SIGNET JEWELERS LTD
Form DEF 14A
April 26, 2011
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

SCHEDULE 14A

Proxy Statement Pursuant to Section 14(a)

of the Securities Exchange Act of 1934

Filed by the Registrant x

Filed by a Party other than the Registrant ¨

Check the appropriate box:

¨ PreliminaryProxy Statement
¨ Confidential,for Use of the Commission Only
(as permitted by Rule 14a-6(e)(2))
x DefinitiveProxy Statement
¨ Definitive Additional Materials
¨ Soliciting Material Pursuant to §240.14a-12

SIGNET JEWELERS LIMITED

(Name of Registrant as Specified In Its Charter)

Payment of Filing Fee (Check the appropriate box):

x No fee required.

¨ Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.

(1) Title of each class of securities to which the transaction applies:

(2) Aggregate number of securities to which the transaction applies:

(3) Per unit price or other underlying value of the transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):

(4) Proposed maximum aggregate value of the transaction:

(5) Total fee paid:

¨ Fee paid previously with preliminary materials.

¨ Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.

(1) Amount Previously Paid:

(2) Form, Schedule or Registration Statement No.:

(3) Filing Party:

(4) Date Filed:

Table of Contents

Signet Jewelers Limited

(Registered in Bermuda, No. 42069)

Registered Office:

Clarendon House

2 Church Street

Hamilton HM11

Bermuda

Dear Shareholder April 26, 2011

ANNUAL GENERAL MEETING (Meeting)

It is my pleasure to invite you to the 2011 Annual General Meeting of the Shareholders of Signet Jewelers Limited, which will be held on Thursday, June 16, 2011 at 11:00 a.m. EDT, at Hilton Akron/Fairlawn, 3180 W. Market Street, Akron, Ohio, 44333, United States.

In accordance with best practice governance principles, at the Meeting you will be asked to approve an amendment to the Bye-laws of the Company providing for the annual election of Directors effective at the Meeting. In the event the amendment is approved, you will be asked to elect seven directors to the Company s Board to serve until the 2012 annual general meeting of shareholders or until their respective successors are elected in accordance with the amended Bye-laws of the Company. The Shareholder vote required to approve this amendment is very high (75 percent of the outstanding shares). Our Board of Directors is committed to strong and effective corporate governance and so, in the event that the required majority is not reached, you will still be asked to elect seven directors to the Company s Board, because each of the seven members of the Board intends to resign from the Board and offer himself or herself for election. In that event, four directors will retire in accordance with the current Bye-laws, and three directors will retire voluntarily. You are also being asked to appoint KPMG LLP, the US member firm of KPMG International, as our independent registered public accounting firm, in place of KPMG Audit plc, the UK member firm of KPMG International. This change is occurring in recognition that our accounting function is relocating to the United States. Further, we are asking you to approve the Signet Jewelers Limited Annual Performance Bonus Plan, which is designed to enable our Compensation Committee to grant incentive compensation that is not subject to the deduction limitation of Section 162(m) of the U.S. Internal Revenue Code. We are also providing Shareholders with an advisory vote to approve the compensation of named executive officers as disclosed in the Proxy Statement (referred to as a Say-on-Pay vote) and an advisory vote on the frequency of the Say-on-Pay vote (referred to as a frequency vote), pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act.

Information regarding the matters to be voted upon at this year s Meeting is contained in the Notice of Meeting and Proxy Statement which are included in the following pages.

The Company s audited financial statements for the fiscal year ended January 29, 2011 (Fiscal 2011) as approved by the Board will be presented at the Meeting.

This year we are again taking advantage of the rules under the Securities Exchange Act of 1934 that allow companies to furnish proxy materials to Shareholders electronically by the internet. You will receive a notice regarding the availability of Proxy Materials (the Notice) by mail or email. You will not receive a printed copy of the proxy materials unless you specifically request one or have previously requested one. The Notice instructs you how to access and review all of the important information contained in the Proxy Statement, as well as how to submit your proxy electronically by the internet or, additionally for US Shareholders, by telephone. If you would like to receive a printed copy of our proxy materials, you should follow the instructions for requesting these materials which are included in the Notice. The Notice, form of proxy and form of direction include instructions on how you can access and review the Notice of Meeting and Proxy Statement on the Company s website.

It is important that your shares are represented and voted at the Meeting, regardless of the size of your holdings. Your vote is important.

Sir Malcolm Williamson

Chairman

Table of Contents

Notice of Annual General Meeting

Notice is hereby given that the 2011 Annual General Meeting (Meeting) of the Shareholders of Signet Jewelers Limited (the Company) will be held at the Hilton Akron/Fairlawn, 3180 W. Market Street, Akron, Ohio, 44333, United States on Thursday, June 16, 2011 at 11:00 a.m. EDT, to consider the following items of business:

1. To vote on a proposal to amend the Company s Bye-laws to provide for the annual election of Directors in the manner contemplated in Appendix 1 to the Proxy Statement accompanying this notice.

2. If proposal 1 is approved, to elect seven directors to the Company s Board of Directors to serve until the next Annual General Meeting of the Company or until their respective successors are elected in accordance with the amended Bye-laws of the Company.

3. If proposal 1 is not approved, to elect the four directors who will retire in accordance with the current Bye-laws of the Company and the three directors who will retire voluntarily.

4. To appoint KPMG LLP as independent auditor of the Company, to hold office from the conclusion of this Meeting until the conclusion of the next Annual General Meeting of the Company and to authorize the Audit Committee to determine its compensation.

5. To approve the Signet Jewelers Limited Annual Performance Bonus Plan.

6. To hold a non-binding, advisory vote to approve the compensation of our named executive officers as disclosed in the Proxy Statement (the Say-on-Pay vote).

7. To hold a non-binding, advisory vote on the frequency of the Say-on-Pay vote.

In addition, we will consider the transaction of any other business properly brought at the Meeting or any adjournment or postponement thereof.

Each of the matters to be presented at the Meeting will be voted upon by poll.

The Company s audited financial statements for Fiscal 2011 as approved by our Board will be presented at the Meeting.

The Board of Directors has fixed the close of business on April 14, 2011, as the record date for the Meeting. All Shareholders of record at the close of business on that date are entitled to notice of, and to be present and vote at, the Meeting and at any adjournment and continuation thereof.

Attendance at the Meeting will be limited to Shareholders of record, beneficial owners of Company Common Shares entitled to provide instructions to vote at the Meeting having evidence of ownership, proxies and corporate representatives of Shareholders, and invited guests of management. Any person claiming to be an authorized representative of a Shareholder must, upon request, produce written evidence of such authorization.

Table of Contents

The Meeting will be conducted pursuant to the Company s Bye-laws and rules of order prescribed by the Chairman of the Meeting.

By Order of the Board

Mark A. Jenkins

Group Company Secretary

Registered Office:

Clarendon House

2 Church Street

Hamilton HM11

Bermuda

Registered in Bermuda No. 42069

April 26, 2011

WHETHER OR NOT YOU PLAN TO ATTEND THE ANNUAL GENERAL MEETING IN PERSON AND REGARDLESS OF THE NUMBER OF SHARES YOU OWN, PLEASE REGISTER YOUR VOTE BY APPOINTING A PROXY ELECTRONICALLY BY INTERNET OR, FOR U.S. SHAREHOLDERS, BY TELEPHONE IN ACCORDANCE WITH THE INSTRUCTIONS ON THE FORM OF PROXY OR ALTERNATIVELY MARK, SIGN AND DATE THE FORM OF PROXY IN ACCORDANCE WITH THE INSTRUCTIONS THEREON AND MAIL IT PROMPTLY TO ENSURE THAT YOUR SHARES WILL BE REPRESENTED. YOU MAY VOTE IN PERSON IF YOU ATTEND THE ANNUAL GENERAL MEETING. YOUR PROXY IS REVOCABLE AT ANY TIME BY SENDING WRITTEN NOTICE OF REVOCATION OR BY SUBMISSION OF A PROPERLY EXECUTED PROXY BEARING A LATER DATE TO THE TRANSFER AGENT OR BY VOTING IN PERSON AT THE MEETING.

Table of Contents

SIGNET JEWELERS LIMITED

TABLE OF CONTENTS

Table of Contents

SIGNET JEWELERS LIMITED

2011 Annual General Meeting of Shareholders

Registered in Bermuda No. 42069

April 26, 2011

PROXY STATEMENT

For

Annual General Meeting of Shareholders

To Be Held On June 16, 2011

This Proxy Statement (the Proxy Statement) is being furnished to the holders of Common Shares, par value $0.18 per share (the Common Shares) of Signet Jewelers Limited (the Company or Signet), a company registered in Bermuda, in connection with the solicitation of proxies by and on behalf of the Board of Directors of the Company (the Board of Directors or the Board) for use at the Annual General Meeting of Shareholders to be held on Thursday June 16, 2011 at 11:00 a.m. EDT, at the Hilton Akron/Fairlawn, 3180 W. Market Street, Akron, Ohio, 44333, United States, and at any adjournments or postponements thereof (the Annual General Meeting or the Meeting). The purpose of the Annual General Meeting is to conduct the following items of business:

1. To vote on a proposal to amend the Company s Bye-laws to provide for the annual election of Directors in the manner contemplated in Appendix 1 to the Proxy Statement.

2. If proposal 1 is approved, to elect seven directors to the Company s Board of Directors to serve until the next Annual General Meeting of the Company or until their respective successors are elected in accordance with the amended Bye-laws of the Company.

3. If proposal 1 is not approved, to elect the four directors who will retire in accordance with the current Bye-laws of the Company and the three directors who will retire voluntarily.

4. To appoint KPMG LLP as independent auditor of the Company, to hold office from the conclusion of this Meeting until the conclusion of the next Annual General Meeting of the Company and to authorize the Audit Committee to determine its compensation.

5. To approve the Signet Jewelers Limited Annual Performance Bonus Plan.

6. To hold a non-binding, advisory vote to approve the compensation of our named executive officers as disclosed in the Proxy Statement (the Say-on-Pay vote).

7. To hold a non-binding, advisory vote on the frequency of the Say-on-Pay vote.

In addition we will consider the transaction of any other business properly brought at the Meeting or any adjournment or postponement thereof.

The Company s audited financial statements for Fiscal 2011 as approved by our Board will be presented at the Meeting.

Table of Contents

INFORMATION ABOUT ANNUAL GENERAL MEETING & PROXY VOTING

Electronic Delivery Of Proxy Materials

This year, the Company is again furnishing proxy materials to Shareholders electronically by internet. You will receive a Notice regarding the availability of Proxy Materials (Internet Notice) by mail or e-mail, and you will not receive a printed copy of the proxy materials, unless you specifically request one or have previously requested one. If you would like to receive a printed copy of our proxy materials, you should follow the instructions for requesting these materials included in the Internet Notice or by any of the following methods: by internet at www.signetjewelers.com/shareholders, by telephone 808-776-9962 for US Shareholders or 0871 664 0300 for UK Shareholders; or by sending an e-mail to info@amstock.com for US Shareholders or ssd@capitaregistrars.com for UK Shareholders with Proxy Materials Signet Jewelers Limited in the subject line. We plan to mail the Internet Notice to Shareholders on April 27, 2011.

Record Date and Quorum

We first made available the proxy solicitation materials on April 26, 2011 by filing them with the United States Securities and Exchange Commission (the SEC) and posting them on our website, www.signetjewelers.com. We expect to begin to mail the proxy solicitation materials to Shareholders who requested hard copies on April 27, 2011.

Each outstanding Common Share entitles the holder thereof as of the close of business on April 14, 2011 (the Record Date) to one vote on each matter to come before the Annual General Meeting. As of the Record Date, excluding treasury shares, there were 86,408,697 Common Shares outstanding. There are no other outstanding voting securities of the Company other than the Common Shares.

The presence at the Annual General Meeting in person or by proxy of two holders of Common Shares outstanding and entitled to vote will constitute a quorum for the transaction of business. Abstentions and broker non-votes are treated as present and entitled to vote, and therefore are counted in determining the existence of a quorum. A broker non-vote occurs when a nominee holding shares for a beneficial owner does not vote on a particular proposal because the nominee does not have discretionary voting power with respect to that item and has not received voting instructions from the beneficial owner with respect to such item. At the Annual General Meeting, the Group Company Secretary will determine whether or not a quorum is present.

Voting and Who May Vote

Voting on the matters to come before the meeting will be conducted by way of a poll. After each resolution has been introduced, Shareholders will have an opportunity to ask questions relating to the resolution. Voting on the specific resolution will be deferred to the end of the Meeting in order to simplify and aid the voting procedure other than Proposal 1 (Amendment of Bye-laws). The Company s transfer agent, American Stock Transfer & Trust Company, will explain and conduct the poll on each resolution, count the votes and certify the results. The final figures of the proxy votes cast for, against and in abstention from the resolutions will be filed with the SEC and the London Stock Exchange and will be published on the Company s website as soon as practicable, after the conclusion of the Meeting. Only Shareholders who were recorded in the register of Shareholders of the Company at the Record Date will be entitled to vote. Other than Shareholders, only proxies or corporate representatives are entitled to vote at the meeting. In order to do so, the proxy card must be signed by the Shareholder, or the proxy. Holders of depositary interests should see the paragraph headed Electronic Voting through CREST for Depositary Interest Holders below for details of the deadline to register their vote.

Table of Contents

Electronic Voting Instruction through CREST for Depositary Interest Holders

This method of voting instruction is only open to persons who hold interests in the Company s shares through depositary interests held in CREST outside the United States.

CREST Shareholders who wish to appoint Capita IRG Trustees (Nominees) Limited to vote on their behalf utilizing the CREST proxy voting service may do so for the Meeting and any adjournment(s) thereof by using the procedures described in the CREST manual. CREST personal Shareholders or other CREST sponsored Shareholders, and those CREST Shareholders who have appointed a voting service provider(s) should refer to their CREST sponsor or voting service provider(s), who will be able to take appropriate action on their behalf.

In order for a voting instruction made using the CREST service to be valid, the appropriate CREST message (a CREST Voting Instruction) must be properly authenticated in accordance with Euroclear UK & Ireland Limited s specifications and must contain the information required for such instructions as described in the CREST manual. The CREST message must, in order to be valid, be transmitted so as to be received by Capita Registrars (CREST participant ID RA 10) no later than **72** hours before the time appointed for the holding of the Meeting or adjourned Meeting. For this purpose, the time of receipt will be taken to be the time (as determined by the timestamp applied to the CREST message by the CREST Applications Host) from which the Company s agent is able to retrieve the CREST message by enquiry to CREST in the manner prescribed by CREST. After this time any change of voting instructions through CREST should be communicated through other means.

CREST Shareholders and, where applicable, their CREST sponsors or voting service provider(s), should note that Euroclear UK & Ireland Limited does not make available special procedures in CREST for any particular messages. Normal system timings and limitations will therefore apply in relation to the input of CREST Voting Instructions. It is the responsibility of the CREST member concerned to take (or, if the CREST member is a CREST personal member or sponsored member or has appointed a voting service provider(s), to procure that the CREST sponsor or voting service provider(s) take(s)) such action as shall be necessary to ensure that a CREST message is transmitted by means of the CREST system by any particular time. In this connection, CREST Shareholders and, where applicable, their CREST sponsors or voting service provider(s) is/are referred, in particular, to those sections of the CREST Manual concerning practical limitations of the CREST system timings which can be found at www.euroclear.com/site/public/EU.

The Company may treat as invalid a CREST Voting Instruction in the circumstances set out in Regulation 35(5)(a) of the Uncertificated Securities Regulations 2001.

Appointment of Proxies

A Shareholder entitled to attend and vote at the Meeting is entitled to appoint one or more proxies to attend, speak and vote on his behalf. A proxy may be appointed by returning a proxy card or by internet at www.signetjewelers.com, and, for US Shareholders, by telephone. For more information refer to the form of proxy card for instruction. A proxy need not be a Shareholder of the Company, but must attend the Meeting in person to represent the Shareholder. If a Shareholder appoints more than one proxy, each proxy must be appointed to exercise the rights attaching to different shares held by that Shareholder. If you do not nominate your own proxy, the Chairman of the Meeting will be appointed as your proxy.

To be valid, the form of proxy and any power of attorney or other authority under which it is signed must be received at the office of the Company s registrars/transfer agents, American Stock Transfer & Trust Company Operations Center, 6201 15th Avenue, Brooklyn, NY 11219 for US Shareholders, or Capita Registrars, The Registry, 34 Beckenham Road, Beckenham, Kent BR3 4TU for UK Shareholders, by 12:01 am EDT (5.01 am UK time) on June 16, 2011. Completing and returning a form of proxy will not prevent a Shareholder from attending and voting at the Meeting should he so wish. To change your proxy instructions you may return a new proxy appointment using the methods set out above. Where you have appointed a proxy using the form of proxy and would like to change the instructions using another form of proxy, please contact the Company s relevant registrars. Where two or more valid separate appointments of proxy are received in respect of the same share in respect of the same Meeting, the one which is last sent will be treated as replacing and revoking the other or others.

Proxies

If you submit your proxy by mail, please ensure that the form of proxy is properly completed signed, dated and returned to the Company as directed by 12:01 am EDT (5.01 am UK time) on June 16, 2011, which is approximately 11 hours before the start of the meeting. The individual(s) identified as proxies thereon will vote the shares represented by the form of proxy in accordance with the directions noted thereon. Alternatively, you can appoint a proxy to cast your vote electronically by internet or, if you are a US Shareholder, by telephone as set out in the Internet Notice. If you do not indicate how your shares should be voted on a matter, the shares represented by your properly completed form of proxy, in which no named proxy is appointed, will be voted as the Board of Directors recommends. The Company s management does not know of any matters other than those discussed in this Proxy Statement that will be presented at the Annual General Meeting. If, however, other matters are presented, all proxies, in which no named proxy is appointed, will be voted in accordance with the recommendations of the Board of Directors.

Returning your completed proxy card or appointing a proxy electronically by the internet or by telephone will not prevent you from voting in person at the Annual General Meeting if you are able to attend and wish to vote.

Revocation of Proxy

You may revoke your proxy at any time before it is voted by sending written notice of revocation, or by submission of a properly executed form of proxy bearing a later date to the Company s Registrars/transfer agents prior to the Annual General Meeting at: American Stock Transfer & Trust Company Operations Center, 6201 15th Avenue, Brooklyn, NY 11219 for US Shareholders or Capita Registrars, The Registry, 34 Beckenham Road, Beckenham, Kent, BR3 4TU for UK Shareholders or by attending the Annual General Meeting and giving notice of revocation in person.

Required Votes

***Proposal One (Proposal to Amend the Company s Bye-laws)*:** Certain Bye-laws of the Company (including those relating to election of directors) cannot be rescinded, altered or amended without the affirmative vote of the holders of at least 75% of the outstanding Common Shares represented in person or by proxy. Abstentions and broker non-votes are not counted as votes cast for the purpose of amending the Bye-laws, and accordingly will have the effect of a no vote. In accordance with the New York Stock Exchange (NYSE) rules, brokers will be able to vote shares with respect to the amendment of the Bye-laws without instructions from the underlying Shareholders.

***Proposal Two (Election of Seven Directors if Proposal 1 is Approved)*:** The election of Directors is decided by the affirmative vote of a majority of the votes cast by the holders of Common Shares represented in person or by proxy at the Annual General Meeting entitled to vote in the election. Abstentions and broker non-votes are not counted as votes cast for the purpose of electing Directors. Accordingly, abstentions and broker non-votes will not be taken into account and, therefore, will not affect the outcome of the election of Directors. In accordance with the NYSE rules, brokers will not be able to vote shares with respect to the election of Directors without instructions from the underlying Shareholders.

***Proposal Three (Election of Seven Directors if Proposal 1 is Not Approved)*:** The election of Directors is decided by the affirmative vote of a majority of the votes cast by the holders of Common Shares represented in person or represented by proxy at the Annual General Meeting entitled to vote in the election. Abstentions and broker non-votes are not counted as votes cast for the purpose of electing Directors. Accordingly, abstentions and broker non-votes will not be taken into account and, therefore, will not affect the outcome of the election of Directors. In accordance with the NYSE rules, brokers will not be able to vote shares with respect to the election of directors without instructions from the underlying Shareholders.

***Proposal Four (Appointment of KPMG LLP, Independent Registered Public Accounting Firm as Auditor)*:** The affirmative vote of a majority of the votes cast by the holders of Common Shares represented in person or by proxy at the Annual General Meeting and entitled to vote on this proposal is required to appoint KPMG LLP as the Company s independent registered public accounting firm as auditor to the Company until the end of the next Annual General Meeting of the Company and to authorize the Audit Committee to determine its compensation. Abstentions and broker non-votes are not counted as votes cast for the purpose of the appointment of KPMG LLP. Accordingly, abstentions and broker non-votes will not be taken into account and, therefore, will not affect the outcome of the appointment of the Company s independent registered public accounting firm. In accordance with NYSE rules, brokers will be able to vote shares with respect to the appointment of the Company s independent registered public accounting firm without instructions from the underlying Shareholders.

***Proposal Five (Approval of the Signet Jewelers Limited Annual Performance Bonus Plan)*:** The affirmative vote of a majority of the votes cast by the holders of Common Shares represented in person or by proxy at the Annual General Meeting and entitled to vote on this proposal is required to approve the Signet Jewelers Limited Annual Performance Bonus Plan. Abstentions and broker non-votes are not counted as votes cast for the purpose of the approval. Accordingly, abstentions and broker non-votes will not be taken into account and, therefore, will not affect the outcome of the approval of the bonus plan. In accordance with NYSE rules, brokers will not be able to vote shares with respect to the bonus plan without instruction from the underlying Shareholders.

***Proposal Six (Advisory Vote to Approve the Compensation of Named Executive Officers as Disclosed in the Proxy Statement)*:** The affirmative vote of a majority of the votes cast by the holders of Common Shares represented in person or by proxy at the Annual General Meeting and entitled to vote on this proposal is required to approve, on a non-binding, advisory basis, the compensation of the named executive officers as disclosed in the Proxy Statement. The Say-on-Pay vote is advisory, and therefore not binding on the Company, the Compensation Committee or our Board of Directors. Abstentions and broker non-votes are not counted as votes cast for the purpose of the advisory vote. Accordingly, abstentions and broker non-votes will not be taken into account and, therefore, will not affect the outcome of the advisory vote. In accordance with NYSE rules, brokers will not be able to vote shares with respect to the Say-on-Pay advisory vote without instruction from the underlying Shareholders.

***Proposal Seven (Advisory Vote on the Frequency of the Say-on-Pay Vote)*:** The option of one year, two years or three years that receives the highest number of votes cast by the holders of Common Shares represented in person or by proxy at the Annual General Meeting and entitled to vote on this proposal will be the frequency for the advisory vote on executive compensation that has been selected by Shareholders. However, because this vote is advisory and not binding on the Board of Directors or the Company in any way, the Board may decide that it is in the best interests of our Shareholders and the Company to hold an advisory vote on executive compensation more or less frequently than the option approved by our Shareholders. Abstentions and broker non-votes are not counted as votes cast for the purpose of the advisory vote. Accordingly, abstentions and broker non-votes will not be taken into account and, therefore, will not affect the outcome of the advisory vote. In accordance with NYSE rules, brokers will not be able to vote shares with respect to the frequency vote without instruction from the underlying Shareholders.

Other Matters

Shareholder Proposals for Inclusion in the Proxy Statement for the 2012

Annual General Meeting

Shareholder proposals submitted pursuant to Rule 14a-8 under the Exchange Act will be considered for inclusion in the Company s 2012 Proxy Statement and proxy card for the 2012 Annual General Meeting if the proposal is received in writing by the Group Company Secretary by no later than December 28, 2011. The notice of proposal must comply with the requirements established by the SEC, and must include the information specified in Bye-law 26 of the Company s Bye-laws and must be a proper subject for Shareholder action under Bermuda law. A copy of the Company s Bye-Laws may be found on the Company s website, www.signetjewelers.com.

Notice of business to be brought at the 2012 Annual General Meeting submitted pursuant to Bye-law 26 of the Company s Bye-laws must be received in writing by the Group Company Secretary between February 17 and March 18, 2012. Bye-law 26 of the Company s Bye-laws sets forth the procedures (including, without limitation, advance notice requirements disclosed above) a Shareholder must follow to request that an item be put on the agenda of a general meeting of Shareholders.

Additionally, under Bermuda law, Shareholders holding not less than five percent of the total voting rights or 100 or more Shareholders together may require us to give notice to our Shareholders of a proposal to be submitted at an annual general meeting. Generally, notice of such a proposal must be received not less than six weeks before the date of the meeting and must otherwise comply with the requirements of Bermuda law.

Proposals should be sent to the Company at Clarendon House, 2 Church Street, Hamilton HM11 Bermuda, addressed to the attention of Mark A. Jenkins, Group Company Secretary.

Householding

Exchange Act rules allow the Company to deliver a single Internet Notice (or proxy materials and Annual Report on Form 10-K in the case of Shareholders who receive paper copies of proxy materials) to an address shared by two or more of our Shareholders. This delivery method, referred to as householding, can result in significant cost savings for the Company. In order to take advantage of this opportunity, the Company and the banks and brokerage firms that hold your shares have delivered only one Internet Notice (or proxy materials and Annual Report on Form 10-K in the case of Shareholders who receive paper copies) to multiple Shareholders who share an address unless one or more of the Shareholders has provided contrary instructions. The Company will deliver promptly, upon written or oral request, a separate copy of the Internet Notice (or, proxy materials and Annual Report on Form 10-K in the case of Shareholders who receive paper copies), to a Shareholder at a shared address to which a single copy of the document was delivered. A Shareholder who wishes to receive a separate copy of the Internet Notice (or proxy materials and Annual Report on Form 10-K in the case of Shareholders who receive paper copies), now or in the future, may obtain one, promptly and without charge, by addressing a request to, Signet Jewelers Limited c/o Signet Group Services Limited 15, Golden Square, London, W1F 9JG or by calling +44 (0) 20 7317 9700. You may also download a copy of each of these documents from the Company s website www.signetjewelers.com. Shareholders of record sharing an address who are receiving multiple copies of these materials and wish to receive a single copy of such materials in the future should submit their request by contacting us in the same manner.

If you are the beneficial owner, but not the record holder, of Common Shares and wish to receive only one copy of these materials in the future, you will need to contact your broker, bank or other nominee to request that only a single copy of each document be mailed to all Shareholders at the shared address in the future.

Table of Contents

Solicitation of Proxies

The Company will bear the cost of the solicitation of proxies. The Company has instructed the firm of Innisfree M&A Incorporated to assist in the solicitation of proxies on behalf of the Board. Innisfree M&A Incorporated has agreed to perform this service for a fee of not more than $10,000, plus any out of pocket expenses. In addition, solicitation may occur by internet, by mail and/or by telephone. The Company will request banks, brokers and the custodian nominees and fiduciaries to supply proxy materials to the beneficial owners of the Company s Common Shares of whom they have knowledge, and will reimburse them for their expenses in so doing. Certain Directors, officers and other employees of the Company, not specially employed for the purpose, may solicit proxies, without additional remuneration, by personal interview, mail, telephone, fax or email.

Table of Contents

OWNERSHIP OF THE COMPANY

Except to the extent noted below, each director, named executive officer or entity has sole voting and investment power over the Common Shares reported.

Shareholders Who Beneficially Own At Least Five Percent

of the Common Shares

The following table shows all persons who were known to us to be beneficial owners (determined in accordance with Rule 13d-3 of the Exchange Act) of at least five percent of the Common Shares as of April 14, 2011. This table is based upon reports filed with the SEC. Copies of these reports are publicly available from the SEC on its website, www.sec.gov.

Name and address of beneficial holder	% of Class	Number of shares	Nature of holding
Group consisting of Artisan Partners Holdings LP, Artisan Investment Corporation, Artisan Partners Limited Partnership, Artisan Investments GP LLC, ZFIC, Inc., Andrew A. Ziegler and Carlene M. Ziegler 875 East Wisconsin Avenue Suite 800 Milwaukee WI 53202 USA	11.6	9,981,234	(1)
Sprucegrove Investment Management Ltd 181 University Avenue Suite 1300 Toronto Ontario Canada M5H 3M7	6.81	5,842,374	(2)
Select Equity Group, Select Offshore Advisors, LLC and George S. Loening 380 Lafayette Street, 6th Floor New York, NY 10003 USA	5.90	5,061,695	(3)

Investec Asset Management Limited 2 Gresham Street London EC2V 7QP England	5.86	5,028,945	(4)
FMR LLC 82 Devonshire Street Boston MA 02109 USA	5.86	5,023,062	(5)
Harris Associates L.P. Two North LaSalle Street Suite 500 Chicago IL 60602 3790 USA	5.28	4,527,040	(6)

Table of Contents

None of the Company s Common Shares entitle the holder to any preferential voting rights.

(1) Based upon a Schedule 13G filed on February 10, 2011, by Artisan Partners Holdings LP, Artisan Investment Corporation, Artisan Partners Limited Partnership, Artisan Investments GP LLC, ZFIC, Inc., Andrew A. Ziegler and Carlene M. Ziegler (together, Artisan), the 9,981,234 shares reported in Artisan s Schedule 13G have been acquired on behalf of discretionary clients of Artisan Partners Limited Partnership and Artisan Partners Holdings LP, including 9,163,359 shares over which there is shared voting power and 9,981,234 shares over which there is shared dispositive power.

(2) Based upon a Schedule 13G filed on February 2, 2011, Sprucegrove Investment Management Ltd may be deemed to be the beneficial owner of 5,842,374 shares, including 321,617 shares over which there is shared voting power.

(3) Based upon a Schedule 13G filed on February 15, 2011, Select Equity Group, Inc. (Select) may be deemed to be the beneficial owner of 3,961,733 shares, and Select Offshore Advisors, LLC (Select Offshore) may be deemed to be the beneficial owner of 1,099,962 shares. As the Chairman and controlling Shareholder of Select and the Manager of Select Offshore, George S. Loening has the power to vote or to direct the voting of and the power to dispose or direct the disposition of the securities owned by Select and Select Offshore. Accordingly, George S. Loening may also be deemed to be the beneficial owner of those securities.

(4) Based upon a Schedule 13G filed on February 10, 2011, Investec Asset Management Limited, in its capacity as discretionary investment adviser to its various clients, may be deemed to be the beneficial owner of 5,028,945 shares owned by such clients or for such clients benefit.

(5) Based upon a Schedule 13G filed on February 14, 2011, FMR LLC may be deemed to be the beneficial owner of 5,023,062 shares owned by various persons, who have the right to receive or the power to direct the receipt of dividends from, or the proceeds from the sale of shares.

(6) Based upon a Schedule 13G filed on January 7, 2011, by reason of advisory and other relationships with the person who owns the shares, Harris Associates L.P. may be deemed to be the beneficial owner of 4,527,040 shares.

Ownership by Directors, Director Nominees and Executive Officers

The following table shows the number of Common Shares of the Company beneficially owned (determined in accordance with Rule 13d-3 of the Exchange Act) as of April 14, 2011 by each current Director, each executive officer named in the Summary Compensation Table, and all of the Company s executive officers and Directors as a group:

Name of beneficial owner	Common Shares[1]	Shares that may be acquired upon exercise of options within 60 days[2]	Total[3]
Sir Malcolm Williamson[4]	17,459		17,459
Michael W. Barnes[4][5][6]	66,329		66,329
Robert Blanchard[4]	10,359		10,359
Walker Boyd[7]	5,000	43,922	48,922
Terry Burman[8]	1,851	156,463	158,314
Dale Hilpert[4]	10,859		10,859

Marianne Parrs(4)	9,859		9,859
Thomas Plaskett(4)	7,864		7,864
Ronald Ristau(5)(9)			
Russell Walls(4)	7,251		7,251
Mark Light(5)(9)	20,530	84,684	105,214
William Montalto(5)(9)	10,000	57,883	67,883
Robert Anderson(5)(9)	1,114	43,847	44,961
All Executive Officers and Directors as a group (16 persons)	169,287	486,484	655,771

Table of Contents

(1) No shares are pledged as security and all are owned directly.
(2) Shares issuable upon the exercise of vested stock options.
(3) All holdings represent less than 1% of the class outstanding.
(4) Director.
(5) Executive officer.
(6) Did not serve as an executive officer during Fiscal 2011.
(7) Former director and executive officer.
(8) Director and Chief Executive Officer.
(9) Does not include restricted stock subject to time-based vesting under the Company s Omnibus Incentive Plan.

See Compensation Discussion and Analysis below for a discussion of the Company s Common Share ownership policy.

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Exchange Act requires the Company s Directors, executive officers and persons who beneficially own more than 10% of a registered class of our equity securities to file with the SEC reports of ownership and changes in ownership. Based solely upon a review of the copies of the forms furnished to us and written representations from our executive officers, Directors and greater than 10% Shareholders, we believe that during Fiscal 2011, all persons subject to the reporting requirements of Section 16(a) filed the required reports on a timely basis.

PROPOSALS FOR THE ANNUAL GENERAL MEETING

PROPOSAL ONE

(Item 1 on the Proxy Card)

Amendment of the Bye-laws of the Company

On February 23, 2011, the Board of Directors voted to approve and to recommend to the Company s Shareholders that they approve a proposal to amend the Company s current Bye-laws to eliminate the requirement for one-third of the Directors or if their number is not three or a multiple of three, the number nearest to one-third to retire at every annual general meeting and to provide instead for the annual election of directors effective at the Annual General Meeting. If approved, the Shareholders will be asked to elect seven directors at the Annual General Meeting, each of whom will serve until the next annual general meeting of the Company or until his or her successor is duly elected (see Proposal 2). Because our board of directors is committed to strong and effective corporate governance, in the event that Proposal 1 is not approved, each of the seven members of the Board intends to resign from the Board and offer himself or herself for election to the Board (see Proposal 3). In such case, four directors will retire in accordance with the current Bye-laws of the Company and three directors will retire voluntarily.

Background of Proposal

This proposal is the result of an ongoing review of corporate governance matters by the Board. The Board, assisted by the Nomination and Corporate Governance Committee, considered the advantages and disadvantages of maintaining the current board structures (where approximately one-third of the Directors retire at every annual general meeting). The Board believes that the current board structure reduces accountability of directors to Shareholders as the structure limits the ability of Shareholders to evaluate and elect all directors on an annual basis. The election of directors is the primary means for Shareholders to influence corporate governance and annual election of the entire board of directors is in line with best corporate governance standards in the US and UK.

Table of Contents

Text of Amendments

Paragraphs 40, 41 and 79 of the Company s Bye-laws contain the provisions that will be affected if this proposal is adopted. Appendix 1 to this Proxy Statement shows the proposed changes.

THE BOARD OF DIRECTORS RECOMMENDS THAT SHAREHOLDERS VOTE **FOR** THE AMENDMENT TO THE COMPANY S BYE-LAWS

PROPOSAL TWO

(Item 2 on the Proxy Card)

Election of Seven Directors if Proposal 1 is Approved

If our Shareholders approve Proposal 1 at the Annual General Meeting, our Shareholders will be asked to consider seven nominees for election to our Board of Directors to serve until the next annual general meeting of the Company or until their successors are duly elected. If our Shareholders do not approve Proposal 1, this Proposal 2 will not be submitted to a vote of our Shareholders at the Annual General Meeting, and instead Proposal 3 (Election of Seven Directors if Proposal 1 is Not Approved) will be submitted in its place. If Proposal 1 is approved, the amended Bye-laws of the Company will provide that at every Annual General Meeting, each member of the Board of Directors shall retire from office. This will commence with the 2011 Annual General Meeting. Biographical details for each of our current Directors, all of whom stand for election with the endorsement of the Board and the Nominating and Corporate Governance Committee, is set out below under NOMINEES FOR DIRECTORS.

PROPOSAL THREE

(Item 3 on the Proxy Card)

Election of Seven Directors if Proposal 1 is Not Approved

The Bye-laws of the Company currently specify that at every Annual General Meeting, a total of one-third of the Directors, or the nearest number to one-third, shall retire from office, as shall any Director who was not elected to the Board by Shareholders. If the Shareholders do not approve Proposal 1, each of the seven members of the Board intends to resign from the Board and offer himself or herself for election. Sir Malcolm Williamson, Dale Hilpert and Russell Walls will retire from the Board having been appointed in 2008, and offer themselves for election in accordance with the current Bye-laws of the Company. Michael W. Barnes, having been appointed to the Board since the last Annual General Meeting, will also retire in accordance with the Bye-laws and offer himself for election. Robert Blanchard, Marianne Parrs and Thomas Plaskett will voluntarily retire from the Board and also offer themselves for election.

Each of our current Directors, whose biographical details are set forth below under NOMINEES FOR DIRECTORS , offers himself or herself for election with the endorsement of the Board and the Nomination and Corporate Governance Committee.

NOMINEES FOR DIRECTORS

Set forth below is biographical information concerning each of our nominees for Director of the Company. (An asterisk connotates an Independent Director who satisfies the definitions of independence and has been affirmed by the Board as being independent in accordance with NYSE Listing Standards.)

Table of Contents

Sir Malcolm Williamson*, 72, Chairman of the Board, appointed a director of the Company in 2005 and Chairman since June 2006. He was President and Chief Executive Officer of Visa International between 1998 and 2004 before which he was Group Chief Executive of Standard Chartered PLC from 1993 to 1998. He is Chairman of National Australia Group Europe Limited and Youth Business International Advisory Board. He is also Chairman of Friends Provident Holdings (UK) Plc, a non-executive director of National Australia Bank Limited and Friends Provident Group plc, a member of the Board of Trustees for The Prince of Wales International Business Leaders Forum and Chairman of the Cass Business School Strategy & Development Board. He was, until May 2008, a Director and Deputy Chairman of Resolution Plc, and until May 2008 and January 2010, respectively, a non-executive director of G4S PLC and of JP Morgan Cazenove Holdings. He was also Chairman of CDC Group plc until January 2010. Sir Malcolm joined the Board with a view to becoming Chairman. It was on the basis of his proven leadership skills and ability to take on the responsibility of Chairman of the Board that he was invited to do so, together with his previous Board and banking experience, which was a specialization that the Board did not have and one which was considered to be a benefit. The Board has concluded that Sir Malcolm should continue to serve on the Board for these reasons.

Robert Blanchard*, 66, Director, appointed to the Board of the Company in 2000. He was a Group Vice President of Procter & Gamble and President of its Global Skin Care and Cosmetics business until his retirement in 1999. He was an independent Director of Bandag Inc. and Best Buy Co. Inc. until May 2006 and June 2005, respectively. Mr. Blanchard was invited to join the Board as both his general management skills together with his marketing specialization were attributes the Board felt would add to the effectiveness of the Board. The Board has concluded that Mr. Blanchard should continue to serve on the Board for these reasons.

Dale W. Hilpert*, 68, Director, appointed to the Board of the Company in 2003. Mr. Hilpert has served on the Board of Ann Taylor Stores Corporation since 2004. He was Chief Executive of Williams-Sonoma, Inc. from April 2001 until his retirement in January 2003. Prior to this he was Chairman and Chief Executive of Foot Locker, Inc. which he joined as President and Chief Operating Officer in 1995. Mr. Hilpert was asked to join the Board in order that it might benefit from his general management and retail specific skills. The Board has concluded that Mr. Hilpert should continue to serve on the Board for these reasons.

Marianne Miller Parrs*, 67, Director, appointed to the Board in October 2008. Ms. Parrs has served on the boards of Stanley Black & Decker, Inc. (previously The Stanley Works Inc.), and CIT Group Inc. as an independent director since April 2008 and 2003 respectively. In addition, Ms. Parrs serves on the board of United Way of the Mid-South. Ms. Parrs retired in 2007 as Executive Vice President and Chief Financial Officer of International Paper Company where she had been since joining in 1974 as a Pension Trust Investment Manager and holding a number of positions before first being appointed Senior Vice President and Chief Financial Officer in 1995. She held this position until 1999 when she was appointed Executive Vice President with responsibility for Information Technology, Global Sourcing, Global Supply Chain and Investor Relations. She held this role for six years and she was also reappointed Chief Financial Officer in 2005. Previously Ms. Parrs was a Security Analyst at a number of firms including Merrill Lynch. The Board considered it necessary to recruit to the Board a director with substantial US financial reporting experience. The Board has concluded that Ms. Parrs should continue to serve on the Board for these reasons.

Thomas G. Plaskett*, 67, Director, appointed to the Board in October 2008. Since 1991 Mr. Plaskett has been Chairman of Fox Run Capital Associates, a private consulting firm focusing on financial advisory and corporate governance services for emerging companies. From 1999 until 2000 he served as the Chairman, President and Chief Executive Officer of Probex Corp, an energy technology company. He also served as Vice Chairman of Legend Airlines, from 1997 until 2001. Mr. Plaskett served as Interim President, Chief Executive Officer, and Acting Chief Financial Officer of Greyhound Lines for two years before becoming Chairman from 1995 until 1999, when the company was sold. Previously, he was Chairman, President and Chief Executive Officer of Pan Am Corporation from 1988 until 1991. Prior to that, Mr. Plaskett was President and Chief Executive Officer of Continental Airlines from 1986 to 1987. Mr. Plaskett also held several senior management positions at American Airlines and AMR Company between 1974 and 1986. Mr. Plaskett currently serves as a director of Alcon

Table of Contents

Laboratories, Inc. and Radioshack Corporation and was a director of Novell Corporation until April 2010. Mr. Plaskett joined the Board as his considerable general management skills were considered to be an enhancement to the overall efficiency and effectiveness of the Board. The Board has concluded that Mr. Plaskett should continue to serve on the Board for these reasons.

Russell Walls*, 67, Director, appointed to the Board of the Company in 2002. He was Group Finance Director of BAA plc until his retirement in August 2002 and was the senior independent director of Hilton Group plc until May 2003 and Stagecoach Group plc until August 2006. Mr. Walls is a non-executive director of Aviva plc, is Treasurer of the British Red Cross Society and was a non-executive director of Delphic Diagnostics Limited until January 2010. He is a Fellow of the Association of Chartered Certified Accountants. Mr. Walls has considerable experience as a financial manager and as such has developed a financial expertise considered to be of significant benefit to the efficiency and effectiveness of the Board. The Board has concluded that Mr. Walls should continue to serve on the Board for these reasons.

Michael W. Barnes, 50, Chief Executive Officer and Director, was appointed to the Board in January 2011. Mr. Barnes joined the Company as Chief Executive Officer Designate on December 1, 2010, and succeeded Mr. Burman as Chief Executive Officer and Director upon Mr. Burman s retirement on January 29, 2011. Prior to joining the Company, Mr. Barnes was President, Chief Operating Officer and a director of Fossil, Inc., having served in those and other executive capacities at Fossil since 1985, and as a director of Fossil since it became a public company in 1993. Mr. Barnes has diverse functional expertise, a broad retail skill set and substantial leadership experience, with responsibilities ranging from overseeing Fossil s state-of-the-art international sourcing and supply chain operations to leading business development and managing the relationships with many of Fossil s current retail and licensing/brand partners. The Board has concluded that Mr. Barnes should continue to serve on the Board for these reasons.

No Director is or was the subject of legal proceedings that are required to be disclosed pursuant to SEC rules.

THE BOARD OF DIRECTORS RECOMMENDS A VOTE FOR THE ABOVE NAMED NOMINEES **FOR** ELECTION AS DIRECTORS.

PROPOSAL FOUR

(Item 4 on the Proxy Card)

Appointment of Independent Registered Public Accounting Firm

Proposal 4 is to appoint KPMG LLP as independent auditor to the Company until the end of the next Annual General Meeting and to authorize the Audit Committee of the Board to determine its compensation.

Change in Independent Registered Public Accounting Firm

KPMG Audit Plc, the UK member firm of KPMG International (KPMG UK), has served as the Company s long standing independent registered public accounting firm and auditor. In view of the fact that the Company s accounting function will relocate from the UK to the US during Fiscal 2012, the Audit Committee believes a change from KPMG UK to KPMG LLP, the U.S. member firm of KPMG International (KPMG US), is appropriate.

The Audit Committee has selected KPMG US as the independent registered public accounting firm to audit the Company s financial statements and effectiveness of internal control over financial reporting of the Company until the end of the next Annual General Meeting in 2012. While the Shareholders are required to appoint the independent auditor pursuant to Bermuda law, the Audit Committee is responsible for recommending which independent auditors should be appointed.

Table of Contents

On March 28, 2011, the Audit Committee, in consultation with KPMG UK has determined to terminate the engagement of KPMG UK, effective May 1, 2011 and to appoint KPMG US as independent registered public auditor on an interim basis effective on the same date. If the Audit Committee s selection of KPMG US is approved by Shareholders at the Annual General Meeting, KPMG US will be engaged until the conclusion of the next Annual General Meeting as the Company s independent registered public accounting firm as of the day of the Annual General Meeting.

We have been advised by KPMG UK that KPMG UK (being the auditors of the Company for Fiscal 2011) have appointed Adam Wieder of KPMG US as their authorized representative to attend, speak and respond to appropriate questions (as the case may be) on behalf of KPMG UK at the Annual General Meeting and at any adjournment of the Meeting.

The audit reports of KPMG UK on the Company s consolidated financial statements as of and for Fiscal 2010 and Fiscal 2011 did not contain any adverse opinion or disclaimer of opinion, and were not qualified or modified as to uncertainty, audit scope, or accounting principles. The audit reports of KPMG UK on the effectiveness of internal control over financial reporting as of January 30, 2010 and January 29, 2011 did not contain any adverse opinion or disclaimer of opinion, and were not qualified or modified as to uncertainty, audit scope, or accounting principles. During Fiscal 2010 and Fiscal 2011, and the subsequent interim period through the date of the Audit Committee s determination to transfer accounting responsibilities from KPMG UK to KPMG US, (1) there were no disagreements within the meaning set forth in Item 304(a)(1)(iv) of Regulation S-K between the Company and KPMG UK on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure, which disagreements, if not resolved to the satisfaction of KPMG UK, would have caused KPMG UK to make reference to the subject matter of the disagreements in connection with its reports on the consolidated financial statements of the Company, and (2) there were no reportable events involving the Company within the meaning set forth in Item 304(a)(1)(v) of Regulation S-K.

Other than consultations during the normal course of the client auditor relationship described above, the Company has not, nor has anyone on its behalf, consulted KPMG US during Fiscal 2010 and Fiscal 2011 and the subsequent interim period through the date of the Audit Committee s nomination of KPMG US regarding either (1) the application of accounting principles to a specific transaction, either completed or proposed, or the type of audit opinion that might be rendered on the consolidated financial statements of the Company, or (2) any matter that was either the subject of a disagreement within the meaning set forth in Item 304(a)(1)(iv) of Regulation S-K or a reportable event as described in the preceding paragraph. Further, no written report or oral advice was provided by KPMG US to the Company that KPMG US concluded was an important factor considered by the Company in reaching a decision as to any accounting, auditing or financial reporting issue.

The Company provided KPMG UK and KPMG US with a copy of the foregoing disclosure and each has stated in response that it agrees with such disclosure in all respects.

Fees and Services of KPMG

The Audit Committee has adopted a policy requiring advance approval of the Company s independent registered public accounting firm s fees and services by the Audit Committee (subject to a de minimis amount). The Audit Committee reviews all approved services and fees at subsequent meetings. This policy also prohibits the Company s independent registered public accounting firm from performing certain non-audit services for the Company including: (i) bookkeeping, (ii) systems design and implementation, (iii) appraisal or valuation, (iv) actuarial, (v) internal audit, (vi) management or human resources, (vii) investment advice or investment banking, (viii) legal services, and (ix) expert services unrelated to the audit. All fees paid to KPMG UK by the Company as shown in the table that follows were approved by the Audit Committee pursuant to this policy.

Table of Contents

The following table presents fees for professional audit services rendered by KPMG UK for the audit of the Company s consolidated financial statements and the effectiveness of internal control over financial reporting for Fiscal 2011, Fiscal 2010[(1)] and for its reviews of the Company s unaudited condensed consolidated interim financial statements. This table also reflects fees for other services rendered by KPMG UK.

	Fiscal 2011 $million	Fiscal 2010 $million
Audit Fees	**1.2**	1.2
Audit-related Fees[(2)]	**0.5**	0.3
Total Fees	**1.7**	1.5

THE BOARD OF DIRECTORS RECOMMENDS A VOTE **FOR** THIS PROPOSAL.

(1) Fiscal 2010 is the fiscal year ended January 30, 2010.

(2) During Fiscal 2011 and Fiscal 2010, audit related fees consisted principally of assurance and audit related services that are reasonably related to the performance of the audit or review of financial statements.

Table of Contents

PROPOSAL FIVE

(Item 5 on the Proxy Card)

Approval of the Signet Jewelers Limited Annual Performance Bonus Plan

Proposal 5 is to ratify and approve the adoption of the Signet Jewelers Limited Annual Performance Bonus Plan.

The Board of Directors has adopted the Signet Jewelers Limited Annual Performance Bonus Plan (the Bonus Plan), subject to Shareholder approval. The Bonus Plan is designed to provide performance based cash incentive awards to employees in order to attract, motivate, maintain and reward employees who have outstanding skills and abilities and who achieve superior performance. Under the terms of the Bonus Plan, a cash incentive compensation award may be paid to a participant upon satisfaction of specified performance goals for a particular performance period (as described below).

Description of the Bonus Plan

The following is a summary of the material features of the Plan. The following summary does not purport to be complete and is qualified in its entirety by reference to the terms of the Plan, which are attached to this Proxy Statement as Appendix 2.

Purpose of Plan. The purpose of the Bonus Plan is to motivate and reward employees of the Company by providing for annual incentive bonuses if pre-established annual performance goals are achieved. The Bonus Plan is also intended to qualify as a performance-based compensation plan under Section 162(m) of the United States Internal Revenue Code of 1986, as amended (the **Code**).

Administration

The Bonus Plan shall be administered by the compensation committee (the **Committee**), each of whose members will be an outside director for purposes of Section 162(m) of the Code. The Committee has the authority (a) to select the employees eligible to participate in the Bonus Plan; (b) to establish and administer the Performance Goals (defined below) and bonus opportunities applicable to each participant and to certify whether the goals have been attained; (c) to construe and interpret the Bonus Plan and any agreement or instrument entered into under or in connection with the Bonus Plan; and (d) to make all other determinations that may be necessary or advisable for the administration of the Bonus Plan. Any determination by the Committee pursuant to the Bonus Plan shall be final and binding upon the participants, the Company, and all other interested individuals.

Eligibility

Eligibility to participate in the Bonus Plan shall be limited to employees of the Company who qualify as covered employees within the meaning of Code Section 162(m)(4) and United States Treasury Regulation § 1.162-27(c)(2) and such other employees, as determined by the Committee in its discretion. The Committee, in its discretion, shall designate in writing those eligible employees of the Company who shall participate in the Bonus Plan (each, a **Participant**) for any fiscal year or other period selected by the Committee no later than the applicable deadline (the **Determination Date**) for the establishment of Performance Goals (as defined below) under United States Treasury Regulation § 1.162-27(e). Designation as a Participant shall be conclusive for the fiscal year or period to which the designation applies whether or not such employee is deemed a covered employee (within the meaning of Code Section 162(m)) in respect of such period. Designation as a Participant for any fiscal year or period shall not entitle an employee to participate in the Bonus Plan for any other fiscal year or period.

Performance Goals

Establishment of Performance Goals. A Participant s bonus shall be determined based on the attainment of written performance goals (the **Performance Goals**) established by the Committee as of the beginning of

Table of Contents

each of the Company s fiscal years or other accounting periods selected by the Committee (**Performance Periods**). The Performance Goals shall be established (a) while the outcome for the Performance Period is substantially uncertain and (b) no later than ninety (90) days after the commencement of the Performance Period to which the Performance Goal relates (or, if the Performance Period is less than one (1) year, no later than the number of days which is equal to twenty-five percent (25%) of such Performance Period). The Performance Goals need not be the same for all Participants.

Performance Measures. Performance Goals shall be based on any of the following business criteria (the Performance Measures), either alone or in any combination, on either a consolidated or business unit or divisional level, as the Committee may determine: (a) consolidated earnings before or after taxes (including earnings before interest, taxes, depreciation and amortization); (b) net income; (c) operating income; (d) earnings per Share; (e) book value per Share; (f) return on Shareholders equity; (g) expense management; (h) return on investment; (i) improvements in capital structure; (j) profitability of an identifiable business unit or product; (k) maintenance or improvement of profit margins; (l) stock price; (m) market share; (n) revenues or sales; (o) costs; (p) cash flow; (q) working capital; (r) return on assets, (s) store openings or refurbishment plans, (t) staff training, and (u) corporate social responsibility policy implementation.

Any Performance Measure may be (i) used to measure the performance of the Company as a whole, any business unit thereof or any combination thereof against any goal including past performance or (ii) compared to the performance of a group of comparable companies, or a published or special index, in each case that the Committee, in its sole discretion, deems appropriate. Subject to Section 162(m) of the Code, the Committee may adjust the Performance Goals (including to pro-rate goals and payments for a partial Performance Period) in the event of the following occurrences and may include such adjustments when setting a Performance Goal: (i) non-recurring events, including divestitures, spin-offs, or changes in accounting standards or policies; (ii) mergers and acquisitions; and (iii) financing transactions, including selling accounts receivable.

Bonus Opportunity

No later than the Determination Date for each Performance Period, the Committee shall establish, in writing, the method for computing the amount of compensation that will be payable under the Bonus Plan to each Participant if the Performance Goals established by the Committee for such Performance Period are attained in whole or in part. Such method shall be stated in terms of an objective formula that precludes discretion to increase the amount of the bonus that would otherwise be payable under the Bonus Plan. The method need not be the same for all Participants. Notwithstanding anything to the contrary contained herein, the Committee may exercise negative discretion (within the meaning of United States Treasury Regulation § 1.162-27(e)(2)(iii)(A)) with respect to any bonus payable hereunder to reduce any amount that would otherwise be payable hereunder. Except as expressly provided in a Participant s employment agreement, a Participant must be employed on the last day of the Performance Period to be eligible to receive a bonus.

Maximum Bonus

The maximum amount of compensation that may be paid under the Bonus Plan to any Participant for any fiscal year shall be $4,000,000.

Certification of Performance Goals and Payment of Bonus

Certification by Committee. As soon as practicable after the close of the Performance Period and prior to the payment of any bonus, the Committee shall review the Company s performance and certify in writing the extent to which the applicable Performance Goals have been achieved. In accordance with Code Section 162(m), for this purpose, approved minutes of the Committee meeting in which the certification is made are treated as written certification.

Table of Contents

Payment of Bonus After Certification. Each bonus, to the extent earned, shall be paid in a single lump sum cash payment, less applicable withholding taxes, as soon as practicable following the Committee s certification described in the preceding sentence. Payments under the Bonus Plan are intended to qualify as short-term deferrals under Code Section 409A and shall be made no later than the 15th day of the third month following the later of Signet s taxable year or the Participant s taxable year in which the bonus is no longer subject to a substantial risk of forfeiture (as defined under Code Section 409A); *provided*, *however*, that any payment that is delayed due to an event described in United States Treasury Regulation § 1.409A-1(b)(4)(ii), shall be paid as soon as practicable.

Funding

The Bonus Plan shall be unfunded. The Company shall not be required to segregate any assets to ensure payment of any bonus under the Bonus Plan.

Amendment and Termination

The Company may amend or terminate the Bonus Plan at any time; *provided, however,* that no amendment shall cause any performance-based bonus payable under the Bonus Plan not to qualify under Code Section 162(m).

Shareholder Approval

Payment of any bonus under the Bonus Plan shall be contingent upon approval of the Bonus Plan (including the applicable Performance Goals relating thereto), in a separate vote, by a majority of the votes cast on this issue by Shareholders (including abstentions to the extent abstentions are counted as voting under applicable Bermuda law). Unless and until such Shareholder approval is obtained, no bonus shall be paid pursuant to the Bonus Plan. To the extent necessary for purposes of Code Section 162(m), the Bonus Plan shall be resubmitted to Shareholders, for their reapproval with respect to bonuses payable for the taxable years of Signet commencing on or after the fifth (5th) anniversary of the initial Shareholder approval, or at such earlier time required by Code Section 162(m).

Effective Date

The Bonus Plan shall be effective on the date that Shareholder approval is received.

Interpretation and Construction the Bonus Plan

Any contrary provision of the Bonus Plan notwithstanding, (a) bonuses to be granted under the Bonus Plan are intended to qualify as qualified performance-based compensation under Treasury Regulation § 1.162-27(e) and (b) any provision of the Bonus Plan that would prevent any bonus under the Bonus Plan from so qualifying shall be administered, interpreted and construed to carry out such intention and any provision that cannot be so administered, interpreted and construed shall be disregarded. No provision of the Bonus Plan, nor the selection of any Participant participate in the Bonus Plan, shall constitute an employment agreement or affect the duration of any Participant s employment, which shall remain employment at will unless an employment agreement between the Company and the Participant provides otherwise. All references in the Bonus Plan to sections of the Code or to Treasury Regulations shall be interpreted to include any amendment or successor provisions thereto. All bonuses awarded under the Bonus Plan shall be subject to the written policies of the Board, including any policy relating to the clawback of compensation, as they exist from time to time.

THE BOARD OF DIRECTORS RECOMMENDS THAT SHAREHOLDERS VOTE **FOR** APPROVAL OF THE BONUS PLAN.

Table of Contents

BOARD OF DIRECTORS AND CORPORATE GOVERNANCE

The Role of the Board

The Board is currently comprised of seven members. The Board s prime objective is the sustainable enhancement of business performance and Shareholder value. It is responsible for determining all major policies, ensuring that effective strategies and management are in place, assessing Signet s performance and its senior management, reviewing the systems of internal control and setting policy relating to social, ethical, environmental and other matters.

Separate and Independent Chairman

The Company has a Chairman of the Board who is separate from its Chief Executive Officer and whom the Board has determined to be independent under the listing standards of the NYSE. The Board considers it to be important for its effectiveness and efficiency to maintain a clear division of responsibilities between the running of the Board and the executive responsibility for the running of the Company s business; therefore the Board has agreed that the roles of Chairman and Chief Executive Officer should be separate.

The division of responsibilities between the Chairman and the Chief Executive Officer has been specifically agreed by the Board.

In summary, the Chairman is responsible for:

- effective running of the Board, including evaluating its performance and that of the individual Directors, and the Board s compliance with corporate governance requirements and best practice;
- reviewing, prior to their presentation to the Board by executive management, strategy, medium term plans and the annual budget;
- reviewing, prior to their presentation to the Compensation Committee, the recommendations of the Chief Executive Officer regarding the compensation of senior executive officers and for making a recommendation regarding the compensation of the Chief Executive Officer;
- maintaining contact with major Shareholders to understand directly their issues and concerns;
- keeping the other independent Directors appropriately informed of developments within the business and Shareholders attitude toward the Company; and
- safeguarding Signet s reputation, and representing it both internally and externally.

Chief Executive Officer

In summary the Board has agreed that the Chief Executive Officer is responsible for:

- the executive leadership of the business;
- developing and presenting to the Board, strategy, medium term plans and budgets;

within this framework, the performance of the business;

complying with legal and corporate governance requirements, together with the social, ethical and environmental principles of Signet; and

making recommendations on the appointment and compensation of senior Executive Officers and management development.

Executive Sessions of Independent Directors

Independent Directors meet regularly in executive session without management participation. At those meetings the Chairman presides. This encourages open discussion. In addition, at least once per year the independent

Table of Contents

Directors, excluding the Chairman, meet separately in executive session to consider the independent Chairman s performance. At those meetings, Russell Walls, Chairman of the Audit, and Nomination and Corporate Governance Committees, presides.

Independent Directors Constitute a Majority of the Board

The Board currently comprises one executive Director and six independent Directors including the Chairman.

The Board has affirmatively determined that each of the following Directors is independent under the NYSE listing standards: Sir Malcolm Williamson, Robert Blanchard, Dale Hilpert, Marianne Parrs, Thomas Plaskett, and Russell Walls. In considering independence the Board considers any commercial, consulting, legal, accounting, charitable or any other business or non-business relationships that a Director or his or her immediate family may have with the Company. No such relationship exists for any of the independent Directors.

Self-evaluation

The Directors conduct an annual evaluation of the workings and efficiency of the Board and of each of the Board committees on which they serve and make recommendations for change, if required.

Director Attendance at Annual General Meetings

All of the Directors are required to attend the Annual General Meeting. The Board schedules a Board meeting on the date of the Annual General Meeting of Shareholders to facilitate attendance at the Annual General Meeting by the Directors. All of the Directors attended the Annual General Meeting held in June 2010, other than Thomas Plaskett, who although able to attend the Board Meeting scheduled just prior to the Annual General Meeting, was unexpectedly unable to remain for the Annual General Meeting.

Meetings and Attendance During Fiscal 2011

In Fiscal 2011, the Board met six times (including meetings by telephone). All incumbent Directors attended at least 94% of the aggregate number of meetings of the Board and those Board committees on which they served during their period of service in Fiscal 2011.

Communication with Directors

Any member of the public who wishes to send communications to the Board of Directors, the Chairman or any other individual Director may do so in writing, addressed to Mark Jenkins, Group Company Secretary c/o Signet Group Limited, at 15 Golden Square, London, W1F 9JG, UK. All such communications will be reviewed promptly by the Group Company Secretary and sent to the appropriate director or Committee Chair with a copy to the Chairman.

Transactions with Related Persons

The Board has adopted written policies and procedures for the review, approval or ratification of transactions in which the Company participates and in which any Director or executive officer, any nominee for election as a Director, or any five percent holder of the Company s securities, or any immediate family member of such an officer, director or nominee or security holder, has a direct or indirect material interest. In determining whether to approve or ratify any such transaction the Board, on the recommendation of the Nomination and Corporate Governance Committee and/or the Audit Committee (dependent upon the nature of the transaction), would consider whether based on the specific facts and circumstances of the transaction, such a transaction would be in the best interests of the Company. Any transaction considered to jeopardize the independence of the Director, be contrary to law or regulation, or potentially create or give the appearance of a conflict of interest (also prevented by the Code of Ethics) would be prohibited.

Table of Contents

The Company did not participate in any related person transactions in Fiscal 2011.

Risk Management

The identification of major business risks is carried out in conjunction with operational management and appropriate steps are taken to monitor and mitigate risks. The Business Risk Assurance Manager, who is not a named executive officer of the Company, co-ordinates the collection of risk management information and is responsible for assessing Signet s day to day risk management processes and internal control structure, ensuring such processes satisfy the applicable standards in both the US and UK division. His findings are reported to the Audit Committee.

The Risk Management Committee (the RMC), which is chaired by the Business Risk Assurance Manager, has a written charter approved by the Board and its members include the Chief Financial Officer, the Group Financial Controller, the Divisional Chief Financial Officers and the Divisional Heads of Risk. The RMC meets at least four times a year and reviews Signet s risk management processes, the consolidated principal risks identified by the Company, emerging issues and new regulations. The external auditor and the Chairman of the Audit Committee receive copies of all papers submitted to the RMC. The Business Risk Assurance Manager and the Chairman of the Audit Committee meet periodically to discuss key matters arising from Signet s risk management process. A report from each RMC meeting highlighting any material non-compliance or emerging issue is provided to the Board. Risk and control committees also have been established at both divisional and corporate levels. The divisional committees are chaired by the divisional Chief Executive Officers and the corporate committee is chaired by the Chief Financial Officer. Each committee has a formalized charter and requires participation by the executive management teams. The Business Risk Assurance Manager attends all divisional and corporate risk management committee meetings to provide a consistent approach and independent review.

In its role in the oversight of risk management, the Board will on an annual basis: agree the prioritized risks impacting the Board and associated responsibilities; invite the Chief Executive Officer from each division to present to the Board their prioritized risks and strategies for risk mitigation; and review Signet s internal controls and risk governance framework and developments thereof. In addition, on a periodic basis the Board reviews risk and internal audit updates provided by the Chairman of the Audit Committee and on a quarterly basis it reviews and discusses reports provided by the Business Risk Assurance Manager on divisional risk management activity.

Compensation Policies and Risk Taking

The Board has evaluated the policies and practices of compensating its employees and has determined that they are not reasonably likely to have a material adverse effect on the Company. The Board has reached this conclusion based on a number of factors, including an evaluation of the nature of the performance targets, concluding that the targets set for the strategic and financial development of the Company are appropriate in terms of short and long term horizons and that the allocation of the performance pay and the payments to be made to employees if the maximum target is achieved is not material either on an individual or aggregated basis and have been taken into account in establishing performance targets.

Corporate Governance Guidelines

The Company has adopted a set of corporate governance guidelines that address a number of corporate governance matters, in accordance with section 303A of the NYSE Rules and are available at www.signetjewelers.com/sj/pages/shareholders/corp-governance/cg-statement. The Company strives to act in accordance with the laws and customs of each country in which it operates; to adopt proper standards of business practice and procedure; to operate with integrity; and to observe and respect the culture of each country in which it operates. To that end, Signet has adopted a statement of social, ethical and environmental principles and supporting policies applicable to all officers and employees of the Company and complies with the requirements of the NYSE. In addition, Signet has a policy on business integrity, as well as more detailed guidance and regulations on Signet s staff induction, training and operational procedures. These policies include a code of

Table of Contents

business conduct and ethics that is applicable to all directors, officers and employees as well as a Code of Ethics for the Chairman, CEO and senior officers. Copies of these codes are available from www.signetjewelers.com.

Internal Controls and Risk Management Systems

The Board exercises ultimate responsibility for Signet s system of internal controls and for monitoring its effectiveness. The internal controls system is designed to safeguard shareholders investments and Signet s assets, both tangible and intangible, including the reputation of Signet with its various stakeholders. Procedures are in place to ensure the maintenance of proper accounting records, the reliability of the financial information used within the business or for publication and the determination of disclosure obligations and of materiality. These procedures also cover disclosure on a timely basis of information to the investment markets. However, such procedures are designed to manage rather than wholly eliminate the risk of failure to achieve business objectives and can provide only reasonable, not absolute, assurance against material misstatement or loss.

Signet s disclosure control procedures are designed to help ensure that processes and procedures for information management are in place at all levels of Signet. The disclosure control procedures aim to provide reasonable assurance that any information disclosed by Signet is recorded, processed, verified, and summarised appropriately and on a consistent basis. The procedures are also designed to provide reasonable assurance that information is accumulated and communicated to management to allow timely decisions to be made regarding required disclosure. Signet s Disclosure Control Committee has formalised terms of reference and consult with Signet s external advisers and auditor, as necessary. These procedures are designed to enable Signet to make timely, appropriate and accurate public disclosures. The activities and findings of the Disclosure Control Committee are reported to the Audit Committee and are subject to periodic internal audit review.

Key procedures designed to provide effective internal controls are:

Control environment control is exercised through an organisational structure with clearly defined levels of responsibility and authority together with appropriate reporting procedures, particularly with respect to financial information, capital expenditure, investment, granting of guarantees and the use of treasury products as well as health, safety, environmental and customer service issues.

Reporting and information systems Signet has a comprehensive budgeting and strategic planning system with an annual budget and strategic plan approved by the Board. Reported monthly trading results and balance sheets include the corresponding figures for the budget or revised forecast and for the previous year. Any significant variances are examined by divisional operating management and discussed with senior management, with action being taken as appropriate. A forecast of the full year s results is updated regularly, based on performance to date and any changes in outlook. The senior executives regularly report to the Board on the development of the business, the competitive environment and any material breaches of procedure. Through these mechanisms, Signet s performance is continually monitored, risks identified in a timely manner and their implications assessed.

Control procedures each operating division maintains documented financial and operating controls as well as procedures appropriate to its own business environment and in conformity with Signet s guidelines. Each of the operating divisions has an internal audit function which primarily reviews the processes in the store operations but also reviews central service functions. The work of internal audit is monitored by senior divisional executives, and/or Signet management, the RMC and the Audit Committee.

Reviews of effectiveness the Board, in addition to receiving summaries of the RMC reports, annually reviews the effectiveness of the internal controls system on the basis of a report from, and the recommendation of, the Audit Committee. Signet s Disclosure Control Committee reports to the Audit Committee on a quarterly basis as to the effectiveness of the disclosure control procedures.

Board Committees

Certain matters are delegated to Board Committees, each with a charter setting out defined terms of reference, procedures, responsibilities and powers. The principal committees are the Audit, Compensation, and Nomination and Corporate Governance Committees. The composition of the Board Committees is set out below and the Group Company Secretary acts as secretary to each of them. Each of the Committees acts in accordance with its charter as adopted by the Board, which is reviewed annually and which is available on request from the Group Company Secretary or may be downloaded from www.signetjewelers.com.

The composition of the Board Committees, all members of which are independent under the NYSE listing standards, are as follows:

Audit Committee	Compensation Committee	Nomination and Corporate Governance Committee
Russell Walls (Chairman)	Robert Blanchard (Chairman)	Russell Walls (Chairman)
Dale Hilpert	Dale Hilpert	Robert Blanchard
Marianne Parrs	Thomas Plaskett	Marianne Parrs
		Thomas Plaskett

As part of the Board s succession planning process, the Board has agreed that with effect from the date of the Annual General Meeting, Mr. Plaskett will replace Mr. Blanchard as Chair of the Compensation Committee and Ms. Parrs will replace Mr. Walls as Chair of the Audit Committee. Mr. Blanchard and Mr. Walls will each continue to serve as a member of the Compensation and Audit Committees respectively.

Audit Committee

The primary function of the Audit Committee is to assist the Board in fulfilling its oversight responsibilities with respect to the Company s financial matters.

All of the members of the Audit Committee have significant financial experience as a result of senior executive positions held in other companies. The Audit Committee met nine times in Fiscal 2011.

The Board has determined that all members of the Audit Committee are financially literate, and that Mr. Walls is qualified as the audit committee financial expert within the meaning of SEC regulation.

The Audit Committee s responsibilities include:

- reviewing Signet s financial statements, earnings releases and audit findings, and reviewing its accounting principles and policies;

- recommending for appointment by Shareholders and terminating the Company s independent registered public accounting firm, providing oversight of such firm, reviewing the quality-control procedures and independence of such firm and evaluating its proposed audit scope, performance and fee arrangements;

- approving in advance all audit and non-audit services to be rendered by the independent registered public accounting firm;

providing oversight of Signet s system of internal control over financial reporting, disclosure controls and procedures and risk management;

reviewing the effectiveness of the Company s internal auditors, and the Disclosure Control Committee; and

establishing procedures for complaints regarding accounting, internal accounting controls or auditing or other matters.

Table of Contents

The Compensation Committee

The Compensation Committee s responsibilities include:

- setting the overall compensation policy which will attract and retain superior executives needed to deliver exceptional results;
- setting specific compensation for the Chairman as well as the Chief Executive Officer, the Chief Financial Officer , the divisional CEOs, the Group Company Secretary and other executive officers;
- recommending to the Board any amendment to the fee level or structure of fees paid to the independent Directors;
- ensuring that executives are fairly rewarded for their individual contributions to the business, having due regard for the interests of Shareholders, Signet s financial and commercial health and pay and other conditions throughout the business; and
- approving any share based compensation awarded to any employees of the Company.

The Compensation Committee sets the compensation of the Chairman of the Board and of the Chief Executive Officer. The compensation of the Chief Financial Officer, the divisional CEOs and the Group Company Secretary and other executive officers, is set by the Compensation Committee based on recommendations made by the Chief Executive Officer after consultation with the Chairman. At the commencement of each fiscal year, the Compensation Committee sets annual performance targets for executive officers. Where executive officers are involved in assisting the Compensation Committee, care is taken to recognize and avoid possible conflicts of interest.

The compensation of the independent Directors is determined by the full Board on the basis of recommendations made by the Committee as a result of consultation with the Chairman and Chief Executive Officer. Such recommendations will be made after consideration of, among other factors, external comparisons, the time commitment and the responsibilities of the independent Directors.

The Compensation Committee met seven times during Fiscal 2011.

For additional information regarding the operation of the Compensation Committee, including the role of consultants and management in the process of determining the amount and form of executive compensation, see Compensation Discussion and Analysis below.

The Nomination and Corporate Governance Committee

The Nomination and Corporate Governance Committee s responsibilities include:

- assisting the Board in the selection and nomination of Directors and other senior management;
- reviewing the composition and balance of the Board and its Committees, as well as Board and senior management succession; and
- assisting the Board in the consideration and development of appropriate corporate governance guidelines and other matters of corporate governance.

The Nomination and Corporate Governance Committee uses the services of external recruitment agencies to identify suitable candidates for senior executive posts and for all Board appointments with interviews carried out in accordance with a formal process.

The Nomination and Corporate Governance Committee has no formal requirements, standards, or a diversity policy in relation to the individuals that it nominates, but considers each candidate on his or her own merits. In evaluating candidates, the criteria that the Nomination and Corporate Governance Committee generally views as relevant and likely to consider includes experience, particularly experience that is specifically relevant to the business, or reflects a discipline or diversity that the Committee feels is either missing or would be particularly important to the Board s effectiveness and efficiency. The candidate must also be able to demonstrate the highest personal and professional ethics and integrity and be prepared to commit to the time and effort on a consistent basis that are necessary to fulfill the duties and responsibilities of the position.

When the role of the Chairman or any matter relating to succession to that role is discussed, the Chairman may be consulted, but the responsibility for preparing a job specification and making any recommendation to the Board rests solely with the Nomination and Corporate Governance Committee, which also reviews a number of other senior appointments within Signet, such as that of the Group Company Secretary.

A Shareholder who wishes to propose an individual to the Nomination and Corporate Governance Committee for its consideration as a nominee for election to the Board may do so in writing to the Group Company Secretary, Signet Jewelers Limited c/o Signet Group Limited, 15 Golden Square, London, W1F 9JG UK. As more fully described in the Company s Bye-laws, a Shareholder desiring to propose a person for election as a director must include in a written notice all of the information required to be disclosed in solicitations of proxies for election of directors, or as otherwise required pursuant to Regulation 14A under the Exchange Act. This includes the person s written consent to being named in the proxy statement as a nominee and to serving as a director if elected and the name and address of the Shareholder and the number of shares of the Company owned as of record by such Shareholder.

The Nomination and Corporate Governance Committee met six times in Fiscal 2011.

Table of Contents

REPORT OF THE AUDIT COMMITTEE

The Company s Annual Report to Shareholders on Form 10-K includes the audited consolidated balance sheets of the Company and its subsidiaries as of January 29, 2011, and January 30, 2010, and the related audited consolidated income statements, shareholders equity, accumulated other comprehensive income, and cash flows for each of Fiscal 2011, Fiscal 2010 and Fiscal 2009. These balance sheets and statements (the Audited Financial Statements) are the subject of a report by the Company s independent registered public accounting firm, KPMG UK. The Audited Financial Statements are also available from www.signetjewelers.com.

The Audit Committee reviewed and discussed the Audited Financial Statements with the Company s management and otherwise fulfilled the responsibilities set forth in its charter. The Audit Committee has also discussed with the Company s management and independent registered public accounting firm their evaluations of the effectiveness of the Company s internal control over financial reporting.

The Audit Committee has discussed with KPMG UK the matters required to be discussed by Statement on Auditing Standards No. 61, as amended, (AICPA, Professional Standards, Vol.1 AU Section 380), as amended by the Public Company Accounting Oversight Board in Rule 3200T.

The Audit Committee received from KPMG UK the written disclosures and letter from KPMG UK required by applicable requirements of the Public Company Accounting Oversight Board and has discussed the independence of KPMG UK with that firm.

Based upon the review and discussions referred to above, the Audit Committee recommended to the Company s Board that the Audited Financial Statements be included in the Company s Annual Report on Form 10-K for Fiscal 2011.

Members of the Audit Committee

Russell Walls (Chairman)

Dale Hilpert

Marianne Parrs

The information contained in the foregoing report shall not be deemed to be soliciting material or to be filed with the Securities and Exchange Commission, nor shall the information be incorporated by reference into any future filing under the Securities Act of 1933 or the Securities Exchange Act of 1934, except to the extent that the Company specifically incorporates it by reference in a filing.

Table of Contents

EXECUTIVE OFFICERS OF THE COMPANY

The Executive Officers of the Company are:

NAME	AGE	Position	Year Joined Signet
Michael W. Barnes	50	Chief Executive Officer	2010
Ronald Ristau	57	Chief Financial Officer	2010
Mark Jenkins	53	Group Company Secretary	2004
Mark Light	49	CEO US Division	1978
Robert Anderson	52	CEO UK Division	2000
William Montalto	64	COO US Division	1986
Robert Trabucco	56	CFO US Division	2003
Michael Povall	52	CAO UK Division	2002
Kenneth Pratt	49	CFO UK Division	2007
Kevin Ryan	53	Operations Director UK Division	2000
Sebastian Hobbs	41	Commercial Director UK Division	2011

Michael W. Barnes, 50, Chief Executive Officer and Director, was appointed to the Board in January 2011. Mr. Barnes joined the Company as Chief Executive Officer Designate on December 1, 2010 and succeeded Terry Burman as Chief Executive Officer and Director upon Mr. Burman s retirement on January 29, 2011. Prior to joining the Company, Mr. Barnes was President, Chief Operating Officer and director of Fossil, Inc., having served in those and other executive capacities at Fossil since 1985, and as a director of Fossil since it became a public company in 1993.

Ronald Ristau, 57, joined Signet as Chief Financial Officer Designate on April 15, 2010, and became Chief Financial Officer on June 26, 2010. Prior to joining the Company he spent ten years with New York & Company, Inc., most recently as President, CFO and director. He has also held posts at Revlon, Inc., Playtex International, United Technologies Corporation and Peat, Marwick Mitchell & Co. Mr. Ristau is a Certified Public Accountant.

Mark Jenkins, 53, Group Company Secretary, was appointed in 2004. Previously, he was director and Company Secretary at COLT Telecom Group plc and Group Company Secretary at Peek plc. He is a barrister.

Mark Light, 49, became Chief Executive of Signet s US division in January 2006 having been President and Chief Operating Officer of the US division from 2002. He joined Signet in 1978.

Robert Anderson, 52, became Chief Executive of Signet s UK division in January 2003 having joined the Company as Chief Operating Officer of the UK division in August 2000. Mr. Anderson is a non-executive director of Provident Financial Plc. Prior to joining Signet, Mr. Anderson worked at Marks & Spencer Plc for 19 years, lastly as Business Unit Director.

William Montalto, 64, was promoted to Executive Vice President and Chief Operating Officer of the US division in 2006. Mr. Montalto had previously held the positions of Executive Vice President and Chief Administrative Officer (2002), Executive Vice President Strategic Services (1995) and Senior Vice President Management Information Systems & Distribution (1990), having joined the US division in 1986 as Vice President Management Information Systems.

Robert Trabucco, 56, joined the US division in 2003 as Executive Vice President and Chief Financial Officer of the US division. He had previously worked for KLS Associates, a retail consulting practice.

Michael Povall, 52, joined Signet s UK division in April 2002. Prior to this, his career was predominantly in retail working in the food retail sector including roles in supply chain and retail operations. In his current role as Chief Administrative Officer of the UK division, he is responsible for IT, Human Resources and Central Facilities.

Table of Contents

Kenneth Pratt, 49, re-joined Signet in April 2007 as CFO of the UK division, having first joined the Company in 1987 and was Group Financial Controller from 1991 until 1997. From 1997 to 2007, Mr. Pratt worked for a European Division of Liz Claiborne, Inc. in a number of positions with leadership roles spanning Finance, Retail Operations, Supply Chain, Human Resources and IT. In his current role as CFO of Signet s UK division, Mr. Pratt is responsible for the Finance, Logistics, Corporate Sales and Compliance functions, as well as strategic planning.

Kevin Ryan, 53, joined Signet s UK division in February 2000. Previously Mr. Ryan spent his career predominantly in retail fulfilling a number of field operational roles. As Operations Director of the UK division, Mr. Ryan is currently responsible for all store operations within the UK including management of the field team, property portfolio and the capital fit out program.

Sebastian Hobbs, 41, joined Signet s UK division in March 2011. Prior to joining Signet, Mr. Hobbs worked in a number of retail companies, most recently at Blacks Leisure Group plc for 5 years. In his current role as Commercial Director of the UK division, he is responsible for marketing and purchasing of watches and jewelry for the UK division.

No Executive Officer is or was the subject of legal proceedings that are required to be disclosed pursuant to SEC rules.

Table of Contents

EXECUTIVE COMPENSATION

Compensation Discussion and Analysis

Overview

This Compensation Discussion and Analysis (CDA) describes the objectives and the role of the Compensation Committee and further discusses the philosophy upon which the Compensation Committee bases its decisions in its endeavors to meet the objectives. It also describes the principles that are the foundation of the Company s executive compensation policies and details the individual material elements of compensation awarded to, earned by, or paid to the named executive officers. Compensation for named executive officers residing in the US is paid in US dollars, while compensation for named executive officers residing in the UK is paid in pounds sterling.

Introduction

Signet s compensation program has been designed to assist in achieving its business objective of consistently outperforming the specialty retail jewelry market segment and thereby deliver superior returns to Shareholders.

In order to accomplish a superior performance, we have to be able to employ, motivate and retain superior management. The primary compensation principle, therefore, is to target total delivered compensation at approximately the median of a customized group of comparator companies. Those companies are specifically chosen as they reflect various attributes similar to ours but also because they pose a potential threat as to solicitation of our executives if their compensation is not competitive. Executives are paid in a range related to that median dependent upon experience and proven ability to consistently deliver a superior performance. The Company does not conduct any wealth accumulation analysis in determining executive compensation.

Our named executive officers have considerable individual and collective experience, both general and specific. Although some are new to Signet, all of our named executive officers have a proven track record of superior performance. The aggregate total direct compensation at target performance places the compensation of the named executive officers, at approximately the 54th percentile of the comparator company median.

A number of sub-principles have also been developed as follows:

1. The compensation program must align the interests of senior management with those of Shareholders. This is achieved by delivering approximately 60% of total compensation for named executive officers as incentives dependent on factors that should produce long-term share price growth.

2. The only element of guaranteed pay is base salary with the percentage of at risk compensation increasing in line with the responsibility and experience of each executive. Base salary accounts for only 33% of the annual value of the Chief Executive Officer s potential total cash compensation versus approximately 40% for other named executive officers.

3. Elements of compensation that are at risk should separately reward both annual and multi-year performance as well as reward exceptional performance. This is achieved through the annual bonus plan, which represents approximately 20% to 25% of the named executive officers   target total direct compensation, together with awards of performance restricted stock units, which account for approximately another 15% to 20% of the total.

4. Compensation should include a retention component, which encourages high performing executives to remain with the Company. An award of service-based restricted stock which accounts for approximately 15% to 20% of named executive officers total compensation and which doesn t vest until the third anniversary of the grant, strengthens the retention value of the compensation.

5.

The compensation program should be simply constructed and easily understood so that the named executive officers are in no doubt as to the performance requirements and their relationship to the level of payments and therefore remain motivational.

6. The compensation program should encourage all senior executives to build a substantial holding of the Company s shares.

The Committee has awarded compensation in Fiscal 2011 on the basis of continuing superior performance. The Company has continued to increase profitable market share during the year in the face of an uncertain economic outlook, which reflects the strong performance of the Company in Fiscal 2011: positive free cash flow (determined as described in the Company s Annual Report on Form 10-K for Fiscal 2011) of $315.8 million (excluding a make whole payment resulting from the Company s prepayment of its then outstanding private placement notes in November 2010); an increase in income before income tax of 50.9% (excluding the make whole payment) with basic diluted earnings per share of $2.32 ($2.66, excluding the make whole payment), and year end net cash (determined as described in the Company s Annual Report on Form 10-K for Fiscal 2011) of $271.1 million.

The Role of the Compensation Committee

The Compensation Committee s role is to set the compensation for Signet s named executive officers to ensure that they are fairly rewarded for their individual contributions to Signet s performance having due regard to the interests of Shareholders, the financial and commercial health of the business and pay and conditions throughout Signet. It is also the role of the Committee to ensure that Signet s compensation remains competitive.

Surveys are undertaken on a regular basis to ensure that total compensation packages remain in the percentile range close to the comparator company median described herein. Recognizing that approximately 80% of Signet s sales and profits are generated in the US, and that significant differences in compensation practices exist between the US and the UK, separate surveys are conducted in each country.

The Role of Compensation Consultants

The Compensation Committee regularly uses external professional advice and annually uses competitive market surveys conducted independently in both the US and in the UK.

The Committee has retained PayGovernance (formerly part of Towers Watson) as advisers who were not retained by Signet in any other capacity in Fiscal 2011 such that would require additional disclosure. PayGovernance is a human resources and compensation consulting firm which assists the Compensation Committee in its review, evaluation and analysis of Signet s executive compensation program. In this role, PayGovernance collects relevant market data in order to assist the Compensation Committee in delivering effective and competitive executive compensation. PayGovernance also advises the Compensation Committee on the best ways of motivating, rewarding and retaining executives in terms of both short and long term performance and advising the Committee of the most effective way of linking the interests of management and Shareholders.

PayGovernance collects market data of compensation programs both within and outside the retail sector. In analyzing the market data provided by PayGovernance, the Compensation Committee focuses on established peer groups of companies for benchmarking purposes. The Compensation Committee annually reviews the composition of the peer groups in order to ensure that they continue to comprise appropriate representative companies. The Committee did so in Fiscal 2011 and a customized group of retail peers was used in assessing the compensation of Signet s Chief Executive Officer. The peer group was based upon the following criteria:

- peer focus on retailers with international operations, headquartered in the US and listed on a US stock market;
- the median peer has total sales similar to Signet s;
- most peer companies revenue ranges from half to twice the Company s revenue; and
- approximately half of the peers generate higher and half lower sales than Signet.

Table of Contents

The peer group used for assessing the compensation of Signet s Chief Executive Officer and Chief Financial Officer is:

Nordstrom Inc., Bed Bath and Beyond Inc., Foot Locker Inc., Barnes & Noble Inc., Liz Claiborne Inc., Jones Apparel Group Inc., Collective Brands Inc., Williams-Sonoma, Inc., Coach Inc., Saks Inc., American Eagle Outfitters Inc., Tiffany & Co., Phillips Van Heusen Corporation, Ann Taylor Stores Corporation, Zale Corp., The Talbots Inc., Pier 1 Imports Inc., Abercrombie & Fitch Co., and Charming Shoppes Inc.

For the assessment of the UK named executive officers, PayGovernance collected data from a customized group of companies that participated in the Towers Watson Top Executive remuneration survey for the UK. This survey includes executives employed in general industry, which was until this year used to assess the compensation of the former Group Finance Director (who retired in June 2010), and retail industry, which was used to assess the compensation of the CEO of the UK division. With the recruitment of a US based Chief Financial Officer, it was no longer appropriate to use this survey and instead the same US peer group that was used to assess the Chief Executive Officer s compensation was also used to assess compensation of the Chief Financial Officer.

For the assessment of the current US named executive officers, i.e., the Chief Executive Officer, the Chief Financial Officer and the Chief Operating Officer of the US division, the Retail/Wholesale Executives Database within the PayGovernance Compensation Database was used, which provides compensation data for a variety of retail and wholesale companies located in the US.

PayGovernance has also been used to provide data to the Compensation Committee in relation to the compensation structure and pay practices for independent directors of US companies.

The Allocation of Executive Compensation

It is the objective of the Compensation Committee to deliver and maintain a competitive executive compensation program in accordance with its compensation principles. The Compensation Committee has established an executive compensation program that provides a broad mix of overall direct compensation (base salary, short term incentive compensation in the form of an annual cash bonus and long-term incentive compensation in the form of an equity interest) for its named executive officers.

In allocating the various elements of total compensation, the Compensation Committee seeks to ensure that the greater the responsibility and direct influence over the performance of the Company an executive officer has, the more their total compensation will be weighted toward incentive payments. The Compensation Committee evaluates the annual compensation benchmarking data, with total remuneration, including base salary and incentive based payments, being targeted at the median of industry total compensation of the comparator group as determined by the benchmarking process, along with other factors such as an executive officer s level of experience, the Company s desire to retain the executive, the availability of replacement personnel, as well as the individual s responsibilities and actual performance. Responsibility for external factors that potentially have an impact on the results of the Company will also be considered. The various elements of a named executive officer s compensation package are then allocated as a percentage of base salary.

The Compensation Committee reviews and evaluates the impact of tax laws, accounting changes and similar factors affecting the Company s executive compensation program. The Committee believes that ordinarily it is in its best interests to retain maximum flexibility in the compensation programs to enable the Company to appropriately reward, retain and attract the executive talent necessary for success. To the extent these goals can be met in a tax and accounting efficient manner, the Committee will endeavor to do so. However, the Board and the Compensation Committee believe it is important to retain the flexibility to provide compensation that is appropriate in the circumstances, taking all relevant matters into consideration.

Table of Contents

Performance Criteria

For performance based compensation, the Compensation Committee reviews proposed performance measures and targets in order to effectively motivate management and drive the creation of Shareholder value, while seeking to ensure that the targets are set at a level that is stretching but not out of reach. Bonuses are reviewed annually to confirm that they remain appropriate and clearly aligned with business strategy and objectives.

The Compensation Committee believes that the choice of performance measures should be made in the context of Signet s business strategy, reflect Signet s particular circumstances and be related to overall corporate performance. In certain circumstances it may be appropriate to set performance criteria that are specific to individual roles within the corporate strategy.

The Compensation Committee believes that where performance criteria are used they should be: easily understood; directly linked to the performance of the Company or the relevant business unit; directly influenced by management s actions; able to incentivize the efficient use of capital; and, for long term awards, be equity based. In assessing actual performance, it is the Compensation Committee s policy to measure the Company or relevant business unit s results on the basis of constant exchange rates so that executive officers neither benefit from, nor are penalized by, exchange rate fluctuations over which they have no control.

The vesting of incentive awards will normally be subject to the participant s continued employment within the business until the end of the performance period. However, partial vesting pro-rata to the length of time since grant may occur at the end of the performance period if the participant s employment within the business ends before the end of the performance period on account of death, redundancy, retirement, injury, disability or other circumstances as determined by the Compensation Committee, provided that it is satisfied that the performance conditions have been fulfilled in respect of the period from the date of grant of an award to the date of cessation of employment.

Compensation Overview, Objectives and Key Features

The Compensation Committee has established an executive compensation plan that contains the following key components:

Component	Objective	Key Features
Base Salary	Provides a minimum level of pay that is not at risk that sustained individual performance warrants. A competitive base salary is important to attract and retain an appropriate caliber of talent for any given position.	Designed to retain key Executive Officers by being competitive but is not considered to be the primary means of recognizing performance.
Annual bonus	Motivate and reward achievement of annual financial results. Compensation aimed at recognizing short-term performance against established annual financial performance goals of the Company.	Cash payments dependent on the degree of achievement against an annual performance target. This element is payable in the year following the year in which it was earned.
Long-term incentives (time and performance-based restricted shares, units and share options)	Align management interests with those of Shareholders; retain executive officers; motivate and reward achievement of sustainable earnings growth.	Time based restricted shares and restricted share unit awards vest upon the continuance of service; performance based restricted share units require achievement of Company financial goals over a three-year performance period and require continued service. Share option awards vest over three years of continued employment (although, as further discussed, no share options were granted in Fiscal 2011).

An additional component of the compensation plan is the provision of a benefits package which consists of a pension, health and life insurance and has the objective of retaining executive officers over the course of their careers.

Elements of Executive Compensation

Based upon the policies, principles and philosophy described above, the Compensation Committee has designed, developed and implemented an executive compensation program that it believes provides executive officers with total compensation that adequately rewards the executive for his or her contribution in achieving superior corporate performance and increasing the share price. Each of these elements is described below.

(a) Base salary

The Committee determines the salaries for each named executive officer as one part of a competitive total compensation program designed to attract and retain the Company s named executive officers.

Each named executive officer receives a fixed level of base annual salary, which is paid monthly, as compensation for services rendered during the fiscal year. Base salary encourages and rewards attainment of

Table of Contents

individual performance. The level of base salary also recognizes and is a reflection of experience, expertise, responsibility, seniority and leadership qualities, as well as individual achievements and accomplishments and other significant contributions to the achievement of corporate performance targets. The Compensation Committee has established the base salary range as derived from the benchmarking process in accordance with the Company s Compensation Principles. This benchmarking is based upon market data of comparable companies described above, trends and geographic location of each position, as well as the movement of base salary within the business or division as a whole. Base salary ranges are monitored to ensure that attraction, retention and motivational objectives are maintained.

For Fiscal 2012, the Compensation Committee determined to increase the base salaries for the continuing named executive officers following the benchmarking analysis, and specific levels of increase were determined by the Committee s evaluation of the named executive officer s performance of his particular executive role. The increases placed the aggregate total direct compensation at target performance at approximately the 54th percentile of the comparator peer companies. The annual base salaries for Fiscal 2012 were set as follows: Mr. Light $911,750 an increase of 6%, Mr. Montalto $648,000 an increase of 6%, and Mr. Anderson $584,350 an increase of 4%. Mr. Ristau, who joined Signet as Chief Financial Officer designate on April 15, 2010, and became Chief Financial Officer following Mr. Boyd s retirement in June 2010, was paid an annual salary of $650,000 for Fiscal 2011. The Compensation Committee set Mr. Ristau s salary for Fiscal 2012 at $682,000, an increase of 5%. Mr. Barnes joined the Company as Chief Executive Officer Designate on December 1, 2010 and became Chief Executive Officer following Mr. Burman s retirement on January 29, 2011 with a salary of $1,050,000. For Fiscal 2012, the Compensation Committee did not increase Mr. Barnes salary.

(b) Annual bonus

Annual bonus performance targets are set by the Compensation Committee each year. In determining the performance target at the commencement of each year, the Compensation Committee gives consideration to relevant market data, i.e. market positioning both of the annual bonus as an element of the total compensation and the positioning of the Company in its sector and in comparison to its competitors, as well as its current business plans. There is a maximum bonus level set each year on such awards, which is equal to twice the target level, and a threshold performance below which no payments are made.

This incentive program has been developed specifically to focus management on the achievement of each year s performance objectives. The annual incentive is based on a pre-determined formula either on a divisional basis or a group basis which is a combination of the divisional performance, depending upon the named executive officer s particular responsibilities. The annual incentives for Mr. Barnes and Mr. Ristau are based (and for Mr. Burman and Mr. Boyd, were based) upon Company performance with a proportion of the bonus based on the performance of each of the divisions, while the annual incentive for Mr. Light and Mr. Montalto is based solely on the performance of the US division as that is where their responsibilities are. Similarly, the annual incentive for Mr. Anderson is based solely upon the performance of the UK division for the same reason.

Annual bonus Fiscal 2011

In setting the performance criteria for Fiscal 2011, the Compensation Committee agreed that it was appropriate to determine the entire bonus on profit measures equal to targeted operating profit, as the main focus should be on driving profit.

The financial performance measure for the annual bonus plan for Fiscal 2011 upon which 100% of the total annual bonus capacity could be earned was based on target operating profit for each division set at the beginning of the bonus period. The bonuses for the corporate executive officers were calculated on the same basis proportionately on the divisional results and for UK divisional results, were calculated on a constant exchange rate basis. The level of achievement, between 85% and 115% of the performance target over the period determined the level of the award that was paid. No bonus was paid for achievement at or below 85% of the

Table of Contents

performance target and performance in excess of 115% of the target will not increase the bonus above the maximum amount. Bonus target and potential maximum entitlement opportunities for the named executive officers remain at the same levels as a percentage of base salary as for Fiscal 2011 (See chart on Page 36 for more details).

Having reviewed the performance achieved against the performance criteria set by the Compensation Committee at the beginning of the period, the Committee determined as part of the Fiscal 2011 year end process in March 2011 that each performance measure had been met and exceeded at the maximum level in the US division but at the UK divisional and Group level at 61.5% and 90.4% respectively. Accordingly, the Committee approved bonus payments as follows:

		Operating Profit	
	Target **$**	**Max** **$**	**Achieved** **$**
US Criteria	**246,000,000**	**282,900,000**	**342,679,000**
UK Criteria	**55,180,000**	**63,395,000**	**57,066,000**
Terry Burman	1,721,000	3,442,000	3,111,568
Michael W. Barnes[(1)]			
Walker Boyd[(2)]	149,838	299,676	270,907
Ronald Ristau	390,000	780,000	705,120
Mark Light	517,860	1,035,720	1,035,720
Robert Anderson	281,939	563,878	346,785
William Montalto	305,000	610,000	610,000

(1) Mr. Barnes was not eligible for a bonus for Fiscal 2011, as he did not join the Company until December 1, 2010.

(2) Bonus amount was pro-rated to reflect Mr. Boyd s retirement in June 2010.

Annual bonus Fiscal 2012

In setting the performance criteria for Fiscal 2012, the Compensation Committee agreed to adopt the same performance measure that had been employed for Fiscal 2011 as it was still considered appropriate to determine the entire bonus on profit measures equal to targeted operating profit, as the main focus should still be on driving profit. For Fiscal 2012, the Compensation Committee determined the performance criteria based upon the achievement of targeted operating profit.

Table of Contents

Therefore the financial performance measure for the annual bonus plan for Fiscal 2012 upon which 100% of the total annual bonus capacity may be earned is based on target operating profit for each division set at the beginning of the bonus period. The bonuses for the corporate executive officers will be calculated on the same basis as for Fiscal 2011, namely proportionately on the divisional results and calculated on a constant exchange rate basis as appropriate. However, the Compensation Committee did consider that it was appropriate to reconsider the range between which a bonus can be achieved to reflect the specific economic and operational position of each division. Therefore, bonuses for executive officers in the US division have been tightened and concentrated so that bonuses will not begin to be earned until a greater amount of the performance target is achieved, although maximum bonus can be achieved earlier. For Fiscal 2012, the level of achievement between 92% and 110% of the performance target over the period will determine the level of the award that is paid. In the UK division, the range has been expanded to reflect the specific economic requirements of driving targeted operating profit. Therefore, in Fiscal 2012, bonuses for executive officers in the UK division can be earned between 85% and 110% of the performance target over the period. Bonus target and potential maximum entitlement for the named executive officers remain at the same levels as a percentage of base salary as for Fiscal 2010 and 2011.

Executive[(1)]	**Position**	**Target Incentive as a percentage of Base Salary**	**Maximum Incentive as a percentage of Base Salary**
Michael W. Barnes	Chief Executive Officer	100	200
Ronald Ristau	Chief Financial Officer	60	120
Mark Light	CEO US Division	60	120
Robert Anderson	CEO UK Division	50	100
William Montalto	COO US Division	50	100

(1) Mr. Burman and Mr. Boyd retired from the Company prior to Fiscal 2012.

(c) Long Term Incentive Plans

The Compensation Committee believes that long term share based incentives are appropriate and necessary measures to properly focus the executive officers on long term results and align the interests with those of Shareholders. In determining the construction of the long term incentive each year, the Compensation Committee chooses from three main elements (1) time-based restricted shares, designed to incentivize executives to remain with the Company; (2) performance-based restricted units awarded on the basis of performance against targets set over a three year period; and (3) traditional share options which achieve value only if management action produces growth in share price.

Long Term Incentive Grants Fiscal 2011

In order to provide balance to the Company s long-term incentives, the Committee determined that as a general rule the ratio of the estimated value of time based restricted shares, performance-based restricted share unit grants and the estimated value of share option grants should be as nearly equally split as practicable. However market conditions at any given time may require that one or more of the elements of the long term incentive plan be reduced in value or even temporarily suspended. After consideration, the Compensation Committee determined that, in line with Fiscal 2010 grants, incentive grants for Fiscal 2011 should not include the share option element due to the depressed share price at that time and the Committee s concern that named executive officers potentially could unfairly benefit from a correction in the market. As a result, long-term incentive compensation granted in Fiscal 2011 was split equally between time based restricted share grants requiring that named executive officers remain in employment for three years from the time of grant and performance based share units requiring not only that named executive officers remain in employment for three years from the time of grant but also achieve performance criteria over that three year period, at which time the performance based restricted stock units will cliff vest. The Committee determined that the performance targets would be over three years and based upon the achievement of targeted operating profit, either on a divisional basis for divisional named executive officers or on a blend of the two, similar to the short term bonus for corporate named executive officers discussed above. Named executive officer participants can earn between 0% to 200% of their performance based grant based on results that range from 85% to 115% of annual targeted operating profit on a cumulative basis. The first and second year operating targets were in accordance with the target set for Fiscal 2010 and 2011 and the subsequent years would also be based upon target operating profit and will be agreed by the Board at the commencement of the relevant fiscal year. This was agreed at the time of grant so as to better assess the prevailing economic environment and therefore apply meaningful and relevant performance targets at the relevant time.

The level of achievement, between 85% and 115% of the performance target on a straight line basis over the period will determine the amount of the award between nil and maximum that vests on a cliff vesting basis. The Compensation Committee considered it to be important that there was a sliding scale of achievement rather than all or nothing so as to adequately compensate named executive officers for actual performance against the criteria.

Share option and long term incentive plan grants to executive officers are set out in the tables below.

Generally grants are made at the same time as the annual compensation reviews, although in Fiscal 2010 they were delayed pending Shareholder approval of the Omnibus Incentive Plan. As the restricted share and performance unit grants would in effect be full value awards, the grant amounts were determined based upon the award methodology for all participants, which was equal to the historic Black Scholes valuation applied to the previous option valuation being a percentage of salary; and where appropriate, the target performance of the previous LTIP (i.e. 37.5% of the maximum award achievable).

The Committee determined that the share price to be used to determine the amount of these grants to UK officers would be equal to the average of the closing prices of a Common Share on the London Stock Exchange on the three trading days immediately preceding April 2, 2010, and the amount of grants to US officers would be equal to the closing price of a Common Share on the trading day before April 2, 2010.

The number of time-based restricted shares and performance-based restricted units granted to executive officers in Fiscal 2011 based upon this award methodology can be seen in the Grants of Plan-Based Awards table below.

The Committee determined in Fiscal 2011, that the pre-determined performance conditions relating to the options over shares that were granted in Fiscal 2008 were not met, and therefore the Committee agreed that they had all failed to vest and subsequently lapsed. The time-served options grants awarded in Fiscal 2008, vested during Fiscal 2010. Additionally, the Committee determined that the pre-determined performance conditions relating to the performance based awards under the Company s LTIP made in Fiscal 2008 were not met. Therefore, the Committee determined that none of these options vested in Fiscal 2011 and none of the cash element under the LTIP for the award made in Fiscal 2008 was payable.

No grants were made to Mr. Barnes in Fiscal 2011, other than to satisfy the compensation make-whole provision of this employment contract which is further discussed below under Employment Agreements. In the case of Mr. Ristau, a share award was made on June 17, 2010 and is reflected in the Grant of Plan-Based Awards table below.

No grants were made to Mr. Burman and Mr. Boyd in Fiscal 2011.

Long Term Incentive Grants Fiscal 2012

The Committee approved grants to Messrs. Barnes, Ristau, Light, Anderson and Montalto in Fiscal 2012. As in the previous year, the grant amounts were determined on the same basis with the restricted share and performance unit grant amounts being determined as a percentage of salary and, where appropriate, factored in previous LTIP target performance. In previous years, performance targets for divisional executives were based upon divisional operating profit targets and performance targets for group executives were based upon Company operating profit, however for the grant made in Fiscal 2012, the Compensation Committee decided that it was appropriate that the short term annual cash bonus should continue to be granted, based in that way, but it was more appropriate for the performance based Long Term Incentive grants now to be based on overall Company performance for all participants, including divisional executives, as the Committee believes that the focus should be on driving profitability of the whole Company. Therefore, performance targets for Messrs. Barnes, Ristau Light, Anderson and Montalto were based upon the Company s targeted operating profit over a three year period, on a cumulative basis. The level of achievement between 95% and 105% of the performance targets over the period will determine the amount of the award between nil and maximum that vest on a cliff vesting basis. The Compensation Committee considered it to be important to maintain the sliding scale for the reasons already described. Grants were in the form of time based restricted stock and performance based restricted stock units with cliff vesting after three years for both types of awards. Again, no share options were granted. The share price to be used to determine the amount of the grant to all officers was to be equal to the closing price of a Common Share on the trading day before the grant date, which for Fiscal 2012 was April 12, 2011.

No grants were made to Mr. Burman and Mr. Boyd in Fiscal 2012 because they had each retired from the Company.

(d) Pensions & Deferred Compensation

The Company provides pension, deferred compensation and retirement benefits to named executive officers and employees, both as a retention mechanism and as a means to assist with the provision of a degree of financial security post retirement. There are different plans operating in the US and the UK.

(i) UK Executive Officers

Mr. Anderson participates in the UK Group Plan, which is a funded, HM Revenue & Customs registered, final salary, occupational pension plan, and Mr. Boyd participated in the plan until his retirement in June 2010. Pensionable salary is the member s base salary, excluding all bonuses

The main features of this pension plan are:

- a normal pension age of 60;
- pension at normal pension age of two-thirds of final pensionable salary, subject to completion of 20 years service;
- life assurance cover of four times pensionable salary; and
- spouse s pension on death.

All UK Group Plan benefits were, until April 5, 2006, subject to Inland Revenue limits. Since the changes to pension taxation in the UK from April 6, 2006 and the removal of existing limits, a scheme specific earnings cap has been maintained equivalent to the previous earnings cap, increased by the Retail Price Index annually. As the tax treatment and other advantages of contributing to funded unapproved retirement benefit schemes (FURBS) to fund benefits above the earnings cap has been eroded, the Company has ceased paying contributions to the Signet FURBS. In substitution a supplement is paid in accordance with the compensation principles on an individual basis. The Company will not compensate or protect members against the consequences of the changes in taxation, but will provide members with a cash supplement in lieu of pension accrual once members reach the Lifetime Allowance limit set by the legislation if they choose to exercise this option.

Table of Contents

(ii) US Executive Officers

In the US there are two defined contribution savings vehicles. The primary retirement vehicle is the company sponsored Sterling Jewelers Inc. 401(k) Retirement Savings Plan (the 401(k) Plan) which is a qualified plan under Federal guidelines. The Company matched employee contributions to the 401(k) Plan at 25% of an employee s contribution up to a maximum of 6% of an employee s basic salary until December 2008 when the Company match was suspended. Under Federal guidelines, the 401(k) Plan contributions by senior management may be reduced based on the participation levels of lower paid employees. A supplemental plan, the Deferred Compensation Plan, an unfunded non-qualified plan under Federal guidelines, was established in 1996 for senior management to assist with pre-tax retirement savings in addition to the 401(k) Plan. In 2004, the Company froze the DCP (the Frozen DCP), to new participants and new deferrals for tax purposes and created a second unfunded, non-qualified deferred compensation plan, for management and highly compensated employees or executives (the DCP).

Messrs. Light and Montalto have benefits provided via the 401(k) Plan, the Frozen DCP, and the DCP as did Mr. Burman until his retirement in January 2011. The deferred compensation rules allowed for individual contractual contribution arrangements without any effect to its tax beneficial status. Pursuant to Mr. Burman s employment agreement, the Company was required to contribute annually to the DCP 20% of Mr. Burman s base salary, without regard to any corresponding contribution from Mr. Burman.

Beginning in July 2010, the Company re-introduced the Company match under the 401(k) Plan at 25% of an employee s contribution up to 6% of the employee s basic salary. Beginning in April 2011, the matching contribution was increased to be market competitive and amounts to 50% of an employee s contribution up to a maximum of 6% of an employee s basic salary.

Similarly, the Company re-introduced the matching contribution under the Deferred Compensation Plans of 50%, up to 10% of the participant s eligible compensation deferred to the DCP beginning in April 2011.

(e) Health & Welfare

Named executive officers participate in various health and welfare programs as well as life insurance and long term disability plans, which are generally available to other executive officers of the Company.

(f) Perquisites

Signet leases, or pays an allowance in lieu of an automobile in order to provide named executive officers with the use of a company car for business travel needs but recognizes that the vehicles may also be used for personal purposes. Vehicles are typically leased for a three year term and the cost of insurance, maintenance and fuel is also met by Signet. Historically, Signet had in certain circumstances made gross-up payments pursuant to existing employment agreements with certain named executive officers to account for the tax assessed against such executive officers with respect to these amounts. The Compensation Committee determined to commence elimination of tax gross-ups in March 2010. Except for relocation expenses in limited circumstances, future tax gross-ups have now been eliminated.

A limited number of other perquisites are made available to some named executive officers in order to promote business objectives and to reward experience, expertise, responsibility, seniority and leadership qualities. Signet reimburses fees for one private club membership for Mr. Light to encourage him to entertain business colleagues and customers, engage in social interaction with peers from other companies, and foster local leadership and community activities. In limited circumstances, where it is appropriate that spouses attend, Signet reimburses named executive officers for the travel expenses of spouses who accompany them on business. Historically, Signet has in certain circumstances made gross-up payments to account for the tax assessed against certain named executive officers with respect to these amounts. This practice has now been eliminated.

Table of Contents

The Compensation Committee intends to consider its position with regards to the remaining perquisites during Fiscal 2012.

(g) Employment Agreements

It is the Compensation Committee s policy that the employment agreements with its executive officers should be on a rolling basis with the notice period to terminate by either party not exceeding one year. Generally, employment agreements in effect may all be terminated upon notice of one year or less. In unusual circumstances, including times of possible or actual transition of corporate control, corporate restructuring or just the desire to keep an executive or the team of named executive officers in place, free of distractions that might arise out of concern for personal financial advantage or job security, the Committee will enter into a retention agreement with one or more executive officers. At the present time the Company has retention agreements with Messrs. Light and Anderson. In addition, the Company previously had a retention agreement with Mr. Burman, Signet s Chief Executive Officer who retired in January 2011. All three retention agreements are described below.

i) Michael W. Barnes

Mr. Barnes has an employment agreement dated September 29, 2010 with a US subsidiary. The term of the Employment Agreement will expire on January 31, 2014, subject to earlier termination by either party. He joined the Company as Chief Executive Officer Designate on December 1, 2010 and succeeded Mr. Burman following his retirement on January 29, 2011 as Signet s Chief Executive Officer.

During the term of employment, Mr. Barnes will (i) receive a starting annual base salary equal to $1,050,000, subject to annual review, (ii) be eligible for an annual target bonus equal to 100% of his annual base salary, (iii) be eligible for a long-term incentive plan payment, with the target payment for a three-year performance cycle equal to $3,250,000 (subject to a maximum of $4,875,000), to be comprised of equity-based awards (or cash, if so determined by the Compensation Committee of the Board of Directors of Signet), (iv) be entitled to participate in the Company s deferred compensation plan (and will receive a Company matching contribution under such plan if he chooses to participate in the plan), (v) be entitled to such welfare benefits as are made available from time to time to executive officers of the Company, (vi) be entitled to five weeks of paid vacation per year, and (vii) be entitled to certain relocation benefits (including a tax gross-up payment in respect of such benefits).

The employment agreement also provides that Mr. Barnes was to be granted a make-whole payment on or as soon as practicable after the date he commences employment with the Company. This payment will be comprised of (i) a cash payment equal to $641,666 (in respect of the 2010 annual bonus that Mr. Barnes forfeited by his termination of employment with Fossil, Inc.), and (ii) a number of stock options and restricted shares equal to the value of the unvested Fossil, Inc. stock appreciation rights and restricted shares held by Mr. Barnes (and forfeited by him) on the date of his termination of employment with Fossil, Inc. Due to accounting and other considerations, the Company and Mr. Barnes agreed to the issuance of shares and restricted shares only. On January 19, 2011, the Compensation Committee granted to Mr. Barnes, 116,392 unrestricted shares equal to the value of restricted stock and unvested stock appreciation rights from Fossil, Inc. that would have vested in February, March and June 2011 ($5.0 million), and 173,162 restricted shares equal to the value of the remaining restricted stock and unvested stock appreciation rights from Fossil, Inc. that would have vested in Fiscal 2013 ($3.9 million), 2014 ($2.6 million) and 2015 ($0.8 million) in satisfaction of this make whole obligation. 11,432 restricted shares will vest on February 1, 2012; 67,734 restricted shares will vest on March 15, 2012; 12,917 restricted shares will vest on June 1, 2012; 61,127 restricted shares will vest on March 15, 2013; and 19,952 restricted shares will vest on March 15, 2014.

As Chief Executive Officer, Mr. Barnes is required to build a holding of Common Shares equal to at least five times his base salary over a five-year period and is subject to all written Board policies in effect during his employment, including any policies relating to the clawback of compensation. The Company has agreed to provide Mr. Barnes with coverage under a directors and officers liability insurance policy while employed under the Employment Agreement, at a level no less than that maintained for substantially all of the executive officers of the Company or Signet and the members of the Board of Directors of Signet.

Mr. Barnes will be entitled to severance payments (i) if he is terminated by the Company without cause (as defined in the Employment Agreement), (ii) if Mr. Barnes terminates his employment for good reason (as defined in the Employment Agreement) either prior to or following a change in control of the Company or Signet (as defined in the Employment Agreement), or (iii) if he dies during the term of the Employment Agreement. In the event of any such termination, in addition to any accrued but unpaid benefits or obligations as of the date of termination, Mr. Barnes generally will be entitled to (i) continued payment of base salary for 12 months following the date of termination, (ii) a lump sum amount equal to the target annual bonus for the fiscal year in which such termination occurs, (iii) a lump sum amount in respect of each then-ongoing performance cycle under the long-term incentive plan based on actual performance for any completed fiscal year and assuming that target performance was attained for the fiscal year of termination, pro-rated based on the number of calendar days that Mr. Barnes was employed during such fiscal year, (iv) continued group medical coverage for Mr. Barnes and his eligible dependents for up to 12 months following the date of termination, and (v) vesting of unvested stock options or restricted shares granted to Mr. Barnes as part of his make-whole payment. If Mr. Barnes is terminated by the Company for cause or resigns without good reason, he will be entitled to accrued and unpaid benefits or obligations as well as a lump sum amount based on his annual target bonus for the fiscal year of termination, pro-rated for the number of days he was employed during such fiscal year. All severance payments and benefits (that were not accrued prior to termination) will be conditioned on the execution of a general release of claims against the Company, its affiliates and related parties and on continued compliance with the restricted covenants discussed above.

During the term of employment and for specified periods thereafter, Mr. Barnes will be subject to confidentiality, non-solicitation, and non-competition restrictions.

ii) Ronald Ristau

Mr. Ristau has an employment agreement dated April 12, 2010 with a US subsidiary. He joined the Company on April 15, 2010 as Chief Financial Officer Designate and succeeded Mr. Boyd upon his retirement in June 2010. During the term of employment, Mr. Ristau will (i) receive a starting salary of $650,000, subject to annual review, (ii) be eligible for an annual target bonus of 60% of base salary in accordance with the Company s annual bonus plan then in effect and (iii) be eligible for a long-term incentive bonus with a target payment of 115% of base salary to be comprised of cash and/or equity based awards.

The Company may terminate the agreement at any time by notice in writing with immediate effect. In the case of termination other than for cause (as defined in the contract), the Company is obligated to continue to pay salary for 12 months from the date of termination. Mr. Ristau would also be entitled to earn a bonus and Omnibus Incentive Plan award on a pro-rata basis for the year of termination. The agreement contains confidentiality and non-competition clauses. Termination will be subject to severance obligations if Mr. Ristau s employment is terminated without cause (as defined in the agreement) or if Mr. Ristau terminates his employment due to constructive termination (as defined in the agreement and including certain events occurring within the one-year following a change of control). Upon the events described above, in addition to any accrued but unpaid benefits or obligations as of the date of termination, Mr. Ristau will be entitled to (i) continued payment of base salary then in effect for 12 months (6 months in the case of the executive s resignation during a specified period as described in the definition of constructive termination), (ii) a pro-rata portion of the annual bonus for the fiscal year in which such termination occurs, and (iii) a pro-rata portion of the Omnibus Incentive Plan award for the performance period in which such termination occurs. The agreement also includes other customary terms, including with respect to disability and death.

During the term of employment and for specified periods thereafter, Mr. Ristau will be subject to confidentiality, non-solicitation, and non-competition restrictions.

Table of Contents

iii) Mark Light

Mr. Light has an employment contract dated April 26, 2002, as amended and restated with a US subsidiary. The Company may terminate the agreement at any time by notice in writing with immediate effect. In the case of termination other than for cause (as defined in the agreement), the Company is obligated to continue to pay salary for 12 months from the date of termination and pay Mr. Light a pro-rata portion of his annual bonus for the year of termination. Mr. Light also receives a pro rata portion of his annual bonus upon disability and six months of salary continuation and a pro rata portion of his annual bonus upon death. Entitlement to any share options or LTIP awards is governed by the terms of the relevant plan, and the agreement contains confidentiality and non-competition clauses. See below for further details of termination payments. In recognition of Mr. Light s important role in the transition of Mr. Barnes into his new position as Chief Executive Officer, the Company has agreed it is important to retain Mr. Light s services for the Company; in order to do so the Board of Directors has agreed to make a cash payment to him of $750,000 (subject to legally required deductions), provided that he continues to be an employee of the Company in good standing on August 1, 2012. The payment will be made as soon as practical following that date.

During the term of employment and for specified periods thereafter, Mr. Light will be subject to confidentiality, non-solicitation and non-competition restrictions.

iv) Robert Anderson

Mr. Anderson has an employment contract dated March 1, 2003 with a UK subsidiary which can be terminated on one year s notice in writing by either party or terminates on his 65th birthday. In the case of early termination, the agreement provides for salary to be paid in lieu of notice for 12 months from date of termination and a pro-rata portion of his annual bonus for the year of termination. Entitlement to any share options or LTIP awards is governed by the terms of the relevant plan, and the agreement contains confidentiality and non-competition clauses. See below for further details of termination payments. In recognition of Mr. Anderson s important role in the transition of Mr. Barnes into his new position as Chief Executive Officer, the Company agreed it is important to retain Mr. Anderson s services for the Company. In order to do so, the Board of Directors agreed to make a cash payment to him of $500,000 (subject to legally required deductions), provided that he continues to be an employee of the Company in good standing on August 1, 2012. The payment, which will be made in pounds sterling calculated at the exchange rate in effect on August 1, 2012, will be made as soon as practical following that date.

v) William Montalto

Mr. Montalto has an employment contract dated May 10, 1996, as amended and restated with a US subsidiary. The Company may terminate the agreement at any time by notice in writing with immediate effect. In the case of termination other than for cause (as defined in the agreement) the Company is obligated to continue to pay salary for 12 months from the date of termination and pay Mr. Montalto a pro-rata portion of his annual bonus for the year of termination. Mr. Montalto also receives a pro rata portion of his annual bonus upon disability and six months of salary continuation and a pro rata portion of his annual bonus upon death. Entitlement to any share options or LTIP awards is governed by the terms of the relevant plan, and the agreement contains confidentiality and non-competition clauses. See below for further details of termination payments.

During the term of employment and for specified periods thereafter, Mr. Montalto will be subject to confidentiality, non-solicitation and non-competition restrictions.

vi) Terry Burman

Mr. Burman had an employment agreement dated December 20, 2000, as amended and restated with a US subsidiary, with certain covenants given by Signet Jewelers Limited. Mr. Burman retired from the Company on

January 29, 2011. The agreement provided for a 3% increase in base salary in each of Fiscal 2010 (which was declined by Mr. Burman) and 2011 and a retention payment equal to $6,547,709, in lieu of the grant of any award under the Signet Jewelers Limited Long Term Incentive Plans in Fiscal 2010 and Fiscal 2011. An increase in basic salary of 6.1% was agreed for Fiscal 2011, which reflected the contractual undertaking for Fiscal 2010 and Fiscal 2011. The Compensation Committee agreed to amend Mr. Burman s agreement in this way in 2008, as being in the best interests of the Company s Shareholders to secure his continued service until the end of Fiscal 2011, thereby providing consistency and stability at a time of general economic difficulty and securing the continuation of his services through three holiday trading periods (Fiscal 2009, Fiscal 2010 and Fiscal 2011), being key trading periods for the Company. The retention payment was paid, in a cash lump sum on January 31, 2011.

Following Mr. Burman s retirement from the Company on January 29, 2011, the Compensation Committee exercised its discretion, where possible under the terms of the relevant compensation plans, to extend exercisability of options beyond cessation of Mr. Burman s employment (but not beyond normal lapse dates) for already vested options of 156,463 options having an exercise price of $41.00 until their stated lapse date of April 4, 2014.

Mr. Burman currently holds awards under the Company s old long term incentive plan entitling him to certain stock and cash, valued at $3,638,000 based upon the closing price of a common share of $41.56 at January 29, 2011, if specified performance criteria are met. The specified performance criteria for this award were achieved to the extent of 16% of the total award.

vii) Walker Boyd

Mr. Boyd had an employment agreement dated June 14, 1995, as amended with a UK subsidiary. Mr. Boyd retired from the Company on June 25, 2010.

In response to Mr. Boyd s intention to retire in June 2010, and in recognition of his long and distinguished service with the Company, the Compensation Committee exercised its discretion, where possible under the terms of the relevant compensation plans, to accelerate vesting of options and restricted stock grants and extend exercisability of options beyond cessation of his employment (but not beyond normal lapse dates) as follows:

For 62,338 already vested options having an exercise price ranging from $21.95 to $41.00, the Compensation Committee extended the exercise date of these options for an additional 12 months following cessation of employment or until their normal lapse date;

For 40,407 options having an exercise price of $24.80 that have not yet vested, the Compensation Committee agreed to permit exercise of these options until their stated lapse date of April 13, 2018;

For time-based restricted stock grants, the Compensation Committee accelerated vesting of 4,777 restricted stock units pro rata from the date of grant to June 25, 2010;

For performance-based restricted stock grants, the Compensation Committee accelerated vesting of 13,535 restricted stock units, pro rata from the date of grant to June 25, 2010 (first full year of three year performance cycle, and first five months of second year, with pro rata performance criteria to be based upon actual performance).

Mr. Boyd currently holds awards under the Company s old long term incentive plan entitling him to certain stock and cash, valued at $848,018 based upon the closing price of a Common Share of $41.56 at January 29, 2011, if specified performance criteria are met. The specified performance criteria for this award was achieved to the extent of 16% of the total award but pro-rata to June 25, 2010.

As reflected above, the Compensation Committee agreed that any short term bonus due to Mr. Boyd in respect of Fiscal 2011 would be paid pro rata to his date of retirement.

Table of Contents

(h) Termination for Cause and Violation of Non-Compete Covenants

Share options granted under the employee incentive plans may not be exercised after a termination for cause. Performance-based restricted share units will not vest if termination for cause occurs before the conclusion of the three-year performance period. All executive officer service agreements contain a non-competition covenant that has between a 9 and 12 month post-employment term. Violation of the non-compete covenants will result in potential litigation.

(i) Limitation under Section 162(m) of the Revenue Code

Section 162(m) of the Revenue Code generally denies a federal income tax deduction to the Company for compensation in excess of $1 million per year paid to certain of the named executive officers. This denial of deduction is subject to an exception for performance-based compensation . Although the Committee has designed the executive compensation program with tax considerations in mind, the Committee does not believe that it would be in the best interests of the Company to adopt a policy that would preclude compensation arrangements subject to deduction limitations and current outstanding cash and equity awards do not qualify as performance-based compensation.

(j) Claw Back

Recognizing that the SEC has yet to publish regulations on claw back policies as mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act, the Compensation Committee considered it to be appropriate to adopt an interim claw back policy. The policy provides that in the event of a material restatement of the Company s financial results, the Compensation Committee will recalculate incentive compensation based on the restated results. In the event of an overpayment, the Company will seek to recover the difference, balancing the amount to be recovered against the cost of doing so. Similarly in the interest of fairness, should a restatement result in an under payment of incentive compensation, the Company will make up any difference.

(k) Share Ownership Policy/Hedging Prohibition

It is the Company s policy that the Chief Executive Officer build a holding of Common Shares equal to at least five times his base salary over a five-year period. In addition, a $250,000 minimum share ownership requirement, to be achieved within five years of selection as Chairman, is required of the Chairman, and a $150,000 minimum share ownership requirement, to be achieved within five years of election to the Board is required of the independent directors. However once achieved at any given share price, the requirement is considered to have been met notwithstanding any subsequent change in share price. Once achieved, the holding is to be maintained while a director of the Company (or with respect to the Chief Executive Officer, so long as he holds such office). It is the Company s policy to prohibit hedging or monetization transactions that would allow an officer, director or employee who is a security holder to engage in transactions that would separate the risks and rewards of ownership of Company securities from actual ownership of those securities.

Table of Contents

REPORT OF THE COMPENSATION COMMITTEE

The Compensation Committee has reviewed and discussed with the Company s management the Compensation Discussion and Analysis section of this Proxy Statement. Based on this review and discussions, we have recommended to the Board of Directors that the Compensation Discussion and Analysis be included in the Proxy Statement.

Members of the Compensation Committee:

Robert Blanchard (Chairman)

Dale Hilpert

Thomas Plaskett

Table of Contents

EXECUTIVE COMPENSATION

SUMMARY COMPENSATION TABLE

Salary $	Stock Awards $(1)	Option Awards $(1)	Non-equity incentive plan compensation $	Change in pension value and non-quali deferred compensatio earnings $(2)
,704,668			**3,111,568**	
,622,250			3,244,500	
,613,891				

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

8

Table of Contents

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).

Table of Contents

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.

10

Table of Contents

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

Table of Contents

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

12

Table of Contents

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

13

Table of Contents

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

Table of Contents

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.

15

Table of Contents

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.

Table of Contents

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)		
Assets at Fair Value					
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	$ 159,558	$ 204,542	$ 17,919	$ (63,496)	$ 318,523

17

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Counterparty and Cash Collateral Netting	Balance at June 30, 2013
	(dollars in millions)				
Liabilities at Fair Value					
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	$ 96,890	$ 133,957	$ 6,017	$ (38,787)	$ 198,077

(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.

18

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Counterparty and Cash Collateral Netting	Balance at December 31, 2012
			(dollars in millions)		
Liabilities at Fair Value					
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.

Table of Contents

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.

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

22

Table of Contents

MORGAN STANLEY

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)								
Assets at Fair Value									
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

Table of Contents

MORGAN STANLEY

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)								
Liabilities at Fair Value									
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	151	3						148	3
Other secured financings	406	29			14	(135)		256	21
Long-term borrowings	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.

24

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Changes in Level 3 Assets and Liabilities Measured at Fair Value on a Recurring Basis for 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)								
Assets at Fair Value									
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)	
	3,807	562	208	(2)	(669)	(398)	(325)	3,183	353

Total net derivative and other contracts								
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)

25

Table of Contents

MORGAN STANLEY

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)								
Liabilities at Fair Value									
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.

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Changes in Level 3 Assets and Liabilities Measured at Fair Value on a Recurring Basis for the 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)					
Assets at Fair Value									
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	43	(40)				(207)	(20)	(224)	(102)
Equity contracts	(1,234)	117	211	(1)	(74)	(244)	52	(1,173)	102
	570	320	5		(4)	34	12	937	338

Commodity contracts									
Other	(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)

Table of Contents

MORGAN STANLEY

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)								
Liabilities at Fair Value									
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.

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Quantitative Information about and Sensitivity of Significant Unobservable Inputs Used in Recurring Level 3 Fair Value Measurements at 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)
Assets					
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)	Comparable bond price / (A)	17 to 94 points	63 points
		Correlation model	Credit correlation / (B)	38 to 50%	47%
Loans and lending commitments	5,243	Corporate loan model	Credit spread / (C)	15 to 894 basis points	194 basis points
		Comparable pricing	Comparable bond price / (A)	80 to 120 points	101 points
		Margin loan model	Credit spread / (C)(D)	30 to 306 basis points	195 basis points
			Volatility skew / (C)(D)	-2 to 0%	-2%
		Option model	At the money volatility /(A)	31 to 42%	34%
		Comparable pricing(6)	Comparable loan price / (A)	24 to 101 points	86 points
Corporate equities(3)	256	Net asset value(6)	Discount to net asset value / (C)	0 to 50%	19%
		Comparable pricing	Comparable equity price / (A)	0 to 100%	43%
		Comparable pricing	Comparable price / (A)	8 to 100 points	58 points
		Market approach	EBITDA multiple / (A)	7 times	7 times
Net derivative and other contracts:					
Interest rate contracts	16	Option model	Interest rate volatility concentration liquidity multiple / (C)(D)	0 to 8 times	2 times
			Comparable bond price / (A)(D)	5 to 98 points	51 points / 51 points(4)

			Interest rate - Foreign exchange correlation / (A)(D)	2 to 63%	32% / 38%(4)
			Interest rate volatility skew / (A)(D)	25 to 55%	43% / 35%(4)
			Interest rate quanto correlation / (A)(D)	-53 to 33%	-5% / -9%(4)
			Interest rate curve correlation / (A)(D)	35 to 88%	67% / 70%(4)
			Inflation volatility / (A)(D)	77 to 83%	79% / 78%(4)
Credit contracts	685	Comparable pricing	Cash synthetic basis / (C)(D)	2 to 10 points	4 points
			Comparable bond price / (C)(D)	0 to 84 points	27 points
		Correlation model(6)	Credit correlation / (B)	34 to 90%	54%
Foreign exchange contracts(5)	(96)	Option model	Comparable bond price / (A)(D)	5 to 98 points	51 points / 51 points(4)
			Interest rate quanto correlation / (A)(D)	-53 to 33%	-5% / -9%(4)
			Interest rate - Credit spread correlation / (A)(D)	-59 to 47%	-5% / -3%(4)
			Interest rate curve correlation / (A)(D)	35 to 88%	67% / 70%(4)
			Interest rate - Foreign exchange correlation / (A)(D)	2 to 63%	32% / 38%(4)
			Interest rate volatility skew / (A)(D)	25 to 55%	43% / 35%(4)
			Interest rate curve / (A)(D)	0 to 2%	1% / 1%(4)

Table of Contents

MORGAN STANLEY

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)
Equity contracts(5)	(1,284)	Option model	At the money volatility / (A)(D)	18 to 38 %	34%
			Volatility skew / (A)(D)	-1 to 1 %	-1%
			Equity - Equity correlation / (C)(D)	40 to 99%	71%
			Equity - Foreign exchange correlation / (C)(D)	-70 to 9%	-22%
			Equity - Interest rate correlation / (C)(D)	5 to 68%	38% /34%(4)
Commodity contracts	781	Option model	Forward power price / (C)(D)	$10 to $113 per Megawatt hour	$39 per Megawatt hour
			Commodity volatility / (A)(D)	12 to 58%	12%
			Cross commodity correlation / (C)(D)	43 to 98%	97%
Investments(3):					
Principal investments	2,822	Discounted cash flow	Implied weighted average cost of capital / (C)(D)	10 to 12%	10%
			Exit multiple / (A)(D)	7 to 10 times	9 times
		Discounted cash flow(6)	Capitalization rate / (C)(D)	6 to 9%	7%
			Equity discount rate / (C)(D)	10 to 35%	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)	10 to 12%	10%
			Exit multiple / (A)(D)	5 to 7 times	6 times
		Market approach(6)	EBITDA multiple / (A)	7 to 8 times	8 times
Liabilities					
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)	25 to 33%	28%
			Volatility skew / (A)(D)	-1 to 0%	-1%
			Equity - Equity correlation / (A)(D)	50 to 90%	73%
			Equity - Foreign exchange correlation / (A)(D)	-70 to 9%	-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.

Table of Contents

MORGAN STANLEY

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
Assets					
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	Comparable bond price / (A)	15 to 88 points	59 points
		Correlation model	Credit correlation / (B)	15 to 45%	40%
Loans and lending commitments	4,694	Corporate loan model	Credit spread / (C)	17 to 1,004 basis points	281 basis points
		Comparable pricing	Comparable bond price / (A)	80 to 120 points	104 points
		Comparable pricing	Comparable loan price / (A)	55 to 100 points	88 points
Corporate equities(2)	288	Net asset value	Discount to net asset value / (C)	0 to 37%	8%
		Comparable pricing	Discount to comparable equity price / (C)	0 to 27 points	14 points
		Market approach	EBITDA multiple / (A)	6 times	6 times
Net derivative and other contracts:					
Interest rate contracts	(82)	Option model	Interest rate volatility concentration liquidity multiple / (C)(D)	0 to 8 times	See(3)
			Comparable bond price / (A)(D)	5 to 98 points	
			Interest rate - Foreign exchange correlation / (A)(D)	2 to 63%	
			Interest rate volatility skew / (A)(D)	9 to 95%	
			Interest rate quanto correlation / (A)(D)	-53 to 33%	
			Interest rate curve correlation / (A)(D)	48 to 99%	
			Inflation volatility / (A)(D)	49 to 100%	
		Discounted cash flow	Forward commercial paper rate-LIBOR basis / (A)	-18 to 95 basis points	
Credit contracts	1,822	Comparable pricing	Cash synthetic basis / (C)	2 to 14 points	See(4)
			Comparable bond price / (C)	0 to 80 points	
		Correlation model	Credit correlation / (B)	14 to 94%	

Foreign exchange contracts(5)	(359)	Option model	Comparable bond price / (A)(D)	5 to 98 points	See(6)
			Interest rate quanto correlation / (A)(D)	-53 to 33%	
			Interest rate -Credit spread correlation / (A)(D)	-59 to 65%	
			Interest rate - Foreign exchange correlation / (A)(D)	2 to 63%	
			Interest rate volatility skew / (A)(D)	9 to 95%	
Equity contracts(5)	(1,144)	Option model	At the money volatility / (C)(D)	7 to 24%	See(7)
			Volatility skew / (C)(D)	-2 to 0%	
			Equity - Equity correlation / (C)(D)	40 to 96%	
			Equity - Foreign exchange correlation / (C)(D)	-70 to 38%	
			Equity - Interest rate correlation / (C)(D)	18 to 65%	
Commodity contracts	709	Option model	Forward power price / (C)(D)	$28 to $84 per Megawatt hour	
			Commodity volatility / (A)(D)	17 to 29%	
			Cross commodity correlation / (C)(D)	43 to 97%	
Investments(2):					
Principal investments	2,833	Discounted cash flow	Implied weighted average cost of capital / (C)(D)	8 to 15%	9%
			Exit multiple / (A)(D)	5 to 10 times	9 times
		Discounted cash flow	Capitalization rate / (C)(D)	6 to 10%	7%
			Equity discount rate / (C)(D)	15 to 35%	23%
		Market approach	EBITDA multiple / (A)	3 to 17 times	10 times

31

Table of Contents

MORGAN STANLEY

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%
			Exit multiple / (A)(D)	6 times	6 times
		Market approach	EBITDA multiple / (A)	6 to 8 times	7 times
Liabilities					
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	Comparable bond price / (A)	55 to 139 points	102 points
		Discounted cash flow	Funding spread / (A)	183 to 186 basis points	184 basis points
Long-term borrowings	2,789	Option model	At the money volatility / (A)(D)	20 to 24%	24%
			Volatility skew / (A)(D)	-1 to 0%	0%
			Equity - Equity correlation / (A)(D)	50 to 90%	77%
			Equity - Foreign exchange correlation / (A)(D)	-70 to 36%	-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

Table of Contents

MORGAN STANLEY

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

33

Table of Contents

MORGAN STANLEY

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.

Table of Contents

MORGAN STANLEY

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.

Table of Contents

MORGAN STANLEY

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:

	Trading	Interest Income (Expense)	Gains (Losses) Included in Net Revenues
		(dollars in millions)	
Three Months Ended June 30, 2013			
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
Six Months Ended June 30, 2013			
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
Three Months Ended June 30, 2012			
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
Six Months Ended June 30, 2012			
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

Table of Contents

MORGAN STANLEY

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:

Business Unit	Short-term and Long-term Borrowings At June 30, 2013	At December 31, 2012
	(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	$ 42,409	$ 44,769

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

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

	Three Months Ended June 30, 2013	2012	Six Months Ended June 30, 2013	2012
	(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.

Table of Contents

MORGAN STANLEY

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:				
	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)	Total Gains (Losses) for the Three Months Ended June 30, 2013(2)	Total Gains (Losses) for the Six Months Ended June 30, 2013(2)

	(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	$ 1,600	$	$ 1,254	$ 346	$ (70)	$ (112)

(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.

38

MORGAN STANLEY

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.

		Fair Value Measurements Using:				
	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)	Total Gains (Losses) for the Three Months Ended June 30, 2012(2)	Total Gains (Losses) for the Six Months Ended June 30, 2012(2)
			(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	$ 849	$	$ 146	$ 703	$ (22)	$ (33)

(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.

MORGAN STANLEY

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.

Table of Contents

MORGAN STANLEY

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)				
Financial Assets:					
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
Financial Liabilities:					
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.

Table of Contents

MORGAN STANLEY

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)		
Financial Assets:					
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
Financial Liabilities:					
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.

Table of Contents

MORGAN STANLEY

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				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Other-than-Temporary Impairment	Fair Value
	(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				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Other-than-Temporary Impairment	Fair Value
	(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.

43

Table of Contents

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 Fair Value	Less than 12 Months Gross Unrealized Losses	12 Months or Longer Fair Value	12 Months or Longer Gross Unrealized Losses	Total Fair Value	Total 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 Fair Value	Less than 12 Months Gross Unrealized Losses	12 Months or Longer Fair Value	12 Months or Longer Gross Unrealized Losses	Total Fair Value	Total 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

Table of Contents

MORGAN STANLEY

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.

At June 30, 2013	Amortized Cost	Fair Value	Annualized Average Yield
	(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	15,772	15,708	
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	14,364	14,228	
Total U.S. government and agency securities	30,136	29,936	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	2,426	2,362	
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	913	889	
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	2,056	2,050	

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

At June 30, 2013	Amortized Cost	Fair Value	Annualized Average Yield
	(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	3,679	3,614	
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	1,087	1,079	
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	2,911	2,918	
Total Corporate and other debt	13,072	12,912	1.1%
Total debt securities available for sale	$ 43,208	$ 42,848	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:

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

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

MORGAN STANLEY

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				
	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	Financial Instruments Not Offset in the Condensed Consolidated Statements of Financial Condition(3)	Net Exposure
			(dollars in millions)		
Assets					
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
Liabilities					
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				
	Gross Amounts(1)	Amounts Offset in the	Net Amounts	Financial Instruments	Net Exposure

		Condensed Consolidated Statements of Financial Condition(2)	Presented in the Condensed Consolidated Statements of Financial Condition	Not Offset in the Condensed Consolidated Statements of Financial Condition(3)	
			(dollars in millions)		
Assets					
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
Liabilities					
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

Table of Contents

MORGAN STANLEY

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:

	At June 30, 2013	At December 31, 2012
	(dollars in millions)	
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	9,788	26,377
Total	$ 38,052	$ 56,908

Table of Contents

MORGAN STANLEY

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.

Table of Contents

MORGAN STANLEY

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.

MORGAN STANLEY

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:

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

	At December 31, 2012				
	Mortgage and Asset-Backed Securitizations	Collateralized Debt Obligations	Managed Real Estate Partnerships	Other Structured Financings	Other
	(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.

MORGAN STANLEY

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	$ 22,826	$ 2,280	$ 2,078	$ 1,722	$ 3,558
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	$ 22,826	$ 1,983	$ 83	$ 670	$ 2,871
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	$	$ 2	$	$ 10	$ 54

(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.

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	At December 31, 2012				
	Mortgage and Asset-Backed Securitizations	Collateralized Debt Obligations	Municipal Tender Option Bonds	Other Structured Financings	Other
	(dollars in millions)				
VIE assets that the Company does not consolidate (unpaid principal balance)(1)	$ 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	$ 22,500	$ 1,224	$ 2,158	$ 1,732	$ 4,333
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	$ 22,436	$ 1,181	$ 4	$ 663	$ 3,561
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	$ 11	$ 2	$	$ 12	$ 172

(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

53

Table of Contents

MORGAN STANLEY

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:

	At June 30, 2013			
	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)	$ 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)	$ 52	$ 169	$ 1,953	$ 1,327
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)	$	102	$	92	$	11	$	422
Derivative assets (fair value)	$		$	776	$		$	176
Derivative liabilities (fair value)	$	2	$	1	$		$	189

(1) Amounts include assets transferred by unrelated transferors.

Table of Contents

MORGAN STANLEY

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

Table of Contents

MORGAN STANLEY

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:

	At June 30, 2013 Carrying Value of		At December 31, 2012 Carrying Value of	
	Assets	Liabilities	Assets	Liabilities
		(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.

Table of Contents

MORGAN STANLEY

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.

57

Table of Contents

MORGAN STANLEY

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.

Table of Contents

MORGAN STANLEY

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.

	Commercial and Industrial	Consumer	Residential Real Estate	Wholesale Real Estate	Total
			(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	$ 115	$ 1	$ 4	$ 5	$ 125
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	$ 115	$ 1	$ 4	$ 5	$ 125
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	$ 11,170	$ 9,452	$ 7,602	$ 863	$ 29,087
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	$ 109	$	$	$ 1	$ 110
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	$ 109	$	$	$ 1	$ 110
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	$ 52,245	$ 1,657	$ 2,093	$ 258	$ 56,253

(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.

Table of Contents

MORGAN STANLEY

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.

	Commercial and Industrial	Consumer	Residential Real Estate	Wholesale Real Estate	Total
			(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	$ 65	$ 6	$ 4	$ 2	$ 77
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	$ 96	$ 3	$ 5	$ 2	$ 106
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	$ 9,449	$ 7,618	$ 6,630	$ 326	$ 24,023
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	$ 28	$ 2	$	$ 2	$ 32
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	$ 90	$	$	$ 1	$ 91

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	$ 44,126	$ 1,406	$ 712	$ 101	$ 46,345

(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.

60

MORGAN STANLEY

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.

Table of Contents

MORGAN STANLEY

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:

	Institutional Securities(1)	Wealth Management(1)	Investment Management	Total
		(dollars in millions)		
Goodwill at December 31, 2012(2)	$ 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)
Goodwill at June 30, 2013(2)	$ 298	$ 5,562	$ 740	$ 6,600

(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.

Table of Contents

MORGAN STANLEY

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)		
Amortizable net intangible assets at December 31, 2012	$ 175	$ 3,600	$ 1	$ 3,776
Mortgage servicing rights (see Note 7)		7		7
Net intangible assets at December 31, 2012	$ 175	$ 3,607	$ 1	$ 3,783
Amortizable net intangible assets at December 31, 2012	$ 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)
Amortizable net intangible assets at June 30, 2013	163	3,429	1	3,593
Mortgage servicing rights (see Note 7)		9		9
Net intangible assets at June 30, 2013	$ 163	$ 3,438	$ 1	$ 3,602

(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	$ 161,098	$ 169,571

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.

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Company s other secured financings consisted of the following:

	At June 30, 2013	At December 31, 2012
	(dollars in millions)	
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.

Table of Contents

MORGAN STANLEY

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					
				Amounts Not Offset in the Condensed Consolidated Statements of Financial Condition(3)		
	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	Financial Instruments Collateral	Other Cash Collateral	Net Exposure
	(dollars in millions)					
Derivative assets						
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
Derivative liabilities						
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.

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	At December 31, 2012					
				Amounts Not Offset in the Condensed Consolidated Statements of Financial Condition(3)		
	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	Financial Instruments Collateral	Other Cash Collateral	Net Exposure
	(dollars in millions)					
Derivative assets						
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	$ 1,004,251	$ (968,054)	$ 36,197	$ (7,691)	$ (232)	$ 28,274
Derivative Liabilities						
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	$ 978,773	$ (941,815)	$ 36,958	$ (8,899)	$ (87)	$ 27,972

(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.

Table of Contents

MORGAN STANLEY

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 Less than 1	1-3	3-5	Over 5	Cross-Maturity and Cash Collateral Netting(3)	Net Exposure Post-Cash Collateral	Net Exposure Post-Collateral
	(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	$ 19,274	$ 18,387	$ 18,999	$ 56,576	$ (81,492)	$ 31,744	$ 24,409

(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 Less than 1	1-3	3-5	Over 5	Cross-Maturity and Cash Collateral Netting(3)	Net Exposure Post-Cash Collateral	Net Exposure Post-Collateral
	(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	$ 13,885	$ 20,607	$ 24,331	$ 69,244	$ (96,743)	$ 31,324	$ 23,633

(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.

Table of Contents

MORGAN STANLEY

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.

Table of Contents

MORGAN STANLEY

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 (dollars in millions)

	Fair Value				Notional			
	Bilateral OTC	**Cleared OTC(2)**	**Exchange Traded**	**Total**	**Bilateral OTC**	**Cleared OTC(2)**	**Exchange Traded**	**Total**
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

69

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Derivative Liabilities At June 30, 2013 (dollars in millions)

	Fair Value				Notional			
	Bilateral OTC	Cleared OTC(2)	Exchange Traded	Total	Bilateral OTC	Cleared OTC(2)	Exchange Traded	Total
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.

Table of Contents

MORGAN STANLEY

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

Table of Contents

MORGAN STANLEY

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:

	Gains (Losses) Recognized			
	Three Months Ended June 30,		Six Months Ended June 30,	
Product Type	**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

72

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Derivatives Designated as Net Investment Hedges.

	Gains Recognized in OCI (effective portion)			
	Three Months Ended June 30,		Six Months Ended June 30,	
Product Type	**2013**	**2012(1)**	**2013**	**2012(1)**
	(dollars in millions)			
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:

	Gains (Losses) Recognized in Income(1)(2)			
	Three Months Ended June 30,		Six Months Ended June 30,	
Product Type	**2013**	**2012**	**2013**	**2012**
	(dollars in millions)			
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

Table of Contents

MORGAN STANLEY

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)

74

Table of Contents

MORGAN STANLEY

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	$ 1,893,192	$ 10,883	$ 1,907,401	$ (14,656)

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

	Protection Sold Maximum Potential Payout/Notional Years to Maturity					Fair Value
Credit Ratings of the Reference Obligation	**Less than 1**	**1-3**	**3-5**	**Over 5**	**Total**	**(Asset)/ Liability(1)(2)**
	(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	277,735	290,577	337,328	56,097	961,737	(510)
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	114,159	247,438	382,586	30,886	775,069	4,810
Total credit default swaps sold	$ 391,894	$ 538,015	$ 719,914	$ 86,983	$ 1,736,806	$ 4,300
Other credit contracts(4)(5)	$ 354	$ 44	$ 137	$ 1,181	$ 1,716	$ (390)
Total credit derivatives and other credit contracts	$ 392,248	$ 538,059	$ 720,051	$ 88,164	$ 1,738,522	$ 3,910

(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.

Table of Contents

MORGAN STANLEY

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:

	Protection Sold Maximum Potential Payout/Notional Years to Maturity					Fair Value
Credit Ratings of the Reference Obligation	**Less than 1**	**1-3**	**3-5**	**Over 5**	**Total**	**(Asset)/ Liability(1)(2)**
			(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

Table of Contents

MORGAN STANLEY

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 tranched 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.

MORGAN STANLEY

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				
	Less than 1	1-3	3-5	Over 5	Total at June 30, 2013
	(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
Total	$ 64,303	$ 21,223	$ 44,281	$ 5,089	$ 134,896

(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.

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Guarantees.

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

	Maximum Potential Payout/Notional Years to Maturity					Carrying Amount (Asset)/ Liability	Collateral/ Recourse
Type of Guarantee	**Less than 1**	**1-3**	**3-5**	**Over 5**	**Total**		
				(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.

Table of Contents

MORGAN STANLEY

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.

Table of Contents

MORGAN STANLEY

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

Table of Contents

MORGAN STANLEY

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*

Table of Contents

MORGAN STANLEY

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.

83

Table of Contents

MORGAN STANLEY

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 rescissionary 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 rescissionary 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.

Table of Contents

MORGAN STANLEY

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).

85

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table summarizes the capital measures for the Company:

	June 30, 2013		December 31, 2012	
	Balance	Ratio	Balance	Ratio
	(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:

	June 30, 2013		December 31, 2012	
	Amount	Ratio	Amount	Ratio
	(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%

Table of Contents

MORGAN STANLEY

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.

Table of Contents

MORGAN STANLEY

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	(4,482)
Balance at June 30, 2013	$

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):

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

Balance at June 30, 2013	$ (420)	$ (3)	$ (218)	$ (528)	$ (1,169)

MORGAN STANLEY

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):

	Foreign Currency Translation Adjustments	Net Change in Cash Flow Hedges	Change in Net Unrealized Gains (Losses) on Securities Available for sale	Pension, Postretirement and Other Related Adjustments	Total
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	$ (420)	$ (3)	$ (218)	$ (528)	$ (1,169)

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.

Table of Contents

MORGAN STANLEY

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):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Basic EPS:				
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	$ 803	$ 564	$ 1,739	$ 446
Weighted average common shares outstanding	1,908	1,885	1,904	1,881
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	$ 0.42	$ 0.30	$ 0.91	$ 0.24
Diluted EPS:				
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	1,951	1,912	1,946	1,907
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	$ 0.41	$ 0.29	$ 0.89	$ 0.23

(1) RSUs that are considered participating securities participate in all of the earnings of the Company in the computation of basic EPS, and, therefore, such RSUs are not included as incremental shares in the diluted calculation.

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

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

16. Interest Income and Interest Expense.
Details of Interest income and Interest expense were as follows:

	Three Months Ended June 30, 2013	Three Months Ended June 30, 2012	Six Months Ended June 30, 2013	Six Months Ended June 30, 2012
	(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	330	376	666	783
Total interest income	$ 1,422	$ 1,323	$ 2,820	$ 2,865
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	(263)	(189)	(510)	(363)
Total interest expense	$ 1,218	$ 1,483	$ 2,431	$ 3,084
Net interest	$ 204	$ (160)	$ 389	$ (219)

(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.

Table of Contents

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%.

Table of Contents

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:

Three Months Ended June 30, 2013	Institutional Securities	Wealth Management	Investment Management	Intersegment Eliminations	Total
			(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)	$ 4,346	$ 3,531	$ 673	$ (47)	$ 8,503
Income from continuing operations before income taxes	$ 960	$ 655	$ 160	$	$ 1,775
Provision for income taxes	288	229	38		555
Income from continuing operations	672	426	122		1,220
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	(18)			(11)	(29)
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	$ 564	$ 326	$ 101	$ (11)	$ 980

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Three Months Ended June 30, 2012	Institutional Securities(3)	Wealth Management(3)	Investment Management	Intersegment Eliminations	Total
			(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)	$ 3,332	$ 3,196	$ 456	$ (42)	$ 6,942
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	419	261	37	(4)	713
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	(28)	61		4	37
Net income	391	322	37		750
Net income applicable to nonredeemable noncontrolling interests	45	91	23		159
Net income applicable to Morgan Stanley	$ 346	$ 231	$ 14	$	$ 591

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Six Months Ended June 30, 2013	Institutional Securities	Wealth Management	Investment Management (dollars in millions)	Intersegment Eliminations	Total
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)	$ 8,435	$ 7,001	$ 1,318	$ (93)	$ 16,661
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	1,410	803	257		2,470
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	(37)	(1)	1	(11)	(48)
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	$ 1,186	$ 581	$ 186	$ (11)	$ 1,942

Six Months Ended June 30, 2012	Institutional Securities(3)	Wealth Management(3)	Investment Management (dollars in millions)	Intersegment Eliminations	Total
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)	$ 6,467	$ 6,487	$ 989	$ (77)	$ 13,866
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	196	542	127	(4)	861

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		(44)		62		1		4		23
Net income		152		604		128				884
Net income applicable to nonredeemable noncontrolling interests		124		175		88				387
Net income applicable to Morgan Stanley	$	28	$	429	$	40	$		$	497

95

Table of Contents

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.

Total Assets(1)	Institutional Securities(2)	Wealth Management(2)	Investment Management	Total
		(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.

Net Revenues	Three Months Ended June 30, 2013	Three Months Ended June 30, 2012	Six Months Ended June 30, 2013	Six Months Ended June 30, 2012
	(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.

96

Table of Contents

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:

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

(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.

97

Table of Contents

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).

Table of Contents

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

Table of Contents

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

100

Table of Contents

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
Net revenues:				
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	$ 8,503	$ 6,942	$ 16,661	$ 13,866
Net income	$ 1,191	$ 750	$ 2,422	$ 884
Net income applicable to redeemable noncontrolling interests(2)	100		222	
Net income applicable to nonredeemable noncontrolling interests(2)	111	159	258	387
Net income applicable to Morgan Stanley	$ 980	$ 591	$ 1,942	$ 497
Income from continuing operations applicable to Morgan Stanley:				
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	$ 1,009	$ 562	$ 1,990	$ 483
Amounts applicable to Morgan Stanley:				
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
Net income applicable to Morgan Stanley	$ 980	$ 591	$ 1,942	$ 497
	$ 803	$ 564	$ 1,739	$ 446

Earnings applicable to Morgan Stanley common shareholders				
Earnings per basic common share:				
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)	$ 0.42	$ 0.30	$ 0.91	$ 0.24
Earnings per diluted common share:				
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)	$ 0.41	$ 0.29	$ 0.89	$ 0.23
Regional net revenues:				
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

101

Table of Contents

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

	Three Months Ended June 30, 2013	Three Months Ended June 30, 2012	Six Months Ended June 30, 2013	Six Months Ended June 30, 2012
Average common equity (dollars in billions):				
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	$ 61.5	$ 61.4	$ 61.2	$ 61.0
Return on average common equity(5):				
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%
Book value per common share(6)	$ 31.48	$ 31.02	$ 31.48	$ 31.02
Tangible common equity(7)	$ 51,479	$ 54,765	$ 51,479	$ 54,765
Return on average tangible common equity from continuing operations(8)	6.3%	3.9%	6.7%	1.6%
Tangible book value per common share(9)	$ 26.27	$ 27.70	$ 26.27	$ 27.70
Effective income tax rate from continuing operations(10)	31.3%	23.9%	26.4%	24.4%
Worldwide employees at June 30, 2013 and 2012	55,610	58,627	55,610	58,627
Global liquidity reserve held by the bank and non-bank legal entities at June 30, 2013 and 2012 (dollars in billions)(11)	$ 181	$ 173	$ 181	$ 173
Average global liquidity reserve (dollars in billions)(11):				
Bank legal entities	$ 65	$ 63	$ 68	$ 63
Non-bank legal entities	119	113	118	114
Total average global liquidity reserve	$ 184	$ 176	$ 186	$ 177
Long-term borrowings at June 30, 2013 and 2012	$ 161,098	$ 167,828	$ 161,098	$ 167,828
Maturities of long-term borrowings outstanding at June 30, 2013 and 2012 (next 12 months)	$ 26,921	$ 25,356	$ 26,921	$ 25,356
Capital ratios at June 30, 2013 and 2012:				
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%
Consolidated assets under management or supervision at June 30, 2013 and 2012 (dollars in billions)(14):				
Investment Management(15)	$ 347	$ 311	$ 347	$ 311
Wealth Management(1)(16)	625	511	625	511
Total	$ 972	$ 822	$ 972	$ 822

102

Table of Contents

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

	Three Months Ended June 30, 2013	Three Months Ended June 30, 2012	Six Months Ended June 30, 2013	Six Months Ended June 30, 2012
Institutional Securities(1):				
Pre-tax profit margin(17)	22%	15%	21%	3%
Wealth Management(1)(16):				
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%
Investment Management:				
Pre-tax profit margin(17)	24%	9%	26%	17%
Selected management financial measures, excluding DVA(24):				
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

103

Table of Contents

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.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Reconciliation of Selected Management Financial Measures from a Non-GAAP to a GAAP Basis (dollars in millions, except per share amounts):				
Net revenues				
Net revenues Non-GAAP	$ 8,328	$ 6,592	$ 16,803	$ 15,494
Impact of DVA	175	350	(142)	(1,628)
Net revenues GAAP	$ 8,503	$ 6,942	$ 16,661	$ 13,866
Income (loss) from continuing operations applicable to Morgan Stanley				
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	$ 1,009	$ 562	$ 1,990	$ 483
Earnings (loss) per diluted common share				
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	$ 0.43	$ 0.28	$ 0.92	$ 0.23
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)	1,951	1,912	1,946	1,907

Table of Contents

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.

Table of Contents

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

107

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

Table of Contents

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	$ 119	$ 129	$ 324	$ 277
Other revenues:				
Provision for loan losses	$ 1	$ (44)	$ (27)	$ (52)
Losses on loans held for sale	(39)	(14)	(31)	(20)
Total Other revenues	$ (38)	$ (58)	$ (58)	$ (72)

Other expenses: Provision for unfunded commitments	(17)	(15)	(29)	(9)
Total	$ 64	$ 56	$ 237	$ 196

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

Table of Contents

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.

Table of Contents

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

Table of Contents

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.

Table of Contents

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.

Table of Contents

INSTITUTIONAL SECURITIES

INCOME STATEMENT INFORMATION

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012(1)	2013	2012(1)
	(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	4,586	3,863	8,899	7,449
Interest income	1,029	964	2,053	2,141
Interest expense	1,269	1,495	2,517	3,123
Net interest	(240)	(531)	(464)	(982)
Net revenues	4,346	3,332	8,435	6,467
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	3,386	2,844	6,677	6,308
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	672	419	1,410	196
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	(18)	(28)	(37)	(44)
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	$ 564	$ 346	$ 1,186	$ 28
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	$ 564	$ 346	$ 1,186	$ 28

(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.

114

Table of Contents

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	$ 1,078	$ 884	$ 2,023	$ 1,735

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

115

Table of Contents

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	$ 3,077	$ 2,361	$ 5,942	$ 4,643

(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	$ 3,077	$ 2,361	$ 5,942	$ 4,643

(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.

Table of Contents

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	$ 3,077	$ 2,361	$ 5,942	$ 4,643
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	$ 1,920	$ 1,326	$ 3,435	$ 2,901
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	$ 1,214	$ 1,047	$ 2,491	$ 2,040

(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,

117

Table of Contents

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

Table of Contents

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.

Table of Contents

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).

120

Table of Contents

WEALTH MANAGEMENT

INCOME STATEMENT INFORMATION

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012(1)	2013	2012(1)
	(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	3,085	2,816	6,142	5,707
Interest income	511	456	999	914
Interest expense	65	76	140	134
Net interest	446	380	859	780
Net revenues	3,531	3,196	7,001	6,487
Compensation and benefits	2,042	1,911	4,107	3,920
Non-compensation expenses	834	875	1,642	1,754
Total non-interest expenses	2,876	2,786	5,749	5,674
Income from continuing operations before income taxes	655	410	1,252	813
Provision for income taxes	229	149	449	271
Income from continuing operations	426	261	803	542
Discontinued operations:				
Income (loss) from discontinued operations		91	(1)	93
Provision for income taxes		30		31
Net gain (loss) from discontinued operations		61	(1)	62
Net income	426	322	802	604
Net income applicable to redeemable noncontrolling interests	100		221	
Net income applicable to nonredeemable noncontrolling interests		91		175
Net income applicable to Morgan Stanley	$ 326	$ 231	$ 581	$ 429
Amounts applicable to Morgan Stanley:				
Income from continuing operations	$ 326	$ 178	$ 582	$ 376

Net gain (loss) from discontinued operations				53		(1)		53
Net income applicable to Morgan Stanley	$	326	$	231	$	581	$	429

(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.

121

Table of Contents

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.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012(1)	2013	2012(1)
	(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	$ 3,531	$ 3,196	$ 7,001	$ 6,487

(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.

Table of Contents

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.

Table of Contents

INVESTMENT MANAGEMENT

INCOME STATEMENT INFORMATION

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
	(dollars in millions)			
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	674	465	1,323	1,006
Interest income	3	2	5	5
Interest expense	4	11	10	22
Net interest	(1)	(9)	(5)	(17)
Net revenues	673	456	1,318	989
Compensation and benefits	297	214	556	432
Non-compensation expenses	216	199	415	386
Total non-interest expenses	513	413	971	818
Income from continuing operations before income taxes	160	43	347	171
Provision for income taxes	38	6	90	44
Income from continuing operations	122	37	257	127
Discontinued operations:				
Gain from discontinued operations			1	1
Provision for income taxes				
Net gain from discontinued operations			1	1
Net income	122	37	258	128
Net income applicable to nonredeemable noncontrolling interests	21	23	72	88
Net income applicable to Morgan Stanley	$ 101	$ 14	$ 186	$ 40
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	$ 101	$ 14	$ 186	$ 40

Table of Contents

Statistical Data.

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

	At June 30, 2013	At June 30, 2012	Average For The Three Months Ended June 30, 2013	Average For The Three Months Ended June 30, 2012	Average for the Six Months Ended June 30, 2013	Average for the Six Months Ended June 30, 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, 2013	Three Months Ended June 30, 2012	Six Months Ended June 30, 2013	Six Months Ended June 30, 2012
	(dollars in billions)			
Balance at beginning of period	$ 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
Balance at end of period	$ 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.

Table of Contents

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.

Table of Contents

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.

Table of Contents

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.

Table of Contents

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.

Table of Contents

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,

Table of Contents

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.

Table of Contents

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.

Table of Contents

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			
	Institutional Securities	Wealth Management	Investment Management	Total
	(dollars in millions)			
Assets				
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)	$ 671,116	$ 124,319	$ 7,256	$ 802,691

Table of Contents

	At December 31, 2012			
	Institutional Securities(5)	Wealth Management(5)	Investment Management	Total
	(dollars in millions)			
Assets				
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
Total assets(4)	$ 648,049	$ 125,565	$ 7,346	$ 780,960

(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.

137

Table of Contents

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;

Table of Contents

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:

	At June 30, 2013 (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		17
Global Liquidity Reserve	$	181

(1) Non-U.S. sovereign obligations are composed of unencumbered German, French, Dutch, U.K., Brazilian and Japanese government obligations.

Table of Contents

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:

			Average Balance(1)	
	At June 30, 2013	At March 31, 2013	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

140

Table of Contents

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:

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

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:

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

(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).

141

Table of Contents

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:

	Parent	Subsidiaries	Total
		(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	$ 151,215	$ 9,883	$ 161,098

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.

Table of Contents

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:

Company Rating Scenario (Moody s/S&P)	**OTC Agreements**	**Other Agreements**	**Exchanges and Clearing Organizations**
		(dollars in millions)	
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

143

Table of Contents

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) For the Six Months Ended June 30, 2013
	June 30, 2013	December 31, 2012	
		(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	$ 57,812	$ 59,349	$ 59,656
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)	$ 51,479	$ 53,014	$ 53,325

(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.

Table of Contents

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.

Table of Contents

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)	
Allowable capital		
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	47,603	44,794
Qualifying preferred stock	1,508	1,508
Qualifying restricted core capital elements	7,669	8,058
Tier 1 capital	56,780	54,360
Qualifying subordinated debt and restricted core capital elements	3,730	2,783
Other qualifying amounts	235	197
Other deductions	(758)	(714)
Tier 2 capital	3,207	2,266
Total allowable capital	$ 59,987	$ 56,626
Risk-weighted assets(1)		
Market risk	$ 142,966	$ 54,042
Credit risk	260,459	252,704
Total	$ 403,425	$ 306,746
Capital ratios		
Total capital ratio(1)	14.9%	18.5%
Tier 1 common capital ratio(1)	11.8%	14.6%

Tier 1 capital ratio(1)	14.1%	17.7%
Tier 1 leverage ratio	7.1%	7.1%

Table of Contents

(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.

Table of Contents

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

Table of Contents

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	$ 47.1	$ 61.5	$ 45.7	$ 60.9

(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.

Table of Contents

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
	Less than 1	1-3	3-5	Over 5	June 30, 2013
	(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
Total	$ 64,303	$ 21,223	$ 44,281	$ 5,089	$ 134,896

(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.

Table of Contents

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

Table of Contents

Item 3. Quantitative and Qualitative Disclosures about Market Risk.

Market Risk.

Market risk refers to the 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

Table of Contents

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.

Table of Contents

Trading Risks.

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

Table 1: 95% Management VaR	95%/One-Day VaR for the Quarter Ended June 30, 2013				95%/One-Day VaR for the Quarter Ended March 31, 2013			
Market Risk Category	**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	$ 52	$ 55	$ 73	$ 51	$ 56	$ 66	$ 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	$ 60	$ 61	$ 77	$ 56	$ 62	$ 72	$ 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.

Table of Contents

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.

155

Table of Contents

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.

Table of Contents

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.

157

Table of Contents

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

Table of Contents

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.

	June 30, 2013		March 31, 2013	
	+100 Basis Points	+200 Basis Points	+100 Basis Points	+200 Basis Points
	(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.

	10% Sensitivity	
Investments	**June 30, 2013**	**March 31, 2013**
	(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

Table of Contents

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.

	Institutional Securities Corporate Lending(1)	Institutional Securities Other(2)	Wealth Management(3)	Total
		(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	6,604	2,138	20,220	28,962
Loans held for sale	5,481		128	5,609
Loans held at fair value	4,525	9,706		14,231
Total loans	$ 16,610	$ 11,844	$ 20,348	$ 48,802

(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.

Table of Contents

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

	Years to Maturity				Total Corporate Lending
Credit Rating(1)	**Less than 1**	**1-3**	**3-5**	**Over 5**	**Exposure(2)**
	(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	$ 13,458	$ 25,062	$ 49,663	$ 6,450	$ 94,633

(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

Table of Contents

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.

Table of Contents

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	$ 54,941	$ 52,121	$ 2,820	$ 1,715,500	$ 1,736,806

(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

Table of Contents

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.

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

(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.

Table of Contents

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	$ 65	$ 51	$	$	$	$ 116	$ (42)	$ 74
Ireland:								
Sovereigns	$ 63	$ 3	$	$	$ 5	$ 71	$ 11	$ 82
Non-sovereigns	166	47			18	231	(7)	224
Subtotal	$ 229	$ 50	$	$	$ 23	$ 302	$ 4	$ 306
Italy:								
Sovereigns	$ 394	$ 322	$	$	$ 472	$ 1,188	$ (213)	$ 975
Non-sovereigns	445	589	160	883	91	2,168	(432)	1,736
Subtotal	$ 839	$ 911	$ 160	$ 883	$ 563	$ 3,356	$ (645)	$ 2,711
Spain:								
Sovereigns	$ 465	$ 7	$	$	$ 17	$ 489	$ 10	$ 499
Non-sovereigns	110	275	94	1,051	154	1,684	(370)	1,314
Subtotal	$ 575	$ 282	$ 94	$ 1,051	$ 171	$ 2,173	$ (360)	$ 1,813
Portugal:								
Sovereigns	$ (35)	$ (1)	$	$	$ 32	$ (4)	$ (42)	$ (46)
Non-sovereigns	(36)	28	194		22	208	(6)	202
Subtotal	$ (71)	$ 27	$ 194	$	$ 54	$ 204	$ (48)	$ 156
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)	$ 1,637	$ 1,321	$ 448	$ 1,934	$ 811	$ 6,151	$ (1,091)	$ 5,060
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)	$ (339)	$ 3,081	$ 183	$ 1,974	$ 205	$ 5,104	$ (754)	$ 4,350

(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.

Table of Contents

(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:

Industry	**Corporate Lending Exposure (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	$ 94,633

Industry	**OTC Derivative Products(2) (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	$	24,409

(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.

Table of Contents

Item 4. Controls and Procedures.

Under the supervision and with the participation of the Company s management, including our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of the effectiveness of the Company s disclosure controls and procedures (as defined in Rule 13a-15(e) of the Securities Exchange Act of 1934, as amended (the Exchange Act)). Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this report.

No change in the Company s internal control over financial reporting (as defined in Rule 13a-15(f) of the Exchange Act) occurred during the period covered by this report that materially affected, or is reasonably likely to materially affect, the Company s internal control over financial reporting.

Table of Contents

FINANCIAL DATA SUPPLEMENT (Unaudited)

Average Balances and Interest Rates and Net Interest Income

	Three Months Ended June 30, 2013		
	Average Weekly Balance	Interest	Annualized Average Rate
	(dollars in millions)		
Assets			
Interest earning assets:			
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
Total	$ 699,963	$ 1,422	0.8%
Non-interest earning assets	128,296		
Total assets	$ 828,259		
Liabilities and Equity			
Interest bearing liabilities:			
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
Total	$ 659,856	$ 1,218	0.7
Non-interest bearing liabilities and equity	168,403		
Total liabilities and equity	$ 828,259		
Net interest income and net interest rate spread		$ 204	0.1%

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

Table of Contents

FINANCIAL DATA SUPPLEMENT (Unaudited) (Continued)

Average Balances and Interest Rates and Net Interest Income

	Three Months Ended June 30, 2012		
	Average Weekly Balance	Interest	Annualized Average Rate
	(dollars in millions)		
Assets			
Interest earning assets:			
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
Total	$ 662,228	$ 1,323	0.8%
Non-interest earning assets	122,136		
Total assets	$ 784,364		
Liabilities and Equity			
Interest bearing liabilities:			
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
Total	$ 609,657	$ 1,483	1.0
Non-interest bearing liabilities and equity	174,707		
Total liabilities and equity	$ 784,364		
Net interest income and net interest rate spread		$ (160)	(0.2)%

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

Table of Contents

FINANCIAL DATA SUPPLEMENT (Unaudited) (Continued)

Average Balances and Interest Rates and Net Interest Income

	Six Months Ended June 30, 2013		
	Average Weekly Balance	Interest	Annualized Average Rate
	(dollars in millions)		
Assets			
Interest earning assets:			
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
Total	$ 699,353	$ 2,820	0.8%
Non-interest earning assets	126,957		
Total assets	$ 826,310		
Liabilities and Equity			
Interest bearing liabilities:			
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
Total	$ 655,887	$ 2,431	0.8
Non-interest bearing liabilities and equity	170,423		
Total liabilities and equity	$ 826,310		
Net interest income and net interest rate spread		$ 389	%

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

Table of Contents

FINANCIAL DATA SUPPLEMENT (Unaudited) (Continued)

Average Balances and Interest Rates and Net Interest Income

	Six Months Ended June 30, 2012		
	Average Weekly Balance	Interest	Annualized Average Rate
	(dollars in millions)		
Assets			
Interest earning assets:			
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
Total	$ 658,748	$ 2,865	0.9%
Non-interest earning assets	126,274		
Total assets	$ 785,022		
Liabilities and Equity			
Interest bearing liabilities:			
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
Total	$ 607,610	$ 3,084	1.0
Non-interest bearing liabilities and equity	177,412		
Total liabilities and equity	$ 785,022		
Net interest income and net interest rate spread		$ (219)	(0.1)%

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

171

Table of Contents

FINANCIAL DATA SUPPLEMENT (Unaudited) (Continued)

Rate/Volume Analysis

The following tables set forth an analysis of the effect on net interest income of volume and rate changes:

	Three Months Ended June 30, 2013 versus Three Months Ended June 30, 2012 Increase (decrease) due to change in:		
	Volume	Rate	Net Change
	(dollars in millions)		
Interest earning assets			
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)
Change in interest income	$ 188	$ (89)	$ 99
Interest bearing liabilities			
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)
Change in interest expense	$ 24	$ (289)	$ (265)

Change in net interest income	$ 164	$ 200	$ 364

172

Table of Contents

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)		
Interest earning assets			
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)
Change in interest income	$ 403	$ (448)	$ (45)
Interest bearing liabilities			
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)
Change in interest expense	$ (98)	$ (555)	$ (653)
Change in net interest income	$ 501	$ 107	$ 608

173

Table of Contents

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.

174

Table of Contents

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

175

Table of Contents

$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

176

Table of Contents

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 Fondsmaeglerselskab 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.

Table of Contents

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

The table below sets forth the information with respect to purchases made by or on behalf of the Company of its common stock during the quarterly period ended 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
Month #1				
(April 1, 2013 April 30, 2013)				
Share Repurchase Program(A)				$ 1,560
Employee Transactions(B)	174,037	$ 21.86		
Month #2				
(May 1, 2013 May 31, 2013)				
Share Repurchase Program(A)				$ 1,560
Employee Transactions(B)	55,521	$ 23.70		
Month #3				
(June 1, 2013 June 30, 2013)				
Share Repurchase Program(A)				$ 1,560
Employee Transactions(B)	72,527	$ 25.47		
Total				
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.

Table of Contents

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

MORGAN STANLEY

(Registrant)

By: /s/ RUTH PORAT
Ruth Porat

Executive Vice President and

Chief Financial Officer

By: /s/ PAUL C. WIRTH
Paul C. Wirth

Deputy Chief Financial Officer

Date: August 2, 2013

Table of Contents

EXHIBIT INDEX

MORGAN STANLEY

Quarter Ended June 30, 2013

Exhibit No.	Description
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).