340	—	329,858	587,198
Commodity contracts . . . . .	15,886	—	5,945	21,831	169,189	—	155,912	325,101
Other . . . . .	61	—	—	61	5,161	—	—	5,161
Total derivatives not designated as hedges . . . . .	577,532	374,959	25,795	978,286	11,681,992	10,171,795	2,484,720	24,338,507
Total derivatives . . . . .	\$ 578,018	\$ 374,960	\$ 25,795	\$ 978,773	\$11,701,148	\$10,172,455	\$2,484,720	\$24,358,323
Cash collateral netting . . . . .	(41,465)	(1,544)	—	(43,009)	—	—	—	—
Counterparty netting . . . . .	(505,820)	(373,322)	(19,664)	(898,806)	—	—	—	—
Total derivative liabilities . . . . .	\$ 30,733	\$ 94	\$ 6,131	\$ 36,958	\$11,701,148	\$10,172,455	\$2,484,720	\$24,358,323

- (1) Notional amounts include gross notionals related to open long and short futures contracts of \$368 billion and \$1,476 billion, respectively. The unsettled fair value on these futures contracts (excluded from the table above) of \$1,073 million and \$24 million is included in Customer and other receivables and Customer and other payables, respectively, on the condensed consolidated statements of financial condition.
- (2) Includes OTC derivatives that are centrally cleared in accordance with certain regulatory requirements.

The following tables summarize the gains or losses reported on derivative instruments designated and qualifying as accounting hedges for the quarters and six months ended June 30, 2013 and 2012, 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 June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
	(dollars in millions)			
Derivatives . . . . .	\$(2,247)	\$ 979	\$(3,119)	\$432
Borrowings . . . . .	2,629	(753)	3,791	(54)
Total . . . . .	\$ 382	\$ 226	\$ 672	\$378

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

*Derivatives Designated as Net Investment Hedges.*

<u>Product Type</u>	<u>Gains Recognized in OCI (effective portion)</u>			
	<u>Three Months Ended</u>		<u>Six Months Ended</u>	
	<u>June 30,</u>		<u>June 30,</u>	
	<u>2013</u>	<u>2012(1)</u>	<u>2013</u>	<u>2012(1)</u>
	<u>(dollars in millions)</u>			
Foreign exchange contracts(2) . . . . .	\$230	\$130	\$539	\$150
Total . . . . .	\$230	\$130	\$539	\$150

- (1) A gain of \$193 million, net of tax, related to net investment hedges was reclassified from other comprehensive income into income during both the quarter and six months ended June 30, 2012. The amount primarily related to an out of period gain, net of tax, related to the reversal of amounts recorded in cumulative other comprehensive income due to the incorrect application of hedge accounting on certain derivative contracts (see above for further information).
- (2) Losses of \$36 million and \$68 million were recognized in income related to amounts excluded from hedge effectiveness testing during the quarter and six months ended June 30, 2013, respectively. Losses of \$63 million and \$128 million were recognized in income related to amounts excluded from hedge effectiveness testing during the quarter and six months ended June 30, 2012, respectively.

The table below summarizes gains (losses) on derivative instruments not designated as accounting hedges for the quarters and six months ended June 30, 2013 and 2012, respectively:

<u>Product Type</u>	<u>Gains (Losses) Recognized in Income(1)(2)</u>			
	<u>Three Months Ended</u>		<u>Six Months Ended</u>	
	<u>June 30,</u>		<u>June 30,</u>	
	<u>2013</u>	<u>2012</u>	<u>2013</u>	<u>2012</u>
	<u>(dollars in millions)</u>			
Interest rate contracts . . . . .	\$ (65)	\$ (594)	\$ 75	\$ 961
Credit contracts . . . . .	253	1,293	174	621
Foreign exchange contracts . . . . .	1,485	(208)	2,036	427
Equity contracts . . . . .	(301)	188	(3,361)	(628)
Commodity contracts . . . . .	880	908	1,303	302
Other contracts . . . . .	(42)	(32)	(44)	24
Total derivative instruments . . . . .	\$2,210	\$1,555	\$ 183	\$1,707

- (1) Gains (losses) on derivative contracts not designated as hedges are primarily included in Trading in the condensed consolidated statements of income.
- (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 Trading in the condensed consolidated statements of income.

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 \$59 million and \$53 million at June 30, 2013 and December 31, 2012, respectively and a notional value of \$2,143 million and \$2,178 million at June 30, 2013 and December 31, 2012, respectively. The Company recognized gains of \$2 million and losses of less than \$1 million related to changes in the fair value of its bifurcated embedded derivatives for the quarter and six months ended June 30, 2013, respectively. The Company recognized losses of \$13 million and \$6 million related to changes in the fair value of its bifurcated embedded derivatives for the quarter and six months ended June 30, 2012, respectively.

At June 30, 2013 and December 31, 2012, the amount of payables associated with cash collateral received that was netted against derivative assets was \$60.8 billion and \$69.2 billion, respectively, and the amount of receivables in respect of cash collateral paid that was netted against derivative liabilities was \$36.1 billion and

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**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

\$43.0 billion, respectively. Cash collateral receivables and payables of \$83 million and \$50 million, respectively, at June 30, 2013 and \$158 million and \$34 million, respectively, at December 31, 2012, were not offset against certain contracts that did not meet the definition of a derivative.

***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 June 30, 2013, the aggregate fair value of OTC derivative contracts that contain credit-risk-related contingent features that are in a net liability position totaled \$25,020 million, for which the Company has posted collateral of \$20,941 million, in the normal course of business. 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”). At June 30, 2013, the future potential collateral amounts, termination payments or other contractual amounts that could be called by counterparties in the event of a downgrade of the Company’s long-term credit rating under various scenarios are: \$334 million (Baa1 Moody’s/BBB+ S&P) and \$1,853 million (Baa2 Moody’s/BBB S&P). Of these amounts, \$1,646 million at June 30, 2013 related to bilateral arrangements between the Company and other parties where upon the downgrade of one party, the downgraded party must deliver 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 June 30, 2013 and December 31, 2012:

	At June 30, 2013			
	Maximum Potential Payout/Notional			
	Protection Sold		Protection Purchased	
	Notional	Fair Value (Asset)/Liability	Notional	Fair Value (Asset)/Liability
(dollars in millions)				
Single name credit default swaps . . . . .	\$ 961,737	\$ (510)	\$ 911,921	\$ 412
Index and basket credit default swaps . . . . .	547,491	4,326	442,342	(4,372)
Tranched index and basket credit default swaps . . . . .	227,578	484	361,237	(3,160)
Total . . . . .	\$1,736,806	\$4,300	\$1,715,500	\$(7,120)

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

	At December 31, 2012			
	Maximum Potential Payout/Notional			
	Protection Sold		Protection Purchased	
	Notional	Fair Value (Asset)/Liability	Notional	Fair Value (Asset)/Liability
	(dollars in millions)			
Single name credit default swaps . . . . .	\$1,069,474	\$ 2,889	\$1,029,543	\$ (2,456)
Index and basket credit default swaps . . . . .	551,630	5,664	454,800	(5,124)
Tranched index and basket credit default swaps . . . . .	272,088	2,330	423,058	(7,076)
Total . . . . .	<u>\$1,893,192</u>	<u>\$10,883</u>	<u>\$1,907,401</u>	<u>\$(14,656)</u>

The table below summarizes the credit ratings and maturities of protection sold through credit default swaps and other credit contracts at June 30, 2013:

Credit Ratings of the Reference Obligation	Protection Sold					Fair Value (Asset)/ Liability(1)(2)
	Maximum Potential Payout/Notional					
	Years to Maturity					
	Less than 1	1-3	3-5	Over 5	Total	
	(dollars in millions)					
Single name credit default swaps:						
AAA . . . . .	\$ 1,724	\$ 7,207	\$ 16,735	\$ 3,431	\$ 29,097	\$ (102)
AA . . . . .	10,144	20,833	36,277	6,202	73,456	(498)
A . . . . .	64,925	59,232	62,823	7,894	194,874	(2,297)
BBB . . . . .	124,739	122,540	143,344	27,058	417,681	365
Non-investment grade . . . . .	76,203	80,765	78,149	11,512	246,629	2,022
Total . . . . .	<u>277,735</u>	<u>290,577</u>	<u>337,328</u>	<u>56,097</u>	<u>961,737</u>	<u>(510)</u>
Index and basket credit default swaps(3):						
AAA . . . . .	24,815	49,440	52,666	2,458	129,379	(1,245)
AA . . . . .	900	10,854	13,289	6,468	31,511	(43)
A . . . . .	2,687	5,338	23,883	25	31,933	536
BBB . . . . .	26,673	120,435	156,532	8,912	312,552	(1,028)
Non-investment grade . . . . .	59,084	61,371	136,216	13,023	269,694	6,590
Total . . . . .	<u>114,159</u>	<u>247,438</u>	<u>382,586</u>	<u>30,886</u>	<u>775,069</u>	<u>4,810</u>
Total credit default swaps sold . . . . .	<u>\$391,894</u>	<u>\$538,015</u>	<u>\$719,914</u>	<u>\$86,983</u>	<u>\$1,736,806</u>	<u>\$ 4,300</u>
Other credit contracts(4)(5) . . . . .	<u>\$ 354</u>	<u>\$ 44</u>	<u>\$ 137</u>	<u>\$ 1,181</u>	<u>\$ 1,716</u>	<u>\$ (390)</u>
Total credit derivatives and other credit contracts . . . . .	<u>\$392,248</u>	<u>\$538,059</u>	<u>\$720,051</u>	<u>\$88,164</u>	<u>\$1,738,522</u>	<u>\$ 3,910</u>

- (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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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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

Credit Ratings of the Reference Obligation	Protection Sold					Fair Value (Asset)/ Liability(1)(2)
	Maximum Potential Payout/Notional					
	Years to Maturity					
	Less than 1	1-3	3-5	Over 5	Total	
	(dollars in millions)					
Single name credit default swaps:						
AAA	\$ 2,368	\$ 6,592	\$ 19,848	\$ 5,767	\$ 34,575	\$ (204)
AA	10,984	16,804	34,280	7,193	69,261	(325)
A	66,635	72,796	67,285	10,760	217,476	(2,740)
BBB	124,662	145,462	142,714	34,396	447,234	(492)
Non-investment grade	91,743	98,515	92,143	18,527	300,928	6,650
Total	296,392	340,169	356,270	76,643	1,069,474	2,889
Index and basket credit default swaps(3):						
AAA	18,652	36,005	45,789	3,240	103,686	(1,377)
AA	1,255	9,479	12,026	8,343	31,103	(55)
A	2,684	5,423	5,440	125	13,672	(155)
BBB	27,720	105,870	143,562	29,101	306,253	(862)
Non-investment grade	97,389	86,703	153,858	31,054	369,004	10,443
Total	147,700	243,480	360,675	71,863	823,718	7,994
Total credit default swaps sold	\$444,092	\$583,649	\$716,945	\$148,506	\$1,893,192	\$10,883
Other credit contracts(4)(5)	\$ 796	\$ 125	\$ 155	\$ 1,323	\$ 2,399	\$ (745)
Total credit derivatives and other credit contracts	\$444,888	\$583,774	\$717,100	\$149,829	\$1,895,591	\$10,138

- (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.

**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



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### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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.

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 \$1.3 trillion and \$1.5 trillion at June 30, 2013 and December 31, 2012, respectively, compared with a notional amount of approximately \$1.5 trillion and \$1.6 trillion at June 30, 2013 and December 31, 2012, 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.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

12. 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 June 30, 2013 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 June 30, 2013
	Less than 1	1-3	3-5	Over 5	
	(dollars in millions)				
Letters of credit and other financial guarantees obtained to satisfy collateral requirements . . . . .	\$ 953	\$ 14	\$ —	\$ 1	\$ 968
Investment activities . . . . .	729	104	36	270	1,139
Primary lending commitments—investment grade(1) . . . .	8,020	15,798	34,344	562	58,724
Primary lending commitments—non-investment grade(1) . . . . .	3,053	4,882	9,381	3,841	21,157
Secondary lending commitments(2) . . . . .	38	31	20	21	110
Commitments for secured lending transactions . . . . .	636	14	15	—	665
Forward starting reverse repurchase agreements and securities borrowing agreements(3)(4) . . . . .	46,549	—	—	—	46,549
Commercial and residential mortgage-related commitments . . . . .	2,088	30	332	283	2,733
Other commitments . . . . .	2,237	350	153	111	2,851
<b>Total . . . . .</b>	<b>\$64,303</b>	<b>\$21,223</b>	<b>\$44,281</b>	<b>\$5,089</b>	<b>\$134,896</b>

- (1) This amount includes \$41.8 billion of investment grade and \$9.5 billion of non-investment grade unfunded commitments accounted for as held for investment and \$4.9 billion of investment grade and \$7.4 billion of non-investment grade unfunded commitments accounted for as held for sale at June 30, 2013. The remainder of these lending commitments is carried at fair value.
- (2) These commitments are recorded at fair value within Trading assets and Trading liabilities in the condensed consolidated statements of financial condition (see Note 4).
- (3) The Company enters into forward starting reverse repurchase and securities borrowing agreements (agreements that have a trade date at or prior to June 30, 2013 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 total amount at June 30, 2013, \$41.8 billion settled within three business days.
- (4) The Company also has a contingent obligation to provide financing to a clearinghouse through which it clears certain transactions. The financing is required only upon the default of a clearinghouse member. The financing takes the form of a reverse repurchase facility, with a maximum amount of approximately \$1.9 billion.

For further description of these commitments, refer to Note 13 to the consolidated financial statements for the year ended December 31, 2012 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.

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**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**Guarantees.**

The table below summarizes certain information regarding the Company's obligations under guarantee arrangements at June 30, 2013:

Type of Guarantee	Maximum Potential Payout/Notional					Carrying Amount (Asset)/Liability	Collateral/Recourse
	Years to Maturity				Total		
	Less than 1	1-3	3-5	Over 5			
	(dollars in millions)						
Credit derivative contracts(1) . . . . .	\$ 391,894	\$538,015	\$719,914	\$ 86,983	\$1,736,806	\$ 4,300	\$ —
Other credit contracts . . . . .	354	44	137	1,181	1,716	(390)	—
Non-credit derivative contracts(1) . . . .	1,590,165	790,479	344,366	512,286	3,237,296	74,327	—
Standby letters of credit and other financial guarantees issued(2)(3) . . . .	1,211	771	1,178	5,642	8,802	(206)	7,150
Market value guarantees . . . . .	—	73	154	492	719	9	106
Liquidity facilities . . . . .	2,206	148	—	—	2,354	(4)	3,327
Whole loan sales representations and warranties . . . . .	—	—	—	23,873	23,873	80	—
Securitization representations and warranties . . . . .	—	—	—	69,907	69,907	64	—
General partner guarantees . . . . .	73	45	57	185	360	74	—

- (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 11.
- (2) Approximately \$2.0 billion of standby letters of credit are also reflected in the "Commitments" table above in primary and secondary lending commitments. Standby letters of credit are recorded at fair value within Trading assets or Trading liabilities in the condensed consolidated statements of financial condition.
- (3) Amounts include guarantees issued by consolidated real estate funds sponsored by the Company of approximately \$28.4 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 \$3.9 million are reflected as a reduction of the carrying value of the related fund investments, which are reflected in Trading assets 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, 2012 included in the Form 10-K.

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.

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### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

- 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 11 to the consolidated financial statements for the year ended December 31, 2012 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 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.

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.

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### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

#### *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 and involving, 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 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 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 filed on June 10, 2010 allege that defendants made untrue statements and material omissions in connection with the sale to plaintiff of a number of mortgage pass-through certificates backed by securitization trusts containing residential mortgage

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### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

loans. The amount of certificates allegedly sold to plaintiff by the Company in these cases was approximately \$704 million and \$276 million, respectively. 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 both actions sustained defendants' demurrers with respect to claims brought under the Securities Act of 1933, as amended, and overruled defendants' demurrers with respect to all other claims. At June 25, 2013, the current unpaid balance of the mortgage pass-through certificates at issue in these cases was approximately \$345 million, and the certificates had incurred actual losses of approximately \$2.8 million. Based on currently available information, the Company believes it could incur a loss for this action up to the difference between the \$345 million unpaid balance of these certificates (plus any losses incurred) 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 to an offset for interest received by the plaintiff prior to a judgment.

On July 9, 2010 and February 11, 2011, Cambridge Place Investment Management Inc. filed two separate complaints against the Company and other defendants in the Superior Court of the Commonwealth of Massachusetts, both styled *Cambridge Place Investment Management Inc. v. Morgan Stanley & Co., Inc., et al.* The complaints assert claims on behalf of certain clients of plaintiff's affiliates and allege that defendants made untrue statements and material omissions in the sale of a number of mortgage pass-through certificates backed by securitization trusts containing residential mortgage loans. The total amount of certificates allegedly issued by the Company or sold to plaintiff's affiliates' clients by the Company in the two matters was approximately \$263 million. Plaintiff filed amended complaints on October 14, 2011, which raise claims under the Massachusetts Uniform Securities Act and seek, among other things, to rescind the plaintiff's purchase of such certificates. On November 22, 2011, defendants filed a motion to dismiss the amended complaints. On March 12, 2012, the court 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, which the court denied, in substantial part, on October 2, 2012. At June 25, 2013, the current unpaid balance of the mortgage pass-through certificates at issue in these cases was approximately \$216 million, and the certificates had incurred actual losses of approximately \$109 million. Based on currently available information, the Company believes it could incur a loss for these actions of up to the difference between the \$216 million unpaid balance of these certificates (plus any losses incurred) 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 to an offset for interest received by the plaintiff prior to a judgment.

On July 15, 2010, China Development Industrial Bank ("CDIB") filed a complaint against the Company, 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 ("Supreme Court of NY"). 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 denied the Company's motion to dismiss the complaint. 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 October 15, 2010, the Federal Home Loan Bank of Chicago filed a complaint against the Company and other defendants in the Circuit Court of the State of Illinois styled *Federal Home Loan Bank of Chicago v. Bank of*



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### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

*America Funding Corporation et al.* The complaint alleges that defendants made untrue statements and material omissions in the sale to plaintiff of a number of mortgage pass-through certificates backed by securitization trusts containing residential mortgage loans. The total amount of certificates allegedly sold to plaintiff by the Company in this action was approximately \$203 million. The complaint raises claims under Illinois law and seeks, among other things, to rescind the plaintiff's purchase of such certificates. On March 24, 2011, the court granted plaintiff leave to file an amended complaint. The defendants' motion to dismiss the amended complaint was denied on September 19, 2012. The Company filed its answer on December 21, 2012. At June 25, 2013, the current unpaid balance of the mortgage pass-through certificates at issue in this action was approximately \$100 million and certain certificates had incurred actual losses of approximately \$1 million. Based on currently available information, the Company believes it could incur a loss in this action up to the difference between the \$100 million unpaid balance of these certificates (plus any losses incurred) 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 to an offset for interest received by the plaintiff prior to a judgment.

On July 18, 2011, the Western and Southern Life Insurance Company and certain affiliated companies filed a complaint against the Company and other defendants in the Court of Common Pleas in Ohio, styled *Western and Southern Life Insurance Company, et al. v. Morgan Stanley Mortgage Capital Inc., et al.* An amended complaint was filed on April 2, 2012 and 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 amount of the certificates allegedly sold to plaintiffs by the Company was approximately \$153 million. The amended complaint raises claims under the Ohio Securities Act, federal securities laws, and common law and seeks, among other things, to rescind the plaintiffs' purchases of such certificates. On May 21, 2012, the Company filed a motion to dismiss the amended complaint, which motion was denied on August 3, 2012. The court has set a trial date in May 2015. At June 25, 2013, the current unpaid balance of the mortgage pass-through certificates at issue in this action was approximately \$121 million, and the certificates had incurred actual losses of approximately \$1 million. Based on currently available information, the Company believes it could incur a loss in this action up to the difference between the \$121 million unpaid balance of these certificates (plus any losses incurred) and their fair market value at the time of a judgment against the Company, plus post-judgment interest, fees and costs. The Company may be entitled to an offset for interest received by the plaintiff prior to a judgment.

On September 2, 2011, the Federal Housing Finance Agency ("FHFA"), as conservator for Fannie Mae and Freddie Mac, filed 17 complaints against numerous financial services companies, including the Company. A complaint against the Company and other defendants was filed in the Supreme Court of NY, styled *Federal Housing Finance Agency, as Conservator v. Morgan Stanley et al.* The complaint alleges that defendants made untrue statements and material omissions in connection with the sale to Fannie Mae and Freddie Mac of residential mortgage pass-through certificates with an original unpaid balance of approximately \$11 billion. The complaint raises claims under federal and state securities laws and common law and seeks, among other things, rescission and compensatory and punitive damages. On September 26, 2011, defendants removed the action to the United States District Court for the Southern District of New York. On July 13, 2012, the Company filed a motion to dismiss the complaint, which motion was denied in large part on November 19, 2012. Trial is currently scheduled to begin in January 2015. At June 25, 2013, the current unpaid balance of the mortgage pass-through certificates at issue in this action was approximately \$2.86 billion, and the certificates had incurred actual losses of approximately \$59 million. Based on currently available information, the Company believes it could incur a loss in this action up to the difference between the \$2.86 billion unpaid balance of these certificates (plus any losses incurred) 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 to an offset for interest received by the plaintiff prior to a judgment.

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### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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 NY styled *Metropolitan Life Insurance Company, et al. v. Morgan Stanley, et al.* An amended complaint was filed on June 29, 2012 and 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 \$758 million. The amended complaint raises common law claims of fraud, fraudulent inducement, and aiding and abetting fraud and seeks, among other things, rescission, compensatory and/or rescissory damages, as well as punitive damages, associated with plaintiffs' purchases of such certificates. On September 21, 2012, the Company filed a motion to dismiss the amended complaint, which was granted in part and denied in part on July 16, 2013. Following that decision, the total amount of certificates allegedly sponsored, underwritten and/or sold by the Company was approximately \$656 million. At June 25, 2013, the current unpaid balance of the mortgage pass-through certificates remaining at issue in this case was approximately \$369 million, and the certificates incurred actual losses of approximately \$28.3 million. Based on currently available information, the Company believes it could incur a loss up to the difference between the \$369 million unpaid balance of these certificates (plus any losses incurred) 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 to an offset for interest received by the plaintiff prior to a judgment.

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 is 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 October 16, 2012, plaintiffs filed an amended complaint which, among other things, increases the total amount of the certificates at issue by approximately \$80 million, adds causes of action for fraudulent inducement, equitable fraud, aiding and abetting fraud, and violations of the New Jersey RICO statute, and includes a claim for treble damages. On March 15, 2013, defendants' motion to dismiss was denied. At June 25, 2013, the current unpaid balance of the mortgage pass-through certificates at issue in this action was approximately \$674 million, and the certificates had not yet incurred actual losses. Based on currently available information, the Company believes it could incur a loss in this action up to the difference between the \$674 million unpaid balance of these certificates (plus any losses incurred) 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 to an offset for interest received by the plaintiff prior to a judgment.

### 13. 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 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 Morgan Stanley Bank, N.A. and Morgan Stanley Private Bank, National Association.



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### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The Company calculates its capital ratios and risk-weighted assets (“RWAs”) 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 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 December 2010, the Basel Committee reached an agreement on Basel III. In July 2013, the U.S. banking regulators issued a final rule to implement many aspects of Basel III (the “U.S. Basel III final rule”). The U.S. Basel III final rule contains new capital standards that raise the capital requirements, strengthen counterparty credit risk capital requirements and replace the use of externally developed credit ratings with alternatives such as the Organisation for Economic Co-operation and Development’s country risk classifications. The U.S. Basel III final rule also requires certain banking organizations, including the Company, to maintain both a capital conservation buffer and, if deployed, a countercyclical capital buffer, above the minimum risk-based capital ratios. Failure to maintain such buffers will result in restrictions on the banking organization’s ability to make capital distributions and pay discretionary bonuses to executive officers. The U.S. Basel III final rule also subjects certain banking organizations, including the Company, to a minimum supplementary leverage ratio of 3%. The calibration of the supplementary leverage ratio is broadly similar to the December 2010 version of the Basel III leverage ratio and includes off-balance sheet exposures in the denominator. The Company will become subject to the U.S. Basel III final rule beginning on January 1, 2014. Certain requirements in the U.S. Basel III final rule, including the new capital buffers, will be phased in over several years.

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 minimum capital requirements that are not less than the generally applicable risk-based capital requirements. Currently, this minimum “capital floor” is based on Basel I. Beginning January 1, 2015, the U.S. Basel III final rule will replace the current Basel I-based “capital floor” with a standardized approach that, among other things, modifies the existing risk weights for certain types of asset classes and which is applicable to both minimum capital requirements and the sum of conservation and countercyclical capital buffers if deployed. On January 1, 2013, the U.S. banking regulators’ rules to implement the Basel Committee’s market risk capital framework amendment, commonly referred to as “Basel 2.5”, became effective, which increased the capital requirements for securitizations and correlation trading within the Company’s trading book as well as incorporated add-ons for stressed VaR and incremental risk requirements (“market risk capital framework amendment”).

At June 30, 2013, the Company’s capital levels calculated under Basel I, inclusive of the market risk capital framework amendment, were in excess of well-capitalized levels with ratios of Tier 1 capital to RWAs of 14.1% and total capital to RWAs of 14.9% (6% and 10% being well-capitalized for regulatory purposes, respectively). The Company’s ratio of Tier 1 common capital to RWAs was 11.8% (5% under stressed conditions is the current minimum under the Federal Reserve’s Comprehensive Capital Analysis and Review (“CCAR”) framework). Financial holding companies, including the Company, are subject to a Tier 1 leverage ratio defined by the Federal Reserve. Consistent with the Federal Reserve’s definition, 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 period. At June 30, 2013, the Company was in compliance with the Federal Reserve’s Tier 1 leverage requirement, with a Tier 1 leverage ratio of 7.1% (5% is the current well-capitalized standard for regulatory purposes).

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**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

The following table summarizes the capital measures for the Company:

	<u>June 30, 2013</u>		<u>December 31, 2012</u>	
	<u>Balance</u>	<u>Ratio</u>	<u>Balance</u>	<u>Ratio</u>
	(dollars in millions)			
Tier 1 common capital . . . . .	\$ 47,603	11.8%	\$ 44,794	14.6%
Tier 1 capital . . . . .	56,780	14.1%	54,360	17.7%
Total capital . . . . .	59,987	14.9%	56,626	18.5%
RWAs . . . . .	403,425	—	306,746	—
Adjusted average total assets . . . . .	804,932	—	769,495	—
Tier 1 leverage . . . . .	—	7.1%	—	7.1%

*The Company's U.S. Bank Operating Subsidiaries.* The Company's U.S. 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 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 June 30, 2013, 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, calculated in a manner consistent with the guidelines described under Basel I, inclusive of the market risk capital framework amendment:

	<u>June 30, 2013</u>		<u>December 31, 2012</u>	
	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>
	(dollars in millions)			
Total capital (to RWAs):				
MSBNA . . . . .	\$12,006	15.8%	\$11,509	17.2%
MSPBNA . . . . .	\$ 1,736	26.5%	\$ 1,673	28.8%
Tier 1 capital (to RWAs):				
MSBNA . . . . .	\$10,386	13.7%	\$ 9,918	14.9%
MSPBNA . . . . .	\$ 1,729	26.4%	\$ 1,665	28.7%
Tier 1 leverage:				
MSBNA . . . . .	\$10,386	13.1%	\$ 9,918	13.3%
MSPBNA . . . . .	\$ 1,729	10.9%	\$ 1,665	10.6%

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### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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 total 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 June 30, 2013 and December 31, 2012, the 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 (the "SEC"), the Financial Industry Regulatory Authority, Inc. and the U.S. Commodity Futures Trading Commission (the "CFTC"). MS&Co. has consistently operated with capital in excess of its regulatory capital requirements. MS&Co's net capital and excess net capital decreased from December 31, 2012 due to regulatory capital deductions required for the composition of trading assets held at June 30, 2013. MS&Co.'s net capital totaled \$6,678 million and \$7,820 million at June 30, 2013 and December 31, 2012, respectively, which exceeded the amount required by \$5,237 million and \$6,453 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 June 30, 2013, MS&Co. had tentative net capital in excess of the minimum and the notification requirements.

MSSB 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 CFTC. MSSB LLC has consistently operated with capital in excess of its regulatory capital requirements.

MSIP, a London-based broker-dealer subsidiary, is subject to the capital requirements of the Prudential Regulation 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 A2 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.

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**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**14. Redeemable Noncontrolling Interests and Total Equity.**

**Redeemable Noncontrolling Interests.**

Redeemable noncontrolling interests related to the Wealth Management JV (see Note 3). Changes in redeemable noncontrolling interests for the six months ended June 30, 2013 were as follows (dollars in millions):

Balance at December 31, 2012 .....	\$ 4,309
Net income applicable to redeemable noncontrolling interests .....	222
Distributions .....	(38)
Other .....	(11)
Carrying value of additional stake in Wealth Management JV purchased from Citi .....	<u>(4,482)</u>
Balance at June 30, 2013 .....	<u>\$ —</u>

**Total Equity.**

**Morgan Stanley Shareholders' Equity.**

During the quarters and six months ended June 30, 2013 and 2012, the Company did not purchase any of its common stock as part of its share repurchase program. At June 30, 2013, the Company had approximately \$1.6 billion remaining under its current share repurchase authorization. Share repurchases by the Company are subject to regulatory approval (see Note 22).

**Accumulated Other Comprehensive Income (Loss).**

The following table presents changes in Accumulated other comprehensive income (loss) by component, net of tax and net of noncontrolling interests, in the quarter ended June 30, 2013 (dollars in millions):

	<u>Foreign Currency Translation Adjustments</u>	<u>Net Change in Cash Flow Hedges</u>	<u>Change in Net Unrealized Gains (Losses) on Securities Available for Sale</u>	<u>Pension, Postretirement and Other Related Adjustments</u>	<u>Total</u>
Balance at March 31, 2013 .....	<u>\$(276)</u>	<u>\$ (4)</u>	<u>\$ 124</u>	<u>\$(538)</u>	<u>\$ (694)</u>
Other comprehensive income (loss) before reclassifications .....	(144)	—	(322)	5	(461)
Amounts reclassified from accumulated other comprehensive income (loss) .....	<u>—</u>	<u>1</u>	<u>(20)</u>	<u>5</u>	<u>(14)</u>
Net other comprehensive income (loss) during the period .....	<u>(144)</u>	<u>1</u>	<u>(342)</u>	<u>10</u>	<u>(475)</u>
Balance at June 30, 2013 .....	<u>\$(420)</u>	<u>\$ (3)</u>	<u>\$(218)</u>	<u>\$(528)</u>	<u>\$(1,169)</u>

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**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

The following table presents changes in Accumulated other comprehensive income (loss) by component, net of tax and net of noncontrolling interests, in the six months ended June 30, 2013 (dollars in millions):

	<u>Foreign Currency Translation Adjustments</u>	<u>Net Change in Cash Flow Hedges</u>	<u>Change in Net Unrealized Gains (Losses) on Securities Available for sale</u>	<u>Pension, Postretirement and Other Related Adjustments</u>	<u>Total</u>
Balance at December 31, 2012 . . . . .	\$(123)	\$ (5)	\$ 151	\$(539)	\$ (516)
Other comprehensive income (loss) before reclassifications . . . . .	(297)	—	(347)	2	(642)
Amounts reclassified from accumulated other comprehensive income (loss) . . . . .	—	2	(22)	9	(11)
Net other comprehensive income (loss) during the period . . . . .	(297)	2	(369)	11	(653)
Balance at June 30, 2013 . . . . .	<u>\$(420)</u>	<u>\$ (3)</u>	<u>\$(218)</u>	<u>\$(528)</u>	<u>\$(1,169)</u>

The Company had no significant reclassifications out of Accumulated other comprehensive income (loss) for the quarter and six months ended June 30, 2013.

***Nonredeemable Noncontrolling Interests.***

Changes in nonredeemable noncontrolling interests primarily resulted from distributions related to MSMS of \$292 million and a real estate fund of \$195 million in the six months ended June 30, 2013. Changes in nonredeemable noncontrolling interests in the six months ended June 30, 2012 primarily resulted from \$622 million in net assets received from Citi related to Citi's required equity contribution in connection with the Wealth Management JV platform integration, partially offset by distributions related to MSMS of \$151 million. See Note 20.

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**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**15. Earnings per Common Share.**

Basic earnings per common share (“EPS”) is computed by dividing earnings (loss) applicable 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, 2012 in the Form 10-K). The following table presents the calculation of basic and diluted EPS (in millions, except for per share data):

	<u>Three Months Ended</u> <u>June 30,</u>		<u>Six Months Ended</u> <u>June 30,</u>	
	<u>2013</u>	<u>2012</u>	<u>2013</u>	<u>2012</u>
<b>Basic EPS:</b>				
Income from continuing operations . . . . .	\$1,220	\$ 713	\$2,470	\$ 861
Net gain (loss) from discontinued operations . . . . .	(29)	37	(48)	23
Net income . . . . .	1,191	750	2,422	884
Net income applicable to redeemable noncontrolling interests . . . . .	100	—	222	—
Net income applicable to nonredeemable noncontrolling interests . . . . .	111	159	258	387
Net income applicable to Morgan Stanley . . . . .	980	591	1,942	497
Less: Preferred dividends (Series A Preferred Stock) . . . . .	(11)	(11)	(22)	(22)
Less: Preferred dividends (Series C Preferred Stock) . . . . .	(13)	(13)	(26)	(26)
Less: Wealth Management JV redemption value adjustment (see Note 3) . . . . .	(151)	—	(151)	—
Less: Allocation of (earnings) loss to participating RSUs(1): From continuing operations . . . . .	(2)	(3)	(4)	(3)
Earnings applicable to Morgan Stanley common shareholders . . . . .	<u>\$ 803</u>	<u>\$ 564</u>	<u>\$1,739</u>	<u>\$ 446</u>
Weighted average common shares outstanding . . . . .	<u>1,908</u>	<u>1,885</u>	<u>1,904</u>	<u>1,881</u>
Earnings per basic common share:				
Income from continuing operations . . . . .	\$ 0.44	\$ 0.28	\$ 0.94	\$ 0.23
Net gain (loss) from discontinued operations . . . . .	(0.02)	0.02	(0.03)	0.01
Earnings per basic common share . . . . .	<u>\$ 0.42</u>	<u>\$ 0.30</u>	<u>\$ 0.91</u>	<u>\$ 0.24</u>
<b>Diluted EPS:</b>				
Earnings applicable to Morgan Stanley common shareholders . . . . .	\$ 803	\$ 564	\$1,739	\$ 446
Weighted average common shares outstanding . . . . .	1,908	1,885	1,904	1,881
Effect of dilutive securities:				
Stock options and RSUs(1) . . . . .	43	27	42	26
Weighted average common shares outstanding and common stock equivalents . . . . .	<u>1,951</u>	<u>1,912</u>	<u>1,946</u>	<u>1,907</u>
Earnings per diluted common share:				
Income from continuing operations . . . . .	\$ 0.43	\$ 0.28	\$ 0.92	\$ 0.23
Net gain (loss) from discontinued operations . . . . .	(0.02)	0.01	(0.03)	—
Earnings per diluted common share . . . . .	<u>\$ 0.41</u>	<u>\$ 0.29</u>	<u>\$ 0.89</u>	<u>\$ 0.23</u>

(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.

**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:

<u>Number of Antidilutive Securities Outstanding at End of Period:</u>	<u>Three Months Ended June 30,</u>		<u>Six Months Ended June 30,</u>	
	<u>2013</u>	<u>2012</u>	<u>2013</u>	<u>2012</u>
	(shares in millions)			
RSUs and performance-based stock units .....	4	32	4	13
Stock options .....	<u>36</u>	<u>45</u>	<u>36</u>	<u>45</u>
Total .....	<u>40</u>	<u>77</u>	<u>40</u>	<u>58</u>

**16. Interest Income and Interest Expense.**

Details of Interest income and Interest expense were as follows:

	<u>Three Months Ended June 30,</u>		<u>Six Months Ended June 30,</u>	
	<u>2013</u>	<u>2012</u>	<u>2013</u>	<u>2012</u>
	(dollars in millions)			
Interest income(1):				
Trading assets(2) .....	\$ 613	\$ 662	\$1,217	\$1,453
Securities available for sale .....	110	76	206	162
Loans .....	278	139	522	257
Interest bearing deposits with banks .....	25	24	51	51
Federal funds sold and securities purchased under agreements to resell and Securities borrowed .....	66	46	158	159
Other .....	<u>330</u>	<u>376</u>	<u>666</u>	<u>783</u>
Total interest income .....	<u>\$1,422</u>	<u>\$1,323</u>	<u>\$2,820</u>	<u>\$2,865</u>
Interest expense(1):				
Deposits .....	\$ 41	\$ 45	\$ 82	\$ 90
Commercial paper and other short-term borrowings .....	5	11	14	24
Long-term debt .....	917	1,087	1,877	2,341
Securities sold under agreements to repurchase and Securities loaned .....	518	529	968	992
Other .....	<u>(263)</u>	<u>(189)</u>	<u>(510)</u>	<u>(363)</u>
Total interest expense .....	<u>\$1,218</u>	<u>\$1,483</u>	<u>\$2,431</u>	<u>\$3,084</u>
Net interest .....	<u>\$ 204</u>	<u>\$ (160)</u>	<u>\$ 389</u>	<u>\$ (219)</u>

(1) 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 Trading revenues or Investments revenues. Otherwise, it is included within Interest income or Interest expense.

(2) Interest expense on Trading liabilities is reported as a reduction to Interest income on Trading assets.

**17. 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.



**MORGAN STANLEY**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
	(dollars in millions)			
Service cost, benefits earned during the period . . . . .	\$ 7	\$ 7	\$ 14	\$ 15
Interest cost on projected benefit obligation . . . . .	39	41	78	82
Expected return on plan assets . . . . .	(29)	(27)	(57)	(55)
Net amortization of prior service costs . . . . .	(3)	(4)	(7)	(7)
Net amortization of actuarial loss . . . . .	10	7	20	14
Net periodic benefit expense . . . . .	\$ 24	\$ 24	\$ 48	\$ 49

**18. 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 in states in which the Company has significant business operations, such as New York. The Company is currently under review 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 2013, the Company expects to reach a conclusion with the U.K. tax authorities on substantially all issues through tax year 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 six months ended June 30, 2013 included a discrete tax benefit of \$81 million due to the retroactive effective date of the American Taxpayer Relief Act of 2012 (the “Relief Act”). The Relief Act that was enacted on January 2, 2013, among other things, extended with retroactive effect to January 1, 2012 a provision of U.S. tax law that defers the imposition of tax on certain active financial services income of certain foreign subsidiaries earned outside of the U.S. until such income is repatriated to the U.S. as a dividend. Additionally, the Company’s effective tax rate from continuing operations for the six months ended June 30, 2013 included a discrete net tax benefit of \$61 million associated with remeasurement of reserves and related interest based on new information regarding the status of certain tax authority examinations. Excluding these discrete tax benefits, the annual effective tax rate in the six months ended June 30, 2013 would have been 30.8%.



**MORGAN STANLEY**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**19. 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, Wealth Management and Investment 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 Wealth Management business segment related to the bank deposit program.

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

<u>Three Months Ended June 30, 2013</u>	<u>Institutional Securities</u>	<u>Wealth Management</u>	<u>Investment Management</u>	<u>Intersegment Eliminations</u>	<u>Total</u>
	(dollars in millions)				
Total non-interest revenues . . . . .	\$4,586	\$3,085	\$674	\$ (46)	\$8,299
Interest income . . . . .	1,029	511	3	(121)	1,422
Interest expense . . . . .	1,269	65	4	(120)	1,218
Net interest . . . . .	(240)	446	(1)	(1)	204
Net revenues(1) . . . . .	<u>\$4,346</u>	<u>\$3,531</u>	<u>\$673</u>	<u>\$ (47)</u>	<u>\$8,503</u>
Income from continuing operations before income taxes . . . . .	\$ 960	\$ 655	\$160	\$ —	\$1,775
Provision for income taxes . . . . .	288	229	38	—	555
Income from continuing operations . . . . .	<u>672</u>	<u>426</u>	<u>122</u>	<u>—</u>	<u>1,220</u>
Discontinued operations(2):					
Gain (loss) from discontinued operations . . . . .	(27)	—	—	(15)	(42)
Provision for (benefit from) income taxes . . . . .	(9)	—	—	(4)	(13)
Net gain (loss) on discontinued operations . . . . .	<u>(18)</u>	<u>—</u>	<u>—</u>	<u>(11)</u>	<u>(29)</u>
Net income (loss) . . . . .	654	426	122	(11)	1,191
Net income applicable to redeemable noncontrolling interests . . . . .	—	100	—	—	100
Net income applicable to nonredeemable noncontrolling interests . . . . .	90	—	21	—	111
Net income (loss) applicable to Morgan Stanley . . . . .	<u>\$ 564</u>	<u>\$ 326</u>	<u>\$101</u>	<u>\$ (11)</u>	<u>\$ 980</u>

**MORGAN STANLEY**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

<u>Three Months Ended June 30, 2012</u>	<u>Institutional Securities(3)</u>	<u>Wealth Management(3)</u>	<u>Investment Management</u>	<u>Intersegment Eliminations</u>	<u>Total</u>
	(dollars in millions)				
Total non-interest revenues . . . . .	\$3,863	\$2,816	\$465	\$ (42)	\$7,102
Interest income . . . . .	964	456	2	(99)	1,323
Interest expense . . . . .	1,495	76	11	(99)	1,483
Net interest . . . . .	(531)	380	(9)	—	(160)
Net revenues(1) . . . . .	<u>\$3,332</u>	<u>\$3,196</u>	<u>\$456</u>	<u>\$ (42)</u>	<u>\$6,942</u>
Income (loss) from continuing operations before income taxes . . . . .	\$ 488	\$ 410	\$ 43	\$ (4)	\$ 937
Provision for income taxes . . . . .	69	149	6	—	224
Income (loss) from continuing operations . . . . .	<u>419</u>	<u>261</u>	<u>37</u>	<u>(4)</u>	<u>713</u>
Discontinued operations(2):					
Gain (loss) from discontinued operations . . . . .	(43)	91	—	4	52
Provision for (benefit from) income taxes . . . . .	(15)	30	—	—	15
Net gain (loss) on discontinued operations . . . . .	<u>(28)</u>	<u>61</u>	<u>—</u>	<u>4</u>	<u>37</u>
Net income . . . . .	391	322	37	—	750
Net income applicable to nonredeemable noncontrolling interests . . . . .	45	91	23	—	159
Net income applicable to Morgan Stanley . . . . .	<u>\$ 346</u>	<u>\$ 231</u>	<u>\$ 14</u>	<u>\$—</u>	<u>\$ 591</u>

**MORGAN STANLEY**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

<u>Six Months Ended June 30, 2013</u>	<u>Institutional Securities</u>	<u>Wealth Management</u>	<u>Investment Management</u>	<u>Intersegment Eliminations</u>	<u>Total</u>
	(dollars in millions)				
Total non-interest revenues .....	\$8,899	\$6,142	\$1,323	\$ (92)	\$16,272
Interest income .....	2,053	999	5	(237)	2,820
Interest expense .....	2,517	140	10	(236)	2,431
Net interest .....	(464)	859	(5)	(1)	389
Net revenues(1) .....	<u>\$8,435</u>	<u>\$7,001</u>	<u>\$1,318</u>	<u>\$ (93)</u>	<u>\$16,661</u>
Income from continuing operations before income taxes .....	\$1,758	\$1,252	\$ 347	\$ —	\$ 3,357
Provision for income taxes .....	348	449	90	—	887
Income from continuing operations .....	<u>1,410</u>	<u>803</u>	<u>257</u>	<u>—</u>	<u>2,470</u>
Discontinued operations(2):					
Gain (loss) from discontinued operations ....	(57)	(1)	1	(14)	(71)
Provision for (benefit from) income taxes ...	(20)	—	—	(3)	(23)
Net gain (loss) on discontinued operations .....	<u>(37)</u>	<u>(1)</u>	<u>1</u>	<u>(11)</u>	<u>(48)</u>
Net income (loss) .....	1,373	802	258	(11)	2,422
Net income applicable to redeemable noncontrolling interests .....	1	221	—	—	222
Net income applicable to nonredeemable noncontrolling interests .....	186	—	72	—	258
Net income (loss) applicable to Morgan Stanley ..	<u>\$1,186</u>	<u>\$ 581</u>	<u>\$ 186</u>	<u>\$ (11)</u>	<u>\$ 1,942</u>
<u>Six Months Ended June 30, 2012</u>	<u>Institutional Securities(3)</u>	<u>Wealth Management(3)</u>	<u>Investment Management</u>	<u>Intersegment Eliminations</u>	<u>Total</u>
	(dollars in millions)				
Total non-interest revenues .....	\$7,449	\$5,707	\$1,006	\$ (77)	\$14,085
Interest income .....	2,141	914	5	(195)	2,865
Interest expense .....	3,123	134	22	(195)	3,084
Net interest .....	(982)	780	(17)	—	(219)
Net revenues(1) .....	<u>\$6,467</u>	<u>\$6,487</u>	<u>\$ 989</u>	<u>\$ (77)</u>	<u>\$13,866</u>
Income (loss) from continuing operations before income taxes .....	\$ 159	\$ 813	\$ 171	\$ (4)	\$ 1,139
Provision for (benefit from) income taxes .....	(37)	271	44	—	278
Income (loss) from continuing operations .....	<u>196</u>	<u>542</u>	<u>127</u>	<u>(4)</u>	<u>861</u>
Discontinued operations(2):					
Gain (loss) from discontinued operations ....	(18)	93	1	4	80
Provision for income taxes .....	26	31	—	—	57
Net gain (loss) on discontinued operations .....	<u>(44)</u>	<u>62</u>	<u>1</u>	<u>4</u>	<u>23</u>
Net income .....	152	604	128	—	884
Net income applicable to nonredeemable noncontrolling interests .....	124	175	88	—	387
Net income applicable to Morgan Stanley ...	<u>\$ 28</u>	<u>\$ 429</u>	<u>\$ 40</u>	<u>\$ —</u>	<u>\$ 497</u>

**MORGAN STANLEY**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

- (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 \$335 million at June 30, 2013 and approximately \$205 million at December 31, 2012 (see Note 2 to the consolidated financial statements for the year ended December 31, 2012 included in the Form 10-K).
- (2) See Notes 1 and 21 for discussion of discontinued operations.
- (3) On January 1, 2013, the International Wealth Management business was transferred from the Wealth Management business segment to the Equity division within the Institutional Securities business segment. Accordingly, prior period amounts have been recast to reflect the International Wealth Management business as part of the Institutional Securities business segment.

<u>Total Assets(1)</u>	<u>Institutional Securities(2)</u>	<u>Wealth Management(2)</u>	<u>Investment Management</u>	<u>Total</u>
	(dollars in millions)			
At June 30, 2013	\$671,116	\$124,319	\$7,256	\$802,691
At December 31, 2012	\$648,049	\$125,565	\$7,346	\$780,960

- (1) Corporate assets have been fully allocated to the Company's business segments.
- (2) Prior period amounts have been recast to reflect the transfer of the International Wealth Management business from the Wealth Management business segment to the Institutional Securities business segment.

***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 and managed 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.
- Wealth Management: wealth management representative coverage location.
- Investment Management: client location, except for Merchant Banking and Real Estate Investing businesses, which are based on asset location.

<u>Net Revenues</u>	<u>Three Months Ended</u>		<u>Six Months Ended</u>	
	<u>June 30,</u>	<u>2012</u>	<u>2013</u>	<u>2012</u>
	(dollars in millions)			
Americas	\$6,014	\$5,104	\$11,970	\$ 9,888
Europe, Middle East and Africa	1,132	977	2,198	2,126
Asia	1,357	861	2,493	1,852
Net revenues	\$8,503	\$6,942	\$16,661	\$13,866

**20. Equity Method Investments.**

The Company has investments accounted for under the equity method of accounting (see Note 1) of \$4,542 million and \$4,682 million at June 30, 2013 and December 31, 2012, respectively, included in Other investments in the condensed consolidated statements of financial condition. Income from these investments were \$127 million and \$191 million for the quarter and six months ended June 30, 2013, respectively, and are included in Other revenues in the condensed consolidated statements of income. Income (losses) from these investments were \$12 million and \$(20) million for the quarter and six months ended June 30, 2012, respectively.

**MORGAN STANLEY**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

***Japanese Securities Joint Venture.***

The Company holds a 40% voting interest and Mitsubishi UFJ Financial Group, Inc. (“MUFG”) holds a 60% voting interest in Mitsubishi UFJ Morgan Stanley Securities Co., Ltd. (“MUMSS”), while the Company holds a 51% voting interest and MUFG holds a 49% voting interest in MSMS. The Company consolidates MSMS in its condensed consolidated financial statements and accounts for its interest in MUMSS as an equity method investment within the Institutional Securities business segment (see Note 14). During the quarters ended June 30, 2013 and 2012, the Company recorded income of \$174 million and \$54 million, respectively, and income of \$299 million and \$81 million in the six months ended June 30, 2013 and 2012, respectively, within Other revenues in the condensed consolidated statements of income, arising from the Company’s 40% stake in MUMSS.

In June of 2013, MUMSS paid a dividend of approximately \$287 million, of which the Company received approximately \$115 million for its proportionate share of MUMSS.

**21. 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:

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2013</b>	<b>2012</b>	<b>2013</b>	<b>2012</b>
	<b>(dollars in millions)</b>			
Net revenues(1):				
Saxon .....	\$—	\$ 1	\$—	\$ 77
Quilter .....	—	132	(1)	163
Other .....	(9)	6	(18)	14
	<u>\$ (9)</u>	<u>\$ 139</u>	<u>\$ (19)</u>	<u>\$ 254</u>
Pre-tax gain (loss) on discontinued operations(1):				
Saxon .....	\$ (19)	\$ (40)	\$ (39)	\$ (15)
Quilter(2) .....	—	95	(1)	97
Other .....	(23)	(3)	(31)	(2)
	<u>\$ (42)</u>	<u>\$ 52</u>	<u>\$ (71)</u>	<u>\$ 80</u>

(1) Amounts included eliminations of intersegment activity.

(2) Amount for the quarter and six months ended June 30, 2012 included a pre-tax gain of approximately \$108 million in connection with the sale of Quilter.

## MORGAN STANLEY

### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

#### **22. Subsequent Events.**

The Company has evaluated subsequent events for adjustment to or disclosure in the condensed consolidated financial statements through the date of this report and the Company has not identified any recordable or disclosable events, not otherwise reported in these condensed consolidated financial statements or the notes thereto, except for the following:

#### ***Common Dividend.***

On July 18, 2013, the Company announced that its Board of Directors declared a quarterly dividend per common share of \$0.05. The dividend is payable on August 15, 2013 to common shareholders of record on July 31, 2013.

#### ***Share Repurchases.***

In July 2013, the Company received no objection from the Federal Reserve to repurchase up to \$500 million of the Company's outstanding common stock under rules permitting annual capital distributions (12 Code of Federal Regulations 225.8, *Capital Planning*). Share repurchases will be made pursuant to the share repurchase program previously authorized by the Company's Board of Directors and will be exercised from time to time through March 31, 2014, at prices the Company deems appropriate subject to various factors, including the Company's capital position and market conditions. The share repurchases may be effected through open market purchases or privately negotiated transactions, including through Rule 10b5-1 plans, and may be suspended at any time (see Note 14 and "Unregistered Sales of Equity Securities and Use of Proceeds" in Part II, Item 2).

#### ***Wealth Management JV.***

In July 2013, approximately \$17 billion of deposits held by Citi relating to customer accounts were transferred to the Company's depository institutions (see Note 3).

## 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 June 30, 2013, the related condensed consolidated statements of income and comprehensive income for the three-month and six-month periods ended June 30, 2013 and 2012, and the condensed consolidated statements of cash flows and changes in total equity for the six-month periods ended June 30, 2013 and 2012. 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, 2012, and the 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 26, 2013, 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, 2012 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

August 2, 2013



## **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, 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.

Effective with the quarter ended June 30, 2013, the Global Wealth Management Group and Asset Management business segments were re-titled Wealth Management and Investment Management, respectively.

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* (formerly known as Global Wealth Management Group), 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 trading, which primarily facilitates clients’ trading or investments in such securities.

*Investment Management* (formerly known as 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 21 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, consumer and business sentiment and confidence in the financial markets; the performance of the Company’s acquisitions, joint ventures, strategic alliances or other strategic arrangements (including 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; the effectiveness of the Company’s risk management policies; 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 adverse 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, 2012 (the "Form 10-K"), and "Other Matters" herein.

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 "Business—Competition" and "Business—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 June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
<b>Net revenues:</b>				
Institutional Securities(1)	\$4,346	\$3,332	\$ 8,435	\$ 6,467
Wealth Management(1)	3,531	3,196	7,001	6,487
Investment Management	673	456	1,318	989
Intersegment Eliminations	(47)	(42)	(93)	(77)
Consolidated net revenues	<u>\$8,503</u>	<u>\$6,942</u>	<u>\$16,661</u>	<u>\$13,866</u>
<b>Net income</b>	<u>\$1,191</u>	<u>\$ 750</u>	<u>\$ 2,422</u>	<u>\$ 884</u>
<b>Net income applicable to redeemable noncontrolling interests(2)</b>	100	—	222	—
<b>Net income applicable to nonredeemable noncontrolling interests(2)</b>	111	159	258	387
<b>Net income applicable to Morgan Stanley</b>	<u>\$ 980</u>	<u>\$ 591</u>	<u>\$ 1,942</u>	<u>\$ 497</u>
<b>Income from continuing operations applicable to Morgan Stanley:</b>				
Institutional Securities(1)	\$ 582	\$ 374	\$ 1,223	\$ 72
Wealth Management(1)	326	178	582	376
Investment Management	101	14	185	39
Intersegment Eliminations	—	(4)	—	(4)
Income from continuing operations applicable to Morgan Stanley	<u>\$1,009</u>	<u>\$ 562</u>	<u>\$ 1,990</u>	<u>\$ 483</u>
<b>Amounts applicable to Morgan Stanley:</b>				
Income from continuing operations applicable to Morgan Stanley	\$1,009	\$ 562	\$ 1,990	\$ 483
Net gain (loss) from discontinued operations applicable to Morgan Stanley(3)	(29)	29	(48)	14
<b>Net income applicable to Morgan Stanley</b>	<u>\$ 980</u>	<u>\$ 591</u>	<u>\$ 1,942</u>	<u>\$ 497</u>
<b>Earnings applicable to Morgan Stanley common shareholders</b>	<u>\$ 803</u>	<u>\$ 564</u>	<u>\$ 1,739</u>	<u>\$ 446</u>
<b>Earnings per basic common share:</b>				
Income from continuing operations	\$ 0.44	\$ 0.28	\$ 0.94	\$ 0.23
Net gain (loss) from discontinued operations(3)	(0.02)	0.02	(0.03)	0.01
Earnings per basic common share(4)	<u>\$ 0.42</u>	<u>\$ 0.30</u>	<u>\$ 0.91</u>	<u>\$ 0.24</u>
<b>Earnings per diluted common share:</b>				
Income from continuing operations	\$ 0.43	\$ 0.28	\$ 0.92	\$ 0.23
Net gain (loss) from discontinued operations(3)	(0.02)	0.01	(0.03)	—
Earnings per diluted common share(4)	<u>\$ 0.41</u>	<u>\$ 0.29</u>	<u>\$ 0.89</u>	<u>\$ 0.23</u>
<b>Regional net revenues:</b>				
Americas	\$6,014	\$5,104	\$11,970	\$ 9,888
Europe, Middle East and Africa	1,132	977	2,198	2,126
Asia	1,357	861	2,493	1,852
Net revenues	<u>\$8,503</u>	<u>\$6,942</u>	<u>\$16,661</u>	<u>\$13,866</u>

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
<b>Average common equity (dollars in billions):</b>				
Institutional Securities . . . . .	\$ 38.3	\$ 29.3	\$ 39.2	\$ 29.5
Wealth Management . . . . .	13.3	13.3	13.3	13.3
Investment Management . . . . .	2.8	2.5	2.8	2.5
Parent capital . . . . .	7.1	16.3	5.9	15.7
Consolidated average common equity . . . . .	<u>\$ 61.5</u>	<u>\$ 61.4</u>	<u>\$ 61.2</u>	<u>\$ 61.0</u>
<b>Return on average common equity(5):</b>				
Institutional Securities . . . . .	5.9%	4.8%	6.0%	0.2%
Wealth Management . . . . .	5.2%	5.2%	6.4%	5.6%
Investment Management . . . . .	14.0%	2.1%	13.0%	3.0%
Consolidated . . . . .	5.4%	3.5%	5.8%	1.4%
<b>Book value per common share(6) . . . . .</b>	<b>\$ 31.48</b>	<b>\$ 31.02</b>	<b>\$ 31.48</b>	<b>\$ 31.02</b>
<b>Tangible common equity(7) . . . . .</b>	<b>\$ 51,479</b>	<b>\$ 54,765</b>	<b>\$ 51,479</b>	<b>\$ 54,765</b>
<b>Return on average tangible common equity from continuing operations(8) . . . . .</b>				
	6.3%	3.9%	6.7%	1.6%
<b>Tangible book value per common share(9) . . . . .</b>	<b>\$ 26.27</b>	<b>\$ 27.70</b>	<b>\$ 26.27</b>	<b>\$ 27.70</b>
<b>Effective income tax rate from continuing operations(10) . . . . .</b>	<b>31.3%</b>	<b>23.9%</b>	<b>26.4%</b>	<b>24.4%</b>
<b>Worldwide employees at June 30, 2013 and 2012 . . . . .</b>	<b>55,610</b>	<b>58,627</b>	<b>55,610</b>	<b>58,627</b>
<b>Global liquidity reserve held by the bank and non-bank legal entities at June 30, 2013 and 2012 (dollars in billions)(11) . . . . .</b>				
	\$ 181	\$ 173	\$ 181	\$ 173
<b>Average global liquidity reserve (dollars in billions)(11):</b>				
Bank legal entities . . . . .	\$ 65	\$ 63	\$ 68	\$ 63
Non-bank legal entities . . . . .	119	113	118	114
Total average global liquidity reserve . . . . .	<u>\$ 184</u>	<u>\$ 176</u>	<u>\$ 186</u>	<u>\$ 177</u>
<b>Long-term borrowings at June 30, 2013 and 2012 . . . . .</b>	<b>\$161,098</b>	<b>\$167,828</b>	<b>\$161,098</b>	<b>\$167,828</b>
<b>Maturities of long-term borrowings outstanding at June 30, 2013 and 2012 (next 12 months) . . . . .</b>				
	\$ 26,921	\$ 25,356	\$ 26,921	\$ 25,356
<b>Capital ratios at June 30, 2013 and 2012:</b>				
Total capital ratio(12) . . . . .	14.9%	18.4%	14.9%	18.4%
Tier 1 common capital ratio(12) . . . . .	11.8%	13.6%	11.8%	13.6%
Tier 1 capital ratio(12) . . . . .	14.1%	17.2%	14.1%	17.2%
Tier 1 leverage ratio(13) . . . . .	7.1%	7.1%	7.1%	7.1%
<b>Consolidated assets under management or supervision at June 30, 2013 and 2012 (dollars in billions)(14):</b>				
Investment Management(15) . . . . .	\$ 347	\$ 311	\$ 347	\$ 311
Wealth Management(1)(16) . . . . .	625	511	625	511
Total . . . . .	<u>\$ 972</u>	<u>\$ 822</u>	<u>\$ 972</u>	<u>\$ 822</u>

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
<b>Institutional Securities(1):</b>				
Pre-tax profit margin(17)	22%	15%	21%	3%
<b>Wealth Management(1)(16):</b>				
Wealth Management representatives at June 30, 2013 and 2012(18)	16,321	16,478	16,321	16,478
Annualized revenues per representative (dollars in thousands)(19)	\$ 866	\$ 770	\$ 858	\$ 775
Assets by client segment at June 30, 2013 and 2012 (dollars in billions):				
\$10 million or more	\$ 604	\$ 519	\$ 604	\$ 519
\$1 million to \$10 million	720	681	720	681
Subtotal \$1 million or more	1,324	1,200	1,324	1,200
\$100,000 to \$1 million	410	391	410	391
Less than \$100,000	44	44	44	44
Total client assets	\$ 1,778	\$ 1,635	\$ 1,778	\$ 1,635
Fee-based client assets as a percentage of total client assets(20)	35%	31%	35%	31%
Client assets per representative(21)	\$ 109	\$ 99	\$ 109	\$ 99
Fee-based client asset flows (dollars in billions)(22)	\$ 10.0	\$ 3.0	\$ 25.3	\$ 13.2
Bank deposits at June 30, 2013 and 2012 (dollars in billions)(23)	\$ 127	\$ 112	\$ 127	\$ 112
Retail locations at June 30, 2013 and 2012	676	722	676	722
Pre-tax profit margin(17)	19%	13%	18%	13%
<b>Investment Management:</b>				
Pre-tax profit margin(17)	24%	9%	26%	17%
<b>Selected management financial measures, excluding DVA(24):</b>				
Net revenues, excluding DVA(24)	\$ 8,328	\$ 6,592	\$ 16,803	\$ 15,494
Income from continuing operations applicable to Morgan Stanley, excluding DVA(24)	\$ 898	\$ 337	\$ 2,080	\$ 1,712
Income per diluted common share from continuing operations, excluding DVA(24)	\$ 0.37	\$ 0.16	\$ 0.96	\$ 0.87
Return on average common equity from continuing operations, excluding DVA(5)	4.6%	2.1%	6.0%	5.6%
Return on average tangible common equity from continuing operations, excluding DVA(8)	5.3%	2.3%	6.9%	6.3%

DVA—Debt Valuation Adjustment represents the change in the fair value of certain of the Company's long-term and short-term borrowings resulting from the fluctuation in the Company's credit spreads and other credit factors.

- (1) On January 1, 2013, the International Wealth Management business was transferred from the Wealth Management business segment to the Equity division within the Institutional Securities business segment. Accordingly, all results and statistical data have been recast for all periods to reflect the International Wealth Management business as part of the Institutional Securities business segment.
- (2) See Notes 2, 3 and 15 to the consolidated financial statements for the year ended December 31, 2012 included in the Form 10-K and Notes 3 and 14 to the condensed consolidated financial statements for information on redeemable and nonredeemable noncontrolling interests.
- (3) See Notes 1 and 21 to the condensed consolidated financial statements for information on discontinued operations.
- (4) For the calculation of basic and diluted earnings per share ("EPS"), see Note 15 to the condensed consolidated financial statements.
- (5) The calculation of each business segment's return on average common equity uses income from continuing operations applicable to Morgan Stanley less preferred dividends as a percentage of each business segment's average common equity. The return on average common equity from continuing operations is a non-generally accepted accounting principle ("non-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—Regulatory Requirements—Required

- Capital” herein). The effective tax rates used in the computation of business segment return on average common equity were determined on a separate legal entity basis. To determine the return on average common equity from continuing operations, excluding the impact of DVA, also a non-GAAP financial measure, both the numerator and the denominator were adjusted to exclude the impact of DVA. The impact of DVA for the quarters ended June 30, 2013 and 2012 was 0.8% and 1.4%, and the impact of DVA for the six months ended June 30, 2013 and 2012 was (0.2)% and (4.2)%, respectively.
- (6) Book value per common share equals common shareholders’ equity of \$61,673 million at June 30, 2013 and \$61,333 million at June 30, 2012 divided by common shares outstanding of 1,959 million at June 30, 2013 and 1,977 million at June 30, 2012.
  - (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) Return on average tangible common equity from continuing operations 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. The calculation of return on average tangible common equity uses income from continuing operations applicable to Morgan Stanley less preferred dividends as a percentage of average tangible common equity. To determine the return on average tangible common equity from continuing operations, excluding the impact of DVA, also a non-GAAP financial measure, both the numerator and the denominator were adjusted to exclude the impact of DVA. The impact of DVA for the quarters ended June 30, 2013 and 2012 was 1.0% and 1.6%, and the impact of DVA for the six months ended June 30, 2013 and 2012 was (0.2)% and (4.7)%, respectively.
  - (9) 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.
  - (10) For a discussion of the effective income tax rate, see “Overview of the Quarter Ended June 30, 2013 Financial Results” and “Significant Items—Income Tax Items” herein.
  - (11) For a discussion of global liquidity reserve, see “Liquidity and Capital Resources—Liquidity Risk Management Framework—Global Liquidity Reserve” herein.
  - (12) The Company calculates its Tier 1 capital ratio and risk-weighted assets (“RWAs”) in accordance with the capital adequacy standards for financial holding companies adopted by the Board of Governors of the Federal Reserve System (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. On January 1, 2013, the U.S. banking regulators’ rules to implement the Basel Committee on Banking Supervision’s market risk capital framework amendment, commonly referred to as “Basel 2.5”, became effective, which increased the capital requirements for securitizations and correlation trading within the Company’s trading book, as well as incorporated add-ons for stressed Value-at-Risk (“VaR”) and incremental risk requirements (“market risk capital framework amendment”). The Company’s Tier 1 capital ratio and RWAs for the current periods were calculated under this revised framework. The Company’s Tier 1 capital ratio and RWAs for prior periods have not been recalculated under this revised framework. For a discussion of Total capital ratio, Tier 1 capital ratio and Tier 1 common capital ratio, see “Liquidity and Capital Resources—Regulatory Requirements” herein.
  - (13) For a discussion of Tier 1 leverage ratio, see “Liquidity and Capital Resources—Regulatory Requirements” herein.
  - (14) Revenues and expenses associated with these assets are included in the Company’s Wealth Management and Investment Management business segments.
  - (15) Amounts exclude the Investment Management business segment’s proportionate share of assets managed by entities in which it owns a minority stake.
  - (16) Prior-period amounts have been recast to exclude Quilter & Co. Ltd. (“Quilter”). See Notes 1 and 21 to the condensed consolidated financial statements for information on discontinued operations.
  - (17) 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.
  - (18) For the quarters ended June 30, 2013 and 2012, global representatives for the Company are 16,705 and 16,934, which include approximately 384 and 456 representatives associated with the International Wealth Management business, the results of which are reported in the Institutional Securities business segment, respectively.
  - (19) Annualized revenues per representative for the quarters ended June 30, 2013 and 2012 equal Wealth Management business segment’s annualized revenues divided by the average representative headcount for the quarters ended June 30, 2013 and 2012, respectively.
  - (20) Fee-based client assets represent the amount of assets in client accounts where the basis of payment for services is a fee calculated on those assets. Effective from the quarter ended March 31, 2013, client assets also include certain additional non-custodied assets as a result of the completion of the Morgan Stanley Wealth Management platform conversion.
  - (21) Client assets per representative equal total period-end client assets divided by period-end representative headcount.
  - (22) Beginning January 1, 2013, the Company enhanced its definition of fee-based asset flows. Fee-based asset flows have been recast for all periods to include dividends, interest and client fees, and to exclude cash management related activity.
  - (23) Approximately \$70 billion and \$58 billion of the bank deposit balances at June 30, 2013 and 2012, 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 deposits, see “Liquidity and Capital Resources—Funding Management—Deposits” herein and Notes 3 and 22 to the condensed consolidated financial statements.

(24) 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 U.S. The U.S. Securities and Exchange Commission 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 and the GAAP financial measure.

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2013</b>	<b>2012</b>	<b>2013</b>	<b>2012</b>
<b>Reconciliation of Selected Management Financial Measures from a Non-GAAP to a GAAP Basis (dollars in millions, except per share amounts):</b>				
<b>Net revenues</b>				
Net revenues—Non-GAAP .....	\$8,328	\$6,592	\$16,803	\$15,494
Impact of DVA .....	175	350	(142)	(1,628)
Net revenues—GAAP .....	<u>\$8,503</u>	<u>\$6,942</u>	<u>\$16,661</u>	<u>\$13,866</u>
<b>Income (loss) from continuing operations applicable to Morgan Stanley</b>				
Income applicable to Morgan Stanley—Non-GAAP .....	\$ 898	\$ 337	\$ 2,080	\$ 1,712
Impact of DVA .....	111	225	(90)	(1,229)
Income (loss) applicable to Morgan Stanley—GAAP .....	<u>\$1,009</u>	<u>\$ 562</u>	<u>\$ 1,990</u>	<u>\$ 483</u>
<b>Earnings (loss) per diluted common share</b>				
Income per diluted common share from continuing operations—Non-GAAP .....	\$ 0.37	\$ 0.16	\$ 0.96	\$ 0.87
Impact of DVA .....	0.06	0.12	(0.04)	(0.64)
Income (loss) per diluted common share from continuing operations—GAAP .....	<u>\$ 0.43</u>	<u>\$ 0.28</u>	<u>\$ 0.92</u>	<u>\$ 0.23</u>
Average diluted shares—Non-GAAP (in millions) .....	1,951	1,912	1,946	1,907
Impact of DVA (in millions) .....	—	—	—	—
Average diluted shares—GAAP (in millions) .....	<u>1,951</u>	<u>1,912</u>	<u>1,946</u>	<u>1,907</u>



### ***Global Market and Economic Conditions.***

During the six months ended June 30, 2013 global market and economic conditions improved modestly from 2012 year-end. The U.S. economy continued to grow moderately despite payroll and income tax increases that were implemented in January. Europe remained in recession, but market strains associated with the European financial crisis continued to ease after temporary concerns that were raised by election results in Italy and developments in Cyprus subsided. Despite these improvements, global market and economic conditions continued to be challenged by investor concerns about the scaling back of the U.S. monetary policy, the remaining European sovereign debt issues, the need to raise the U.S. federal debt ceiling and reduce government spending, and slowing economic growth in emerging markets.

In the U.S., major equity market indices ended the second quarter and the first six months of 2013 higher compared with the beginning of the quarter and the year, primarily due to improved investor confidence about the U.S. economy and dissipated concerns about the “fiscal cliff” (*i.e.*, the combination of expiring tax cuts and spending cuts on or after January 1, 2013). The U.S. economy continued its moderate growth pace in the first six months of 2013. A shrinking labor force helped push the unemployment rate down to 7.6% in June 2013 from 7.8% at 2012 year-end. Residential real estate markets strengthened, and home prices rose amid falling inventories across much of the country during the first six months of 2013, but investments in commercial real estate projects remained challenged. Consumer spending improved during the first six months of 2013 despite lower after-tax household income, but business investment spending growth moderated. Energy price volatility boosted consumer price inflation early in the year, but underlying inflation excluding food and energy slowed to near historical lows. The Federal Open Market Committee (“FOMC”) of the Federal Reserve kept key interest rates at historically low levels. At June 30, 2013, the federal funds target rate remained between 0.0% and 0.25% and the discount rate remained at 0.75%. In June 2013, the FOMC decided to continue purchasing U.S. Treasury securities and agency mortgage-backed securities until the job market improves “substantially” and also continued to anticipate that key interest rates will remain “exceptionally low” until the unemployment rate falls to 6.5% or lower, as long as medium-term inflation expectations remain below 2.5%. However, since the end of May 2013, concerns about the Federal Reserve’s plan to scale back its stimulus plan later this year caused investors to sell off significant amounts of stocks and bonds, resulting in the rapid increase in interest rates. Addressing the recent market volatility, in July 2013, the chairman of the Federal Reserve reiterated that the U.S. economy continues to need a highly accommodative monetary policy.

In Europe, major equity market indices, except for FTSE 100 index in the United Kingdom, ended the second quarter of 2013 either higher or flat compared with the beginning of the quarter. At June 30, 2013, major European equity market indices were higher compared with the beginning of the year, primarily due to investors’ optimism about Europe’s progress in addressing its sovereign debt issues. In the euro-area, the unemployment rate increased to a record 12.1% in June 2013 from 11.7% at 2012 year-end. At June 30, 2013, Bank of England’s (“BOE”) benchmark interest rate was 0.5%, which was unchanged from December 31, 2012. To stimulate economic activity in Europe, in early May 2013 the European Central Bank lowered the benchmark interest rate from 0.75% to 0.5% and indicated it will keep open its special liquidity facilities until at least the middle of 2014. Euro-area manufacturing expanded in July 2013 for the first time in two years, led by Germany, signaling the euro-zone economy is emerging from recession.

Major equity market indices in Asia, except for the indices in China, ended the first quarter and the first six months of 2013 higher compared with the beginning of the year. Japan’s economic activities started to pick up in the second quarter of 2013, primarily resulting from a series of economic stimulus packages announced by the Japanese government and the Bank of Japan in early 2013. Japan’s benchmark interest rate remained within a range of zero to 0.1% in the first half of 2013. China’s gross domestic product growth continued to slow during the first six months of 2013 as exports and domestic spending weakened, adding pressure on China to restructure its economy toward more sustainable growth driven by domestic consumption from reliance on exports and investments.



### ***Overview of the Quarter and Six Months Ended June 30, 2013 Financial Results.***

*Consolidated Results.* The Company recorded net income applicable to Morgan Stanley of \$980 million on net revenues of \$8,503 million during the quarter ended June 30, 2013 (“current quarter”) compared with net income applicable to Morgan Stanley of \$591 million on net revenues of \$6,942 million during the quarter ended June 30, 2012 (“prior year quarter”).

Net revenues in the current quarter included positive revenues due to the impact of DVA of \$175 million compared with positive revenues of \$350 million in the prior year quarter. Non-interest expenses increased 12% to \$6,728 million in the current quarter compared with \$6,005 million in the prior year quarter. Compensation expenses increased 13% to \$4,105 million in the current quarter compared with \$3,631 million in the prior year quarter. Non-compensation expenses increased 10% to \$2,623 million in the current quarter compared with \$2,374 million in the prior year quarter.

Earnings per diluted common share (“diluted EPS”) and diluted EPS from continuing operations were \$0.41 and \$0.43 in the current quarter, respectively, compared with \$0.29 and \$0.28, respectively, in the prior year quarter. The EPS calculation for the current quarter included a negative adjustment of approximately \$151 million, or \$0.08 per diluted share, related to the previously announced purchase of the remaining interest in the Morgan Stanley Smith Barney Holdings LLC (“Wealth Management JV”), which was completed in June 2013.

Excluding the impact of DVA, net revenues were \$8,328 million and diluted EPS from continuing operations were \$0.37 per share in the current quarter, compared with \$6,592 million and \$0.16 per share, respectively, in the prior year quarter.

For the six months ended June 30, 2013, the Company recorded net income applicable to Morgan Stanley of \$1,942 million on net revenues of \$16,661 million, compared with net income applicable to Morgan Stanley of \$497 million on net revenues of \$13,866 million in the six months ended June 30, 2012. Non-interest expenses increased 5% to \$13,304 million from the prior year period. Diluted EPS and diluted EPS from continuing operations were \$0.89 and \$0.92 in the six months ended June 30, 2013, compared with \$0.23 and \$0.23, respectively, in the prior year period.

The Company’s effective tax rate from continuing operations was 31.3% and 23.9% for the quarters ended June 30, 2013 and 2012, respectively. The Company’s effective tax rate from continuing operations was 26.4% and 24.4% for the six months ended June 30, 2013 and 2012, respectively. The results for the six months ended June 30, 2013 included a discrete net tax benefit of \$142 million due to the retroactive effective date of the American Taxpayer Relief Act of 2012 (the “Relief Act”) and remeasurement of reserves and related interest based on new information regarding the status of certain tax authority examinations. Excluding these discrete net tax benefits, the annual effective tax rate for the six months ended June 30, 2013 would have been 30.7%. The increase in the effective tax rate is primarily reflective of the geographic mix of earnings. For further discussion of the discrete net tax benefit, see “Executive Summary—Significant Items—Income Tax Items” herein.

During the quarter ended June 30, 2012, the Company completed the sale of Quilter, its retail wealth management business in the U.K., resulting in a pre-tax gain of \$108 million. In addition, the first phase of the asset sale of Saxon closed on April 2, 2012. The results of Quilter (reported in the Wealth Management business segment) and Saxon (reported in the Institutional Securities business segment) are presented as discontinued operations for all periods presented. Discontinued operations were a net gain (loss) of \$(29) million and \$37 million for the quarters ended June 30, 2013 and 2012, respectively, and a net gain (loss) of \$(48) million and \$23 million in the six months ended June 30, 2013 and 2012, respectively.

*Institutional Securities.* Income from continuing operations before taxes was \$960 million in the current quarter compared with income from continuing operations before taxes of \$488 million in the prior year quarter. Net revenues for the current quarter were \$4,346 million compared with \$3,332 million in the prior year quarter. The results in the current quarter included positive revenues due to the impact of DVA of \$175 million compared with positive revenues of \$350 million in the prior year quarter. Investment banking revenues for the current

quarter increased 22% to \$1,078 million from the prior year quarter, reflecting higher revenues from advisory transactions and equity and fixed income underwriting transactions. The following sales and trading net revenues results exclude the impact of DVA. The presentation of net revenues excluding the impact of DVA 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. Equity sales and trading net revenues, excluding the impact of DVA, of \$1,806 million increased 44% from the prior year quarter, reflecting strong performance across all products and regions, with particular strength in derivatives. Excluding the impact of DVA, fixed income and commodities sales and trading net revenues were \$1,153 million in the current quarter, an increase of 50% from the prior year quarter, reflecting the combination of higher revenues in foreign exchange products and commodities and that the prior year quarter was negatively impacted by period specific charges representing credit valuation allowances and other related adjustments (see “Executive Summary—Significant Items—Rating Agency Downgrade” herein). Other sales and trading net losses were \$57 million in the current quarter compared with net losses of \$12 million in the prior year quarter, primarily due to losses on economic hedges and other costs related to the Company’s long-term debt and costs related to the amount of liquidity held (“negative carry”), partially offset by net gains associated with loans and lending commitments. Other revenues of \$140 million were recognized in the current quarter compared with other revenues of \$41 million in the prior year quarter. The results included income 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 19% to \$3,386 million in the current quarter, primarily due to both higher compensation and non-compensation expenses. Compensation and benefits expenses in the current quarter were \$1,766 million compared with \$1,506 million in the prior year quarter, due to higher net revenues. Non-compensation expenses were \$1,620 million in the current quarter compared with \$1,338 million in the prior year quarter reflecting increased litigation accruals and higher volume-driven expenses.

*Wealth Management.* Income from continuing operations before taxes was \$655 million in the current quarter compared with \$410 million in the prior year quarter. Net revenues were \$3,531 million in the current quarter compared with \$3,196 million in the prior year quarter. Transactional revenues, consisting of Commissions and fees, Trading and Investment banking increased 15% to \$1,048 million from the prior year quarter. Trading revenues increased 18% to \$223 million in the current quarter from the prior year quarter, primarily due to higher gains related to positions associated with certain employee deferred compensation plans and higher revenues from structured notes. Commissions and fees revenues increased 14% to \$567 million in the current quarter from the prior year quarter, primarily due to higher equity and mutual fund activity. Investment banking revenues increased 16% to \$258 million in the current quarter from the prior year quarter, primarily due to higher revenues from closed-end funds. Asset management, distribution and administration fees increased 4% to \$1,896 million in the current quarter from the prior year quarter, primarily due to higher fee-based revenues, partially offset by lower revenues from the bank deposit program and managed futures. Net interest increased 17% to \$446 million in the current quarter from the prior year quarter, primarily resulting from higher revenues from the bank deposit program, higher interest from securities based lending and higher interest on the available for sale portfolio, partially offset by lower customer margin receivables. Total client asset balances were \$1,778 billion at June 30, 2013 and client assets in fee-based accounts were \$629 billion, or 35% of total client assets. Fee-based client asset flows for the current quarter were \$10 billion compared with \$3 billion in the prior year quarter. Prior period amounts have been recast to reflect the transfer of the International Wealth Management business from the Wealth Management business segment to the Institutional Securities business segment and for the Company’s enhanced definition of fee-based asset flows (see “Business Segments” herein). Compensation and benefit expenses increased 7% to \$2,042 million in the current quarter from the prior year quarter, primarily due to higher compensable revenues. Non-compensation expenses decreased 5% to \$834 million in the current quarter from the prior year quarter, partially driven by the absence of platform integration costs.

*Investment Management.* Income from continuing operations before taxes was \$160 million in the current quarter compared with \$43 million in the prior year quarter. Net revenues were \$673 million in the current quarter compared with \$456 million in the prior year quarter. The increase in net revenues reflected higher net

gains predominantly within the Company's Merchant Banking investments, as well as higher gains within Traditional Asset Management and Real Estate Investing. Non-interest expenses were \$513 million in the current quarter compared with \$413 million in the prior year quarter. Compensation and benefits expenses increased 39% to \$297 million in the current quarter, primarily due to higher net revenues. Non-compensation expenses increased 9% to \$216 million in the current quarter, primarily due to higher brokerage and clearing expenses.

**Significant Items.**

*Wealth Management JV.* The Company completed the purchase of the remaining 35% interest in the Wealth Management JV from Citi on June 28, 2013 for the previously established price of \$4.725 billion. The Company recorded a negative adjustment to retained earnings of approximately \$151 million (net of tax) to reflect the difference between the purchase price for the 35% redeemable noncontrolling interest in the joint venture and its carrying value.

*Litigation Accruals.* During the quarter and six months ended June 30, 2013, the Company increased litigation accruals by approximately \$199 million and \$270 million, respectively, compared with increases of approximately \$4 million and \$21 million, during the quarter and six months ended June 30, 2012, respectively. Changes to litigation accruals are included in Other non-interest expenses in the condensed consolidated statements of income.

*Available for Sale Securities.* During the quarters ended June 30, 2013 and 2012, the available for sale portfolio held within the Wealth Management segment reported unrealized gains (losses) of \$(342) million and \$41 million, net of tax, respectively. During the six months ended June 30, 2013 and 2012, the Company reported unrealized gains (losses) of \$(369) million and \$22 million, net of tax, respectively, included in Accumulated other comprehensive income. These losses in 2013 were due to rising interest rates during the quarter ended June 30, 2013.

*Severance Costs.* In the quarter and six months ended June 30, 2013, the Company incurred severance costs of approximately \$32 million and \$164 million, respectively, and approximately \$15 million and \$153 million, in the quarter and six months ended June 30, 2012, respectively, associated with reduction in force events which are included in Compensation and benefits expenses in the condensed consolidated statements of income.

*Corporate Lending.* The Company recorded the following amounts primarily associated with loans and lending commitments within the Institutional Securities business segment (see "Business Segments—Institutional Securities" herein):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
	(dollars in millions)			
Other sales and trading:				
Gains on loans and lending commitments and Net interest . . . . .	\$149	\$ 38	\$403	\$ 823
Gains (losses) on hedges . . . . .	(30)	91	(79)	(546)
Total Other sales and trading revenues . . . . .	<u>\$119</u>	<u>\$129</u>	<u>\$324</u>	<u>\$ 277</u>
Other revenues:				
Provision for loan losses . . . . .	\$ 1	\$(44)	\$(27)	\$ (52)
Losses on loans held for sale . . . . .	(39)	(14)	(31)	(20)
Total Other revenues . . . . .	<u>\$(38)</u>	<u>\$(58)</u>	<u>\$(58)</u>	<u>\$ (72)</u>
Other expenses: Provision for unfunded commitments . . . . .	(17)	(15)	(29)	(9)
Total . . . . .	<u>\$ 64</u>	<u>\$ 56</u>	<u>\$237</u>	<u>\$ 196</u>

*Income Tax Items.* The Company's effective tax rate from continuing operations for the six months ended June 30, 2013 included a discrete tax benefit of \$81 million due to the retroactive effective date of the Relief Act. The Relief Act that was enacted on January 2, 2013, among other things, extended with retroactive effect to

January 1, 2012 a provision of U.S. tax law that defers the imposition of tax on certain active financial services income of certain foreign subsidiaries earned outside of the U.S. until such income is repatriated to the U.S. as a dividend. Additionally, the Company's effective tax rate from continuing operations for the six months ended June 30, 2013 included a discrete net tax benefit of \$61 million associated with remeasurement of reserves and related interest based on new information regarding the status of certain tax authority examinations.

*Japanese Securities Joint Venture.* During the quarters ended June 30, 2013 and 2012, the Company recorded income of \$174 million and \$54 million, respectively, within Other revenues in the condensed consolidated statements of income, arising from the Company's 40% stake in MUMSS, and income of \$299 million and \$81 million for the six months ended June 30, 2013 and 2012, respectively. Net income applicable to nonredeemable noncontrolling interests associated with MUFG's interest in Morgan Stanley MUFG Securities Co., Ltd. ("MSMS") was \$82 million and \$49 million for the quarters ended June 30, 2013 and 2012, respectively, and \$172 million and \$130 million for the six months ended June 30, 2013 and 2012, respectively (see Note 20 to the condensed consolidated financial statements).

*Rating Agency Downgrade.* On June 21, 2012, as a result of one rating agency's downgrade of the Company's long-term and short-term debt ratings, the amount of additional collateral requirements or other payments that could have been called by counterparties, exchanges or clearing organizations under the terms of certain over-the-counter ("OTC") trading agreements and certain other agreements was approximately \$6.3 billion, of which \$2.9 billion was called and posted at June 30, 2012. Additionally, the Company incurred period specific charges of approximately \$225 million representing credit valuation allowances, novations and other contractual adjustments in Trading revenues in the condensed consolidated statement of income in the quarter and six months ended June 30, 2012.

## **Business Segments.**

Substantially all of the Company's operating revenues and operating expenses are allocated to its business segments. Certain revenues and expenses have been allocated to each business segment, generally in proportion to its respective net revenues, non-interest expenses or other relevant measures.

Effective with the quarter ended June 30, 2013, the Global Wealth Management Group and Asset Management business segments were re-titled Wealth Management and Investment Management, respectively.

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 Wealth Management business segment related to the bank deposit program. The Company did not recognize any gains or losses from continuing operations before income taxes in Intersegment Elimination in the quarter and six months ended June 30, 2013. Losses from continuing operations before income taxes recorded in Intersegment Eliminations were \$4 million in both the quarter and six months ended June 30, 2012.

On January 1, 2013, the International Wealth Management business was transferred from the Wealth Management business segment to the Equity division within the Institutional Securities business segment. Accordingly, all results and statistical data have been recast for all periods to reflect the International Wealth Management business as part of the Institutional Securities business segment.

## ***Net Revenues.***

*Trading.* Trading revenues include revenues from customers' purchases and sales of financial instruments in which the Company acts as a market maker and gains and losses on the Company's related positions. Trading revenues include 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.

The Company often invests directly, as a principal, in investments or other financial instruments to economically hedge its obligations under its deferred compensation plans. Changes in value of such investments made by the Company are recorded in Trading revenues and Investments revenues. Expenses associated with the related deferred compensation plans are recorded in Compensation and benefits. Compensation expense is calculated based on the notional value of the award granted, adjusted for upward and downward changes in fair value of the referenced investment and is recognized ratably over the prescribed vesting period for the award. Generally, changes in compensation expense resulting from changes in fair value of the referenced investment will be offset by changes in fair value of investments made by the Company. However, there may be a timing difference between the immediate revenue recognition of gains and losses on the Company's investments and the deferred recognition of the related compensation expense over the vesting period.

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 rebalancing 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.

*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 (as mentioned in the paragraph above). 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 4 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 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 Wealth Management business segment also include revenues from individual investors electing a fee-based pricing arrangement and fees for investment management. Mutual fund distribution fees in the Wealth Management 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 Investment 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 Investment 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 trading assets and trading liabilities, 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.



**INSTITUTIONAL SECURITIES**  
**INCOME STATEMENT INFORMATION**

	<u>Three Months Ended</u> <u>June 30,</u>		<u>Six Months Ended</u> <u>June 30,</u>	
	<u>2013</u>	<u>2012(1)</u>	<u>2013</u>	<u>2012(1)</u>
	(dollars in millions)			
Revenues:				
Investment banking .....	\$1,078	\$ 884	\$2,023	\$1,735
Trading .....	2,598	2,287	5,012	4,362
Investments .....	51	46	193	(3)
Commissions and fees .....	650	544	1,259	1,150
Asset management, distribution and administration fees .....	69	61	135	113
Other .....	140	41	277	92
Total non-interest revenues .....	<u>4,586</u>	<u>3,863</u>	<u>8,899</u>	<u>7,449</u>
Interest income .....	1,029	964	2,053	2,141
Interest expense .....	1,269	1,495	2,517	3,123
Net interest .....	<u>(240)</u>	<u>(531)</u>	<u>(464)</u>	<u>(982)</u>
Net revenues .....	<u>4,346</u>	<u>3,332</u>	<u>8,435</u>	<u>6,467</u>
Compensation and benefits .....	1,766	1,506	3,658	3,709
Non-compensation expenses .....	1,620	1,338	3,019	2,599
Total non-interest expenses .....	<u>3,386</u>	<u>2,844</u>	<u>6,677</u>	<u>6,308</u>
Income from continuing operations before income taxes .....	960	488	1,758	159
Provision for (benefit from) income taxes .....	288	69	348	(37)
Income from continuing operations .....	<u>672</u>	<u>419</u>	<u>1,410</u>	<u>196</u>
Discontinued operations:				
Gain (loss) from discontinued operations .....	(27)	(43)	(57)	(18)
Provision for (benefit from) income taxes .....	(9)	(15)	(20)	26
Net gains (losses) on discontinued operations .....	<u>(18)</u>	<u>(28)</u>	<u>(37)</u>	<u>(44)</u>
Net income .....	654	391	1,373	152
Net income applicable to redeemable noncontrolling interests .....	—	—	1	—
Net income applicable to nonredeemable noncontrolling interests .....	90	45	186	124
Net income applicable to Morgan Stanley .....	<u>\$ 564</u>	<u>\$ 346</u>	<u>\$1,186</u>	<u>\$ 28</u>
Amounts applicable to Morgan Stanley:				
Income from continuing operations .....	\$ 582	\$ 374	\$1,223	\$ 72
Net gains (losses) from discontinued operations .....	(18)	(28)	(37)	(44)
Net income applicable to Morgan Stanley .....	<u>\$ 564</u>	<u>\$ 346</u>	<u>\$1,186</u>	<u>\$ 28</u>

(1) Prior period amounts have been recast to reflect the transfer of the International Wealth Management business from the Wealth Management business segment to the Institutional Securities business segment.

**Investment Banking.** Investment banking revenues were as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
	(dollars in millions)			
Advisory revenues . . . . .	\$ 333	\$263	\$ 584	\$ 576
Underwriting revenues:				
Equity underwriting revenues . . . . .	327	283	610	455
Fixed income underwriting revenues . . . . .	418	338	829	704
Total underwriting revenues . . . . .	745	621	1,439	1,159
Total investment banking revenues . . . . .	<u>\$1,078</u>	<u>\$884</u>	<u>\$2,023</u>	<u>\$1,735</u>

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 June 30,		Six Months Ended June 30,	
	2013(1)	2012(1)	2013(1)	2012(1)
	(dollars in billions)			
Announced mergers and acquisitions(2) . . . . .	\$ 97	\$146	\$168	\$246
Completed mergers and acquisitions(2) . . . . .	136	109	329	185
Equity and equity-related offerings(3) . . . . .	15	11	29	23
Fixed income offerings(4) . . . . .	67	55	138	128

- (1) Source: Thomson Reuters, data at July 16, 2013. 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. Announced mergers and acquisitions exclude terminated transactions.
- (3) Amounts include Rule 144A and public common stock, convertible and rights offerings.
- (4) Amounts include non-convertible preferred stock, mortgage-backed and 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 June 30, 2013 increased 22% from the comparable period in 2012, reflecting higher revenues from advisory and underwriting transactions. Overall, underwriting revenues of \$745 million increased 20% from the quarter ended June 30, 2012. Equity underwriting revenues increased 16% to \$327 million in the quarter ended June 30, 2013, driven by increased activity in Europe and Asia, particularly initial public offerings. Fixed income underwriting revenues were \$418 million in the quarter ended June 30, 2013, an increase of 24% from the comparable period of 2012, reflecting a favorable debt underwriting environment which saw volumes increase in investment and non-investment grade bond issuances. Advisory revenues from merger, acquisition and restructuring transactions (“M&A”) were \$333 million in the quarter ended June 30, 2013, an increase of 27% from the comparable period of 2012, with cross-border and financial sponsor-led transactions representing a significant portion of completed M&A volumes. Industry-wide announced and completed M&A activity for the quarter ended June 30, 2013 declined compared with the quarter ended June 30, 2012.

Investment banking revenues for the six months ended June 30, 2013 increased 17% from the comparable period in 2012, primarily due to higher revenues from equity and fixed income underwriting transactions reflecting higher market volumes.

**Sales and Trading Net Revenues.** Sales and trading net revenues are composed of Trading revenues; Commissions and fees; Asset management, distribution and administration fees; and Net interest revenues (expenses). See “Business Segments—Net Revenues” herein for further information about what is included in the above-referenced components of sales and trading revenues. In assessing the profitability of its sales and trading

activities, the Company views these net revenues in the aggregate. In addition, decisions relating to trading 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, 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 11 to the condensed consolidated financial statements for further information related to gains (losses) on derivative instruments.

Sales and trading net revenues were as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012(1)	2013	2012(1)
	(dollars in millions)			
Trading	\$2,598	\$2,287	\$5,012	\$4,362
Commissions and fees	650	544	1,259	1,150
Asset management, distribution and administration fees	69	61	135	113
Net interest	(240)	(531)	(464)	(982)
Total sales and trading net revenues	<u>\$3,077</u>	<u>\$2,361</u>	<u>\$5,942</u>	<u>\$4,643</u>

(1) All prior period amounts have been recast to conform to the current year's presentation. For further information, see "Business Segments" herein and Notes 1 and 21 to the condensed consolidated financial statements.

Total sales and trading net revenues increased to \$3,077 million in the quarter ended June 30, 2013 from \$2,361 million in the quarter ended June 30, 2012, reflecting higher revenues in equity and fixed income and commodities sales and trading net revenues, partially offset by higher losses in other sales and trading net revenues.

Sales and trading net revenues by business were as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012(1)	2013	2012(1)
	(dollars in millions)			
Equity	\$1,920	\$1,326	\$3,435	\$2,901
Fixed income and commodities	1,214	1,047	2,491	2,040
Other(2)	(57)	(12)	16	(298)
Total sales and trading net revenues	<u>\$3,077</u>	<u>\$2,361</u>	<u>\$5,942</u>	<u>\$4,643</u>

(1) All prior period amounts have been recast to conform to the current year's presentation. For further information, see "Business Segments" herein and Notes 1 and 21 to the condensed consolidated financial statements.

(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, net gains (losses) on economic hedges related to the Company's long-term debt and net losses associated with costs related to negative carry.

The following sales and trading net revenues results exclude the impact of DVA (see footnote 2 in the following table). 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 June 30,		Six Months Ended June 30,	
	2013	2012(1)	2013	2012(1)
	(dollars in millions)			
Total sales and trading net revenues—non-GAAP(2) . . . . .	\$2,902	\$2,011	\$6,084	\$ 6,271
Impact of DVA . . . . .	175	350	(142)	(1,628)
Total sales and trading net revenues . . . . .	<u>\$3,077</u>	<u>\$2,361</u>	<u>\$5,942</u>	<u>\$ 4,643</u>
Equity sales and trading net revenues—non-GAAP(2) . . . . .	\$1,806	\$1,252	\$3,400	\$ 3,208
Impact of DVA . . . . .	114	74	35	(307)
Equity sales and trading net revenues . . . . .	<u>\$1,920</u>	<u>\$1,326</u>	<u>\$3,435</u>	<u>\$ 2,901</u>
Fixed income and commodities sales and trading net revenues— non-GAAP(2) . . . . .	\$1,153	\$ 771	\$2,668	\$ 3,361
Impact of DVA . . . . .	61	276	(177)	(1,321)
Fixed income and commodities sales and trading net revenues . . . . .	<u>\$1,214</u>	<u>\$1,047</u>	<u>\$2,491</u>	<u>\$ 2,040</u>

- (1) All prior period amounts have been recast to conform to the current year's presentation. For further information, see "Business Segments" herein and Notes 1 and 21 to the condensed consolidated financial statements.
- (2) Sales and trading net revenues, including fixed income and commodities and equity sales and trading net revenues that exclude the impact of DVA, 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 increased 45% to \$1,920 million in the quarter ended June 30, 2013 from the comparable period in 2012. The results in equity sales and trading net revenues included positive revenue due to the impact of DVA of \$114 million in the quarter ended June 30, 2013 compared with positive revenue of \$74 million in the quarter ended June 30, 2012. Equity sales and trading net revenues, excluding the impact of DVA, increased 44% to \$1,806 million in the quarter ended June 30, 2013 from the comparable period in 2012, reflecting strong performance across all products and regions, with particular strength in derivatives.

In the quarter ended June 30, 2013, equity sales and trading net revenues also reflected losses of \$6 million related to changes in the fair value of net derivative contracts attributable to the widening of counterparties' credit default swap ("CDS") spreads and other factors compared with losses of \$4 million in the quarter ended June 30, 2012. The Company also recorded gains of \$18 million in the quarter ended June 30, 2013 related to changes in the fair value of net derivative contracts attributable to the widening of the Company's CDS spreads and other factors compared with losses of \$69 million in the quarter ended June 30, 2012 due to the tightening of such spreads and other factors. The gains and losses on CDS spreads and other factors include gains and losses on related hedging instruments.

*Fixed Income and Commodities.* Fixed income and commodities sales and trading net revenues increased 16% to \$1,214 million in the quarter ended June 30, 2013 from \$1,047 million in the quarter ended June 30, 2012. Results in the quarter ended June 30, 2013 included positive revenue of \$61 million due to the impact of DVA, compared with positive revenue of \$276 million in the quarter ended June 30, 2012 due to the impact of DVA. Fixed income product net revenues, excluding the impact of DVA, in the quarter ended June 30, 2013 increased 25% over the comparable period in 2012, reflecting the combination of strong client activity in foreign exchange products and that the prior year quarter was negatively impacted by period specific charges representing credit valuation allowances and other related adjustments as detailed in the following paragraph. See "Executive Summary—Significant Items—Rating Agency Downgrade" for further information. Commodity net revenues,

excluding the impact of DVA, in the quarter ended June 30, 2013 increased significantly over the comparable period in 2012, benefitting primarily from improved client activity in the North American power market and volatility in the metals markets.

In the quarter ended June 30, 2013, fixed income and commodities sales and trading net revenues reflected net gains of \$56 million related to changes in the fair value of net derivative contracts attributable to the tightening of counterparties' CDS spreads and other factors compared with losses of \$193 million in the quarter ended June 30, 2012, due to the widening of such spreads and other factors. The Company also recorded gains of \$125 million in the quarter ended June 30, 2013 related to changes in the fair value of net derivative contracts attributable to the widening of the Company's CDS spreads and other factors compared with losses of \$47 million in the quarter ended June 30, 2012 due to the tightening of such spreads and other factors. The gains and losses on CDS spreads and other factors include gains and 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 net revenues included other trading revenues, consisting of certain activities associated with the Company's corporate lending activities, gains (losses) on economic hedges related to the Company's long-term debt and costs related to negative carry. The fair value measurement of corporate loans and lending commitments takes into account fee income that is considered an attribute of the contract. The valuation of these commitments could change in future periods depending on, among other things, the extent that they are renegotiated or repriced or if the associated acquisition transaction does not occur. Effective April 1, 2012, the Company began accounting for all new corporate 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" in Part I, Item 3, herein.

Other sales and trading net losses were \$57 million in the quarter ended June 30, 2013 compared with net losses of \$12 million in the quarter ended June 30, 2012. The results in both quarters included losses related to negative carry. The results in the quarter ended June 30, 2013 included losses on economic hedges and other costs related to the Company's long-term debt compared with gains in the prior year quarter. Results in the quarters ended June 30, 2013 and 2012 were partially offset by net gains of \$119 million and \$129 million, respectively, associated with corporate loans and lending commitments. Also included in other sales and trading net revenues in the quarter ended June 30, 2012 is a net impact of \$76 million representing an out of period gain of \$300 million on the incorrect application of hedge accounting on certain derivative contracts previously designated as net investment hedges of certain foreign, non-U.S. dollar denominated subsidiaries, partially offset by a loss of \$224 million resulting from fair value changes within the quarter of the related derivative positions not qualifying for net investment hedge accounting (see Note 11 to the condensed consolidated financial statements).

*Net Interest.* Net interest expense decreased to \$240 million in the quarter ended June 30, 2013 from net interest expense of \$531 million in the quarter ended June 30, 2012, primarily due to lower interest costs associated with the Company's long-term borrowings.

*Sales and Trading Net Revenues in the Six Months Ended June 30, 2013.* Total sales and trading revenues increased 28% in the six months ended June 30, 2013 from the comparable period of 2012, reflecting higher equity and fixed income and commodities sales and trading net revenues. The results in the six months ended June 30, 2013 also included gains in other sales and trading net revenues compared with losses in the prior year period. Equity sales and trading net revenues increased 18% in the six months ended June 30, 2013 from the comparable period in 2012. The results in equity sales and trading net revenues included positive revenue in the six months ended June 30, 2013 of \$35 million due to the impact of DVA compared with negative revenue of approximately \$307 million in the six months ended June 30, 2012. Equity sales and trading net revenues, excluding the impact of DVA, in the six months ended June 30, 2013 increased 6% over the comparable period in 2012, primarily due to higher revenues in the prime brokerage business reflecting increased client activity. Fixed income and commodities sales and trading net revenues increased 22% in the six months ended June 30, 2013 from the comparable period in 2012. Results in the six months ended June 30, 2013 included negative

revenue of \$177 million due to the impact of DVA, compared with negative revenue of approximately \$1,321 million in the six months ended June 30, 2012. Fixed income and commodities sales and trading net revenues, excluding the impact of DVA, in the six months ended June 30, 2013 decreased 21% over the comparable period in 2012 primarily due to lower results in the interest rates business due to global volatility. In the six months ended June 30, 2013, other sales and trading net gains were \$16 million compared with losses of \$298 million in the six months ended June 30, 2012. Results in both periods included net losses related to negative carry and losses on economic hedges and other costs related to the Company's long-term debt. Results in both periods also included gains related to certain activities associated with the Company's corporate loans and lending commitments. Net interest expense decreased to \$464 million in the six months ended June 30, 2013 from \$982 million in the six months ended June 30, 2012 primarily due to lower interest costs associated with the Company's long-term borrowings.

**Investments.** Net investment gains of \$51 million and \$193 million were recognized in the quarter and six months ended June 30, 2013, respectively, compared with net investment gains of \$46 million and net investment losses of \$3 million in the quarter and six months ended June 30, 2012, respectively. The results in all periods included net gains from investments associated with the Company's deferred compensation and co-investment plans. The results in the six months ended June 30, 2013 and June 30, 2012 also included mark to market gains on investments in real estate funds. The results in the six months ended June 30, 2012 were offset by mark-to-market losses on certain investments.

**Other.** Other revenues of \$140 million and \$277 million were recognized in the quarter and six months ended June 30, 2013, respectively, compared with other revenues of \$41 million and \$92 million in the quarter and six months ended June 30, 2012, respectively. The results in the quarter and six months ended June 30, 2013 primarily included income of \$174 million and \$299 million, respectively, arising from the Company's 40% stake in MUMSS compared with income of \$54 million and \$81 million, in the quarter and six months ended June 30, 2012, respectively (see "Executive Summary—Significant Items—Japanese Securities Joint Venture" herein).

**Non-interest Expenses.** Non-interest expenses increased 19% and 6% in the quarter and six months ended June 30, 2013, respectively. The increase in the quarter ended June 30, 2013 was primarily due to both higher compensation and non-compensation expenses. The increase in the six months ended June 30, 2013 was primarily due to higher non-compensation expenses. Compensation and benefits expenses increased 17% in the quarter ended June 30, 2013, primarily due to higher net revenues. Compensation and benefits expenses decreased 1% in the six months ended June 30, 2013, primarily due to lower headcount. Results included severance expenses of \$28 million and \$141 million related to reductions in force in the quarter and six months ended June 30, 2013, respectively, compared with \$12 million and \$120 million in the quarter and six months ended June 30, 2012, respectively. The results in the quarter and six months ended June 30, 2012 also reflected an adjustment of approximately \$160 million to reduce previously accrued discretionary above base compensation due to an updated 2012 outlook. Non-compensation expenses increased 21% and 16% in the quarter and six months ended June 30, 2013, respectively, compared with the prior year periods. Brokerage, clearing and exchange expenses increased 18% and 13% in the quarter and six months ended June 30, 2013, respectively, primarily due to higher volumes of activity. Information processing and communications expense decreased 15% and 10% in the quarter and six months ended June 30, 2013, respectively, primarily due to lower technology costs. Professional services expenses increased 16% and 15% in the quarter and six months ended June 30, 2013, respectively, primarily due to higher consulting expenses. Other expenses increased 107% and 91% in the quarter and six months ended June 30, 2013, respectively, primarily due to an increase in litigation accruals.

**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. The transaction, which was restructured as a sale of Saxon's assets during the first quarter of 2012, was substantially completed in the second quarter of 2012. The results of Saxon are reported as discontinued operations within the Institutional Securities business segment for all periods presented.

For further information, see Notes 1 and 21 to the condensed consolidated financial statements.

**Nonredeemable Noncontrolling Interests.**

Nonredeemable noncontrolling interests primarily relate to MSMS (see "Executive Summary—Significant Items—Japanese Securities Joint Venture" herein).



**WEALTH MANAGEMENT**  
**INCOME STATEMENT INFORMATION**

	<u>Three Months Ended</u> <u>June 30,</u>		<u>Six Months Ended</u> <u>June 30,</u>	
	<u>2013</u>	<u>2012(1)</u>	<u>2013</u>	<u>2012(1)</u>
	(dollars in millions)			
Revenues:				
Investment banking . . . . .	\$ 258	\$ 223	\$ 532	\$ 428
Trading . . . . .	223	189	521	524
Investments . . . . .	2	1	5	3
Commissions and fees . . . . .	567	496	1,126	1,068
Asset management, distribution and administration fees . . . . .	1,896	1,829	3,754	3,548
Other . . . . .	139	78	204	136
Total non-interest revenues . . . . .	<u>3,085</u>	<u>2,816</u>	<u>6,142</u>	<u>5,707</u>
Interest income . . . . .	511	456	999	914
Interest expense . . . . .	65	76	140	134
Net interest . . . . .	<u>446</u>	<u>380</u>	<u>859</u>	<u>780</u>
Net revenues . . . . .	<u>3,531</u>	<u>3,196</u>	<u>7,001</u>	<u>6,487</u>
Compensation and benefits . . . . .	2,042	1,911	4,107	3,920
Non-compensation expenses . . . . .	834	875	1,642	1,754
Total non-interest expenses . . . . .	<u>2,876</u>	<u>2,786</u>	<u>5,749</u>	<u>5,674</u>
Income from continuing operations before income taxes . . . . .	655	410	1,252	813
Provision for income taxes . . . . .	229	149	449	271
Income from continuing operations . . . . .	<u>426</u>	<u>261</u>	<u>803</u>	<u>542</u>
Discontinued operations:				
Income (loss) from discontinued operations . . . . .	—	91	(1)	93
Provision for income taxes . . . . .	—	30	—	31
Net gain (loss) from discontinued operations . . . . .	<u>—</u>	<u>61</u>	<u>(1)</u>	<u>62</u>
Net income . . . . .	426	322	802	604
Net income applicable to redeemable noncontrolling interests . . . . .	100	—	221	—
Net income applicable to nonredeemable noncontrolling interests . . . . .	<u>—</u>	<u>91</u>	<u>—</u>	<u>175</u>
Net income applicable to Morgan Stanley . . . . .	<u>\$ 326</u>	<u>\$ 231</u>	<u>\$ 581</u>	<u>\$ 429</u>
Amounts applicable to Morgan Stanley:				
Income from continuing operations . . . . .	\$ 326	\$ 178	\$ 582	\$ 376
Net gain (loss) from discontinued operations . . . . .	<u>—</u>	<u>53</u>	<u>(1)</u>	<u>53</u>
Net income applicable to Morgan Stanley . . . . .	<u>\$ 326</u>	<u>\$ 231</u>	<u>\$ 581</u>	<u>\$ 429</u>

(1) Prior period amounts have been recast to reflect the transfer of the International Wealth Management business from the Wealth Management business segment to the Institutional Securities business segment.

**Net Revenues.** Wealth Management business segment's net revenues are composed of Transactional, Asset management, Net interest and Other revenues. Transactional revenues include Investment banking, 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 Investments.

	<u>Three Months Ended</u> <u>June 30,</u>		<u>Six Months Ended</u> <u>June 30,</u>	
	<u>2013</u>	<u>2012(1)</u>	<u>2013</u>	<u>2012(1)</u>
	(dollars in millions)			
Net revenues:				
Transactional .....	\$1,048	\$ 908	\$2,179	\$2,020
Asset management .....	1,896	1,829	3,754	3,548
Net interest .....	446	380	859	780
Other .....	141	79	209	139
Net revenues .....	<u>\$3,531</u>	<u>\$3,196</u>	<u>\$7,001</u>	<u>\$6,487</u>

(1) Prior period amounts have been recast to reflect the transfer of the International Wealth Management business from the Wealth Management business segment to the Institutional Securities business segment.

**Wealth Management JV.** At June 30, 2013, the Company owns 100% of the Wealth Management JV. In June 2013, the Company received all regulatory approvals to acquire the remaining 35% stake in the Wealth Management JV and on June 28, 2013, the Company completed the purchase of the remaining 35% for \$4.725 billion. As a 100% owner of the Wealth Management JV, the Company will retain all of the related net income previously applicable to the noncontrolling interests in the Wealth Management JV, and benefit from the termination of certain related debt and operating agreements with the Wealth Management JV partner.

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. As result of the termination of the deposit sweep agreement, approximately \$57 billion of deposits will no longer be swept to Citi but will instead be transferred to the Company's depository institutions on an agreed upon basis over a 24-month period with approximately \$17 billion of the related deposits transferred in July 2013 and the estimated remaining \$40 billion to be swept ratably over the next 23 months starting in August 2013.

For further information, see Note 3 to the condensed consolidated financial statements.

**Transactional.**

**Investment Banking.** Investment banking revenues increased 16% to \$258 million in the quarter ended June 30, 2013 from the comparable period of 2012 and increased 24% to \$532 million in the six months ended June 30, 2013 from the comparable period of 2012. The increase in both periods was primarily due to higher revenues from closed-end funds.

**Trading.** Trading revenues increased 18% to \$223 million in the quarter ended June 30, 2013 from the comparable period of 2012, primarily due to higher gains related to positions associated with certain employee deferred compensation plans and higher revenues from structured notes. Trading revenues decreased 1% to \$521 million in the six months ended June 30, 2013 from the comparable period of 2012, primarily due to lower gains related to positions associated with certain employee deferred compensation plans and lower revenues from mortgages and other fixed income products, partially offset by higher revenues from structured notes.

*Commissions and Fees.* Commissions and fees revenues increased 14% to \$567 million in the quarter ended June 30, 2013 from the comparable period of 2012, primarily due to higher equity and mutual fund activity. Commissions and fees revenues increased 5% to \$1,126 million in the six months ended June 30, 2013 from the comparable period of 2012, primarily due to higher mutual fund and alternatives activity.

***Asset Management.***

*Asset Management, Distribution and Administration Fees.* Asset management, distribution and administration fees increased 4% to \$1,896 million in the quarter ended June 30, 2013 from the comparable period of 2012 and increased 6% to \$3,754 million in the six months ended June 30, 2013 from the comparable period of 2012. The increase in both periods was primarily due to higher fee-based revenues, partially offset by lower revenues from the bank deposit program and managed futures. The referral fees for deposits placed with Citi-affiliated depository institutions were \$68 million and \$98 million in the quarters ended June 30, 2013 and 2012, respectively, and \$156 million and \$180 million in the six months ended June 30, 2013 and 2012, respectively.

Balances in the bank deposit program increased to \$127 billion at June 30, 2013 from \$112 billion at June 30, 2012. Deposits held by Company-affiliated FDIC-insured depository institutions were \$70 billion at June 30, 2013 and \$58 billion at June 30, 2012. As a result of the Company's 100% ownership of the Wealth Management JV as of June 28, 2013, the deposits held in non-affiliated depositories will transfer to the Company-affiliated depositories over a 24 month period.

Client assets in fee-based accounts increased to \$629 billion and represented 35% of total client assets at June 30, 2013 compared with \$509 billion and 31% at June 30, 2012, respectively. Total client asset balances increased to \$1,778 billion at June 30, 2013 from \$1,635 billion at June 30, 2012, 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 \$1,324 billion at June 30, 2013 from \$1,200 billion at June 30, 2012. Effective from the quarter ended March 31, 2013, client assets also include certain additional non-custodied assets as a result of the completion of the Wealth Management JV platform conversion. Fee-based client asset flows for the quarter ended June 30, 2013 were \$10 billion compared with \$3 billion in the quarter ended June 30, 2012.

Beginning January 1, 2013, the Company enhanced its definition of fee-based asset flows. Fee-based asset flows have been recast for all periods to include dividends, interest and client fees, and to exclude cash management related activity.

***Net Interest.***

Net interest increased 17% to \$446 million in the quarter ended June 30, 2013 from the comparable period of 2012, primarily resulting from higher revenues from the bank deposit program, higher interest from securities based lending and higher interest on the available for sale portfolio, partially offset by lower customer margin receivables. Net interest increased 10% to \$859 million in the six months ended June 30, 2013 from the comparable period of 2012, primarily resulting from higher revenues from the bank deposit program and higher interest from securities based lending, partially offset by lower customer margin receivables.

***Other.***

Other revenues were \$139 million and \$204 million in the quarter and six months ended June 30, 2013, respectively, an increase of 78% and 50% from the comparable periods of 2012, primarily due to gains on sales of the available for sale portfolio and a gain on sale of the global stock plan business.

***Non-interest Expenses.***

Non-interest expenses increased 3% and 1% in the quarter and six months ended June 30, 2013, respectively, from the comparable periods of 2012. Compensation and benefits expenses increased 7% and 5% in the quarter

and six months ended June 30, 2013, respectively, from the comparable periods of 2012, primarily due to higher compensable revenues. The increase in the six months ended June 30, 2013 was partially offset by lower amortization of deferred awards and severance expense. Non-compensation expenses decreased 5% and 6% in the quarter and six months ended June 30, 2013, respectively, from the comparable periods of 2012, primarily driven by the absence of platform integration costs. Professional services expenses decreased 31% and 19% in the quarter and six months ended June 30, 2013, respectively, from the comparable periods of 2012, primarily due to lower technology consulting costs. Other expenses decreased 2% and 10% in the quarter and six months ended June 30, 2013, respectively, from the comparable periods of 2012, primarily due to a lower FDIC assessment on deposits. The decrease in the six months ended June 30, 2013 was also due to lower printing costs, partially offset by higher amortization expense. These decreases were partially offset by an increase in marketing and business development expenses of 31% and 14% in the quarter and six months ended June 30, 2013, respectively, from the comparable periods of 2012, primarily due to higher costs associated with advertisement, conferences and seminars.

#### **Discontinued Operations.**

On April 2, 2012, the Company completed the sale of Quilter, its retail wealth management business in the U.K., resulting in a pre-tax gain of \$108 million in both the quarter and six months ended June 30, 2012 in the Wealth Management business segment. The results of Quilter are reported as discontinued operations for all periods presented. See Notes 1 and 21 to the condensed consolidated financial statements.

**INVESTMENT MANAGEMENT**  
**INCOME STATEMENT INFORMATION**

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>June 30,</b>		<b>June 30,</b>	
	<b>2013</b>	<b>2012</b>	<b>2013</b>	<b>2012</b>
	<b>(dollars in millions)</b>			
Revenues:				
Investment banking .....	\$ 1	\$ 1	\$ 6	\$ 8
Trading .....	53	(3)	47	(9)
Investments .....	135	16	328	148
Asset management, distribution and administration fees .....	473	408	928	819
Other .....	12	43	14	40
Total non-interest revenues .....	<u>674</u>	<u>465</u>	<u>1,323</u>	<u>1,006</u>
Interest income .....	3	2	5	5
Interest expense .....	4	11	10	22
Net interest .....	<u>(1)</u>	<u>(9)</u>	<u>(5)</u>	<u>(17)</u>
Net revenues .....	<u>673</u>	<u>456</u>	<u>1,318</u>	<u>989</u>
Compensation and benefits .....	297	214	556	432
Non-compensation expenses .....	216	199	415	386
Total non-interest expenses .....	<u>513</u>	<u>413</u>	<u>971</u>	<u>818</u>
Income from continuing operations before income taxes .....	160	43	347	171
Provision for income taxes .....	38	6	90	44
Income from continuing operations .....	<u>122</u>	<u>37</u>	<u>257</u>	<u>127</u>
Discontinued operations:				
Gain from discontinued operations .....	—	—	1	1
Provision for income taxes .....	—	—	—	—
Net gain from discontinued operations .....	<u>—</u>	<u>—</u>	<u>1</u>	<u>1</u>
Net income .....	122	37	258	128
Net income applicable to nonredeemable noncontrolling interests .....	<u>21</u>	<u>23</u>	<u>72</u>	<u>88</u>
Net income applicable to Morgan Stanley .....	<u>\$101</u>	<u>\$ 14</u>	<u>\$ 186</u>	<u>\$ 40</u>
Amounts applicable to Morgan Stanley:				
Income from continuing operations .....	\$101	\$ 14	\$ 185	\$ 39
Net gain from discontinued operations .....	—	—	1	1
Net income applicable to Morgan Stanley .....	<u>\$101</u>	<u>\$ 14</u>	<u>\$ 186</u>	<u>\$ 40</u>

**Statistical Data.**

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

	At June 30,		Average For The Three Months Ended June 30,		Average for the Six Months Ended June 30,	
	2013	2012	2013	2012	2013	2012
	(dollars in billions)					
Assets under management or supervision by asset class:						
Traditional Asset Management:						
Equity .....	\$125	\$113	\$128	\$114	\$127	\$112
Fixed income .....	59	58	62	58	62	58
Liquidity .....	106	86	100	81	101	78
Alternatives(1) .....	29	26	29	26	28	25
Total Traditional Asset Management .....	319	283	319	279	318	273
Real Estate Investing .....	20	19	20	19	20	19
Merchant Banking .....	8	9	9	9	9	9
Total assets under management or supervision .....	\$347	\$311	\$348	\$307	\$347	\$301
Share of minority stake assets(2) .....	\$ 6	\$ 5	\$ 6	\$ 5	\$ 6	\$ 5

(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) Amounts represent the Investment Management business segment's proportional share of assets managed by entities in which it owns a minority stake.

Activity in the Investment Management business segment's assets under management or supervision during the quarters and six months ended June 30, 2013 and 2012 was as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
	(dollars in billions)			
<b>Balance at beginning of period</b> .....	\$341	\$304	\$338	\$287
Net flows by asset class:				
Traditional Asset Management:				
Equity .....	—	1	—	—
Fixed income .....	(2)	(1)	—	(1)
Liquidity .....	11	12	6	13
Alternatives(1) .....	1	1	1	—
Total Traditional Asset Management .....	10	13	7	12
Real Estate Investing .....	(1)	—	(1)	1
Merchant Banking .....	1	—	1	—
Total net flows .....	10	13	7	13
Net market appreciation (depreciation) .....	(4)	(6)	2	11
Total net increase .....	6	7	9	24
<b>Balance at end of period</b> .....	\$347	\$311	\$347	\$311

(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.

**Trading.** The Company recognized gains of \$53 million and \$47 million in the quarter and six months ended June 30, 2013, respectively, compared with losses of \$3 million and \$9 million in the quarter and six months ended June 30, 2012, respectively. Trading results in the quarter and six months ended June 30, 2013, primarily reflected gains related to certain consolidated real estate funds sponsored by the Company. Trading results in the quarter and six months ended June 30, 2012, primarily reflected losses related to certain consolidated real estate funds sponsored by the Company.

**Investments.** The Company recorded net investment gains of \$135 million and \$328 million in the quarter and six months ended June 30, 2013, respectively, compared with gains of \$16 million and \$148 million in the quarter and six months ended June 30, 2012, respectively. The increase in the quarter and six months ended June 30, 2013 was primarily related to higher net gains predominantly within the Company's Merchant Banking investments, as well as higher gains within Traditional Asset Management and Real Estate Investing. Results in all periods included gains on certain investments associated with the Company's employee deferred compensation and co-investment plans.

**Asset Management, Distribution and Administration Fees.** Asset management, distribution and administration fees increased 16% to \$473 million and 13% to \$928 million in the quarter and six months ended June 30, 2013, respectively. The increase primarily reflected higher management and administration revenues, primarily due to higher average assets under management and higher performance fees.

The Company's assets under management increased \$36 billion from \$311 billion at June 30, 2012 to \$347 billion at June 30, 2013, reflecting positive flows and market appreciation. The Company recorded net inflows of \$10 billion and \$7 billion in the quarter and six months ended June 30, 2013, respectively, primarily reflecting net customer inflows in liquidity funds. The inflows in the quarter ended June 30, 2013 were partially offset by net customer outflows in fixed income funds. The Company recorded net customer inflows of \$13 billion in both the quarter and six months ended June 30, 2012, which included approximately \$4.5 billion related to the conversion of Wealth Management JV client money fund holdings from third party managers into Morgan Stanley managed funds.

**Other.** Other revenues were \$12 million and \$14 million in the quarter and six months ended June 30, 2013, respectively, as compared with other revenues of \$43 million and \$40 million in the comparable periods of 2012, respectively. The results in the quarter and six months ended June 30, 2013 included gains associated with the Company's minority investments in Lansdowne Partners, a London-based investment manager, and Avenue Capital Group, a New York-based investment manager. The results in the quarter and six months ended June 30, 2012 included gains associated with the expiration of a lending facility to a real estate fund sponsored by the Company.

**Non-interest Expenses.** Non-interest expenses were \$513 million and \$971 million in the quarter and six months ended June 30, 2013, respectively, as compared with \$413 million and \$818 million in the comparable periods of 2012, respectively. Compensation and benefits expenses increased 39% and 29% in the quarter and six months ended June 30, 2013, respectively, primarily due to higher net revenues. Non-compensation expenses increased 9% and 8% in the quarter and six months ended June 30, 2013, respectively, primarily due to higher brokerage and clearing expenses.

#### **Nonredeemable Noncontrolling Interests.**

Nonredeemable noncontrolling interests are primarily related to the consolidation of certain real estate funds sponsored by the Company. Investment losses associated with these consolidated funds were \$25 million in the quarter ended June 30, 2013 and gains of \$41 million in the six months ended June 30, 2013 compared with gains of \$27 million and \$101 million in the quarter and six months ended June 30, 2012, respectively.



## **Accounting Developments.**

### **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 Financial Accounting Standards Board (“FASB”) issued an accounting update providing guidance on the financial statement presentation of an unrecognized tax benefit when 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 a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward if such settlement is required or expected in the event the uncertain tax position is disallowed. This guidance is effective for the Company beginning January 1, 2014. This guidance is expected to be applied prospectively to all unrecognized tax benefits that exist at the effective date. The adoption of this accounting guidance is not expected to have a material impact on the Company’s condensed consolidated financial statements.

### **Inclusion of the Fed Funds Effective Swap Rate (or Overnight Index Swap Rate) as a Benchmark Interest Rate for Hedge Accounting Purposes.**

In July 2013, the FASB issued an accounting update that includes amendments permitting the Fed Funds Effective Swap Rate to be used as a U.S. benchmark interest rate for hedge accounting purposes, in addition to interest rates on direct Treasury obligations of the U.S. government and the London Interbank Offered Rate. The amendments also remove the restriction on using different benchmark rates for similar hedges. The amendments are effective prospectively for the Company for qualifying new or redesignated hedging relationships entered into on or after July 17, 2013. The adoption of this accounting guidance is not expected to 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 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 is effective for the Company prospectively beginning January 1, 2014. The Company is currently evaluating the potential impact of adopting this accounting update.

### **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 is effective for the Company prospectively beginning on January 1, 2014. The adoption of this accounting guidance is not expected to have a material impact on the Company’s condensed consolidated financial statements.

### **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 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 is effective for the Company retrospectively beginning on January 1, 2014. The adoption of this accounting guidance is not expected to have a material impact on the Company's condensed consolidated financial statements.

## **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 June 30, 2013 and December 31, 2012 are described below. Such amounts exclude investments associated with certain employee deferred compensation and co-investment plans.

At June 30, 2013 and December 31, 2012, the condensed consolidated statements of financial condition included amounts representing real estate investment assets of condensed consolidated subsidiaries of approximately \$2.1 billion and \$2.2 billion, respectively, including noncontrolling interests of approximately \$1.7 billion and \$1.8 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 \$0.4 billion at June 30, 2013.

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 Note 12 to the condensed consolidated financial statements for further information.

### **Regulatory Outlook.**

The Dodd-Frank Act was enacted on July 21, 2010. While certain portions of the Dodd-Frank Act were effective immediately, other portions will be effective following extended transition periods or through numerous rulemakings by multiple governmental agencies, and only a portion of those rulemakings 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 and ongoing revision and recalibration of risk-based capital, leverage and liquidity standards by the Basel Committee on Banking Supervision ("Basel Committee") will continue to impact the Company in the coming years.

It is likely that 2013 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 the exact impact these changes will have on the Company's business, financial condition, results of operations and cash flows for a particular future period.

In July 2013, the U.S. banking regulators issued a final rule to implement the Basel III (the "U.S. Basel III final rule") capital framework in the United States. For certain U.S. banking organizations, including the Company, the U.S. Basel III final rule will become effective on January 1, 2014, and the new requirements will be phased in over a number of years. In July 2013, the U.S. banking regulators also proposed higher leverage capital requirements for certain U.S. banking organizations, including the Company. The Federal Reserve has indicated that it intends to propose additional capital-related requirements for large U.S. banking organizations. For a further discussion of final and proposed regulatory capital requirements applicable to the Company, please refer to "Liquidity and Capital Resources—Regulatory Requirements—Capital" herein.

The Federal Reserve has indicated that it intends to issue a final rule pursuant to the Dodd-Frank Act that would apply certain enhanced prudential standards to large U.S. bank holding companies, including the Company. For a further discussion regarding the regulatory outlook for the Company, please refer to “Business—Supervision and Regulation” in Part I, Item 1 included in the Form 10-K.

## 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, 2012 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:

- Trading assets and Trading liabilities;
- 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, 2012 included in the Form 10-K and Note 4 to the 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 \$17.9 billion and \$20.4 billion at June 30, 2013 and December 31, 2012, respectively, and represented approximately 6% at June 30, 2013 and December 31, 2012, of the assets measured at fair value (approximately 2% and 3% of total assets at June 30, 2013 and December 31, 2012, respectively). Level 3 liabilities before the impact of cash collateral and counterparty netting across the levels of the fair value hierarchy were \$6.0 billion and \$7.7 billion at June 30,

2013 and December 31, 2012, respectively, and represented approximately 3% and 4% of the Company's liabilities measured at fair value, at June 30, 2013 and December 31, 2012, respectively. During the quarters ended June 30, 2013 and 2012, Net derivative and other contracts categorized as Level 3 had a net loss of approximately \$0.3 billion and a net gain of approximately \$0.6 billion, respectively. During the six months ended June 30, 2013 and 2012, Net derivative and other contracts categorized as Level 3 had net losses of approximately \$0.9 billion and \$0.7 billion, respectively. See Note 4 to the condensed consolidated financial statements for further information about changes in Level 3 assets and liabilities.

**Assets and Liabilities Measured at Fair Value on a Non-recurring Basis.** At June 30, 2013, 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.

See Note 4 to the condensed consolidated financial statements for further information on assets and liabilities that are measured at fair value on a non-recurring basis.

**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.

See Note 2 to the consolidated financial statements for the year ended December 31, 2012 included in the Form 10-K for additional information regarding the Company's valuation policies, processes and procedures.

### **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 and price-to-earnings multiples of certain

comparable companies. The Company also utilizes a discounted cash flow methodology for certain reporting units. At December 31, 2012, each of the Company's reporting units with goodwill had a fair value that was substantially in excess of its carrying value.

*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.

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 4 and 9 to the condensed consolidated financial statements for additional information about goodwill and intangible assets.

#### **Legal and Regulatory 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.



Significant judgment is required in deciding when and if to make these accruals and the actual cost of a legal claim or regulatory fine/penalty may ultimately be materially different from the recorded accruals.

See Note 12 to the condensed consolidated financial statements for additional information on legal proceedings.

### **Income Taxes.**

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.

The Company's provision for income taxes is composed of current and deferred taxes. Current income taxes approximate taxes to be paid or refunded for the current period. The Company's deferred income taxes reflect the net tax effects of temporary differences between the financial reporting and tax bases of assets and liabilities and are measured using the applicable enacted tax rates and laws that will be in effect when such differences are expected to reverse. The Company's deferred tax balances also include deferred assets related to tax attributes carryforwards, such as net operating losses and tax credits that will be realized through reduction of future tax liabilities and, in some cases, are subject to expiration if not utilized within certain periods. The Company performs regular reviews to ascertain whether deferred tax assets are realizable. These reviews include management's estimates and assumptions regarding future taxable income and incorporate various tax planning strategies, including strategies that may be available to utilize net operating losses before they expire. Once the deferred tax asset balances have been determined, the Company may record a valuation allowance against the deferred tax asset balances to reflect the amount of these balances (net of valuation allowance) that the Company estimates it is more likely than not to realize at a future date. Both current and deferred income taxes could reflect adjustments related to the Company's unrecognized tax benefits.

Significant judgment is required in estimating the consolidated provision for (benefit from) income taxes, current and deferred tax balances (including valuation allowance, if any), accrued interest or penalties and uncertain tax positions. Revisions in our estimates and/or the actual costs of a tax assessment may ultimately be materially different from the recorded accruals and unrecognized tax benefits, if any.

See Note 2 to the consolidated financial statements for the year ended December 31, 2012 included in the Form 10-K for additional information on the Company's significant assumptions, judgments and interpretations associated with the accounting for income taxes and Note 18 to the condensed consolidated financial statements for additional information on the Company's tax examinations.

## Liquidity and Capital Resources.

The Company's senior management establishes the liquidity and capital policies. 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 monitors and evaluates the composition and size of its balance sheet on a regular basis. The Company's balance sheet management process includes quarterly planning, business specific limits, monitoring of business specific usage versus limits, key metrics and new business impact assessments.

The Company establishes balance sheet limits at the consolidated, business segment and business unit levels. The Company monitors balance sheet usage versus limits and variances resulting from business activity or market fluctuations are reviewed. On a regular basis, the Company reviews current performance versus limits and assesses the need to re-allocate limits based on business unit needs. The Company also monitors key metrics, including asset and liability size, composition of the balance sheet, limit utilization and capital usage.

The tables below summarize total assets for the Company's business segments at June 30, 2013 and December 31, 2012:

	At June 30, 2013			Total
	Institutional Securities	Wealth Management	Investment Management	
	(dollars in millions)			
<b>Assets</b>				
Cash and cash equivalents(1) . . . . .	\$ 34,503	\$ 11,979	\$ 717	\$ 47,199
Cash deposited with clearing organizations or segregated under federal and other regulations or requirements(2) . . .	33,253	2,110	—	35,363
Trading assets . . . . .	253,359	2,229	4,450	260,038
Securities available for sale . . . . .	—	42,858	—	42,858
Securities received as collateral(2) . . . . .	14,749	—	—	14,749
Federal funds sold and securities purchased under agreements to resell(2) . . . . .	131,086	11,408	—	142,494
Securities borrowed(2) . . . . .	128,646	468	—	129,114
Customer and other receivables(2) . . . . .	41,383	22,285	805	64,473
Loans, net of allowance . . . . .	14,223	20,348	—	34,571
Other assets(3) . . . . .	19,914	10,634	1,284	31,832
Total assets(4) . . . . .	<u>\$671,116</u>	<u>\$124,319</u>	<u>\$7,256</u>	<u>\$802,691</u>

	At December 31, 2012			
	Institutional Securities(5)	Wealth Management(5)	Investment Management	Total
	(dollars in millions)			
<b>Assets</b>				
Cash and cash equivalents(1) . . . . .	\$ 33,370	\$ 12,714	\$ 820	\$ 46,904
Cash deposited with clearing organizations or segregated under federal and other regulations or requirements(2) . . . . .	26,116	4,854	—	30,970
Trading assets . . . . .	260,885	2,285	4,433	267,603
Securities available for sale . . . . .	—	39,869	—	39,869
Securities received as collateral(2) . . . . .	14,278	—	—	14,278
Federal funds sold and securities purchased under agreements to resell(2) . . . . .	120,957	13,455	—	134,412
Securities borrowed(2) . . . . .	121,302	399	—	121,701
Customer and other receivables(2) . . . . .	39,362	24,161	765	64,288
Loans, net of allowance . . . . .	12,078	16,968	—	29,046
Other assets(3) . . . . .	19,701	10,860	1,328	31,889
<b>Total assets(4) . . . . .</b>	<b>\$648,049</b>	<b>\$125,565</b>	<b>\$7,346</b>	<b>\$780,960</b>

- (1) Cash and cash equivalents include Cash and due from banks and Interest bearing deposits with banks.
- (2) Certain of these assets are included in secured financing assets (see "Secured Financing" herein).
- (3) Other assets include Other investments; Premises, equipment and software costs; Goodwill; Intangible assets; and Other assets.
- (4) Total assets include Global Liquidity Reserves of \$181 billion and \$182 billion at June 30, 2013 and December 31, 2012, respectively.
- (5) On January 1, 2013, the International Wealth Management business was transferred from the Wealth Management business segment to the Equity division within the Institutional Securities business segment. Accordingly, prior period amounts have been recast to reflect the International Wealth Management business as part of the Institutional Securities business segment.

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 \$802,691 million at June 30, 2013 from \$780,960 million at December 31, 2012. The increase in total assets was primarily due to an increase in Securities borrowed and Federal funds sold and securities purchased under agreements to resell.

The Company's assets and liabilities are primarily related to transactions attributable to sales and trading and securities financing activities. At June 30, 2013, securities financing assets and liabilities were \$367 billion and \$327 billion, respectively. At December 31, 2012, securities financing assets and liabilities were \$348 billion and \$300 billion, respectively. Securities financing transactions include cash deposited with clearing organizations or segregated under federal and other regulations or requirements, repurchase and resale agreements, securities borrowed and loaned transactions, securities received as collateral and obligation to return securities received and customer and other receivables and payables. 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, 2012 included in the Form 10-K and Note 6 to the condensed consolidated financial statements). Securities sold under agreements to repurchase and Securities loaned were \$170 billion at June 30, 2013 and averaged \$183 billion and \$178 billion during the quarter and six months ended June 30, 2013, respectively. The Securities sold under agreements to repurchase and Securities loaned period end balance was lower than the average balances during the quarter and six months ended June 30, 2013 due to a reduction in trading inventory available for securities financing transactions. Securities purchased under agreements to resell and Securities borrowed were \$272 billion at June 30, 2013 and averaged \$283 billion and \$288 billion during the quarter and six months ended June 30, 2013, respectively. The Securities purchased under agreements to resell and Securities borrowed period end balance was lower than the average balances during the quarter and six months ended June 30, 2013 due to a reduction in the Company's requirements for collateral over the periods.

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 in accordance with regulatory requirements. The customer payable portion of the securities financing transactions primarily includes customer payables to the Company's prime brokerage customers. 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 \$15 billion and \$14 billion at June 30, 2013 and December 31, 2012, 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.

### **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 and other planned and contingent outflows;
- 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 ("CFP").

The core components of the Company's liquidity risk management framework are the CFP, Liquidity Stress Tests and the Global Liquidity Reserve (as defined below), which support the Company's target liquidity profile.

### ***Contingency Funding Plan.***

The Company's CFP describes the data and information flows, limits, targets, operating environment indicators, escalation procedures, roles and responsibilities, and available mitigating actions in the event of a liquidity stress. The CFP also sets forth the principal elements of the Company's liquidity stress testing which identifies stress events of different severity and duration, assesses current funding sources and uses and establishes a plan for monitoring and managing a potential liquidity stress event.

### ***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;
- Repayment of all unsecured debt maturing within the stress horizon;
- Higher haircuts and significantly lower availability of secured funding;
- Additional collateral that would be required by trading counterparties, certain exchanges and clearing organizations related to credit rating downgrades;

- Additional collateral that would be required due to collateral substitutions, collateral disputes and uncalled collateral;
- 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 for the Parent and major operating subsidiaries, 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 June 30, 2013, 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. The size of the Global Liquidity Reserve is actively managed by the Company. The following components are considered in sizing the Global Liquidity Reserve: unsecured debt maturity profile, balance sheet size and composition, funding needs in a stressed environment inclusive of contingent cash outflows and collateral requirements. Additionally, the Global Liquidity Reserve includes an additional reserve, which is primarily a discretionary surplus based on the Company’s risk tolerance and is subject to change dependent on market and firm-specific events.

The Global Liquidity Reserve is held within the Parent and major operating subsidiaries. The Global Liquidity Reserve is composed of diversified cash and cash equivalents and highly liquid unencumbered securities. Eligible unencumbered securities include U.S. government securities, U.S. agency securities, U.S. agency mortgage-backed securities, non-U.S. government securities and other highly liquid investment grade securities.

***Global Liquidity Reserve by Type of Investment.***

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

	<u>At</u> <u>June 30, 2013</u> (dollars in billions)
Cash deposits with banks . . . . .	\$ 17
Cash deposits with central banks . . . . .	26
Unencumbered highly liquid securities:	
U.S. government obligations . . . . .	69
U.S. agency and agency mortgage-backed securities . . . . .	34
Non-U.S. sovereign obligations(1) . . . . .	18
Investments in money market funds . . . . .	—
Other investment grade securities . . . . .	<u>17</u>
Global Liquidity Reserve . . . . .	<u>\$ 181</u>

(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 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 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 that are not included in the balances in the table above.

*Global Liquidity Reserve Held by Bank and Non-Bank Legal Entities.*

The table below summarizes the Global Liquidity Reserve held by bank and non-bank legal entities:

	At June 30, 2013	At March 31, 2013	Average Balance(1)	
			For the Three Months Ended June 30, 2013	For the Three Months Ended March 31, 2013
(dollars in billions)				
Bank legal entities:				
Domestic .....	\$ 60	\$ 63	\$ 61	\$ 64
Foreign .....	4	5	4	5
Total Bank legal entities .....	64	68	65	69
Non-Bank legal entities:				
Domestic(2) .....	78	85	86	86
Foreign .....	39	33	33	32
Total Non-Bank legal entities .....	117	118	119	118
Total .....	\$ 181	\$ 186	\$ 184	\$ 187

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

(2) The Parent held \$58 billion at June 30, 2013, which averaged \$66 billion for the quarter ended June 30, 2013.

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.

**Funding Management.**

The Company manages its funding 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 arises 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 financing. Secured financing investors principally focus on the quality of the eligible collateral posted. Accordingly, the Company actively manages its secured financing book based on the quality of the assets being funded.

The Company utilizes shorter-term secured financing only for highly liquid assets and has established longer tenor limits for less liquid asset classes, for which funding may be at risk in the event of a market disruption. The Company defines highly liquid assets as those which are consistent with the standards of the Global Liquidity

Reserve, and less liquid assets as those which do not meet these standards. At June 30, 2013, the weighted average maturity of the Company's secured financing against less liquid assets was greater than 120 days. To further minimize the refinancing risk of secured financing for less liquid assets, the Company has established concentration limits to diversify its investor base and reduce the amount of monthly maturities for secured financing of less liquid assets. Furthermore, the Company obtains spare capacity, or term secured funding liabilities in excess of less liquid inventory, as an additional risk mitigant to replace maturing trades in the event that secured financing markets or our ability to access them become limited. 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. Unencumbered securities and non-security assets are financed with a combination of long- and short-term debt and deposits. The Company's unsecured financings include structured borrowings, whose payments and redemption values are based on the performance of certain underlying assets, including equity, credit, foreign exchange, interest rates and commodities. When appropriate, the Company may use derivative products to conduct asset and liability management and to make adjustments to the Company's interest rate and structured borrowings risk profile (see Note 12 to the consolidated financial statements for the year ended December 31, 2012 included in the Form 10-K).

**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:

	<u>At</u> <u>June 30, 2013</u>	<u>At</u> <u>December 31, 2012</u>
	(dollars in millions)	
Commercial paper . . . . .	\$ 125	\$ 306
Other short-term borrowings . . . . .	<u>2,241</u>	<u>1,832</u>
Total . . . . .	<u>\$2,366</u>	<u>\$2,138</u>

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

Deposits were as follows:

	<u>At</u> <u>June 30, 2013(1)</u>	<u>At</u> <u>December 31, 2012(1)</u>
	(dollars in millions)	
Savings and demand deposits(2) . . . . .	\$77,952	\$80,058
Time deposits(3) . . . . .	<u>3,562</u>	<u>3,208</u>
Total . . . . .	<u>\$81,514</u>	<u>\$83,266</u>

(1) Total deposits subject to FDIC insurance at June 30, 2013 and December 31, 2012 were \$61 billion and \$62 billion, respectively.

(2) Amounts include non-interest bearing deposits of \$1,037 million at December 31, 2012.

(3) Certain time deposit accounts are carried at fair value under the fair value option (see Note 4 to the condensed consolidated financial statements).



**Senior Indebtedness.** At June 30, 2013, the aggregate outstanding carrying amount of the Company's senior indebtedness was approximately \$152 billion (including guaranteed obligations of the indebtedness of subsidiaries) compared with \$158 billion at December 31, 2012. The decrease in the amount of senior indebtedness was primarily due to repayments of notes, net of new issuances of long-term borrowings.

**Long-Term Borrowings.** The Company believes that accessing debt investors through multiple distribution channels helps provide consistent access to the unsecured markets. 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 managed to achieve staggered maturities, thereby mitigating refinancing risk, and to maximize investor diversification through sales to global institutional and retail clients across regions, currencies and product types. 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 June 30, 2013 consisted of the following:

	<u>Parent</u>	<u>Subsidiaries</u>	<u>Total</u>
	(dollars in millions)		
Due in 2013 .....	\$ 10,057	\$ 837	\$ 10,894
Due in 2014 .....	22,210	655	22,865
Due in 2015 .....	19,565	1,381	20,946
Due in 2016 .....	20,627	1,999	22,626
Due in 2017 .....	24,362	1,999	26,361
Thereafter .....	54,394	3,012	57,406
Total .....	<u>\$151,215</u>	<u>\$9,883</u>	<u>\$161,098</u>

**Long-Term Borrowing Activity for the Six Months Ended June 30, 2013.** During the six months ended June 30, 2013, the Company issued and reissued notes with a principal amount of approximately \$22 billion. This amount included the Company's issuance of \$2.0 billion in 10 year subordinated debt on May 21, 2013, \$3.7 billion in senior unsecured debt on April 25, 2013 and \$4.5 billion in senior unsecured debt on February 25, 2013. In connection with the note issuances, the Company generally enters into certain transactions to obtain floating interest rates. The weighted average maturity of the Company's long-term borrowings, based upon stated maturity dates, was approximately 5.4 years at June 30, 2013. During the six months ended June 30, 2013, approximately \$23 billion in aggregate long-term borrowings matured or were retired.

### **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 an impact on certain trading revenues, particularly in those businesses where longer term counterparty performance is a key consideration, such as OTC derivative transactions, including credit derivatives and interest rate swaps. Rating agencies will look at company specific factors, other industry factors such as regulatory or legislative changes, the macro-economic environment and perceived levels of government support among other things.

The rating agencies have stated that they currently incorporate various degrees of credit rating uplift from external sources of potential support, as well as perceived government support of systemically important banks, including the credit ratings of the Company. Rating agencies continue to monitor the 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 and rulemaking 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 and attendant rulemaking also have 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 July 31, 2013, the Parent's and Morgan Stanley Bank, N.A.'s senior unsecured ratings were as set forth below:

	Parent			Morgan Stanley Bank, N.A.		
	Short-Term Debt	Long-Term Debt	Rating Outlook	Short-Term Debt	Long-Term Debt	Rating Outlook
DBRS, Inc. ....	R-1 (middle)	A (high)	Negative	—	—	—
Fitch Ratings, Inc. ....	F1	A	Stable	F1	A	Stable
Moody's Investor Services, Inc. ....	P-2	Baa1	Negative	P-2	A3	Stable
Rating and Investment Information, Inc. ....	a-1	A	Negative	—	—	—
Standard & Poor's Financial Services LLC. . .	A-2	A-	Negative	A-1	A	Negative

In connection with certain OTC trading agreements and certain other agreements where the Company is a liquidity provider to certain financing vehicles 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 or pledge additional collateral to certain exchanges and clearing organizations in the event of a future credit rating downgrade irrespective of whether the company is in a net asset or liability position.

As noted in the table above, the long-term credit ratings on the Company by Moody's Investor Services, Inc. ("Moody's") and Standard & Poor's Financial Services LLC ("S&P") are currently at different levels (commonly referred to as "split ratings"). The table below shows the future potential collateral amounts that could be called by counterparties or exchanges and clearing organizations in the event of the following credit rating scenarios for Moody's and S&P at June 30, 2013:

<u>Company Rating Scenario (Moody's/S&amp;P)</u>	<u>OTC Agreements</u>	<u>Other Agreements</u>	<u>Exchanges and Clearing Organizations</u>
	<u>(dollars in millions)</u>		
Baa1/BBB+ .....	\$ 464	\$—	\$—
Baa2/BBB .....	\$3,056	\$—	\$—
Baa3/BBB- .....	\$3,713	\$320	\$145

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 interrelated 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 included in the Company's Liquidity Stress Tests.

### 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 June 30, 2013, 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 as well as equity-based compensation and benefit plan requirements. Share repurchases by the Company are subject to regulatory approval. During the quarter and six months ended June 30, 2013, the Company did not repurchase common stock as part of its capital management share repurchase program.

In July 2013, the Company received no objection from the Federal Reserve to repurchase up to \$500 million of the Company's outstanding common stock under rules permitting annual capital distributions (12 Code of Federal Regulations 225.8, *Capital Planning*). Share repurchases will be made pursuant to the share repurchase program previously authorized by the Company's Board of Directors and will be exercised from time to time through March 31, 2014, at prices the Company deems appropriate subject to various factors, including the Company's capital position and market conditions. The share repurchases may be effected through open market purchases or privately negotiated transactions, including through Rule 10b5-1 plans, and may be suspended at any time (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 July 2013, the Company announced that its Board of Directors declared a quarterly dividend per common share of \$0.05. In June 2013, 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.

The following table sets forth the Company's tangible common equity at June 30, 2013 and December 31, 2012 and average balances during the six months ended June 30, 2013:

	Balance at		Average Balance(1)
	June 30, 2013	December 31, 2012	For the Six Months Ended June 30, 2013
	(dollars in millions)		
Common equity .....	\$ 61,673	\$60,601	\$61,231
Preferred equity .....	1,508	1,508	1,508
Morgan Stanley shareholders' equity .....	63,181	62,109	62,739
Junior subordinated debentures issued to capital trusts .....	4,825	4,827	4,823
Less: Goodwill and net intangible assets(2) .....	(10,194)	(7,587)	(7,906)
Tangible Morgan Stanley shareholders' equity .....	<u>\$ 57,812</u>	<u>\$59,349</u>	<u>\$59,656</u>
Common equity .....	\$ 61,673	\$60,601	\$61,231
Less: Goodwill and net intangible assets(2) .....	(10,194)	(7,587)	(7,906)
Tangible common equity(3) .....	<u>\$ 51,479</u>	<u>\$53,014</u>	<u>\$53,325</u>

(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 \$8 million and \$6 million at June 30, 2013 and December 31, 2012, respectively, and include only the Company's share of the Wealth Management JV's goodwill and intangible assets at each respective period (100% at June 30, 2013 and 65% at December 31, 2012) (see Note 3 to the condensed consolidated financial statements). The increase in goodwill and net intangible assets at June 30, 2013 from December 31, 2012 is primarily due to the purchase of the remaining 35% interest in the Wealth Management JV.

(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.

**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.

**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 with such capital requirements. The Office of the Comptroller of the Currency (“OCC”) establishes similar capital requirements and standards for the Subsidiary Banks.

The Company calculates its capital ratios and RWAs 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. On January 1, 2013, the U.S. banking regulators’ rules to implement the Basel Committee’s market risk capital framework amendment, commonly referred to as “Basel 2.5”, became effective, which increased the capital requirements for securitizations and correlation trading within the Company’s trading book, as well as incorporated add-ons for stressed VaR and incremental risk requirements (“market risk capital framework amendment”). The Company’s capital ratios and RWAs for quarters subsequent to the Basel 2.5 effective date were calculated under this revised framework. The Company’s capital ratios and RWAs for quarters prior to the Basel 2.5 effective date have not been recalculated under the revised framework. 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 models such as 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.

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 Federal Reserve’s existing regulatory capital framework, 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 qualifying perpetual preferred stock and qualifying restricted core capital elements (qualifying trust preferred securities and noncontrolling interests). Tier 1 capital consists predominantly of common shareholders’ equity as well as qualifying preferred stock and qualifying restricted core capital elements 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 below 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 4 to the condensed consolidated financial statements. As discussed below, the U.S. banking regulators have issued a final rule to implement Basel III, which changes the definition of each tier of regulatory capital.

At June 30, 2013, the Company's capital levels calculated under Basel I, inclusive of the market risk capital framework amendment, were in excess of well-capitalized levels with ratios of Tier 1 capital to RWAs of 14.1% and total capital to RWAs of 14.9% (6% and 10% being well-capitalized for regulatory purposes, respectively). The Company's ratio of Tier 1 common capital to RWAs was 11.8% (5% under stressed conditions is the current minimum under the Federal Reserve's Comprehensive Capital Analysis and Review ("CCAR") framework). Financial holding companies, including the Company, are subject to a Tier 1 leverage ratio defined by the Federal Reserve. Consistent with the Federal Reserve's definition, 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 period. At June 30, 2013, the Company was in compliance with the Federal Reserve's Tier 1 leverage requirement with a Tier 1 leverage ratio of 7.1% (5% is the current well-capitalized standard 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 June 30, 2013 and December 31, 2012:

	At June 30, 2013	At December 31, 2012
	(dollars in millions)	
<b>Allowable capital</b>		
Common shareholders' equity . . . . .	\$ 61,673	\$ 60,601
Less: Goodwill . . . . .	(6,600)	(6,650)
Less: Non-servicing intangible assets . . . . .	(3,594)	(3,777)
Less: Net deferred tax assets . . . . .	(3,546)	(4,785)
After-tax debt valuation adjustment . . . . .	913	823
Other deductions . . . . .	(1,243)	(1,418)
Tier 1 common capital . . . . .	<u>47,603</u>	<u>44,794</u>
Qualifying preferred stock . . . . .	1,508	1,508
Qualifying restricted core capital elements . . . . .	<u>7,669</u>	<u>8,058</u>
Tier 1 capital . . . . .	<u>56,780</u>	<u>54,360</u>
Qualifying subordinated debt and restricted core capital elements . . . . .	3,730	2,783
Other qualifying amounts . . . . .	235	197
Other deductions . . . . .	<u>(758)</u>	<u>(714)</u>
Tier 2 capital . . . . .	<u>3,207</u>	<u>2,266</u>
Total allowable capital . . . . .	<u>\$ 59,987</u>	<u>\$ 56,626</u>
<b>Risk-weighted assets(1)</b>		
Market risk . . . . .	\$142,966	\$ 54,042
Credit risk . . . . .	<u>260,459</u>	<u>252,704</u>
Total . . . . .	<u>\$403,425</u>	<u>\$306,746</u>
<b>Capital ratios</b>		
Total capital ratio(1) . . . . .	<u>14.9%</u>	<u>18.5%</u>
Tier 1 common capital ratio(1) . . . . .	<u>11.8%</u>	<u>14.6%</u>
Tier 1 capital ratio(1) . . . . .	<u>14.1%</u>	<u>17.7%</u>
Tier 1 leverage ratio . . . . .	<u>7.1%</u>	<u>7.1%</u>

- 
- (1) Effective January 1, 2013, in accordance with the U.S. banking regulators' rules the Company implemented the Basel Committee's market risk capital framework amendment, commonly referred to as "Basel 2.5", which increased the capital requirement for securitizations and correlation trading within the Company's trading book as well as incorporated add-ons for stressed VaR and incremental risk requirements. Under the market risk capital framework amendment, total RWAs would have been approximately \$424 billion at December 31, 2012. At December 31, 2012, the capital ratios would have been approximately as follows: Total capital ratio 13.4%, Tier 1 common capital ratio 10.6% and Tier 1 capital ratio 12.8%.

In November 2011 the Federal Reserve issued a final rule regarding capital plans. The final rule requires large bank holding companies such as the Company to submit annual capital plans in order for the Federal Reserve to assess their systems and processes that incorporate forward-looking projections of revenues and losses to monitor and maintain their internal capital adequacy. The rule also requires that such companies receive no objection from the Federal Reserve before making a capital action.

In addition, the Dodd-Frank Act imposes stress test requirements on large bank holding companies, including the Company. In October 2012, the Federal Reserve issued its stress test final rule under the Dodd-Frank Act, which requires the Company to conduct semi-annual company-run stress tests. In July 2013, the Company submitted its 2013 semi-annual capital plan to the Federal Reserve. The rule also subjects the Company to an annual supervisory stress test conducted by the Federal Reserve.

The Company submitted its 2013 annual capital plan to the Federal Reserve in January 2013. In March 2013, the Federal Reserve published a summary of the supervisory stress test results of each company subject to the final rule, including the Company. The Company received no objection to its 2013 capital plan, including the acquisition of the remaining 35% interest in the Wealth Management JV, which was completed on June 28, 2013, and ongoing payment of current common and preferred dividends.

The Dodd-Frank Act also requires a national bank or federal savings association with total consolidated assets of more than \$10 billion to conduct an annual company-run stress test. Beginning in 2012, the OCC's implementing regulation required national banks with \$50 billion or more in average total consolidated assets, including MSBNA, to conduct its first Dodd-Frank stress test. MSBNA submitted its stress test results to the OCC and the Federal Reserve in January 2013. The OCC's regulation also requires a national bank with more than \$10 billion but less than \$50 billion in average total consolidated assets, including MSPBNA, to submit the results of its first Dodd-Frank stress test by March 31, 2014.

In December 2007, the U.S. banking regulators published final regulations incorporating the Basel II Accord, which requires internationally active U.S. 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 December 2010, the Basel Committee reached an agreement on Basel III. In July 2013, the U.S. banking regulators issued the U.S. Basel III final rule. The U.S. Basel III final rule contains new capital standards that raise the capital requirements, strengthen counterparty credit risk capital requirements and replace the use of externally developed credit ratings with alternatives such as the Organisation for Economic Co-operation and Development's country risk classifications. The U.S. Basel III final rule also requires certain banking organizations, including the Company, to maintain both a capital conservation buffer and, if deployed, a countercyclical capital buffer, above the minimum risk-based capital ratios. Failure to maintain such buffers will result in restrictions on the banking organization's ability to make capital distributions and pay discretionary bonuses to executive officers. The U.S. Basel III final rule also subjects certain banking organizations, including the Company, to a minimum supplementary leverage ratio of 3%. The calibration of the supplementary leverage ratio is broadly similar to the December 2010 version of the Basel III leverage ratio and includes off-balance sheet exposures in the denominator.



The Company and other large and internationally active U.S. banking organizations will become subject to the U.S. Basel III final rule beginning on January 1, 2014. Certain requirements in the U.S. Basel III final rule, including the new capital buffers, will be phased in over several years. Pursuant to the U.S. Basel III final rule, existing trust preferred securities will be fully phased out of the Company's Tier 1 capital by January 1, 2016. Thereafter, existing trust preferred securities that do not satisfy the U.S. Basel III final rule's eligibility criteria for Tier 2 capital will be phased out of the Company's regulatory capital by January 1, 2022.

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 minimum capital requirements that are not less than the generally applicable risk-based capital requirements. Currently, this minimum "capital floor" is based on Basel I. Beginning January 1, 2015, the U.S. Basel III final rule will replace the current Basel I-based "capital floor" with a standardized approach that, among other things, modifies the existing risk weights for certain types of asset classes and which is applicable to both minimum capital requirements and the sum of conservation and countercyclical capital buffer if deployed.

In addition to the U.S. Basel III final rule, the Dodd-Frank Act requires the Federal Reserve to establish more stringent capital requirements for certain bank holding companies, including Morgan Stanley. The Federal Reserve has indicated that it intends to implement the Basel Committee's capital surcharge for global systemically important banks ("G-SIB"). The Financial Stability Board has provisionally identified the G-SIBs and assigned each G-SIB a Common Equity Tier 1 capital surcharge ranging from 1.0% to 2.5% of RWAs. Morgan Stanley is provisionally assigned a G-SIB capital surcharge of 1.5%. The Financial Stability Board has stated that it intends to update the list of G-SIBs annually based on new data.

The Company estimates its pro forma risk-based Common Equity Tier 1 capital ratio under the U.S. Basel III final rule to be approximately 9.9% as of June 30, 2013. This estimate is based on a preliminary assessment of the U.S. Basel III final rule and other factors, including approvals of relevant advanced approach regulatory models. If the Company does not receive the model approvals, this could have a significant impact on its U.S. Basel III capital ratio estimates. In addition, the estimate may not be comparable with that of other financial services firms. The pro forma risk-based Common Equity Tier 1 capital ratio is a non-GAAP financial measure that the Company considers to be a useful measure for evaluating compliance with new regulatory capital requirements that have not yet become effective. The pro forma risk-based Common Equity Tier 1 capital ratio estimate is based on shareholders' equity, Common Equity Tier 1 capital, RWAs and certain other data inputs at June 30, 2013. This preliminary estimate is subject to risks and uncertainties that may cause actual results to differ materially and should not be taken as a projection of what the Company's capital ratios, RWAs, earnings or other results will actually be at 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.

In July 2013, the U.S. banking regulators proposed a rule to implement enhanced supplementary leverage standards for bank holding companies (and their insured depository institutions subsidiaries) with at least \$700 billion in total consolidated assets or \$10 trillion in assets under custody. Under this proposal the regulators would establish a leverage buffer of Tier 1 capital of 2% for bank holding companies in scope, in addition to the 3% minimum (for a total of 5%), in order to avoid limitations on capital distributions and discretionary bonus payments. This proposal would further establish a "well capitalized" threshold of 6% for insured depository institution subsidiaries, including MSBNA and MSPBNA. If the proposal is adopted, its requirements would become effective on January 1, 2018 with public disclosure beginning in 2015.

#### ***Required Capital.***

The Company's required capital ("Required Capital") estimation is based on the Required Capital Framework, an internal capital adequacy measure. This framework is a risk-based 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 where applicable, at a point in time. The Company defines the difference between its regulatory capital and aggregate Required Capital as Parent



capital. Average Tier 1 common capital, aggregate Required Capital and Parent capital for the quarter ended June 30, 2013 were approximately \$47.1 billion, \$39.0 billion and \$8.1 billion, respectively. The Company generally holds Parent capital for prospective regulatory requirements, 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 the 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. The Company will continue to evaluate the framework with respect to the impact of future regulatory requirements, as appropriate.

The following table presents the business segments' and Parent's average Tier 1 common capital and average common equity for the quarter ended June 30, 2013 and the quarter ended March 31, 2013:

	June 30, 2013		March 31, 2013	
	Average Tier 1 Common Capital	Average Common Equity	Average Tier 1 Common Capital	Average Common Equity
	(dollars in billions)			
Institutional Securities .....	\$33.1	\$38.3	\$34.2	\$39.9
Wealth Management .....	4.2	13.3	4.1	13.4
Investment Management .....	1.7	2.8	1.6	2.8
Parent capital(1) .....	8.1	7.1	5.8	4.8
Total .....	<u>\$47.1</u>	<u>\$61.5</u>	<u>\$45.7</u>	<u>\$60.9</u>

(1) Average Parent capital increased from the quarter ended March 31, 2013 driven mainly by the reduction in RWAs in fixed income and accretion of net income.

### **Liquidity.**

The Basel Committee has developed two standards intended for use in liquidity risk supervision, the Liquidity Coverage Ratio ("LCR") and the Net Stable Funding Ratio ("NSFR").

The LCR was developed to ensure banks have sufficient high-quality liquid assets to cover net cash outflows arising from significant stress over 30 calendar days. This standard's objective is to promote the short-term resilience of the liquidity risk profile of banks and bank holding companies. The Company is compliant with this liquidity standard.

The 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 standard's objective is to promote resilience over a longer time horizon. After an observation period that began 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 of these standards, including any further calibration by the Basel Committee and their potential impact on the Company's current liquidity and funding requirements.

## Off-Balance Sheet Arrangements with Unconsolidated Entities.

The Company enters into various arrangements with unconsolidated entities, including variable interest entities (“VIE”), primarily in connection with its Institutional Securities and Investment Management business segments. See “Off-Balance Sheet Arrangements with Unconsolidated Entities” included in Part II, Item 7, of the Form 10-K and Note 7 to the condensed consolidated financial statements for further information.

See Note 12 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 June 30, 2013 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 June 30, 2013
	Less than 1	1-3	3-5	Over 5	
	(dollars in millions)				
Letters of credit and other financial guarantees obtained to satisfy collateral requirements . . . . .	\$ 953	\$ 14	\$ —	\$ 1	\$ 968
Investment activities . . . . .	729	104	36	270	1,139
Primary lending commitments—investment grade(1) . . . . .	8,020	15,798	34,344	562	58,724
Primary lending commitments—non-investment grade(1) . . . . .	3,053	4,882	9,381	3,841	21,157
Secondary lending commitments(2) . . . . .	38	31	20	21	110
Commitments for secured lending transactions . . . . .	636	14	15	—	665
Forward starting reverse repurchase agreements and securities borrowing agreements(3)(4) . . . . .	46,549	—	—	—	46,549
Commercial and residential mortgage-related commitments . . . . .	2,088	30	332	283	2,733
Other commitments . . . . .	2,237	350	153	111	2,851
<b>Total . . . . .</b>	<b>\$64,303</b>	<b>\$21,223</b>	<b>\$44,281</b>	<b>\$5,089</b>	<b>\$134,896</b>

- (1) This amount includes \$41.8 billion of investment grade and \$9.5 billion of non-investment grade unfunded commitments accounted for as held for investment and \$4.9 billion of investment grade and \$7.4 billion of non-investment grade unfunded commitments accounted for as held for sale at June 30, 2013. The remainder of these lending commitments is carried at fair value.
- (2) These commitments are recorded at fair value within Trading assets and Trading liabilities in the condensed consolidated statements of financial condition (see Note 4 to the condensed consolidated financial statements).
- (3) The Company enters into forward starting reverse repurchase and securities borrowing agreements (agreements that have a trade date at or prior to June 30, 2013 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 total amount at June 30, 2013, \$41.8 billion settled within three business days.
- (4) The Company also has a contingent obligation to provide financing to a clearinghouse through which it clears certain transactions. The financing is required only upon the default of a clearinghouse member. The financing takes the form of a reverse repurchase facility, with a maximum amount of approximately \$1.9 billion.

## Effects of Inflation and Changes in Foreign Exchange Rates.

To the extent that a worsening inflation outlook results in rising interest rates or has negative impacts on the valuation of financial instruments that exceed the impact on the value of the Company’s liabilities, it may adversely affect the Company’s financial position and profitability. Rising inflation may also result in increases in the Company’s non-interest expenses that may not be readily recoverable in higher prices of services offered.

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.

### **Item 3. Quantitative and Qualitative Disclosures about Market Risk.**

#### **Market Risk.**

Market risk refers to the risk that a change in the level of one or more market prices, rates, indices, implied volatilities (the price volatility of the underlying instrument imputed from option prices), correlations or other market factors, such as market liquidity, will result in losses for a position or portfolio. Generally, the Company incurs market risk as a result of trading, investing and client facilitation activities, principally 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 Wealth Management business segment. The Investment Management business segment incurs principally Non-trading market risk primarily from capital investments in real estate funds and investments in private equity vehicles. 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 the statistical technique known as VaR as one of the tools used to measure, monitor and review the market risk exposures of its trading portfolios. The Market Risk Department calculates and distributes daily VaR-based risk measures to various levels of management.

#### *VaR Methodology, Assumptions and Limitations.*

The Company estimates VaR using a model based on volatility adjusted historical simulation for general market risk factors and Monte Carlo simulation for name-specific risk in corporate shares, bonds, loans and related derivatives. The model constructs a distribution of hypothetical daily changes in the value of trading portfolios based on the following: historical observation of daily changes in key market indices or other market risk factors; and information on the sensitivity of the portfolio values to these market risk factor changes. The Company's VaR model uses four years of historical data with a volatility adjustment to reflect current market conditions. For risk management purposes, the Company's Management VaR is computed at a 95% level of confidence over a one-day time horizon, which is a useful indicator of possible trading losses resulting from adverse daily market moves. The Company's 95%/one-day VaR corresponds to the unrealized loss in portfolio value that, based on historically observed market risk factor movements, would have been exceeded with a frequency of 5%, or five times in every 100 trading days, if the portfolio were held constant for one day.

The Company's VaR model generally takes into account linear and non-linear exposures to equity and commodity price risk, interest rate risk, credit spread risk and foreign exchange rates. The model also takes into account linear exposures to implied volatility risks for all asset classes and non-linear exposures to implied volatility risks for equity, commodity and foreign exchange referenced products. The VaR model also captures certain implied correlation risks associated with portfolio credit derivatives as well as certain basis risks (*e.g.*, corporate debt and related credit derivatives).

The Company uses VaR as one of a range of risk management tools. Among their benefits, VaR models permit estimation of a portfolio's aggregate market risk exposure, incorporating a range of varied market risks and portfolio assets. One key element of the VaR model is that it reflects risk reduction due to portfolio diversification or hedging activities. However, VaR has various 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. VaR is most

appropriate as a risk measure for trading positions in liquid financial markets and will understate the risk associated with severe events, such as periods of extreme illiquidity. The Company is aware of these and other limitations and, therefore, uses VaR as only one component in its risk management oversight process. This process also incorporates stress testing and scenario analyses and extensive risk monitoring, analysis, and control at the trading desk, division and Company levels.

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.

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.

VaR statistics are not readily comparable across firms because of differences in the firms' portfolios, modeling assumptions and methodologies. These differences can result in materially different VaR estimates across firms for similar portfolios. The impact of such differences 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 useful when interpreted as indicators of trends in a firm's risk profile, rather than as an absolute measure of risk to be compared across firms.

The Company utilizes the same VaR model for both risk management purposes as well as regulatory capital calculations. The Company's VaR model has been approved by the Company's regulators for use in regulatory capital calculations.

The portfolio of positions used for the Company's Management VaR differs from that used for its Regulatory VaR, as it contains certain positions which are excluded from Regulatory VaR, as determined by regulatory capital requirements. Examples include counterparty credit valuation adjustments, and loans that are carried at fair value and associated hedges. Additionally, the Company's Management VaR excludes certain risks contained in its Regulatory VaR, such as hedges to counterparty exposures related to the Company's own credit spread.

The table below presents VaR as used for risk management purposes for the Company's Trading portfolio, on a quarter-end, quarterly average and quarterly high and low basis (see Table 1 below). The Credit Portfolio is disclosed as a separate category from the Primary Risk Categories, and includes loans that are carried at fair value and associated hedges, as well as counterparty credit valuation adjustments and related hedges.

### Trading Risks.

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

Market Risk Category	95%/One-Day VaR for the Quarter Ended June 30, 2013				95%/One-Day VaR for the Quarter Ended March 31, 2013			
	Period End	Average	High	Low	Period End	Average	High	Low
	(dollars in millions)							
Interest rate and credit spread . . . . .	\$ 46	\$ 46	\$ 56	\$ 39	\$ 48	\$ 61	\$ 76	\$ 47
Equity price . . . . .	17	19	33	15	17	18	27	15
Foreign exchange rate . . . . .	14	13	19	8	15	11	16	7
Commodity price . . . . .	23	24	31	18	23	20	26	16
Less: Diversification benefit(1)(2) . . . . .	(48)	(47)	N/A	N/A	(47)	(44)	N/A	N/A
Primary Risk Categories . . . . .	<u>\$ 52</u>	<u>\$ 55</u>	\$ 73	\$ 51	<u>\$ 56</u>	<u>\$ 66</u>	\$ 78	\$ 52
Credit Portfolio . . . . .	16	14	16	12	14	16	18	14
Less: Diversification benefit(1)(2) . . . . .	(8)	(8)	N/A	N/A	(8)	(10)	N/A	N/A
Total Management VaR . . . . .	<u>\$ 60</u>	<u>\$ 61</u>	\$ 77	\$ 56	<u>\$ 62</u>	<u>\$ 72</u>	\$ 85	\$ 59

- (1) Diversification benefit equals the difference between the total Management 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 high and low VaR values for the total Management 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 Management VaR for the Primary Risk Categories for the quarter ended June 30, 2013 was \$55 million compared with \$66 million for the quarter ended March 31, 2013. This decrease was primarily driven by reduced risk in interest rate products.

The average Credit Portfolio VaR for the quarter ended June 30, 2013 was \$14 million compared with \$16 million for the quarter ended March 31, 2013. This reduction was driven by reduced counterparty credit risk as well as the transition of loans held at fair value to loans held for investment (net of allowance).

The average Total Management VaR for the quarter ended June 30, 2013 was \$61 million compared with \$72 million for the quarter ended March 31, 2013. This decrease was driven by the reduced risk in Primary Risk Categories.

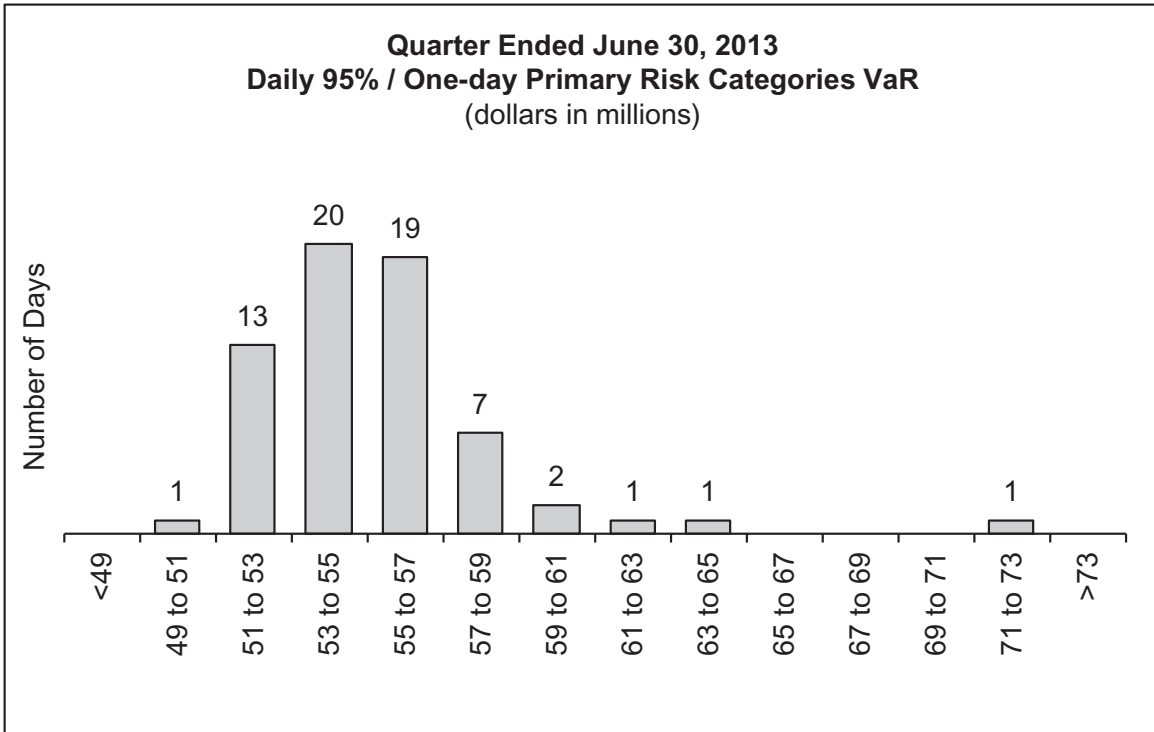
### Distribution of VaR Statistics and Net Revenues for the quarter ended June 30, 2013.

One method of evaluating the reasonableness of the Company's VaR model as a measure of the Company's potential volatility of net revenues is to compare the VaR with actual trading revenues. 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. 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 the Company, as well as individual business units. For days where losses exceed the VaR statistic, the Company examines the drivers of trading losses to evaluate the VaR model's accuracy relative to realized trading results.

The distribution of VaR Statistics and Net Revenues are presented in the histograms below for both the Primary Risk Categories and the Total Trading populations.

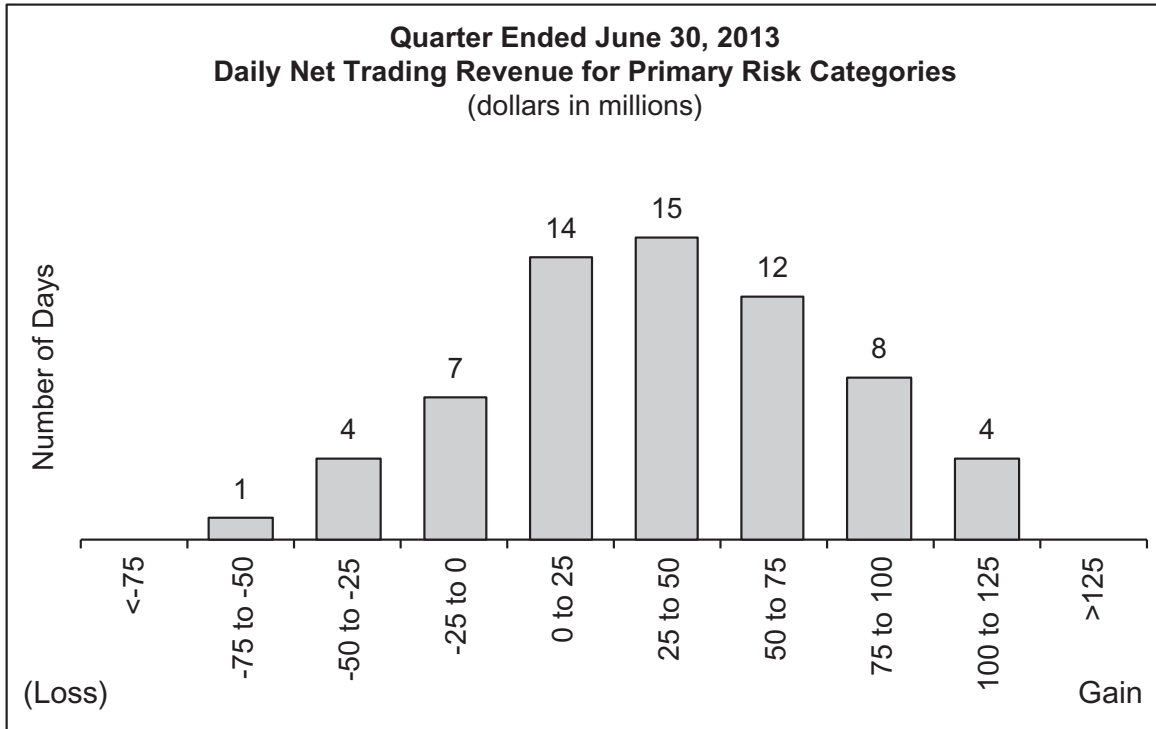
**Primary Risk Categories.**

As shown in Table 1, the Company's average 95%/one-day Primary Risk Categories VaR for the quarter ended June 30, 2013 was \$55 million. The histogram below presents the distribution of the Company's daily 95%/one-day Primary Risk Categories VaR for the quarter ended June 30, 2013, which was in a range between \$51 million and \$59 million for approximately 91% of the trading days during the quarter.



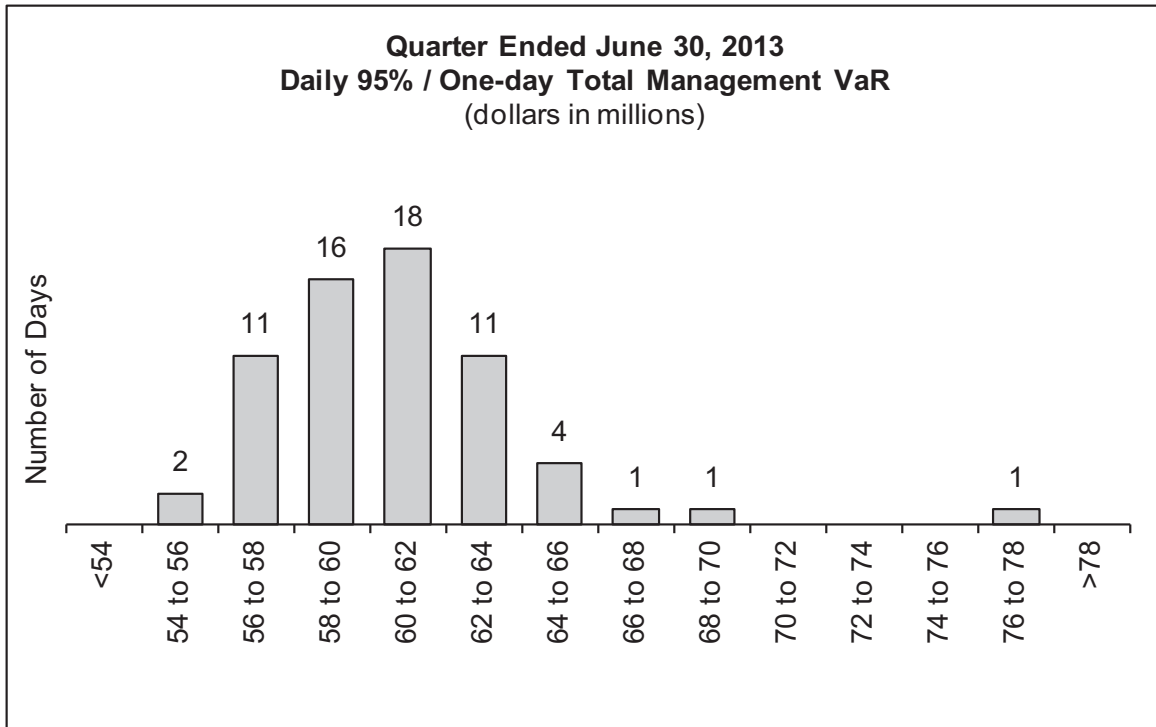


The histogram below shows the distribution of daily net trading revenues for the Company's businesses that comprise the Primary Risk Categories for the quarter ended June 30, 2013. This excludes non-trading revenues of these businesses and revenues associated with the Company's own credit risk. During the quarter ended June 30, 2013, the Company's businesses that comprise the Primary Risk Categories experienced net trading losses on 12 days, of which 1 day was in excess of the 95%/one-day Primary Risk Categories VaR.

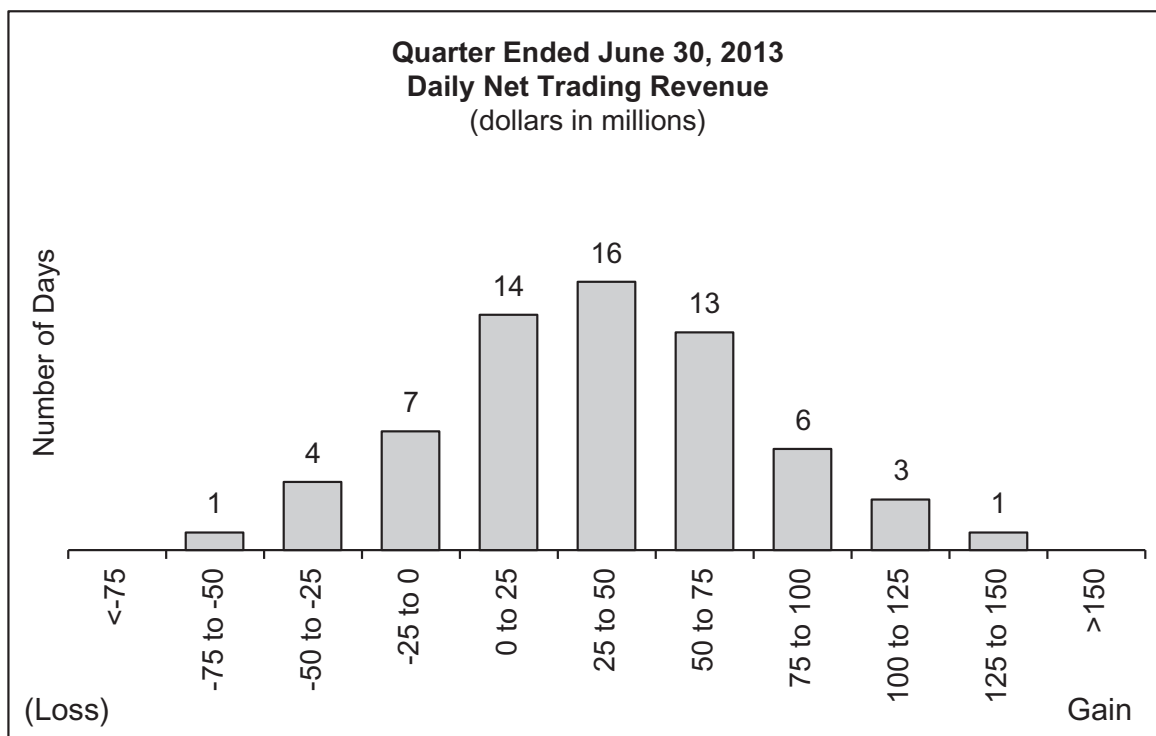


**Total Trading—including the Primary Risk Categories and the Credit Portfolio.**

As shown in Table 1, the Company's average 95%/one-day Total Management VaR, which includes the Primary Risk Categories and the Credit Portfolio, for the quarter ended June 30, 2013 was \$61 million. The histogram below presents the distribution of the Company's daily 95%/one-day Total Management VaR for the quarter ended June 30, 2013, which was in a range between \$56 million and \$64 million for approximately 86% of trading days during the quarter.



The histogram below shows the distribution of daily net trading revenues for the Company's Trading businesses for the quarter ended June 30, 2013. This excludes non-trading revenues of these businesses and revenues associated with the Company's own credit risk. During the quarter ended June 30, 2013, the Company experienced net trading losses on 12 days, of which no day was in excess of the 95%/one-day Management 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 \$5 million for each 1 basis point widening in the Company's credit spread level for both June 30, 2013 and March 31, 2013.

***Funding Liabilities.***

The credit spread risk sensitivity of the Company's mark-to-market funding liabilities corresponded to an increase in value of approximately \$11 million and \$12 million for each 1 basis point widening in the Company's credit spread level for June 30, 2013 and March 31, 2013, respectively.

***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.

	<u>June 30, 2013</u>		<u>March 31, 2013</u>	
	<u>+100 Basis Points</u>	<u>+200 Basis Points</u>	<u>+100 Basis Points</u>	<u>+200 Basis Points</u>
	(dollars in millions)			
Impact on income from continuing operations before income taxes .....	\$655	\$1,099	\$581	\$874

**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 income associated with a 10% decline in investment values.

<u>Investments</u>	<u>10% Sensitivity</u>	
	<u>June 30, 2013</u>	<u>March 31, 2013</u>
	(dollars in millions)	
Investments related to Investment Management activities:		
Hedge fund investments .....	\$102	\$115
Private equity and infrastructure funds .....	132	130
Real estate funds .....	138	138
Other investments:		
Mitsubishi UFJ Morgan Stanley Securities Co., Ltd .....	143	144
Other Company investments .....	262	261

**Credit Risk.**

Credit risk refers to the risk of loss arising when a borrower, counterparty or issuer does not meet its financial obligations. 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 8 and 12 to the condensed consolidated financial statements for additional information about the Company's financing receivables and lending commitments, respectively.

**Lending Activities.**

The Company provides loans to a variety of customers, from large corporate and institutional clients to high net worth individuals. In addition, the Company purchases loans in the secondary market. The table below

summarizes the Company's loans classified as loans held for investment and loans held for sale in Loans and loans carried at fair value in Trading assets in the condensed consolidated statements of financial condition at June 30, 2013. See Notes 4 and 8 to the condensed consolidated financial statements for further information.

	<b>Institutional Securities Corporate Lending(1)</b>	<b>Institutional Securities Other(2)</b>	<b>Wealth Management(3)</b>	<b>Total</b>
	(dollars in millions)			
Commercial and industrial . . . . .	\$ 6,604	\$ 1,179	\$ 3,272	\$11,055
Consumer loans . . . . .	—	107	9,344	9,451
Residential real estate loans . . . . .	—	1	7,597	7,598
Wholesale real estate loans . . . . .	—	851	7	858
Loans held for investment, net of allowance . . . . .	<u>6,604</u>	<u>2,138</u>	<u>20,220</u>	<u>28,962</u>
Loans held for sale . . . . .	<u>5,481</u>	<u>—</u>	<u>128</u>	<u>5,609</u>
Loans held at fair value . . . . .	<u>4,525</u>	<u>9,706</u>	<u>—</u>	<u>14,231</u>
Total loans . . . . .	<u>\$16,610</u>	<u>\$11,844</u>	<u>\$20,348</u>	<u>\$48,802</u>

- (1) In addition to loans, at June 30, 2013, \$51.3 billion of unfunded lending commitments were accounted for as held for investment, \$12.3 billion of unfunded lending commitments were accounted for as held for sale and \$16.3 billion of unfunded lending commitments were accounted for at fair value.
- (2) In addition to loans, at June 30, 2013, \$0.5 billion of unfunded lending commitments were accounted for as held for investment and \$1.2 billion of unfunded lending commitments were accounted for at fair value.
- (3) In addition to loans, at June 30, 2013, \$4.4 billion of unfunded lending commitments were accounted for as held for investment and \$0.2 billion of unfunded lending commitments were accounted for as held for sale.

***Institutional Securities Corporate Lending Activities.*** In connection with certain of its Institutional Securities business segment activities, the Company provides loans or lending commitments to select corporate clients. 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.

The Company's corporate lending credit exposure is primarily from loan and lending commitments used for general corporate purposes, working capital and liquidity purposes and typically consist of revolving lines of credit, letter of credit facilities and certain term loans. In addition, the Company provides "event-driven" loans and lending commitments associated with a particular event or transaction, such as to support client merger, acquisition or recapitalization activities. The Company's "event-driven" loans and lending commitments typically consist of revolving lines of credit, term loans and bridge loans.

Corporate lending commitments 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 or the Company's portion of the commitment may be reduced through the syndication or sales process. Such syndications or sales may involve third-party institutional investors where the Company may have a custodial relationship, such as prime brokerage clients.

The Company may hedge and/or sell its exposures in connection with loans and lending commitments. Additionally, the Company may mitigate credit risk by requiring borrowers to pledge collateral and include financial covenants in lending commitments. In the condensed consolidated statements of financial condition, these loans are carried at either fair value with changes in fair value recorded in earnings or held for investment, which is recorded at amortized cost, or held for sale, which is recorded at lower of cost or fair value.

Effective April 1, 2012, the Company began accounting for all new originated corporate 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 June 30, 2013. The “total corporate lending exposure” column includes funded and unfunded loans and lending commitments. Lending commitments represent legally binding obligations to provide funding to clients at June 30, 2013 for all lending transactions. Since commitments associated with these business activities may expire unused or may not be utilized to full capacity, they do not necessarily reflect the actual future cash funding requirements.

### Corporate Lending Commitments and Funded Loans at June 30, 2013

Credit Rating(1)	Years to Maturity				Total Corporate Lending Exposure(2)
	Less than 1	1-3	3-5	Over 5	
	(dollars in millions)				
AAA .....	\$ 647	\$ 89	\$ 121	\$ 24	\$ 881
AA .....	2,860	1,678	4,728	68	9,334
A .....	2,454	4,585	11,557	374	18,970
BBB .....	3,320	12,419	20,251	824	36,814
Investment grade .....	9,281	18,771	36,657	1,290	65,999
Non-investment grade .....	4,177	6,291	13,006	5,160	28,634
Total .....	<u>\$13,458</u>	<u>\$25,062</u>	<u>\$49,663</u>	<u>\$6,450</u>	<u>\$94,633</u>

(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.

At June 30, 2013, the aggregate amount of investment grade funded loans was \$7.3 billion and the aggregate amount of non-investment grade funded loans was \$7.5 billion. In connection with these corporate lending activities (which include corporate funded and unfunded loans and lending commitments), the Company had hedges (which include “single name,” “sector” and “index” hedges) with a notional amount of \$10.1 billion related to the total corporate lending exposure of \$94.6 billion at June 30, 2013.

#### “Event-Driven” Loans and Lending Commitments at June 30, 2013.

Included in the total corporate lending exposure amounts in the table above at June 30, 2013 were “event-driven” exposures of \$15.0 billion composed of funded loans of \$2.4 billion and lending commitments of \$12.6 billion. Included in the “event-driven” exposure at June 30, 2013 were \$10.3 billion of loans and lending commitments to non-investment grade borrowers. The maturity profile of the “event-driven” loans and lending commitments at June 30, 2013 was as follows: 34% will mature in less than 1 year, 22% will mature within 1 to 3 years, 22% will mature within 3 to 5 years and 22% will mature in over 5 years.

At June 30, 2013, \$724 million of the Company’s “event-driven” loans were on a non-accrual basis; all other “event-driven” loans were current. 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.

**Institutional Securities Other Lending Activities.** In addition to the primary corporate lending activity described above, the Institutional Securities business segment engages in other lending activity. These loans include corporate loans purchased in the secondary market, commercial and residential mortgage loans, asset-backed loans and

financing extended to equities and commodities customers. At June 30, 2013, approximately 99% of Institutional Securities Other lending activities held for investment were current; less than 1% were on non-accrual status because the loans were past due for a period of 90 days or more or payment of principal or interest was in doubt.

***Wealth Management Lending Activities.*** The principal Wealth Management activities that result in credit risk to the Company include purpose and non-purpose securities-based lending, structured credit facilities and residential mortgage lending. At June 30, 2013, approximately 99% of the Wealth Management business segment's loans held for investment portfolio were current. For a further discussion of the Company's credit risks associated with Wealth Management business segment, see "Quantitative and Qualitative Disclosures about Market Risk—Risk Management—Credit Risk—Global Wealth Management Group" in Part II, Item 7A of the Form 10-K.

***Credit Exposure—Derivatives.***

For credit exposure information on the Company's OTC derivative products, see Note 11 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 one or more debt obligations issued by a specified reference entity. The beneficiary typically pays a periodic premium 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, as defined in the contract, may be one or more of the following defined events: bankruptcy, dissolution or insolvency of the referenced entity, failure to pay, obligation acceleration, repudiation, payment moratorium and restructurings.

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. In transactions referencing a portfolio of referenced names or securities, protection may be limited to a tranche of exposure or a single name within the portfolio. 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 manages 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 effectiveness of the Company's CDS protection as a hedge of the Company's exposures may vary depending upon a number of factors, including the contractual terms of the CDS.

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 may 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 Trading in the condensed consolidated statements of income.



The following table summarizes the key characteristics of the Company's credit derivative portfolio by counterparty at June 30, 2013. The fair values shown are before the application of any counterparty or cash collateral netting. For additional credit exposure information on the Company's credit derivative portfolio, see Note 11 to the condensed consolidated financial statements.

	At June 30, 2013				
	Fair Values(1)			Notionals	
	Receivable	Payable	Net	Beneficiary	Guarantor
	(dollars in millions)				
Banks and securities firms . . . . .	\$47,999	\$45,533	\$2,466	\$1,449,445	\$1,413,958
Insurance and other financial institutions . . . . .	6,844	6,527	317	261,678	319,949
Non-financial entities . . . . .	98	61	37	4,377	2,899
Total . . . . .	<u>\$54,941</u>	<u>\$52,121</u>	<u>\$2,820</u>	<u>\$1,715,500</u>	<u>\$1,736,806</u>

(1) The Company's CDS are classified in both Level 2 and Level 3 of the fair value hierarchy. Approximately 5% of both receivable fair values and payable fair values represent Level 3 amounts (see Note 4 to the condensed consolidated financial statements).

**Country Risk Exposure.**

Country risk exposure is the risk that events within a country, such as currency crisis, 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 and allows the Company to effectively identify, monitor and limit country risk. Country risk exposure before and after hedges is monitored and managed.

The Company's obligor credit evaluation process may also identify indirect exposures whereby an obligor has vulnerability or exposure to another country or jurisdiction. Examples of indirect exposures include mutual funds that invest in a single country, offshore companies whose assets reside in another country to that of the offshore jurisdiction and finance company subsidiaries of corporations. Indirect exposures identified through the credit evaluation process may result in a reclassification of country risk.

The Company conducts periodic stress testing that seeks to measure the impact on the Company's credit and market exposures of shocks stemming from negative economic or political scenarios. When deemed appropriate by the Company's risk managers, the stress test scenarios include country exit from the Euro-zone and possible contagion effects. Second order risks such as the impact for core European banks of their peripheral exposures may also be considered. The Company also conducts legal and documentation analysis of its exposures to obligors in peripheral jurisdictions, which are defined as exposures in Greece, Ireland, Italy, Portugal and Spain (the "European Peripherals"), to identify the risk that such exposures could be redenominated into new currencies or subject to capital controls in the case of country exit from the Euro-zone. This analysis, and results of the stress tests, may result in the amendment of limits or exposure mitigation. 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.

The Company's sovereign exposures consist of financial instruments entered into with sovereign and local governments. Its non-sovereign exposures comprise exposures to primarily corporations and financial institutions. The following table shows the Company's significant non-U.S. country risk exposure except for select European countries (see the table in "Country Risk Exposure—Select European Countries" herein) at June 30, 2013. Index credit derivatives are included in the Company's country risk exposure tables. Each

reference entity within an index is allocated to that reference entity's country of risk. Index exposures are allocated to the underlying reference entities in proportion to the notional weighting of each reference entity in the index, adjusted for any fair value receivable/payable for that reference entity. Where credit risk crosses multiple jurisdictions, for example, a CDS purchased from an issuer in a specific country which references bonds issued by an entity in a different country, the fair value of the CDS is reflected in the Net Counterparty Exposure column based on the country of the CDS issuer. Further, the notional amount of the CDS adjusted for the fair value of the receivable/payable is reflected in the Net Inventory column based on the country of the underlying reference entity.

<u>Country</u>	<u>Net Inventory(1)</u>	<u>Net Counterparty Exposure(2)(3)</u>	<u>Funded Lending</u>	<u>Unfunded Commitments</u>	<u>Exposure Before Hedges</u>	<u>Hedges(4)</u>	<u>Net Exposure(5)</u>
			(dollars in millions)				
United Kingdom:							
Sovereigns . . . . .	\$ 775	\$ 28	\$ —	\$ —	\$ 803	\$ (82)	\$ 721
Non-sovereigns . .	<u>1,679</u>	<u>13,435</u>	<u>1,491</u>	<u>5,145</u>	<u>21,750</u>	<u>(2,920)</u>	<u>18,830</u>
Subtotal . . . .	<u>\$2,454</u>	<u>\$13,463</u>	<u>\$1,491</u>	<u>\$5,145</u>	<u>\$22,553</u>	<u>\$(3,002)</u>	<u>\$19,551</u>
Germany:							
Sovereigns . . . . .	\$1,142	\$ 667	\$ —	\$ —	\$ 1,809	\$(1,229)	\$ 580
Non-sovereigns . .	<u>525</u>	<u>3,707</u>	<u>414</u>	<u>5,620</u>	<u>10,266</u>	<u>(2,102)</u>	<u>8,164</u>
Subtotal . . . .	<u>\$1,667</u>	<u>\$ 4,374</u>	<u>\$ 414</u>	<u>\$5,620</u>	<u>\$12,075</u>	<u>\$(3,331)</u>	<u>\$ 8,744</u>
Japan:							
Sovereigns . . . . .	\$2,674	\$ 121	\$ —	\$ —	\$ 2,795	\$ (11)	\$ 2,784
Non-sovereigns . .	<u>622</u>	<u>3,068</u>	<u>33</u>	<u>—</u>	<u>3,723</u>	<u>(71)</u>	<u>3,652</u>
Subtotal . . . .	<u>\$3,296</u>	<u>\$ 3,189</u>	<u>\$ 33</u>	<u>\$ —</u>	<u>\$ 6,518</u>	<u>\$ (82)</u>	<u>\$ 6,436</u>
Brazil:							
Sovereigns . . . . .	\$3,158	\$ —	\$ —	\$ —	\$ 3,158	\$ —	\$ 3,158
Non-sovereigns . .	<u>118</u>	<u>274</u>	<u>1,195</u>	<u>212</u>	<u>1,799</u>	<u>(312)</u>	<u>1,487</u>
Subtotal . . . .	<u>\$3,276</u>	<u>\$ 274</u>	<u>\$1,195</u>	<u>\$ 212</u>	<u>\$ 4,957</u>	<u>\$(312)</u>	<u>\$ 4,645</u>
China:							
Sovereigns . . . . .	\$ 496	\$ 324	\$ —	\$ —	\$ 820	\$ —	\$ 820
Non-sovereigns . .	<u>1,234</u>	<u>393</u>	<u>395</u>	<u>153</u>	<u>2,175</u>	<u>(45)</u>	<u>2,130</u>
Subtotal . . . .	<u>\$1,730</u>	<u>\$ 717</u>	<u>\$ 395</u>	<u>\$ 153</u>	<u>\$ 2,995</u>	<u>\$(45)</u>	<u>\$ 2,950</u>

- (1) Net inventory represents 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). As a market maker, the Company transacts in these CDS positions to facilitate client trading. At June 30, 2013, gross purchased protection, gross written protection and net exposures related to single-name and index credit derivatives for those countries were \$(223.1) billion, \$222.5 billion and \$(0.6) billion, respectively. For a further description of the triggers for purchased credit protection and whether those triggers may limit the effectiveness of the Company's hedges, see "Credit Exposure—Derivatives" herein.
- (2) Net counterparty exposure (*i.e.*, repurchase transactions, securities lending and OTC derivatives) taking into consideration legally enforceable master netting agreements and collateral.
- (3) At June 30, 2013, the benefit of collateral received against counterparty credit exposure was \$13.1 billion in the U.K., with nearly all collateral consisting of cash, U.S. and U.K. government obligations, and \$15.2 billion in Germany with 98% of collateral consisting of cash and government obligations of France, Belgium and Netherlands. The benefit of collateral received against counterparty credit exposure in the three other countries totaled approximately \$2.3 billion, with collateral primarily consisting of cash, U.S. and Japan government obligations. These amounts do not include collateral received on secured financing transactions.
- (4) Represents CDS hedges (purchased and sold) on net counterparty exposure and funded lending executed by trading desks responsible for hedging counterparty and lending credit risk exposures for the Company. Based on the CDS notional amount assuming zero recovery adjusted for any fair value receivable or payable.
- (5) In addition, at June 30, 2013, the Company had exposure to these countries for overnight deposits with banks of approximately \$6.8 billion.

*Country Risk Exposure—Select European Countries.* In connection with certain of its Institutional Securities business segment activities, the Company has exposure to many foreign countries. During the quarter ended June 30, 2013, certain European countries, which include the European Peripherals and France, continued to experience challenges to their creditworthiness due to weakness in their economic and fiscal situations. The following table shows the Company's exposure to the European Peripherals and France at June 30, 2013. Country 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)(3)	Funded Lending	Unfunded Commitments	CDS Adjustment(4)	Exposure Before Hedges	Hedges(5)	Net Exposure
(dollars in millions)								
Greece:								
Sovereigns . . . . .	\$ 15	\$ 42	\$—	\$ —	\$—	\$ 57	\$ —	\$ 57
Non-sovereigns . . . .	50	9	—	—	—	59	(42)	17
Subtotal . . . . .	<u>\$ 65</u>	<u>\$ 51</u>	<u>\$—</u>	<u>\$ —</u>	<u>\$—</u>	<u>\$ 116</u>	<u>\$ (42)</u>	<u>\$ 74</u>
Ireland:								
Sovereigns . . . . .	\$ 63	\$ 3	\$—	\$ —	\$ 5	\$ 71	\$ 11	\$ 82
Non-sovereigns . . . .	166	47	—	—	18	231	(7)	224
Subtotal . . . . .	<u>\$ 229</u>	<u>\$ 50</u>	<u>\$—</u>	<u>\$ —</u>	<u>\$ 23</u>	<u>\$ 302</u>	<u>\$ 4</u>	<u>\$ 306</u>
Italy:								
Sovereigns . . . . .	\$ 394	\$ 322	\$—	\$ —	\$472	\$1,188	\$ (213)	\$ 975
Non-sovereigns . . . .	445	589	160	883	91	2,168	(432)	1,736
Subtotal . . . . .	<u>\$ 839</u>	<u>\$ 911</u>	<u>\$160</u>	<u>\$ 883</u>	<u>\$563</u>	<u>\$3,356</u>	<u>\$ (645)</u>	<u>\$2,711</u>
Spain:								
Sovereigns . . . . .	\$ 465	\$ 7	\$—	\$ —	\$ 17	\$ 489	\$ 10	\$ 499
Non-sovereigns . . . .	110	275	94	1,051	154	1,684	(370)	1,314
Subtotal . . . . .	<u>\$ 575</u>	<u>\$ 282</u>	<u>\$ 94</u>	<u>\$1,051</u>	<u>\$171</u>	<u>\$2,173</u>	<u>\$ (360)</u>	<u>\$1,813</u>
Portugal:								
Sovereigns . . . . .	\$ (35)	\$ (1)	\$—	\$ —	\$ 32	\$ (4)	\$ (42)	\$ (46)
Non-sovereigns . . . .	(36)	28	194	—	22	208	(6)	202
Subtotal . . . . .	<u>\$ (71)</u>	<u>\$ 27</u>	<u>\$194</u>	<u>\$ —</u>	<u>\$ 54</u>	<u>\$ 204</u>	<u>\$ (48)</u>	<u>\$ 156</u>
Sovereigns . . . . .	\$ 902	\$ 373	\$—	\$ —	\$526	\$1,801	\$ (234)	\$1,567
Non-sovereigns . . . . .	735	948	448	1,934	285	4,350	(857)	3,493
Total European Peripherals(6) . . . . .	<u>\$1,637</u>	<u>\$1,321</u>	<u>\$448</u>	<u>\$1,934</u>	<u>\$811</u>	<u>\$6,151</u>	<u>\$ (1,091)</u>	<u>\$5,060</u>
France(6):								
Sovereigns . . . . .	\$ (340)	\$ 24	\$—	\$ —	\$ 32	\$ (284)	\$ (222)	\$ (506)
Non-sovereigns . . . .	1	3,057	183	1,974	173	5,388	(532)	4,856
Total France(6) . . . . .	<u>\$ (339)</u>	<u>\$3,081</u>	<u>\$183</u>	<u>\$1,974</u>	<u>\$205</u>	<u>\$5,104</u>	<u>\$ (754)</u>	<u>\$4,350</u>

(1) Net inventory represents 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). As a market maker, the Company transacts in these CDS positions to facilitate client trading. At June 30, 2013, gross purchased protection, gross written protection and net exposures related to single-name and index credit derivatives for the European Peripherals were \$(129.3) billion, \$129.1 billion and \$(0.2) billion, respectively. Gross purchased protection, gross written protection and net exposures related to single-name and index credit derivatives for France were \$(88.8) billion, \$87.8 billion and \$(1.0) billion, respectively. For a further description of the triggers for purchased credit protection and whether those triggers may limit the effectiveness of the Company's hedges, see "Credit Exposure—Derivatives" herein.

- (2) Net counterparty exposure (*i.e.*, repurchase transactions, securities lending and OTC derivatives) takes into consideration legally enforceable master netting agreements and collateral.
- (3) At June 30, 2013, the benefit of collateral received against counterparty credit exposure was \$4.0 billion in the European Peripherals with nearly all collateral consisting of cash and German government obligations and \$6.3 billion in France with nearly all collateral consisting of cash and U.S. government obligations. These amounts do not include collateral received on secured financing transactions.
- (4) CDS adjustment represents credit protection purchased from European Peripherals' banks on European Peripherals' 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.
- (5) Represents CDS hedges (purchased and sold) on net counterparty exposure and funded lending executed by trading desks responsible for hedging counterparty and lending credit risk exposures for the Company. Based on the CDS notional amount assuming zero recovery adjusted for any fair value receivable or payable.
- (6) In addition, at June 30, 2013, the Company had European Peripherals and French exposure for overnight deposits with banks of approximately \$133 million and \$17 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 June 30, 2013:

<u>Industry</u>	<u>Corporate Lending Exposure</u> (dollars in millions)
Energy .....	\$12,363
Consumer staples .....	10,932
Consumer discretionary .....	10,403
Utilities .....	9,801
Industrials .....	8,964
Healthcare .....	8,279
Funds, exchanges and other financial services(1) .....	7,024
Information technology .....	6,496
Real Estate .....	4,905
Materials .....	4,835
Telecommunications services .....	4,825
Other .....	5,806
Total .....	<u>\$94,633</u>

<u>Industry</u>	<u>OTC Derivative Products(2)</u> (dollars in millions)
Banks and securities firms .....	\$ 4,234
Utilities .....	3,414
Funds, exchanges and other financial services(1) .....	2,908
Special purpose vehicles .....	2,660
Regional governments .....	2,098
Healthcare .....	1,249
Sovereign governments .....	1,123
Industrials .....	1,090
Not-for-profit organizations .....	898
Insurance .....	861
Other .....	3,874
Total .....	<u>\$24,409</u>

(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 11 to the condensed consolidated financial statements.

**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.

**FINANCIAL DATA SUPPLEMENT (Unaudited)**  
**Average Balances and Interest Rates and Net Interest Income**

	<b>Three Months Ended June 30, 2013</b>		
	<b>Average Weekly Balance</b>	<b>Interest</b>	<b>Annualized Average Rate</b>
	(dollars in millions)		
<b>Assets</b>			
<b>Interest earning assets:</b>			
Trading assets(1):			
U.S. ....	\$126,580	\$ 521	1.7%
Non-U.S. ....	104,393	92	0.4
Securities available for sale:			
U.S. ....	41,126	110	1.1
Loans:			
U.S. ....	31,937	254	3.2
Non-U.S. ....	532	24	18.3
Interest bearing deposits with banks:			
U.S. ....	21,541	15	0.3
Non-U.S. ....	8,793	10	0.5
Federal funds sold and securities purchased under agreements to resell and Securities borrowed:			
U.S. ....	185,772	(84)	(0.2)
Non-U.S. ....	96,984	150	0.6
Other:			
U.S. ....	61,827	185	1.2
Non-U.S. ....	20,478	145	2.9
<b>Total</b> .....	<u>\$699,963</u>	<u>\$1,422</u>	<u>0.8%</u>
Non-interest earning assets .....	128,296		
<b>Total assets</b> .....	<u>\$828,259</u>		
<b>Liabilities and Equity</b>			
<b>Interest bearing liabilities:</b>			
Deposits:			
U.S. ....	\$ 79,284	\$ 41	0.2%
Non-U.S. ....	316	—	—
Commercial paper and other short-term borrowings:			
U.S. ....	1,041	—	—
Non-U.S. ....	1,326	5	1.5
Long-term debt:			
U.S. ....	154,864	900	2.4
Non-U.S. ....	14,033	17	0.5
Trading liabilities(1):			
U.S. ....	31,755	—	—
Non-U.S. ....	60,176	—	—
Securities sold under agreements to repurchase and Securities loaned:			
U.S. ....	108,117	188	0.7
Non-U.S. ....	74,909	330	1.8
Other:			
U.S. ....	96,971	(304)	(1.3)
Non-U.S. ....	37,064	41	0.4
<b>Total</b> .....	<u>\$659,856</u>	<u>\$1,218</u>	<u>0.7</u>
Non-interest bearing liabilities and equity .....	168,403		
<b>Total liabilities and equity</b> .....	<u>\$828,259</u>		
Net interest income and net interest rate spread .....		<u>\$ 204</u>	<u>0.1%</u>

(1) Interest expense on Trading liabilities is reported as a reduction of Interest income on Trading assets.

**FINANCIAL DATA SUPPLEMENT (Unaudited)—(Continued)**  
**Average Balances and Interest Rates and Net Interest Income**

	<b>Three Months Ended June 30, 2012</b>		
	<b>Average Weekly Balance</b>	<b>Interest</b>	<b>Annualized Average Rate</b>
	(dollars in millions)		
<b>Assets</b>			
<b>Interest earning assets:</b>			
Trading assets(1):			
U.S. ....	\$132,966	\$ 535	1.6%
Non-U.S. ....	79,886	127	0.6
Securities available for sale:			
U.S. ....	32,082	76	1.0
Loans:			
U.S. ....	18,390	130	2.9
Non-U.S. ....	283	9	12.9
Interest bearing deposits with banks:			
U.S. ....	26,556	8	0.1
Non-U.S. ....	11,448	16	0.6
Federal funds sold and securities purchased under agreements to resell and Securities borrowed:			
U.S. ....	189,565	(58)	(0.1)
Non-U.S. ....	103,320	104	0.4
Other:			
U.S. ....	49,027	149	1.2
Non-U.S. ....	18,705	227	4.9
<b>Total</b> .....	<b>\$662,228</b>	<b>\$1,323</b>	<b>0.8%</b>
Non-interest earning assets .....	122,136		
<b>Total assets</b> .....	<b>\$784,364</b>		
<b>Liabilities and Equity</b>			
<b>Interest bearing liabilities:</b>			
Deposits:			
U.S. ....	\$ 66,381	\$ 45	0.3%
Non-U.S. ....	117	—	—
Commercial paper and other short-term borrowings:			
U.S. ....	102	1	4.0
Non-U.S. ....	1,714	10	2.4
Long-term debt:			
U.S. ....	164,426	1,066	2.6
Non-U.S. ....	7,035	21	1.2
Trading liabilities(1):			
U.S. ....	40,299	—	—
Non-U.S. ....	56,470	—	—
Securities sold under agreements to repurchase and Securities loaned:			
U.S. ....	94,431	243	1.0
Non-U.S. ....	60,488	286	1.9
Other:			
U.S. ....	83,553	(451)	(2.2)
Non-U.S. ....	34,641	262	3.1
<b>Total</b> .....	<b>\$609,657</b>	<b>\$1,483</b>	<b>1.0</b>
Non-interest bearing liabilities and equity .....	174,707		
<b>Total liabilities and equity</b> .....	<b>\$784,364</b>		
Net interest income and net interest rate spread .....		<b>\$ (160)</b>	<b>(0.2)%</b>

(1) Interest expense on Trading liabilities is reported as a reduction of Interest income on Trading assets.



**FINANCIAL DATA SUPPLEMENT (Unaudited)—(Continued)**  
**Average Balances and Interest Rates and Net Interest Income**

	<b>Six Months Ended June 30, 2013</b>		
	<b>Average Weekly Balance</b>	<b>Interest</b>	<b>Annualized Average Rate</b>
	(dollars in millions)		
<b>Assets</b>			
<b>Interest earning assets:</b>			
Trading assets(1):			
U.S. ....	\$127,382	\$1,048	1.7%
Non-U.S. ....	100,285	169	0.3
Securities available for sale:			
U.S. ....	41,269	206	1.0
Loans:			
U.S. ....	30,292	488	3.3
Non-U.S. ....	542	34	12.7
Interest bearing deposits with banks:			
U.S. ....	22,018	30	0.3
Non-U.S. ....	8,203	21	0.5
Federal funds sold and securities purchased under agreements to resell and Securities borrowed:			
U.S. ....	188,330	(86)	(0.1)
Non-U.S. ....	99,587	244	0.5
Other:			
U.S. ....	62,917	371	1.2
Non-U.S. ....	18,528	295	3.2
<b>Total</b> .....	<b>\$699,353</b>	<b>\$2,820</b>	<b>0.8%</b>
Non-interest earning assets .....	126,957		
<b>Total assets</b> .....	<b>\$826,310</b>		
<b>Liabilities and Equity</b>			
<b>Interest bearing liabilities:</b>			
Deposits:			
U.S. ....	\$ 80,416	\$ 82	0.2%
Non-U.S. ....	309	—	—
Commercial paper and other short-term borrowings:			
U.S. ....	910	1	0.2
Non-U.S. ....	1,020	13	2.6
Long-term debt:			
U.S. ....	157,661	1,842	2.4
Non-U.S. ....	11,976	35	0.6
Trading liabilities(1):			
U.S. ....	36,289	—	—
Non-U.S. ....	60,629	—	—
Securities sold under agreements to repurchase and Securities loaned:			
U.S. ....	105,574	394	0.8
Non-U.S. ....	72,356	574	1.6
Other:			
U.S. ....	94,344	(593)	(1.3)
Non-U.S. ....	34,403	83	0.5
<b>Total</b> .....	<b>\$655,887</b>	<b>\$2,431</b>	<b>0.8</b>
Non-interest bearing liabilities and equity .....	170,423		
<b>Total liabilities and equity</b> .....	<b>\$826,310</b>		
Net interest income and net interest rate spread .....		<b>\$ 389</b>	<b>— %</b>

(1) Interest expense on Trading liabilities is reported as a reduction of Interest income on Trading assets.

**FINANCIAL DATA SUPPLEMENT (Unaudited)—(Continued)**  
**Average Balances and Interest Rates and Net Interest Income**

	<u>Six Months Ended June 30, 2012</u>		
	<u>Average Weekly Balance</u>	<u>Interest</u>	<u>Annualized Average Rate</u>
	(dollars in millions)		
<b>Assets</b>			
<b>Interest earning assets:</b>			
Trading assets(1):			
U.S. ....	\$132,273	\$1,166	1.8%
Non-U.S. ....	83,597	287	0.7
Securities available for sale:			
U.S. ....	31,795	162	1.0
Loans:			
U.S. ....	17,158	242	2.9
Non-U.S. ....	239	15	12.7
Interest bearing deposits with banks:			
U.S. ....	27,612	13	0.1
Non-U.S. ....	12,049	38	0.6
Federal funds sold and securities purchased under agreements to resell and Securities borrowed:			
U.S. ....	186,359	(95)	(0.1)
Non-U.S. ....	101,564	254	0.5
Other:			
U.S. ....	49,863	381	1.5
Non-U.S. ....	16,239	402	5.0
<b>Total</b> .....	<u>\$658,748</u>	<u>\$2,865</u>	0.9%
Non-interest earning assets .....	<u>126,274</u>		
<b>Total assets</b> .....	<u><u>\$785,022</u></u>		
<b>Liabilities and Equity</b>			
<b>Interest bearing liabilities:</b>			
Deposits:			
U.S. ....	\$ 65,957	\$ 90	0.3%
Non-U.S. ....	153	—	—
Commercial paper and other short-term borrowings:			
U.S. ....	395	3	1.5
Non-U.S. ....	2,017	21	2.1
Long-term debt:			
U.S. ....	168,927	2,306	2.8
Non-U.S. ....	6,903	35	1.0
Trading liabilities(1):			
U.S. ....	35,423	—	—
Non-U.S. ....	54,579	—	—
Securities sold under agreements to repurchase and Securities loaned:			
U.S. ....	95,344	414	0.9
Non-U.S. ....	61,356	578	1.9
Other:			
U.S. ....	81,855	(835)	(2.1)
Non-U.S. ....	34,701	472	2.8
<b>Total</b> .....	<u>\$607,610</u>	<u>\$3,084</u>	1.0
Non-interest bearing liabilities and equity .....	<u>177,412</u>		
<b>Total liabilities and equity</b> .....	<u><u>\$785,022</u></u>		
Net interest income and net interest rate spread .....		<u>\$ (219)</u>	<u>(0.1)%</u>

(1) Interest expense on Trading liabilities is reported as a reduction of Interest income on Trading assets.

**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:

	<b>Three Months Ended June 30, 2013 versus Three Months Ended June 30, 2012</b>		
	<b>Increase (decrease) due to change in:</b>		
	<b>Volume</b>	<b>Rate</b>	<b>Net Change</b>
	(dollars in millions)		
<b>Interest earning assets</b>			
Trading Assets:			
U.S. ....	\$ (26)	\$ 12	\$ (14)
Non-U.S. ....	39	(74)	(35)
Securities available for sale:			
U.S. ....	21	13	34
Loans:			
U.S. ....	96	28	124
Non-U.S. ....	8	7	15
Interest bearing deposits with banks:			
U.S. ....	(2)	9	7
Non-U.S. ....	(4)	(2)	(6)
Federal funds sold and securities purchased under agreements to resell and Securities borrowed:			
U.S. ....	1	(27)	(26)
Non-U.S. ....	(6)	52	46
Other:			
U.S. ....	39	(3)	36
Non-U.S. ....	22	(104)	(82)
<b>Change in interest income</b> .....	<u>\$188</u>	<u>\$ (89)</u>	<u>\$ 99</u>
<b>Interest bearing liabilities</b>			
Deposits:			
U.S. ....	\$ 9	\$ (13)	\$ (4)
Commercial paper and other short-term borrowings:			
U.S. ....	9	(10)	(1)
Non-U.S. ....	(2)	(3)	(5)
Long-term debt:			
U.S. ....	(62)	(104)	(166)
Non-U.S. ....	21	(25)	(4)
Securities sold under agreements to repurchase and Securities loaned:			
U.S. ....	35	(90)	(55)
Non-U.S. ....	68	(24)	44
Other:			
U.S. ....	(72)	219	147
Non-U.S. ....	18	(239)	(221)
<b>Change in interest expense</b> .....	<u>\$ 24</u>	<u>\$(289)</u>	<u>\$(265)</u>
<b>Change in net interest income</b> .....	<u>\$164</u>	<u>\$ 200</u>	<u>\$ 364</u>

**FINANCIAL DATA SUPPLEMENT (Unaudited)—(Continued)**  
**Rate/Volume Analysis**

	Six Months Ended June 30, 2013 versus Six Months Ended June 30, 2012		
	Increase (decrease) due to change in:		
	Volume	Rate	Net Change
	(dollars in millions)		
<b>Interest earning assets</b>			
Trading assets:			
U.S. ....	\$ (43)	\$ (75)	\$(118)
Non-U.S. ....	57	(175)	(118)
Securities available for sale:			
U.S. ....	48	(4)	44
Loans:			
U.S. ....	185	61	246
Non-U.S. ....	19	—	19
Interest bearing deposits with banks:			
U.S. ....	(3)	20	17
Non-U.S. ....	(12)	(5)	(17)
Federal funds sold and securities purchased under agreements to resell and Securities borrowed:			
U.S. ....	(1)	10	9
Non-U.S. ....	(5)	(5)	(10)
Other:			
U.S. ....	101	(111)	(10)
Non-U.S. ....	57	(164)	(107)
<b>Change in interest income</b> .....	<u>\$ 403</u>	<u>\$(448)</u>	<u>\$ (45)</u>
<b>Interest bearing liabilities</b>			
Deposits:			
U.S. ....	\$ 20	\$ (28)	\$ (8)
Commercial paper and other short-term borrowings:			
U.S. ....	4	(6)	(2)
Non-U.S. ....	(10)	2	(8)
Long-term debt:			
U.S. ....	(154)	(310)	(464)
Non-U.S. ....	26	(26)	—
Securities sold under agreements to repurchase and Securities loaned:			
U.S. ....	44	(64)	(20)
Non-U.S. ....	104	(108)	(4)
Other:			
U.S. ....	(128)	370	242
Non-U.S. ....	(4)	(385)	(389)
<b>Change in interest expense</b> .....	<u>\$ (98)</u>	<u>\$ (555)</u>	<u>\$(653)</u>
<b>Change in net interest income</b> .....	<u>\$ 501</u>	<u>\$ 107</u>	<u>\$ 608</u>

## **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, 2012 (the "Form 10-K"), the Company's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2013 (the "First Quarter Form 10-Q") 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 and the First Quarter Form 10-Q or concern new actions that have been filed since the First Quarter Form 10-Q:

#### **Residential Mortgage and Credit Crisis Related Matters.**

##### ***Class Actions.***

On May 30, 2013, judgment in defendants' favor was entered in both *In re Morgan Stanley ERISA Litigation* and *Coulter v. Morgan Stanley & Co. Incorporated et al.* and plaintiffs filed a notice of appeal with respect to each judgment on June 27, 2013.

On May 2, 2013, certain offerings that had previously been dismissed in *In re IndyMac Mortgage-Backed Securities Litigation* were reinstated in light of recent precedent from the United States Court of Appeals for the Second Circuit. There are now four offerings underwritten by the Company at issue, with a principal amount of \$1.68 billion.

***Other Litigation.***

On May 23, 2013, certain parties in *Abu Dhabi Commercial Bank, et al. v. Morgan Stanley & Co. Inc., et al.* filed a notice of appeal as to certain claims dismissed from the matter prior to the settlement by the remaining parties.

On July 10, 2013, the parties in *Central Mortgage Company v. Morgan Stanley Mortgage Capital Holdings LLC* reached an agreement to resolve the litigation.

On April 11, 2013, the Company filed a notice of appeal from the order denying the motion to dismiss the amended complaint in *Allstate Insurance Company, et al. v. Morgan Stanley, et al.* and on May 3, 2013, the Company filed its answer to that complaint.

On May 21, 2013, the Company filed a motion seeking an interlocutory appeal of the decision denying its motion to dismiss in *Federal Deposit Insurance Corporation, as Receiver for Franklin Bank S.S.B v. Morgan Stanley & Company LLC F/K/A Morgan Stanley & Co. Inc.*

On May 3, 2013, the Company filed a motion to dismiss the second amended complaint in *Sealink Funding Limited v. Morgan Stanley, et al.*

On July 16, 2013, the court in *Metropolitan Life Insurance Company, et al. v. Morgan Stanley, et al.* granted in part and denied in part the Company's motion to dismiss the complaint.

On June 20, 2013, the court in *Federal Deposit Insurance Corporation as Receiver for Colonial Bank v. Countrywide Securities Corporation et al.* granted the defendants' motion to dismiss as to the federal securities law claims and denied the motion with respect to the state law claims.

On July 18, 2013, the court in *Asset Management Fund d/b/a AMF Funds et al v. Morgan Stanley et al.* dismissed claims with respect to seven certificates purchased by the plaintiff. The remaining claims relate to certificates with an original balance of \$10.6 million.

On June 17, 2013, the court in *Royal Park Investments SA/NV v. Merrill Lynch et al.* signed a joint proposed order and stipulation allowing plaintiffs to replead their complaint and defendants to withdraw their motion to dismiss without prejudice.

On May 3, 2013, plaintiffs in *Deutsche Zentral-Genossenschaftsbank AG et al. v. Morgan Stanley et al.* filed a complaint against the Company, certain affiliates, and other defendants in the Supreme Court of the State of New York, New York County ("Supreme Court of NY"). The complaint 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 plaintiff was approximately \$694 million. The complaint alleges causes of action against the Company for common law fraud, fraudulent concealment, aiding and abetting fraud, negligent misrepresentation, and rescission and seeks, among other things, compensatory and punitive damages. On July 12, 2013, defendants filed a motion to dismiss the complaint.

On May 17, 2013, plaintiff in *IKB International S.A. in Liquidation, et al. v. Morgan Stanley, et al.* filed a complaint against the Company and certain affiliates in the Supreme Court of NY. The complaint alleges that defendants made material misrepresentations and omissions in the sale to plaintiff 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 plaintiff was approximately

\$132 million. The complaint alleges causes of action against the Company for common law fraud, fraudulent concealment, aiding and abetting fraud, and negligent misrepresentation, and seeks, among other things, compensatory and punitive damages.

On May 31, 2013, the Federal Housing Finance Agency filed a summons with notice purportedly on behalf of the Trustee of the Morgan Stanley ABS Capital I Inc. Trust, Series 2007-NC3, against the Company. The matter is styled *Federal Housing Finance Agency, as Conservator for the Federal Home Loan Mortgage Corporation, on behalf of the Trustee of the Morgan Stanley ABS Capital I Inc. Trust, Series 2007-NC3 (MSAC 2007-NC3) v. Morgan Stanley Mortgage Capital Holdings LLC* and is pending in the Supreme Court of NY. 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 \$1.3 billion, breached various representations and warranties. The notice seeks, among other relief, specific performance of the loan breach remedy procedures in the transaction documents, unspecified damages and interest.

On July 2, 2013, the trustee, Deutsche Bank became the named plaintiff in *Federal Housing Finance Agency, as Conservator for the Federal Home Loan Mortgage Corporation, on behalf of the Trustee of the Morgan Stanley ABS Capital I Inc. Trust, Series 2007-NC1 v. Morgan Stanley ABS Capital I Inc.*, and filed a complaint in the Supreme Court of NY under the caption, *Deutsche Bank National Trust Company, as Trustee for the Morgan Stanley ABS Capital I Inc. Trust, Series 2007-NC1 v. Morgan Stanley ABS Capital I, Inc.* The complaint 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 \$1.25 billion, breached various representations and warranties. The complaint seeks, among other relief, specific performance of the loan breach remedy procedures in the transaction documents, unspecified damages and interest.

On July 8, 2013, plaintiff filed a complaint in *Morgan Stanley Mortgage Loan Trust 2007-2AX, by U.S. Bank National Association, solely in its capacity as Trustee v. Morgan Stanley Mortgage Capital Holdings LLC, as successor-by-merger to Morgan Stanley Mortgage Capital Inc., and Greenpoint Mortgage Funding, Inc.* The complaint, filed in the Supreme Court of NY, 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 \$650 million, breached various representations and warranties. The complaint seeks, among other relief, specific performance of the loan breach remedy procedures in the transaction documents, unspecified damages and interest.

On July 31, 2013, Wilmington Trust Company, in its capacity as trustee for Morgan Stanley Mortgage Loan Trust 2007-12, filed a summons with notice against the Company. The matter is styled *Wilmington Trust Company v. Morgan Stanley Mortgage Capital Holdings LLC et al.* and is pending in the Supreme Court of NY. 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 \$516 million, breached various representations and warranties. The notice seeks, among other relief, specific performance of the loan breach remedy procedures in the transaction documents and unspecified damages.

#### **Commercial Mortgage Related Matter.**

On June 20, 2013, the court in *The Bank of New York Mellon Trust, National Association v. Morgan Stanley Mortgage Capital, Inc.*, granted in part and denied in part the Company's motion for summary judgment, and denied the plaintiff's motion for summary judgment.

#### **Matters Related to the CDS Market.**

On July 1, 2013, the European Commission ("EC") issued a Statement of Objections ("SO") addressed to twelve financial firms (including the Company), the International Swaps and Derivatives Association, Inc. ("ISDA") and Markit Group Limited ("Markit") and various affiliates alleging that, between 2006 and 2009, the recipients breached European Union competition law by taking and refusing to take certain actions in an effort to prevent the development of exchange traded CDS products. The SO indicates that the EC plans to impose remedial



measures and fines on the recipients. The Company and the other recipients have been given an opportunity to respond to the SO. The Company and others have also responded to an ongoing investigation by the Antitrust Division of the United States Department of Justice related to the CDS market.

On May 5, 2013 and July 11, 2013, twelve financial firms (including the Company), as well as ISDA and Markit, were named as defendants in two purported antitrust class actions styled *Sheet Metal Workers Local No. 33 Cleveland District Pension Plan vs. Bank of America Corporation et al.*, and *Unipension Fondsmæglerselskab A/S. et al v. Bank of America Corporation et al*, respectively. Both actions are pending in the United States District Court for the Northern District of Illinois and allege that defendants violated United States antitrust laws from 2008 to present in connection with their alleged efforts to prevent the development of exchange traded CDS products. The complaints seek, among other relief, certification of a class of plaintiffs who purchased CDS from defendants in the United States, treble damages and injunctive relief.

## 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 June 30, 2013.

### 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
<b>Month #1</b>				
<b>(April 1, 2013—April 30, 2013)</b>				
Share Repurchase Program(A) . . . . .	—	—	—	\$1,560
Employee Transactions(B) . . . . .	174,037	\$21.86	—	—
<b>Month #2</b>				
<b>(May 1, 2013—May 31, 2013)</b>				
Share Repurchase Program(A) . . . . .	—	—	—	\$1,560
Employee Transactions(B) . . . . .	55,521	\$23.70	—	—
<b>Month #3</b>				
<b>(June 1, 2013—June 30, 2013)</b>				
Share Repurchase Program(A) . . . . .	—	—	—	\$1,560
Employee Transactions(B) . . . . .	72,527	\$25.47	—	—
<b>Total</b>				
Share Repurchase Program(A) . . . . .	—	—	—	\$1,560
Employee Transactions(B) . . . . .	302,085	\$23.07	—	—

(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. In July 2013, the Company received no objection from the Federal Reserve to repurchase up to \$500 million of the Company's outstanding common stock under rules permitting annual capital distributions (12 Code of Federal Regulations 225.8, *Capital Planning*). For further information, see "Liquidity and Capital Resources—Capital Management" in Part I, Item 2.

(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 repurchases 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.

An exhibit index has been filed as part of this Report on Page E-1.



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**EXHIBIT INDEX**  
**MORGAN STANLEY**  
**Quarter Ended June 30, 2013**

<u>Exhibit No.</u>	<u>Description</u>
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 August 2, 2013, 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—June 30, 2013 and December 31, 2012, (ii) the Condensed Consolidated Statements of Income—Three Months and Six Months Ended June 30, 2013 and 2012, (iii) the Condensed Consolidated Statements of Comprehensive Income—Three Months and Six Months Ended June 30, 2013 and 2012, (iv) the Condensed Consolidated Statements of Cash Flows—Six Months Ended June 30, 2013 and 2012, (v) the Condensed Consolidated Statements of Changes in Total Equity—Six Months Ended June 30, 2013 and 2012, and (vi) Notes to Condensed Consolidated Financial Statements (unaudited).