MORGAN STANLEY
Form 10-Q
November 09, 2009
Table of Contents

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2009

OR

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

EXCHANGE ACT OF 1934

Commission File Number 1-11758

(Exact Name of Registrant as specified in its charter)

Delaware	**1585 Broadway**	**36-3145972**	**(212) 761-4000**
(State or other jurisdiction of incorporation or organization)	**New York, NY 10036**	(I.R.S. Employer Identification No.)	(Registrant s telephone number, including area code)
	(Address of principal executive offices, including zip code)		

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

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

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

Large Accelerated Filer x	Accelerated Filer ¨
Non-Accelerated Filer ¨	Smaller reporting company ¨
(Do not check if a smaller reporting company)	

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

As of October 31, 2009, there were 1,359,433,369 shares of the Registrant s Common Stock, par value $0.01 per share, outstanding.

Table of Contents

QUARTERLY REPORT ON FORM 10-Q

For the quarter ended September 30, 2009

Table of Contents

Table of Contents

AVAILABLE INFORMATION

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

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

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

- Amended and Restated Certificate of Incorporation;
- Amended and Restated Bylaws;
- Charters for our Audit Committee; Internal Audit Subcommittee; Compensation, Management Development and Succession Committee; and Nominating and Governance Committee;
- Corporate Governance Policies;
- Policy Regarding Communication with the Board of Directors;
- Policy Regarding Director Candidates Recommended by Shareholders;
- Policy Regarding Corporate Political Contributions;
- Policy Regarding Shareholder Rights Plan;
- Code of Ethics and Business Conduct;
- Code of Conduct; and

Integrity Hotline.

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

Table of Contents

Part I Financial Information.

Item 1. Financial Statements.

MORGAN STANLEY

CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

(dollars in millions, except share data)

(unaudited)

	September 30, 2009	December 31, 2008	November 30, 2008
Assets			
Cash and due from banks	$ 6,218	$ 13,354	$ 11,276
Interest bearing deposits with banks	22,392	65,316	67,378
Cash deposited with clearing organizations or segregated under federal and other regulations or requirements	21,753	24,039	25,446
Financial instruments owned, at fair value (approximately $114 billion, $73 billion and $62 billion were pledged to various parties at September 30, 2009, December 31, 2008 and November 30, 2008, respectively):			
U.S. government and agency securities	82,881	28,012	20,251
Other sovereign government obligations	39,576	21,084	20,071
Corporate and other debt	94,794	87,294	88,484
Corporate equities	52,310	42,321	37,174
Derivative and other contracts	55,265	89,418	99,766
Investments	9,252	10,385	10,598
Physical commodities	4,418	2,126	2,204
Total financial instruments owned, at fair value	338,496	280,640	278,548
Securities received as collateral, at fair value	16,414	5,231	5,217
Federal funds sold and securities purchased under agreements to resell	146,985	122,709	106,419
Securities borrowed	128,922	88,052	85,785
Receivables:			
Customers	25,854	29,265	31,294
Brokers, dealers and clearing organizations	4,937	6,250	7,259
Other loans	6,557	6,547	6,528
Fees, interest and other	11,330	7,258	7,034
Other investments	3,899	3,709	3,309
Premises, equipment and software costs (net of accumulated depreciation of $3,532, $3,073 and $3,003 at September 30, 2009, December 31, 2008 and November 30, 2008, respectively)	6,765	5,095	5,057
Goodwill	6,977	2,256	2,243
Intangible assets (net of accumulated amortization of $390, $208 and $200 at September 30, 2009, December 31, 2008 and November 30, 2008, respectively) (includes $144, $184 and $220 at fair value at September 30, 2009, December 31, 2008 and November 30, 2008, respectively)	5,679	906	947
Other assets	16,325	16,137	15,295
Total assets	$ 769,503	$ 676,764	$ 659,035

See Notes to Condensed Consolidated Financial Statements.

Table of Contents

MORGAN STANLEY

CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION (Continued)

(dollars in millions, except share data)

(unaudited)

	September 30, 2009	December 31, 2008	November 30, 2008
Liabilities and Equity			
Commercial paper and other short-term borrowings (includes $1,179, $1,246 and $1,412 at fair value at September 30, 2009, December 31, 2008 and November 30, 2008, respectively)	$ 2,913	$ 10,102	$ 10,483
Deposits (includes $7,784, $9,993 and $6,008 at fair value at September 30, 2009, December 31, 2008 and November 30, 2008, respectively)	62,415	51,355	42,755
Financial instruments sold, not yet purchased, at fair value:			
U.S. government and agency securities	23,646	11,902	10,156
Other sovereign government obligations	24,020	9,511	9,360
Corporate and other debt	7,743	9,927	9,361
Corporate equities	23,658	16,840	16,547
Derivative and other contracts	39,526	68,554	73,521
Physical commodities		33	
Total financial instruments sold, not yet purchased, at fair value	118,593	116,767	118,945
Obligation to return securities received as collateral, at fair value	16,414	5,231	5,217
Securities sold under agreements to repurchase	147,344	92,213	102,401
Securities loaned	26,182	14,580	14,821
Other secured financings, at fair value	10,278	12,539	12,527
Payables:			
Customers	110,765	123,617	115,225
Brokers, dealers and clearing organizations	4,381	1,585	3,141
Interest and dividends	3,143	3,305	2,584
Other liabilities and accrued expenses	18,414	16,179	15,963
Long-term borrowings (includes $37,049, $30,766 and $28,830 at fair value at September 30, 2009, December 31, 2008 and November 30, 2008, respectively)	196,437	179,835	163,437
	717,279	627,308	607,499
Commitments and contingencies			
Equity			
Morgan Stanley shareholders equity:			
Preferred stock	9,597	19,168	19,155
Common stock, $0.01 par value;			
Shares authorized: 3,500,000,000 at September 30, 2009, December 31, 2008 and November 30, 2008;			
Shares issued: 1,487,850,163 at September 30, 2009, 1,211,701,552 at December 31, 2008 and November 30, 2008;			
Shares outstanding: 1,358,900,574 at September 30, 2009, 1,074,497,565 at December 31, 2008 and 1,047,598,394 at November 30, 2008	15	12	12
Paid-in capital	8,441	459	1,619
Retained earnings	34,726	36,154	38,096
Employee stock trust	4,058	4,312	3,901
Accumulated other comprehensive loss	(299)	(420)	(125)
Common stock held in treasury, at cost, $0.01 par value; 128,949,589 shares at September 30, 2009, 137,203,987 shares at December 31, 2008 and 164,103,158 shares at November 30, 2008	(6,131)	(6,620)	(7,926)
Common stock issued to employee trust	(4,058)	(4,312)	(3,901)
Total Morgan Stanley shareholders equity	46,349	48,753	50,831

Non-controlling interests		5,875		703		705	
Total equity		52,224		49,456		51,536	
Total liabilities and equity	$	769,503	$	676,764	$	659,035	

See Notes to Condensed Consolidated Financial Statements.

2

Table of Contents

MORGAN STANLEY

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(dollars in millions, except share and per share data)

(unaudited)

	Three Months Ended September 30, 2009	Three Months Ended September 30, 2008	Nine Months Ended September 30, 2009	Nine Months Ended September 30, 2008
	(unaudited)		(unaudited)	
Revenues:				
Investment banking	$ 1,226	$ 1,025	$ 3,393	$ 3,284
Principal transactions:				
Trading	3,242	13,185	6,304	18,073
Investments	99	(733)	(1,288)	(1,557)
Commissions	1,247	1,107	2,994	3,488
Asset management, distribution and administration fees	2,023	1,379	4,289	4,325
Other	257	1,271	1,093	2,495
Total non-interest revenues	8,094	17,234	16,785	30,108
Interest and dividends	1,989	9,626	5,906	31,532
Interest expense	1,408	8,849	5,659	29,700
Net interest	581	777	247	1,832
Net revenues	8,675	18,011	17,032	31,940
Non-interest expenses:				
Compensation and benefits	4,961	5,059	10,872	11,970
Occupancy and equipment	424	316	1,139	930
Brokerage, clearing and exchange fees	309	394	868	1,285
Information processing and communications	360	298	963	903
Marketing and business development	126	166	370	557
Professional services	403	401	1,130	1,253
Other	877	696	2,002	1,472
Total non-interest expenses	7,460	7,330	17,344	18,370
Income (losses) from continuing operations before income taxes	1,215	10,681	(312)	13,570
Provision for (benefit from) income taxes	422	2,974	(615)	3,759
Income from continuing operations	793	7,707	303	9,811
Discontinued operations:				
Gain from discontinued operations (including gain on disposal of $499 million in the nine months ended September 30, 2009)		756	537	1,553
Provision for income taxes		292	204	602
Gain on discontinued operations		464	333	951
Net income	793	8,171	636	10,762
Net income (loss) applicable to non-controlling interests	36	20	(93)	55
Net income applicable to Morgan Stanley	$ 757	$ 8,151	$ 729	$ 10,707

Earnings (losses) applicable to Morgan Stanley common shareholders	$	498	$	7,684	$	(1,301)	$	10,030
Amounts applicable to Morgan Stanley:								
Income from continuing operations	$	757	$	7,700	$	412	$	9,784
Net gain from discontinued operations after tax				451		317		923
Net income (loss) applicable to Morgan Stanley	$	757	$	8,151	$	729	$	10,707
Earnings (losses) per basic common share:								
Income (loss) from continuing operations	$	0.39	$	6.97	$	(1.41)	$	8.82
Gain on discontinued operations				0.41		0.28		0.84
Earnings (losses) per basic common share	$	0.39	$	7.38	$	(1.13)	$	9.66
Earnings (losses) per diluted common share:								
Income (loss) from continuing operations	$	0.38	$	6.97	$	(1.41)	$	8.80
Gain on discontinued operations				0.41		0.28		0.83
Earnings (losses) per diluted common share	$	0.38	$	7.38	$	(1.13)	$	9.63
Average common shares outstanding:								
Basic		1,294,298,229		1,040,887,906		1,148,161,310		1,038,803,052
Diluted		1,300,070,107		1,041,677,018		1,148,161,310		1,041,808,270

See Notes to Condensed Consolidated Financial Statements.

Table of Contents

MORGAN STANLEY

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(dollars in millions)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
	(unaudited)		(unaudited)	
Net income	$ 793	$ 8,171	$ 636	$ 10,762
Other comprehensive income (loss), net of tax:				
Foreign currency translation adjustments(1)	40	(202)	98	(252)
Net change in cash flow hedges(2)	2	5	10	14
Amortization of net loss related to pension and postretirement benefits(3)	8	4	20	14
Amortization of prior service credit related to pension and postretirement benefits(4)	(1)	(2)	(4)	(4)
Comprehensive income	$ 842	$ 7,976	$ 760	$ 10,534
Net income (loss) applicable to non-controlling interests	36	20	(93)	55
Other comprehensive income (loss) applicable to non-controlling interests	6	(53)	3	(58)
Comprehensive income applicable to Morgan Stanley	$ 800	$ 8,009	$ 850	$ 10,537

(1) Amounts are net of (benefit from) provision for income taxes of $(106) million and $279 million for the quarters ended September 30, 2009 and September 30, 2008, respectively. Amounts are net of (benefit from) provision for income taxes of $(317) million and $112 million for the nine month periods ended September 30, 2009 and September 30, 2008, respectively.

(2) Amounts are net of provision for income taxes of $2 million for the quarters ended September 30, 2009 and September 30, 2008. Amounts are net of provision for income taxes of $6 million and $9 million for the nine month periods ended September 30, 2009 and September 30, 2008, respectively.

(3) Amounts are net of provision for income taxes of $3 million for the quarters ended September 30, 2009 and September 30, 2008. Amounts are net of provision for income taxes of $12 million and $9 million for the nine month periods ended September 30, 2009 and September 30, 2008, respectively.

(4) Amounts are net of (benefit from) income taxes of $(2) million and $(1) million for the quarters ended September 30, 2009 and September 30, 2008, respectively. Amounts are net of (benefit from) income taxes of $(3) million for the nine month periods ended September 30, 2009 and September 30, 2008.

See Notes to Condensed Consolidated Financial Statements.

Table of Contents

MORGAN STANLEY

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(dollars in millions)

	Nine Months Ended September 30, 2009	2008
	(unaudited)	
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 636	$ 10,762
Adjustments to reconcile net income to net cash (used for) provided by operating activities:		
Compensation payable in common stock and options	1,021	1,637
Depreciation and amortization	829	532
Gain on business dispositions	(480)	(2,232)
Impairment charges	689	
Changes in assets and liabilities:		
Cash deposited with clearing organizations or segregated under federal and other regulations or requirements	2,286	12,482
Financial instruments owned, net of financial instruments sold, not yet purchased	(52,560)	2,295
Securities borrowed	(40,870)	77,563
Securities loaned	11,602	(79,488)
Receivables and other assets	(1,029)	16,488
Payables and other liabilities	(3,167)	(50,944)
Federal funds sold and securities purchased under agreements to resell	(24,276)	(13,953)
Securities sold under agreements to repurchase	55,131	87,848
Net cash (used for) provided by operating activities	(50,188)	62,990
CASH FLOWS FROM INVESTING ACTIVITIES		
Net (payments for) proceeds from:		
Premises, equipment and software costs	(2,307)	(1,368)
Business acquisitions, net of cash acquired	(2,160)	(174)
Business dispositions	565	743
Net cash (used for) investing activities	(3,902)	(799)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net (payments for) proceeds from:		
Short-term borrowings	(7,189)	(16,870)
Non-controlling interests		1,005
Derivatives financing activities	(78)	855
Other secured financings	(2,261)	(9,616)
Deposits	11,060	2,500
Excess tax benefits associated with stock-based awards	12	
Net proceeds from:		
Morgan Stanley public offerings of common stock	6,212	
Issuance of common stock	41	296
Issuance of long-term borrowings	36,342	30,159
Payments for:		
Long-term borrowings	(28,546)	(38,506)
Series D Preferred Stock and warrant	(10,950)	
Repurchases of common stock through capital management share repurchase program		(487)
Repurchases of common stock for employee tax withholding	(37)	(1,104)
Cash dividends	(1,445)	(935)
Net cash provided by (used for) financing activities	3,161	(32,703)
Effect of exchange rate changes on cash and cash equivalents	869	(581)

Net (decrease) increase in cash and cash equivalents	(50,060)	28,907
Cash and cash equivalents, at beginning of period	78,670	24,659
Cash and cash equivalents, at end of period	$ 28,610	$ 53,566
Cash and cash equivalents include:		
Cash and due from banks	$ 6,218	$ 25,958
Interest bearing deposits with banks	22,392	27,608
Cash and cash equivalents, at end of period	$ 28,610	$ 53,566

SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION

Cash payments for interest were $5,679 million and $28,854 million for the nine month periods ended September 30, 2009 and September 30, 2008, respectively.

Cash payments for income taxes were $785 million and $881 million for the nine month periods ended September 30, 2009 and September 30, 2008, respectively.

See Notes to Condensed Consolidated Financial Statements.

Table of Contents

MORGAN STANLEY

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN TOTAL EQUITY

For the Nine Months Ended September 30, 2009

(dollars in millions)

(unaudited)

	Preferred Stock	Common Stock	Paid-in Capital	Retained Earnings	Employee Stock Trust	Accumulated Other Comprehensive Loss	Common Stock Held in Treasury at Cost	Common Stock Issued to Employee Trust	Non-controlling Interest	Total Equity
BALANCE AT DECEMBER 31, 2008	$ 19,168	$ 12	$ 459	$ 36,154	$ 4,312	$ (420)	$ (6,620)	$ (4,312)	$ 703	$ 49,456
Net income (loss)				729					(93)	636
Dividends				(1,023)					(17)	(1,040)
Shares issued under employee plans and related tax effects			307		(254)		526	254		833
Repurchases of common stock							(37)			(37)
Morgan Stanley public offerings of common stock		3	6,209							6,212
Preferred stock extinguished and exchanged for common stock	(503)		705	(202)						
Series D preferred stock and warrant	(9,068)		(950)	(932)						(10,950)
Gain on Morgan Stanley Smith Barney transaction			1,711							1,711
Net change in cash flow hedges						10				10
Pension and other postretirement adjustments.						16				16
Foreign currency translation adjustments						95			3	98
Increases in non-controlling interests related to Morgan Stanley Smith Barney transaction									4,821	4,821
Increases in non-controlling interests related to the consolidation of two real estate funds sponsored by the Company									649	649
Decreases in non-controlling interests related to disposition of a subsidiary									(229)	(229)
Other increases in non-controlling interests									38	38
BALANCE AT SEPTEMBER 30, 2009	$ 9,597	$ 15	$ 8,441	$ 34,726	$ 4,058	$ (299)	$ (6,131)	$ (4,058)	$ 5,875	$ 52,224

See Notes to Condensed Consolidated Financial Statements.

6

Table of Contents

MORGAN STANLEY

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN TOTAL EQUITY

For the Nine Months Ended September 30, 2008

(dollars in millions)

(unaudited)

	Preferred Stock	Common Stock	Other Morgan Stanley Common Equity	Non-controlling Interest	Total Equity
BALANCE AT DECEMBER 31, 2007	$ 1,100	$ 12	$ 30,665	$ 1,571	$ 33,348
Net income			10,707	55	10,762
Dividends			(914)	(39)	(953)
Shares issued under employee plans and related tax effects			1,856		1,856
Repurchases of common stock			(1,591)		(1,591)
Net change in cash flow hedges			14		14
Pension and other postretirement adjustments			10		10
Foreign currency translation adjustments			(194)	(58)	(252)
Other			(74)		(74)
Increases in non-controlling interests related to sales of subsidiary s shares by Morgan Stanley				132	132
Decreases in non-controlling interests related to disposition of a subsidiary				(514)	(514)
Other net increases in non-controlling interests				(6)	(6)
BALANCE AT SEPTEMBER 30, 2008	$ 1,100	$ 12	$ 40,479	$ 1,141	$ 42,732

See Notes to Condensed Consolidated Financial Statements.

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

1. Basis of Presentation and Summary of Significant Accounting Policies.

The Company. Morgan Stanley (or the Company) is a global financial services firm that maintains significant market positions in each of its business segments Institutional Securities, Global Wealth Management Group and Asset Management.

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

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

Global Wealth Management Group, which includes the Company s 51% interest in Morgan Stanley Smith Barney Holdings LLC (MSSB) (see Note 2), provides brokerage and investment advisory services 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.

Asset Management provides global asset management products and services in equity, fixed income, alternative investments, which includes hedge funds and funds of funds, and merchant banking, which includes real estate, private equity and infrastructure, to institutional and retail clients through proprietary and third-party distribution channels. Asset Management also engages in investment activities.

Discontinued Operations.

MSCI. In May 2009, the Company divested all of its remaining ownership interest in MSCI Inc. (MSCI). The results of MSCI are reported as discontinued operations for all periods presented. The results of MSCI were formerly included in the continuing operations of the Institutional Securities business segment.

Crescent. In addition, discontinued operations in the quarter and nine month period ended September 30, 2008 include operating results and gains (losses) related to the disposition of certain properties previously owned by Crescent Real Estate Equities Limited Partnership (Crescent), a real estate subsidiary of the Company. The results of certain Crescent properties previously owned by the Company were formerly included in the Asset Management business segment.

See Note 20 for additional information on discontinued operations.

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

All material intercompany balances and transactions have been eliminated.

The condensed consolidated financial statements should be read in conjunction with the Company s consolidated financial statements and notes thereto included in Exhibit 99.1 in the Company s Current Report on Form 8-K

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

dated August 24, 2009 (the Form 8-K). The condensed consolidated financial statements reflect all adjustments that are, in the opinion of management, necessary for the fair presentation of the results for the interim period. The results of operations for interim periods are not necessarily indicative of results for the entire year.

Consolidation. The condensed consolidated financial statements include the accounts of the Company, its wholly owned subsidiaries and other entities in which the Company has a controlling financial interest including certain variable interest entities (VIEs). The Company adopted accounting guidance for non-controlling interests on January 1, 2009. Accordingly, for consolidated subsidiaries that are less than wholly owned, the third-party holdings of equity interests are referred to as non-controlling interests. The portion of net income attributable to non-controlling interests for such subsidiaries is presented as Net income (loss) applicable to non-controlling interests on the condensed consolidated statements of income, and the portion of the shareholders equity of such subsidiaries is presented as Non-controlling interests on the condensed consolidated statements of financial condition and condensed consolidated statements of changes in total equity.

For entities where (1) the total equity investment at risk is sufficient to enable the entity to finance its activities independently and (2) the equity holders bear the economic residual risks of the entity and have the right to make decisions about the entity s activities, the Company consolidates those entities it controls through a majority voting interest or otherwise. For entities that do not meet these criteria, commonly known as VIEs, the Company consolidates those entities where the Company is deemed to be the primary beneficiary when it absorbs a majority of the expected losses or a majority of the expected residual returns, or both, of such entities.

Notwithstanding the above, certain securitization vehicles, commonly known as qualifying special purpose entities (QSPEs), are not consolidated by the Company if they meet certain criteria regarding the types of assets and derivatives they may hold, the types of sales they may engage in and the range of discretion they may exercise in connection with the assets they hold (see Note 5).

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

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

The Company s regulated significant U.S. and international subsidiaries include Morgan Stanley & Co. Incorporated (MS&Co.), Morgan Stanley & Co. International plc (MSIP), Morgan Stanley Japan Securities Co., Ltd. (MSJS), Morgan Stanley Investment Advisors Inc. and MSSB.

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, the Company considers its principal trading, investment banking, commissions, and interest and dividend income, along with the associated interest expense, as one integrated activity for each of the Company s separate businesses.

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

Revenue Recognition.

Investment Banking. Underwriting revenues and advisory fees from mergers, acquisitions and restructuring transactions are recorded when services for the transactions are determined to be completed, generally as set forth under the terms of the engagement. Transaction-related expenses, primarily consisting of legal, travel and other costs directly associated with the transaction, are deferred and recognized in the same period as the related investment banking transaction revenue. Underwriting revenues are presented net of related expenses. Non-reimbursed expenses associated with advisory transactions are recorded within Non-interest expenses.

Commissions. The Company generates commissions from executing and clearing customer transactions on stock, options and futures markets. Commission revenues are recognized in the accounts on trade date.

Asset Management, Distribution and Administration Fees. Asset management, distribution and administration fees are recognized over the relevant contract period. Sales commissions paid by the Company in connection with the sale of certain classes of shares of its open-end mutual fund products are accounted for as deferred commission assets. The Company periodically tests the deferred commission assets for recoverability based on cash flows expected to be received in future periods. 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. Performance-based fees are recorded within Principal transactions investment revenues or Asset management, distribution and administration fees depending on the nature of the arrangement.

Financial Instruments and Fair Value.

A significant portion of the Company s financial instruments is carried at fair value with changes in fair value recognized in earnings each period. A description of the Company s policies regarding fair value measurement and its application to these financial instruments follows.

Financial Instruments Measured at Fair Value. All of the instruments within Financial instruments owned and Financial instruments sold, not yet purchased, are measured at fair value, either through the fair value option election (discussed below) or as required by other accounting pronouncements. These financial instruments primarily represent the Company s trading and investment activities and include both cash and derivative products. In addition, Securities received as collateral and Obligation to return securities received as collateral are measured at fair value as required by other accounting pronouncements. Additionally, certain Commercial paper and other short-term borrowings (primarily structured notes), certain Deposits, Other secured financings and certain Long-term borrowings (primarily structured notes and certain junior subordinated debentures) are measured at fair value through the fair value option election.

Gains and losses on all of these financial instruments carried at fair value are reflected in Principal transactions trading revenues, Principal transactions investment revenues or Investment banking revenues in the condensed consolidated statements of income, except for derivatives accounted for as accounting hedges (see Hedge Accounting section herein and Note 8). Interest income and expense and dividend income are recorded within the condensed consolidated statements of income depending on the nature of the instrument and related market conventions. When interest and dividends are included as a component of the instruments fair value, interest and dividends are included within Principal transactions trading revenues or Principal transactions investment revenues. Otherwise, they are included within Interest and dividend income or Interest expense. The fair value of

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

over-the-counter (OTC) financial instruments, including derivative contracts related to financial instruments and commodities, is presented in the accompanying condensed consolidated statements of financial condition on a net-by-counterparty basis, when appropriate. Additionally, the Company nets fair value of cash collateral paid or received against fair value amounts recognized for net derivative positions executed with the same counterparty under the same master netting arrangement.

Fair Value Option. The fair value option permits the irrevocable fair value option election on an instrument-by-instrument basis at initial recognition of an asset or liability or upon an event that gives rise to a new basis of accounting for that instrument. The Company applies the fair value option for eligible instruments, including certain loans and lending commitments, certain equity method investments, certain structured notes, certain junior subordinated debentures, certain time deposits and certain other secured financings.

Fair Value Measurement Definition and Hierarchy. 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 and establishes a hierarchy for inputs used in measuring fair value that maximizes the use of relevant observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available. Observable inputs are inputs that market participants would use in pricing the asset or liability developed based on market data obtained from sources independent of the Company. Unobservable inputs are inputs that reflect the Company s assumptions about the assumptions of other market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. The hierarchy is broken down into three levels based on the observability of inputs as follows:

Level 1 Valuations based on quoted prices in active markets for identical assets or liabilities that the Company has the ability to access. Valuation adjustments and block discounts are not applied to Level 1 instruments. Since valuations are based on quoted prices that are readily and regularly available in an active market, valuation of these products does not entail a significant degree of judgment.

Level 2 Valuations based on one or more quoted prices in markets that are not active or for which all significant inputs are observable, either directly or indirectly.

Level 3 Valuations based on inputs that are unobservable and significant to the overall fair value measurement.

The availability of observable inputs can vary from product to product and is affected by a wide variety of factors, including, for example, the type of product, whether the product is new and not yet established in the marketplace, the liquidity of markets and other characteristics particular to the transaction. To the extent that valuation is based on models or inputs that are less observable or unobservable in the market, the determination of fair value requires more judgment. Accordingly, the degree of judgment exercised by the Company in determining fair value is greatest for instruments categorized in Level 3.

The Company uses prices and inputs that are current as of the measurement date, including during periods of market dislocation. In periods of market dislocation, the observability of prices and inputs may be reduced for many instruments. This condition could cause an instrument to be reclassified from Level 1 to Level 2 or Level 2 to Level 3 (see Note 3). In addition, a downturn in market conditions could lead to further declines in the valuation of many instruments.

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, for disclosure purposes the level in the fair value hierarchy within which the fair value measurement falls in its entirety is determined based on the lowest level input that is significant to the fair value measurement in its entirety.

Valuation Techniques. Many cash and OTC contracts have bid and ask prices that can be observed in the marketplace. Bid prices reflect the highest price that a party is willing to pay for an asset. Ask prices represent the lowest price that a party is willing to accept for an asset. For financial instruments whose inputs are based on bid-ask prices, the Company does not require that the fair value estimate always be a predetermined point in the bid-ask range. The Company s policy is to allow for mid-market pricing and adjusting to the point within the bid-ask range that meets the Company s best estimate of fair value. For offsetting positions in the same financial instrument, the same price within the bid-ask spread is used to measure both the long and short positions.

Fair value for many cash and OTC contracts is derived using pricing models. Pricing models take into account the contract terms (including maturity) as well as multiple inputs, including, where applicable, commodity prices, equity prices, interest rate yield curves, credit curves, correlation, creditworthiness of the counterparty, option volatility and currency rates. Where appropriate, valuation adjustments are made to account for various factors such as liquidity risk (bid-ask adjustments), credit quality and model uncertainty. Credit valuation adjustments are applied to both cash instruments and OTC derivatives. For cash instruments, the impact of changes in the Company s own credit spreads is considered when measuring the fair value of liabilities and the impact of changes in the counterparty s credit spreads is considered when measuring the fair value of assets. For OTC derivatives, the impact of changes in both the Company s and the counterparty s credit standing is considered when measuring fair value. In determining the expected exposure, the Company considers collateral held and legally enforceable master netting agreements that mitigate the Company s exposure to each counterparty. All valuation adjustments are subject to judgment, are applied on a consistent basis and are based upon observable inputs where available. The Company generally subjects all valuations and models to a review process initially and on a periodic basis thereafter.

Fair value is a market-based measure considered from the perspective of a market participant rather than an entity-specific measure. Therefore, even when market assumptions are not readily available, the Company s own assumptions are set to reflect those that the Company believes market participants would use in pricing the asset or liability at the measurement date.

See Note 3 for a description of valuation techniques applied to the major categories of financial instruments measured at fair value.

Assets and Liabilities Measured at Fair Value on a Non-Recurring Basis. Certain of the Company s assets are measured at fair value on a non-recurring basis. The Company incurs impairment charges for any writedowns of these assets to fair value. A downturn in market conditions could result in impairment charges in future periods.

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

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

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

Hedge Accounting.

The Company applies hedge accounting using various derivative financial instruments and non-U.S. dollar-denominated debt used 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. These derivative financial instruments are included within Financial instruments owned derivative and other contracts or Financial instruments sold, not yet purchased derivative and other contracts in the condensed consolidated statements of financial condition.

The Company s hedges are designated and qualify for accounting purposes as one of the following types of hedges: hedges of changes in fair value of assets and liabilities due to the risk 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 further information on derivative instruments and hedging activities, see Note 8.

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 and readily convertible to known amounts of cash. The Company s significant non-cash activities include assets acquired of $11.0 billion and assumed liabilities, in connection with business acquisitions, of $3.2 billion in the nine month period ended September 30, 2009. The nine month period ended September 30, 2008 included assumed liabilities of $77 million. During the nine month period ended September 30, 2009, the Company consolidated two real estate funds sponsored by the Company with assets of $600 million, liabilities of $18 million and Non-controlling interests of $582 million. During the nine month period ended September 30, 2008, the Company consolidated real estate limited partnership assets and liabilities of approximately $4.7 billion and $3.9 billion, respectively.

Securitization Activities.

The Company engages in securitization activities related to commercial and residential mortgage loans, corporate bonds and loans, U.S. agency collateralized mortgage obligations and other types of financial assets (see Note 5). Generally, such transfers of financial assets are accounted for as sales when the Company has relinquished control over the transferred assets. The gain or loss on sale of such financial assets depends, in part, on the previous carrying amount of the assets involved in the transfer allocated between the assets sold and the retained interests based upon their respective fair values at the date of sale. Transfers that are not accounted for as sales are treated as secured financings (failed sales).

Earnings per Common Share.

Basic earnings per common share (EPS) is computed by dividing income available to Morgan Stanley common shareholders by the weighted average number of common shares outstanding for the period. Income available to Morgan Stanley common shareholders represents net income applicable to Morgan Stanley reduced by preferred stock dividends, amortization and the acceleration of discounts on preferred stock issued and allocations of earnings to participating securities. Common shares outstanding include common stock and vested restricted stock unit awards where recipients have satisfied either the explicit vesting terms or retirement-eligible requirements. Diluted EPS reflects the assumed conversion of all dilutive securities.

Effective October 13, 2008, as a result of the adjustment to Equity Units sold to a wholly owned subsidiary of China Investment Corporation Ltd. (CIC) (see Note 11), the Company calculates EPS in accordance with

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

accounting guidance for determining EPS for participating securities. The accounting guidance for participating securities and the two-class method of calculating EPS addresses the computation of EPS by companies that have issued securities other than common stock that contractually entitle the holder to participate in dividends and earnings of the company along with common shareholders according to a predetermined formula. The two-class method requires the Company to present EPS as if all of the earnings for the period are distributed to Morgan Stanley common shareholders and any participating securities, regardless of whether any actual dividends or distributions are made. The amount allocated to the participating securities is based upon the contractual terms of their respective contract and is reflected as a reduction to Net income applicable to Morgan Stanley common shareholders for both the Company s basic and diluted EPS calculations (see Note 12). The two-class method does not impact the Company s actual net income applicable to Morgan Stanley or other financial results. Unless contractually required by the terms of the participating securities, no losses are allocated to participating securities for purposes of the EPS calculation under the two-class method.

In June 2008, the FASB issued accounting guidance on whether share-based payment transactions are participating securities. This accounting guidance addresses whether instruments granted in share-based payment transactions are participating securities prior to vesting and, therefore, need to be included in the earnings allocation in computing EPS under the two-class method as described in the accounting guidance for calculating EPS. Under this accounting guidance, unvested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and shall be included in the computation of EPS pursuant to the two-class method. The accounting guidance on whether share-based payment transactions are participating securities became effective for the Company on January 1, 2009. All prior-period EPS data presented have been adjusted retrospectively. The Company s adoption of this accounting guidance, which addresses the computation of EPS under the two-class method for share-based payment transactions that are participating securities, reduced basic EPS by $0.44 and $0.61 for the quarter and nine month period ended September 30, 2008, respectively, and reduced diluted EPS by $0.36 and $0.44 for the quarter and nine month period ended September 30, 2008, respectively.

Goodwill and Intangible Assets.

Goodwill and indefinite-lived intangible assets are not amortized and are reviewed annually (or more frequently when certain events or circumstances exist) for impairment. Other intangible assets are amortized over their estimated useful lives and reviewed for impairment.

Deferred Compensation Arrangements.

Deferred Compensation Plans. The Company also maintains various deferred compensation plans for the benefit of certain employees that provide a return to the participating employees based upon the performance of various referenced investments. The Company often invests directly, as a principal, in such referenced investments related to its obligations to perform under the deferred compensation plans. Changes in value of such investments made by the Company are recorded primarily in Principal transactions investments. Expenses associated with the related deferred compensation plans are recorded in Compensation and benefits.

Accounting Developments.

Dividends on Share-Based Payment Awards. In June 2007, the Emerging Issues Task Force reached consensus on accounting for tax benefits of dividends on share-based payment awards to employees. This accounting guidance requires that the tax benefit related to dividend equivalents paid on restricted stock units that

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

are expected to vest be recorded as an increase to additional paid-in capital. The Company adopted this guidance prospectively effective December 1, 2008. The Company previously accounted for this tax benefit as a reduction to its income tax provision. The adoption of this accounting guidance did not have a material impact on the Company s condensed consolidated financial statements.

Transfers of Financial Assets and Repurchase Financing Transactions. In February 2008, the FASB issued accounting guidance to provide implementation guidance for accounting for transfers of financial assets and repurchase financing transactions. Under this guidance, there is a presumption that an initial transfer of a financial asset and a repurchase financing are considered part of the same arrangement (*i.e*., a linked transaction) for purposes of evaluation. If certain criteria are met, however, the initial transfer and repurchase financing shall not be evaluated as a linked transaction and shall be evaluated separately. The adoption of this accounting guidance on December 1, 2008 did not have a material impact on the Company s condensed consolidated financial statements.

Determination of the Useful Life of Intangible Assets. In April 2008, the FASB issued accounting guidance to provide guidance on the determination of the useful life of intangible assets. The guidance removes the requirement for an entity to consider, when determining the useful life of an acquired intangible asset, whether the intangible asset can be renewed without substantial cost or material modifications to the existing terms and conditions associated with the intangible asset. This accounting guidance replaces the previous useful-life assessment criteria with a requirement that an entity shall consider its own experience in renewing similar arrangements. If the entity has no relevant experience, it would consider market participant assumptions regarding renewal. The adoption of this accounting guidance on January 1, 2009 did not have a material impact on the Company s condensed consolidated financial statements.

Instruments Indexed to an Entity s Own Stock. In June 2008, the FASB ratified the consensus reached for determining whether an equity-linked financial instrument (or embedded feature) is indexed to an entity s own stock. This accounting guidance applies to any freestanding financial instrument or embedded feature that has all of the characteristics of a derivative or freestanding instrument that is potentially settled in an entity s own stock with certain exceptions. To meet the definition of indexed to own stock, an instrument s contingent exercise provisions must not be based on (a) an observable market, other than the market for the issuer s stock (if applicable), or (b) an observable index, other than an index calculated or measured solely by reference to the issuer s own operations, and the variables that could affect the settlement amount must be inputs to the fair value of a fixed-for-fixed forward or option on equity shares. The adoption of this accounting guidance on January 1, 2009 did not change the classification or measurement of the Company s financial instruments.

Disclosures about Postretirement Benefit Plan Assets. In December 2008, the FASB issued guidance on employers disclosures about postretirement benefit plan assets. The disclosures about plan assets required by this guidance will be effective December 31, 2009 for the Company.

Subsequent Events. In May 2009, the FASB issued accounting guidance to establish general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. It requires the disclosure of the date through which an entity has evaluated subsequent events and the basis for that date that is, whether that date represents the date the financial statements were issued or were available to be issued. The Company evaluates subsequent events through the date that the Company s financial statements are issued, which is the date the Company files Quarterly Reports on Form 10-Q and its Annual Reports on Form 10-K with the Securities and Exchange Commission (SEC). The Company adopted this accounting guidance in the quarter ended June 30, 2009. Such adoption did not have a material impact on the Company s condensed consolidated financial statements.

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

Transfers of Financial Assets and Extinguishments of Liabilities and Consolidation of Variable Interest Entities. In June 2009, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 166, Accounting for Transfers of Financial Assets (SFAS No. 166), and SFAS No. 167, Amendments to FASB Interpretation No. 46(R) (SFAS No. 167), which change the way entities account for securitizations and special-purpose entities.

SFAS No. 166 amends the accounting for transfers of financial assets and will require additional disclosures about transfers of financial assets, including securitization transactions, and where entities have continuing exposure to the risks related to transferred financial assets. It eliminates the concept of a QSPE and changes the requirements for derecognizing financial assets.

SFAS No. 167 amends the accounting for consolidation and changes how a reporting entity determines when an entity that is insufficiently capitalized or is not controlled through voting (or similar rights) should be consolidated. The determination of whether a reporting entity is required to consolidate another entity is based on, among other things, the other entity s purpose and design and the reporting entity s ability to direct the activities of the other entity that most significantly impact the other entity s economic performance.

The Company is currently evaluating the potential impact of adopting SFAS No. 166 and SFAS No. 167. The adoption of SFAS No. 166 and SFAS No. 167 may have a significant impact on the Company s condensed consolidated financial statements as the Company may be required to consolidate QSPEs to which the Company has previously sold assets. In addition, the Company may also be required to consolidate other VIEs that are not currently consolidated or de-consolidate entities currently consolidated based on an analysis under the current accounting guidance. SFAS No. 166 and SFAS No. 167 will be effective for the Company on January 1, 2010.

FASB Accounting Standards Codification™. In July 2009, the FASB issued accounting guidance to establish the FASB Accounting Standards Codification™ (Codification) to become the source of authoritative U.S. generally accepted accounting principles (U.S. GAAP) recognized by the FASB to be applied by nongovernmental entities. All other accounting literature not included in the Codification will be considered non-authoritative. The Codification does not change current U.S. GAAP. In the quarter ended September 30, 2009, references to authoritative U.S. GAAP literature in the Company s condensed consolidated financial statements and the notes thereto in this Quarterly Report on Form 10-Q have been updated to reflect new Codification references.

Fair Value Measurements and Disclosures. In April 2009, the FASB issued guidance on determining fair value when the volume and level of activity for the asset or liability have significantly decreased and identifying transactions that are not orderly. This accounting guidance provides additional application guidance in determining fair values when there is no active market or where the price inputs being used represent distressed sales. It reaffirms the objective of fair value measurement to reflect how much an asset would be sold for in an orderly transaction (as opposed to a distressed or forced transaction) at the date of the financial statements under current market conditions. Specifically, it reaffirms the need to use judgment to ascertain if a formerly active market has become inactive and in determining fair values when markets have become inactive. The Company adopted this guidance in the second quarter of 2009. The adoption did not have a material impact on the Company s condensed consolidated financial statements.

In April 2009, the FASB issued guidance that requires an entity to provide qualitative and quantitative information on a quarterly basis about fair value estimates for any financial instruments not measured on the balance sheet at fair value. The Company adopted the disclosure requirements in the quarter ended June 30, 2009.

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

In August 2009, the FASB issued Accounting Standards Update (ASU) 2009-05 Fair Value Measurements and Disclosures Measuring Liabilities at Fair Value (ASU 2009-05). ASU 2009-05 updates the Codification and provides guidance about measuring liabilities at fair value. The adoption of ASU 2009-05 on October 1, 2009 did not have a material impact on the Company s condensed consolidated financial statements.

In September 2009, the FASB issued ASU 2009-12 Fair Value Measurements and Disclosures Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent) (ASU 2009-12). ASU 2009-12 updates the Codification and provides additional guidance about measuring the fair value of certain alternative investments, such as hedge funds, private equity funds, real estate funds and venture capital funds. ASU 2009-12 allows companies to determine the fair value of such investments using net asset value (NAV) as a practical expedient. ASU 2009-12 also requires new disclosures of the nature and risks of the investments by major category of alternative investments. ASU 2009-12 will be effective for the Company on December 31, 2009. The Company is currently evaluating the potential impact of adopting ASU 2009-12.

2. Morgan Stanley Smith Barney Holdings LLC.

Smith Barney. On May 31, 2009 (the Closing Date), the Company and Citigroup Inc. (Citi) consummated the previously announced combination of the Company s Global Wealth Management Group and the businesses of Citi s Smith Barney in the U.S., Quilter in the U.K., and Smith Barney Australia (Smith Barney). In addition to the Company s contribution of respective businesses to MSSB, the Company paid Citi $2,755 million in cash. The combined businesses operate as MSSB, which the Company consolidates. Pursuant to the terms of the amended contribution agreement, dated as of May 29, 2009 (amended contribution agreement), certain businesses of Smith Barney and Morgan Stanley will be contributed to MSSB subsequent to May 31, 2009 (the delayed contribution businesses). Citi will own the delayed contribution businesses until they are transferred to MSSB and gains and losses from such businesses will be allocated to the Company s and Citi s respective share of MSSB s gains and losses.

The Company owns 51% and Citi owns 49% of MSSB, with the Company having appointed four directors to the MSSB board and Citi having appointed two directors. As part of the acquisition, the Company has the option (i) following the third anniversary of the Closing Date to purchase a portion of Citi s interest in MSSB representing 14% of the total outstanding MSSB interests, (ii) following the fourth anniversary of the Closing Date to purchase a portion of Citi s interest in MSSB representing an additional 15% of the total outstanding MSSB interests and (iii) following the fifth anniversary of the Closing Date to purchase the remainder of Citi s interest in MSSB. The Company may call all of Citi s interest in MSSB upon a change in control of Citi. Citi may put all of its interest in MSSB to the Company upon a change in control of the Company or following the later of the sixth anniversary of the Closing Date and the one-year anniversary of the Company s exercise of the call described in clause (ii) above. The purchase price for the call and put rights described above is the fair market value of the purchased interests determined pursuant to an appraisal process.

As of May 31, 2009, the Company includes MSSB in its condensed consolidated financial statements. The results of MSSB are included within the Global Wealth Management Group business segment. See Note 11 for further information on MSSB.

The Company accounted for the transaction using the acquisition method of accounting. The fair value of the total consideration transferred to Citi amounted to approximately $6,087 million and the preliminary fair value of Citi s equity in MSSB was approximately $3,973 million. The acquisition method of accounting prescribes the full goodwill method even in business combinations in which the acquirer holds less than 100% of the equity interests in the acquiree at acquisition date. Accordingly, the full fair value of Smith Barney was allocated to the

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

fair value of assets acquired and liabilities assumed to derive the preliminary goodwill amount of approximately $5,029 million, which represents synergies of combining the two businesses. The Company is still finalizing the valuation of the intangible assets and the fair value of the Company s contributed businesses into MSSB. When finalized, the amount of total consideration transferred, non-controlling interest, intangible assets and acquisition-related goodwill could change.

The following table summarizes the preliminary allocation of the purchase price to the net assets of Smith Barney as of May 31, 2009 (dollars in millions).

Total fair value of consideration transferred	$ 6,087
Total fair value of non-controlling interest	3,973
Total fair value of Smith Barney(1)	10,060
Total fair value of net assets acquired	5,031
Preliminary acquisition-related goodwill(2)	$ 5,029

(1) Total fair value of Smith Barney is inclusive of control premium.
(2) Goodwill is recorded within the Global Wealth Management business segment. The Company is currently evaluating the amount of goodwill deductible for tax purposes.

Condensed statement of assets acquired and liabilities assumed. The following table summarizes the preliminary fair values of Smith Barney s assets acquired and liabilities assumed as of the acquisition date. The allocation of the purchase price is preliminary and subject to further adjustment as the valuation of certain intangible assets is still in process.

	At May 31, 2009 (dollars in millions)	
Assets		
Cash and due from banks	$	895
Financial instruments owned		22
Receivables		1,891
Intangible assets		4,890
Other assets		531
Total assets acquired	$	8,229
Liabilities		
Financial instrument sold, not yet purchased	$	76
Long-term borrowings		2,320
Other liabilities and accrued expenses		802
Total liabilities assumed	$	3,198

Net assets acquired	$	5,031

In addition, the Company recorded a receivable of approximately $1.1 billion relating to the fair value of the Smith Barney delayed contribution businesses as of May 31, 2009 from Citi. Such amount is presented in the condensed consolidated statements of financial condition as a reduction from Non-controlling interests.

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

Amortizable intangible assets included the following as of May 31, 2009:

	At May 31, 2009 (dollars in millions)	Estimated useful life (in years)
Customer relationships	$ 4,000	15
Technology	411	5
Research	176	5
Intangible lease asset	24	1-10
Total	$ 4,611	

The Company also recorded an indefinite-lived intangible asset of approximately $279 million related to the Smith Barney trade name.

Citi Managed Futures. Citi contributed its managed futures business and certain related proprietary trading positions to MSSB on July 31, 2009 (Citi Managed Futures). The Company paid Citi approximately $300 million in cash in connection with this transfer. As of July 31, 2009, Citi Managed Futures is wholly-owned and consolidated by MSSB, of which the Company owns 51% and Citi owns 49%.

The Company accounted for this transaction using the acquisition method of accounting. The fair value of the total consideration transferred to Citi was approximately $300 million and the preliminary increase in the fair value of Citi s equity in MSSB was approximately $289 million. The acquisition method of accounting prescribes the full goodwill method even in business combinations in which the acquirer holds less than 100% of the equity interests in the acquiree at acquisition date. Accordingly, the full fair value of Citi Managed Futures was allocated to the fair value of the assets acquired and liabilities assumed to derive the preliminary goodwill amount of approximately $136 million, which represents business synergies of combining the Citi Managed Futures business with MSSB. The Company is still finalizing the valuation of the intangible assets. When finalized, the amount of intangible assets and acquisition-related goodwill could change.

The following table summarizes the preliminary allocation of the purchase price to the net assets of Citi Managed Futures as of July 31, 2009 (dollars in millions).

Total fair value of consideration transferred	$ 300
Total fair value of non-controlling interest	289
Total fair value of Citi Managed Futures	589
Total fair value of net assets acquired	453
Preliminary acquisition-related goodwill(1)	$ 136

(1) Goodwill is recorded within the Global Wealth Management business segment. The Company is currently evaluating the amount of goodwill deductible for tax purposes.

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

Condensed statement of assets acquired and liabilities assumed. The following table summarizes the preliminary fair values of the assets acquired and liabilities assumed as of the acquisition date. The allocation of the purchase price is preliminary and subject to further adjustment as the valuation of certain intangible assets is still in process.

	At July 31, 2009 (dollars in millions)
Assets	
Financial instruments owned	$ 83
Receivables	86
Intangible assets	275
Other assets	11
Total assets acquired	$ 455
Liabilities	
Other liabilities and accrued expenses	$ 2
Total liabilities assumed	$ 2
Net assets acquired	$ 453

As of July 31, 2009, amortizable intangible assets in the amount of $275 million were primarily related to management contracts with an estimated useful life of eight to nine years.

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

Pro forma condensed combined financial information

The following unaudited pro forma condensed combined financial information presents the results of operations of the Company as they may have appeared if the closing of MSSB and Citi Managed Futures had been completed on January 1, 2009 and January 1, 2008 (dollars in millions, except share data).

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
	(unaudited)		(unaudited)	
Net revenues	$ 8,681	$ 20,013	$ 19,838	$ 38,174
Total non-interest expenses	7,464	9,225	19,795	24,126
Income from continuing operations before income taxes	1,217	10,788	43	14,048
Provision for (benefit from) income taxes	423	3,009	(522)	3,884
Income from continuing operations	794	7,779	565	10,164
Discontinued operations:				
Gain from discontinued operations		756	537	1,553
Provision for income taxes		292	204	602
Gain on discontinued operations		464	333	951
Net income	794	8,243	898	11,115
Net income applicable to non-controlling interests	37	100	81	198
Net income applicable to Morgan Stanley	$ 757	$ 8,143	$ 817	$ 10,917
Earnings (loss) applicable to Morgan Stanley common shareholders	$ 498	$ 7,677	$ (1,213)	$ 10,227
Earnings (loss) per basic common share:				
Income (loss) from continuing operations	$ 0.39	$ 6.97	$ (1.34)	$ 9.01
Gain on discontinued operations		0.41	0.28	0.84
Earnings (loss) per basic common share	$ 0.39	$ 7.38	$ (1.06)	$ 9.85
Earnings (loss) per diluted common share:				
Income (loss) from continuing operations	$ 0.38	$ 6.96	$ (1.34)	$ 8.98
Gain on discontinued operations		0.41	0.28	0.84
Earnings (loss) per diluted common share	$ 0.38	$ 7.37	$ (1.06)	$ 9.82

The unaudited pro forma condensed combined financial information is presented for illustrative purposes only and does not indicate the actual financial results of the Company had the closing of Smith Barney and Citi Managed Futures been completed on January 1, 2009 and January 1, 2008, respectively, nor is it indicative of the results of operations in future periods. Included in the unaudited pro forma combined financial information for the quarters and nine month periods ended September 30, 2009 and September 30, 2008, were pro forma adjustments to reflect the results of operations of both Smith Barney and Citi Managed Futures as well as the impact of amortizing certain acquisition accounting adjustments such as amortizable intangible assets. The pro forma condensed financial information does not indicate the impact of possible business model changes nor does it consider any potential impacts of current market conditions, expense efficiencies or other factors.

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

3. Fair Value Disclosures.

Fair Value Measurements.

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

Financial Instruments Owned and Financial Instruments Sold, Not Yet Purchased

U.S. Government and Agency Securities

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

U.S. Agency Securities. U.S. agency securities are comprised of two main categories consisting of agency issued debt and mortgage pass-throughs. 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. Mortgage pass-throughs include mortgage pass-throughs and forward settling mortgage pools. Fair value of mortgage pass-throughs are model driven with respect to spreads of the comparable To-be-announced (TBA) security. Actively traded non-callable agency issued debt securities are categorized in Level 1 of the fair value hierarchy. Callable agency issued debt securities and mortgage pass-throughs are generally categorized in Level 2 of the fair value hierarchy.

Other Sovereign Government Obligations

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

Corporate and Other Debt

State and Municipal Securities. The fair value of state and municipal securities is estimated 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 external price or spread data. When position-specific external price data are not observable, the valuation is based on prices of comparable bonds. Valuation levels of RMBS and CMBS indices are used as an additional data point for benchmarking purposes or to price outright index positions.

Fair value for retained interests in securitized financial assets (in the form of one or more tranches of the securitization) is determined using observable prices or, in cases where observable prices are not available for certain retained interests, the Company estimates fair value based on the present value of expected future cash flows using its best estimates of the key assumptions, including forecasted credit losses, prepayment rates, forward yield curves and discount rates commensurate with the risks involved.

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

RMBS, CMBS and other ABS, including retained interests in these securitized financial assets, are categorized in Level 3 if external prices or spread inputs are unobservable or if the comparability assessment involves significant subjectivity related to property type differences, cash flows, performance and other inputs; otherwise, they are categorized in Level 2 of the fair value hierarchy.

Corporate Bonds. The fair value of corporate bonds is estimated using recently executed transactions, market price quotations (where observable), bond spreads or credit default swap spreads 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 does not reference the issuer, then data that reference a comparable issuer are used. When observable price quotations are not available, fair value is determined based on cash flow models with yield curves, bond or single name credit default swap spreads and recovery rates based on collateral values as significant inputs. Corporate bonds are generally categorized in Level 2 of the fair value hierarchy; in instances where prices, spreads or any of the other aforementioned key inputs are unobservable, they are categorized in Level 3 of the fair value hierarchy.

Collateralized Debt Obligations (CDOs). The Company holds CDOs where the collateral primarily is synthetic and references either a basket credit default swap or CDO-squared. The correlation input between reference credits within the collateral is unobservable and is benchmarked to standardized proxy baskets for which correlation data are available. The other model inputs such as credit spreads, interest rates and recovery rates are observable. CDOs are categorized in Level 2 of the fair value hierarchy when the correlation input is insignificant. In instances where the correlation input is deemed to be significant, these instruments are categorized in Level 3 of the fair value hierarchy.

Corporate Loans and Lending Commitments. The fair value of corporate loans is estimated using recently executed transactions, market price quotations (where observable) and market observable credit default swap spread levels 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 estimated by using executed transactions on comparable loans and the anticipated market price based on pricing indications from syndicate banks and customers. The valuation of these commitments also takes into account certain fee income. Corporate loans and lending commitments are generally categorized in Level 2 of the fair value hierarchy; in instances where prices or significant spread inputs are unobservable, they are categorized in Level 3 of the fair value hierarchy.

Mortgage Loans. Mortgage loans are valued using prices based on trade data for identical or comparable instruments. Where observable prices are not available, the Company estimates fair value based on benchmarking to prices and rates observed in the primary market for similar loan or borrower types, or based on the present value of expected future cash flows using its best estimates of the key assumptions, including forecasted credit losses, prepayment rates, forward yield curves and discount rates commensurate with the risks involved. Due to the subjectivity involved in comparability assessment related to mortgage loan vintage, geographical concentration, prepayment speed and projected loss assumptions, the majority of loans are classified in Level 3 of the fair value hierarchy.

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

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

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 in the current market environment.

Inputs that impact the valuation of SLARS are the underlying collateral types, amount of leverage in each structure, credit rating and liquidity considerations. Inputs that impact the valuation of MARS are independent external market data, the maximum rate, quality of underlying issuers/insurers and evidence of issuer calls. MARS are generally categorized in Level 2 as the valuation technique relies on observable external data. The majority of SLARS are generally categorized in Level 3 of the fair value hierarchy.

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.

Derivative and Other Contracts

Listed Derivative Contracts. Listed derivatives that are actively traded are valued based on quoted prices from the exchange and are categorized in Level 1 of the fair value hierarchy. Listed derivatives that are not actively traded are valued using the same approaches as those applied to 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 formula, 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 within Level 2 of the fair value hierarchy.

Other derivative products include 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 derivative interests in certain mortgage-related CDO securities, basket credit default swaps, CDO-squared positions and certain types of ABS credit default swaps where direct trading activity or quotes are unobservable. These instruments involve significant unobservable inputs and are categorized in Level 3 of the fair value hierarchy.

Derivative interests in complex mortgage-related CDOs and credit default swaps, for which observability of external price data is extremely 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 the underlying collateral performance and pricing, behavior of the tranche under various cumulative loss and prepayment scenarios, deal

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

structures (*e.g.*, non-amortizing reference obligations, call features) 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 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.

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 curves, implied volatility of the underlying commodities and, in some cases, the implied correlation between these inputs. The fair value of these products is estimated using executed trades and broker and consensus data to provide values for the aforementioned inputs. Where these inputs are unobservable, relationships to observable commodities and data points, based on historic and/or implied observations, are employed as a technique to estimate the model input values. Commodity derivatives are generally categorized in Level 2 of the fair value hierarchy; in instances where significant inputs are unobservable, they are categorized in Level 3 of the fair value hierarchy.

For further information on derivative instruments and hedging activities, see Note 8.

Investments

Investments in Private Equity, Real Estate and Hedge Funds. The Company s investments include direct private equity investments and investments in private equity funds, real estate funds and hedge funds. Initially, the transaction price is generally considered by the Company as the exit price and is the Company s best estimate of fair value. Thereafter, valuation is based on an assessment of each underlying investment, considering rounds of financing and third-party transactions, expected cash flows and market-based information, including comparable company transactions, trading multiples and changes in market outlook, among other factors. In determining the fair value of externally managed funds, the Company also considers the net asset value of the fund provided by the fund manager. These investments are included in Level 3 of the fair value hierarchy because, due to infrequent trading, exit prices tend to be unobservable and reliance is placed on the above methods.

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.

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

Structured Notes. The Company issues structured notes that have coupons or repayment terms linked to the performance of debt or equity securities, indices, currencies or commodities. Fair value of structured notes is estimated using valuation models for the derivative and debt portions of the notes. These models incorporate observable inputs referencing identical or comparable securities, including prices that the

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

notes are linked to, interest rate yield curves, option volatility, and currency, commodity or equity rates. 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.

Deposits

Time Deposits. The fair value of certificates of deposit is estimated using third-party quotations. These deposits are generally 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 as of September 30, 2009, December 31, 2008 and November 30, 2008. See Note 1 for a discussion of the Company s policies regarding this fair value hierarchy.

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

Assets and Liabilities Measured at Fair Value on a Recurring Basis as of September 30, 2009

	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 September 30, 2009
			(dollars in millions)		
Assets					
Financial instruments owned:					
U.S. government and agency securities:					
U.S. Treasury securities	$ 19,255	$ 81	$	$	$ 19,336
U.S. agency securities	21,216	42,324	5		63,545
Total U.S. government and agency securities	40,471	42,405	5		82,881
Other sovereign government obligations	35,103	4,466	7		39,576
Corporate and other debt:					
State and municipal securities		3,659	736		4,395
Residential mortgage-backed securities		3,572	771		4,343
Commercial mortgage-backed securities		3,322	2,226		5,548
Asset-backed securities		4,134	669		4,803
Corporate bonds		35,229	1,143		36,372
Collateralized debt obligations		1,570	1,131		2,701
Loans and lending commitments		14,030	17,488		31,518
Other debt		3,489	1,625		5,114
Total corporate and other debt(1)		69,005	25,789		94,794
Corporate equities(2)	45,623	5,827	860		52,310
Derivative and other contracts(3)	2,854	113,940	16,154	(77,683)	55,265
Investments	563	127	8,562		9,252
Physical commodities		4,418			4,418
Total financial instruments owned	124,614	240,188	51,377	(77,683)	338,496
Securities received as collateral	15,853	559	2		16,414
Intangible assets(4)			144		144
Liabilities					
Commercial paper and other short-term borrowings	$	$ 1,163	$ 16	$	$ 1,179
Deposits		7,770	14		7,784
Financial instruments sold, not yet purchased:					
U.S. government and agency securities:					
U.S. Treasury securities	21,679	3			21,682
U.S. agency securities	1,569	395			1,964
Total U.S. government and agency securities	23,248	398			23,646
Other sovereign government obligations	22,586	1,434			24,020
Corporate and other debt:					
State and municipal securities		18			18
Commercial mortgage-backed securities		9	1		10
Asset-backed securities		53	4		57
Corporate bonds		4,224	28		4,252

Unfunded lending commitments		743	470		1,213
Other debt		2,093	100		2,193
Total corporate and other debt		7,140	603		7,743
Corporate equities(2)	21,155	2,481	22		23,658
Derivative and other contracts(3)	4,251	71,993	6,682	(43,400)	39,526
Total financial instruments sold, not yet purchased	71,240	83,446	7,307	(43,400)	118,593
Obligation to return securities received as collateral	15,853	559	2		16,414
Other secured financings(1)	22	6,068	4,188		10,278
Long-term borrowings		29,795	7,254		37,049

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

(1) Approximately $6.5 billion of assets is included in Corporate and other debt and approximately $5.3 billion of related liabilities is included in Other secured financings related to consolidated VIEs or non-consolidated VIEs (in the cases where the assets were transferred by the Company to the VIE and the transfers were accounted for as secured financings). The Company cannot unilaterally remove the assets from the VIEs as these assets are not generally available to the Company. The related liabilities issued by these VIEs are non-recourse to the Company. Approximately $5.4 billion of these assets and approximately $3.9 billion of these liabilities are included in Level 3 of the fair value hierarchy. See Note 5 for additional information on consolidated and non-consolidated VIEs, including retained interests in these entities that the Company holds.
(2) The Company holds or sells short for trading purposes, equity securities issued by entities in diverse industries and size.
(3) 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 8.
(4) Amount represents mortgage servicing rights (MSRs) accounted for at fair value. See Note 5 for further information on MSRs.

Assets and Liabilities Measured at Fair Value on a Recurring Basis as of December 31, 2008

	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, 2008
			(dollars in millions)		
Assets					
Financial instruments owned:					
U.S. government and agency securities	$ 10,150	$ 17,735	$ 127	$	$ 28,012
Other sovereign government obligations	16,118	4,965	1		21,084
Corporate and other debt(1)	99	52,277	34,918		87,294
Corporate equities	37,807	3,538	976		42,321
Derivative and other contracts(2)	1,069	156,224	37,711	(105,586)	89,418
Investments	417	270	9,698		10,385
Physical commodities		2,126			2,126
Total financial instruments owned	65,660	237,135	83,431	(105,586)	280,640
Securities received as collateral	4,623	578	30		5,231
Intangible assets(3)			184		184
Liabilities					
Commercial paper and other short-term borrowings	$	$ 1,246	$	$	$ 1,246
Deposits		9,993			9,993
Financial instruments sold, not yet purchased:					
U.S. government and agency securities	11,133	769			11,902
Other sovereign government obligations	7,303	2,208			9,511
Corporate and other debt	17	6,102	3,808		9,927
Corporate equities	15,064	1,749	27		16,840
Derivative and other contracts(2)	3,886	118,432	14,329	(68,093)	68,554
Physical commodities		33			33
	37,403	129,293	18,164	(68,093)	116,767

Total financial instruments sold, not yet purchased				
Obligation to return securities received as collateral	4,623	578	30	5,231
Other secured financings(1)		6,391	6,148	12,539
Long-term borrowings		25,293	5,473	30,766

28

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

(1) Approximately $8.9 billion of assets is included in Corporate and other debt and approximately $7.9 billion of related liabilities is included in Other secured financings related to consolidated VIEs or non-consolidated VIEs (in the cases where the assets were transferred by the Company to the VIE and the transfers were accounted for as secured financings). The Company cannot unilaterally remove the assets from the VIEs; these assets are not generally available to the Company. The related liabilities issued by these VIEs are non-recourse to the Company. Approximately $8.1 billion of these assets and approximately $5.9 billion of these liabilities are included in Level 3 of the fair value hierarchy. See Note 5 for additional information on consolidated and non-consolidated VIEs, including retained interests in these entities that the Company holds.
(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 8.
(3) Amount represents MSRs accounted for at fair value. See Note 5 for further information on MSRs.

Assets and Liabilities Measured at Fair Value on a Recurring Basis as of November 30, 2008

	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 November 30, 2008
			(dollars in millions)		
Assets					
Financial instruments owned:					
U.S. government and agency securities	$ 5,930	$ 14,115	$ 206	$	$ 20,251
Other sovereign government obligations	9,148	10,920	3		20,071
Corporate and other debt(1)	47	53,977	34,460		88,484
Corporate equities	32,519	3,748	907		37,174
Derivative and other contracts(2)	2,478	150,033	40,852	(93,597)	99,766
Investments	536	330	9,732		10,598
Physical commodities	2	2,202			2,204
Total financial instruments owned	50,660	235,325	86,160	(93,597)	278,548
Securities received as collateral	4,402	800	15		5,217
Intangible assets(3)			220		220
Liabilities					
Commercial paper and other short-term borrowings	$	$ 1,412	$	$	$ 1,412
Deposits		6,008			6,008
Financial instruments sold, not yet purchased:					
U.S. government and agency securities	9,474	682			10,156
Other sovereign government obligations	5,140	4,220			9,360
Corporate and other debt	18	5,400	3,943		9,361
Corporate equities	16,418	108	21		16,547
Derivative and other contracts(2)	5,509	115,621	13,228	(60,837)	73,521
Total financial instruments sold, not yet purchased	36,559	126,031	17,192	(60,837)	118,945
Obligation to return securities received as collateral	4,402	800	15		5,217
Other secured financings(1)		6,780	5,747		12,527

Long-term borrowings	23,413	5,417	28,830

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

(1) Approximately $9.0 billion of assets is included in Corporate and other debt and approximately $7.2 billion of related liabilities is included in Other secured financings related to consolidated VIEs or non-consolidated VIEs (in the cases where the assets were transferred by the Company to the VIE and the transfers were accounted for as secured financings). The Company cannot unilaterally remove the assets from the VIEs; these assets are not generally available to the Company. The related liabilities issued by these VIEs are non-recourse to the Company. Approximately $7.7 billion of these assets and approximately $5.0 billion of these liabilities are included in Level 3 of the fair value hierarchy. See Note 5 for additional information on consolidated and non-consolidated VIEs, including retained interests in these entities that the Company holds.

(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 8.

(3) Amount represents MSRs accounted for at fair value. See Note 5 for further information on MSRs.

The following tables present additional information about Level 3 assets and liabilities measured at fair value on a recurring basis for the quarters and nine month periods ended September 30, 2009 and September 30, 2008. Level 3 instruments may be hedged by instruments classified in Level 1 and Level 2. As a result, the realized and unrealized gains or (losses) for assets and liabilities within the Level 3 category presented in the tables below do not reflect the related realized and unrealized gains or (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 or (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.

The following tables reflect gains or (losses) for all assets and liabilities categorized as Level 3 for the quarters and nine month periods ended September 30, 2009 and September 30, 2008, respectively. For assets and liabilities that were transferred into Level 3 during the period, gains or (losses) are presented as if the assets or liabilities had been transferred into Level 3 as of the beginning of the period; similarly, for assets and liabilities that were transferred out of Level 3 during the period, gains or (losses) are presented as if the assets or liabilities had been transferred out as of the beginning of the period.

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

Changes in Level 3 Assets and Liabilities Measured at Fair Value on a Recurring Basis for the Three Months Ended September 30, 2009

	Beginning Balance at June 30, 2009	Total Realized and Unrealized Gains or (Losses)(1)	Purchases, Sales, Other Settlements and Issuances, net	Net Transfers In and/or (Out) of Level 3	Ending Balance at September 30, 2009	Unrealized Gains or (Losses) for Level 3 Assets/ Liabilities Outstanding at September 30, 2009(2)
	(dollars in millions)					
Assets						
Financial instruments owned:						
U.S. agency securities	$ 28	$	$ (23)	$	$ 5	$
Other sovereign government obligations	3		4		7	
Corporate and other debt:						
State and municipal securities	1,705	4	(72)	(901)	736	2
Residential mortgage-backed securities	820	(29)	23	(43)	771	(41)
Commercial mortgage-backed securities	1,506	(420)	1,574	(434)	2,226	(442)
Asset-backed securities	1,827	8	(444)	(722)	669	14
Corporate bonds	2,449	41	(1,484)	137	1,143	9
Collateralized debt obligations	508	370	171	82	1,131	304
Loans and lending commitments	19,436	594	(1,081)	(1,461)	17,488	670
Other debt	1,489	398	(283)	21	1,625	421
Total corporate and other debt	29,740	966	(1,596)	(3,321)	25,789	937
Corporate equities	1,101	(79)	(102)	(60)	860	(34)
Net derivative and other contracts(3)	12,606	(1,654)	(1,179)	(301)	9,472	(1,251)
Investments	8,172	61	332	(3)	8,562	41
Securities received as collateral	17		(15)		2	
Intangible assets	173	(29)			144	(29)
Liabilities						
Commercial paper and other short-term borrowings	$	$ 2	$	$ 18	$ 16	$ 2
Deposits				14	14	
Financial instruments sold, not yet purchased:						
Corporate and other debt:						
Commercial mortgage-backed securities	4	(1)	(4)		1	(1)
Asset-backed securities	4				4	
Corporate bonds	132	(9)	(151)	38	28	(18)
Unfunded lending commitments	303	60	227		470	60
Other debt	86	(36)	(81)	59	100	(40)
Total corporate and other debt	529	14	(9)	97	603	1
Corporate equities	22	27	3	24	22	(6)

Obligation to return securities received as collateral	17		(15)		2	
Other secured financings	4,463	(272)	(100)	(447)	4,188	(272)
Long-term borrowings	5,900	(77)	(7)	1,284	7,254	(77)

31

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

(1) Total realized and unrealized gains or (losses) are primarily included in Principal transactions trading in the condensed consolidated statements of income except for $61 million related to Financial instruments owned investments, which is included in Principal transactions investments.
(2) Amounts represent unrealized gains or (losses) for the quarter ended September 30, 2009 related to assets and liabilities still outstanding at September 30, 2009.
(3) Net derivative and other contracts represent Financial instruments owned derivative and other contracts net of Financial instruments sold, not yet purchased derivative and other contracts. For further information on derivative instruments and hedging activities, see Note 8.

Financial instruments owned Corporate and other debt. The net gains in Corporate and other debt were primarily driven by mark-to-market gains on corporate loans, CDOs and certain other debt, partially offset by losses in commercial mortgage-backed securities.

During the quarter ended September 30, 2009, the Company reclassified approximately $3.3 billion of certain Corporate and other debt from Level 3 to Level 2. The reclassifications were primarily related to corporate loans, state and municipal securities, asset-backed securities and commercial mortgage-backed securities. The reclassifications were primarily due to an increase in market price quotations for these or comparable instruments, or available broker quotes, such that observable inputs were utilized for the fair value measurement of these instruments. Corporate loans were reclassified as more liquidity entered the market and price transparency increased for certain corporate loans due to refinancing activities. Separately, certain SLARS were reclassified from Level 3 to Level 2 as there was increased activity in the SLARS market and restructuring activity of the underlying trusts.

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

Long-term borrowings. During the quarter ended September 30, 2009, the Company reclassified approximately $1.3 billion of certain Long-term borrowings from Level 2 to Level 3. The reclassifications primarily related to structured notes for which certain significant inputs became unobservable and deemed significant.

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

Changes in Level 3 Assets and Liabilities Measured at Fair Value on a Recurring Basis for the Three Months Ended September 30, 2008

	Beginning Balance at June 30, 2008	Total Realized and Unrealized Gains or (Losses)(1)	Purchases, Sales, Other Settlements and Issuances, net	Net Transfers In and/or (Out) of Level 3	Ending Balance at September 30, 2008	Unrealized Gains or (Losses) for Level 3 Assets/ Liabilities Outstanding at September 30, 2008(2)
	(dollars in millions)					
Assets						
Financial instruments owned:						
U.S. government and agency securities	$ 272	$ (1)	$ 14	$ 50	$ 335	$ (4)
Other sovereign government obligations	2				2	
Corporate and other debt	34,039	(3,354)	3,268	6,300	40,253	(3,566)
Corporate equities	1,288	(132)	(48)	64	1,172	(98)
Net derivative and other contracts(3)	16,153	1,994	(4,011)	138	14,274	1,575
Investments	12,486	(684)	(43)	(12)	11,747	(623)
Securities received as collateral	2		2		4	
Intangible assets	4	(72)	2	327	261	(70)
Liabilities						
Financial instruments sold, not yet purchased:						
Corporate and other debt	$ 1,209	$ 364	$ 1,244	$ 229	$ 2,318	$ 356
Corporate equities	61	19	(19)	36	59	15
Obligation to return securities received as collateral	2		2		4	
Other secured financings	9,117	1,074	(2,684)	3,751	9,110	1,074
Long-term borrowings	5,674	673	18	(28)	4,991	641

(1) Total realized and unrealized gains or (losses) are primarily included in Principal transactions trading in the condensed consolidated statements of income except for $(684) million related to Financial instruments owned investments, which is included in Principal transactions investments.
(2) Amounts represent unrealized gains or (losses) for the quarter ended September 30, 2008 related to assets and liabilities still outstanding at September 30, 2008.
(3) Net derivative and other contracts represent Financial instruments owned derivative and other contracts net of Financial instruments sold, not yet purchased derivative and other contracts. For further information on derivative instruments and hedging activities, see Note 8.

Financial instruments owned Corporate and other debt. The net losses from Corporate and other debt were primarily driven by certain corporate loans and lending commitments, asset-backed securities and collateralized debt obligation cash positions.

The purchases in Corporate and other debt were primarily related to corporate loans and lending commitments.

During the quarter ended September 30, 2008, the Company reclassified certain Corporate and other debt from Level 2 to Level 3. These transfers primarily related to certain loans and commercial mortgage-backed securities. These reclassifications were due to a reduction in the volume of recently executed transactions and market price quotations for these instruments such that certain significant inputs for the fair value measurement of these instruments became unobservable.

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

Financial instruments owned Net derivative and other contracts. The net gains from net derivative contracts were primarily driven by widening of credit spreads on underlying reference entities of certain basket, single name and tranche-indexed credit default swaps where the Company was long protection.

The sales from Net derivative and other contracts were primarily driven by single name credit default swaps.

Other secured financings. The net gains in Other secured financings were primarily due to net gains on liabilities resulting from securitizations recognized on balance sheet. These gains were offset by net losses in Financial instruments owned corporate and other debt.

The Company reclassified Other secured financings from Level 2 to Level 3 because it was determined that certain significant inputs to the fair value measurement were unobservable.

Changes in Level 3 Assets and Liabilities Measured at Fair Value on a Recurring Basis for the Nine Months Ended September 30, 2009

	Beginning Balance at December 31, 2008	Total Realized and Unrealized Gains or (Losses)(1)	Purchases, Sales, Other Settlements and Issuances, net	Net Transfers In and/or (Out) of Level 3	Ending Balance at September 30, 2009	Unrealized Gains or (Losses) for Level 3 Assets/ Liabilities Outstanding at September 30, 2009(2)
	(dollars in millions)					
Assets						
Financial instruments owned:						
U.S. agency securities	$ 127	$ (3)	$ (95)	$ (24)	$ 5	$
Other sovereign government obligations	1	(2)	4	4	7	
Corporate and other debt:						
State and municipal securities	2,065	10	(398)	(941)	736	(17)
Residential mortgage-backed securities	1,251	(118)	(119)	(243)	771	(99)
Commercial mortgage-backed securities	3,130	(1,455)	1,168	(617)	2,226	(1,468)
Asset-backed securities	968	84	(342)	(41)	669	12
Corporate bonds	3,088	222	(2,328)	161	1,143	13
Collateralized debt obligations	982	365	309	(525)	1,131	235
Loans and lending commitments	19,701	(1,169)	(2,608)	1,564	17,488	(896)
Other debt	3,733	727	(1,847)	(988)	1,625	672
Total corporate and other debt	34,918	(1,334)	(6,165)	(1,630)	25,789	(1,548)
Corporate equities	976	105	(663)	442	860	(187)
Net derivative and other contracts(3)	23,382	(4,283)	(867)	(8,760)	9,472	(3,191)
Investments	9,698	(1,430)	336	(42)	8,562	(1,337)
Securities received as collateral	30		(28)		2	
Intangible assets	184	(40)			144	(42)
Liabilities						
Commercial paper and other short-term borrowings	$	$ 11	$	$ 27	$ 16	$ 11
Deposits		(1)		13	14	(1)
Financial instruments sold, not yet purchased:						

Corporate and other debt:						
Commercial mortgage-backed securities	1				1	
Asset-backed securities	4				4	
Corporate bonds	320	8	(221)	(63)	28	7
Unfunded lending commitments	36	(71)	363		470	(71)
Other debt	3,447	(53)	(2,358)	(1,042)	100	(53)
Total corporate and other debt	3,808	(116)	(2,216)	(1,105)	603	(117)
Corporate equities	27	(7)	(81)	69	22	(7)
Obligation to return securities received as collateral	30		(28)		2	
Other secured financings	6,148	685	(902)	(373)	4,188	685
Long-term borrowings	5,473	(492)	(35)	1,324	7,254	(492)

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

(1) Total realized and unrealized gains or (losses) are primarily included in Principal transactions trading in the condensed consolidated statements of income except for $(1,430) million related to Financial instruments owned investments, which is included in Principal transactions investments.
(2) Amounts represent unrealized gains or (losses) for the nine month period ended September 30, 2009 related to assets and liabilities still outstanding at September 30, 2009.
(3) Net derivative and other contracts represent Financial instruments owned derivative and other contracts net of Financial instruments sold, not yet purchased derivative and other contracts. For further information on derivative instruments and hedging activities, see Note 8.

Financial instruments owned Corporate and other debt. The net losses in Corporate and other debt were primarily driven by certain corporate loans and certain commercial mortgage-backed securities, partially offset by gains in certain other debt.

During the nine month period ended September 30, 2009, the Company reclassified approximately $1.6 billion of certain Corporate and other debt from Level 3 to Level 2. The reclassifications were primarily related to certain other debt, state and municipal securities and commercial mortgage-backed securities. As the unobservable inputs became insignificant in the overall valuation, the fair value of these instruments became highly correlated with similar instruments in an observable market. These reclassifications were partly offset by the reclassification of certain corporate loans and lending commitments from Level 2 to Level 3. The reclassifications were due to a reduction in market price quotations for these or comparable instruments, or a lack of available broker quotes, such that unobservable inputs had to be utilized for the fair value measurement of these instruments. The key unobservable inputs include assumptions to establish comparability to bonds, loans or swaps with observable price/spread levels.

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

During the nine month period ended September 30, 2009, the Company reclassified approximately $8.8 billion of certain Derivatives and other contracts from Level 3 to Level 2. These reclassifications of certain Derivatives and other contracts were related to single name mortgage-related credit default swaps and credit default swaps on certain classes of CDOs. The primary reason for the reclassifications is that, due to market deterioration, the values associated with the unobservable inputs, such as correlation, for these derivative contracts were no longer deemed significant to the fair value measurement. In addition, certain corporate tranche-indexed credit default swaps were reclassified due to increased availability of transaction data, broker quotes and/or consensus pricing.

Financial instruments owned Investments. The net losses from investments were primarily related to investments associated with the Company s real estate products.

Financial instruments sold, not yet purchased Corporate and other debt. During the nine month period ended September 30, 2009, the Company reclassified approximately $1.1 billion of certain Corporate and other debt from Level 3 to Level 2. These reclassifications primarily related to contracts referencing commercial mortgage-backed securities, subprime CDOs and other subprime ABS securities. Their fair value was highly correlated with similar instruments in an observable market and, due to market deterioration, the values associated with the unobservable inputs were no longer deemed significant to the fair value measurement.

The sales of Corporate and other debt were primarily related to contracts referencing commercial mortgage-backed securities, subprime CDOs and other subprime ABS securities.

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

Long-term borrowings. During the quarter ended September 30, 2009, the Company reclassified approximately $1.3 billion of certain Long-term borrowings from Level 2 to Level 3. The reclassifications primarily related to structured notes for which certain significant inputs became unobservable.

Changes in Level 3 Assets and Liabilities Measured at Fair Value on a Recurring Basis for the Nine Months Ended September 30, 2008

	Beginning Balance at December 31, 2007	Total Realized and Unrealized Gains or (Losses)(1)	Purchases, Sales, Other Settlements and Issuances, net	Net Transfers In and/or (Out) of Level 3	Ending Balance at September 30, 2008	Unrealized Gains or (Losses) for Level 3 Assets/ Liabilities Outstanding at September 30, 2008(2)
			(dollars in millions)			
Assets						
Financial instruments owned:						
U.S. government and agency securities	$ 622	$ 18	$ (222)	$ (83)	$ 335	$ 1
Other sovereign government obligations	15	(4)	(18)	9	2	
Corporate and other debt	39,707	(9,036)	1,250	8,332	40,253	(7,982)
Corporate equities	1,717	(338)	(448)	241	1,172	(178)
Net derivative and other contracts(3)	5,486	10,835	(1,417)	(630)	14,274	9,019
Investments	12,758	(1,057)	1,291	(1,245)	11,747	(1,501)
Securities received as collateral	71		(67)		4	
Intangible assets	3	(71)	2	327	261	(69)
Liabilities						
Financial instruments sold, not yet purchased:						
Corporate and other debt	$ 717	$ (25)	$ 1,457	$ 119	$ 2,318	$ (23)
Corporate equities	175	(311)	(326)	(101)	59	(7)
Obligation to return securities received as collateral	71		(67)		4	
Other secured financings	6,160	2,556	1,920	3,586	9,110	2,556
Long-term borrowings	5,829	800	(12)	(26)	4,991	800

(1) Total realized and unrealized gains or (losses) are primarily included in Principal transactions trading in the condensed consolidated statements of income except for $(1,057) million related to Financial instruments owned investments, which is included in Principal transactions investments.

(2) Amounts represent unrealized gains or (losses) for the nine month period ended September 30, 2008 related to assets and liabilities still outstanding at September 30, 2008.

(3) Net derivative and other contracts represent Financial instruments owned derivative and other contracts net of Financial instruments sold, not yet purchased derivative and other contracts. For further information on derivative instruments and hedging activities, see Note 8.

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

Financial instruments owned Corporate and other debt. The net losses from Corporate and other debt were primarily driven by commercial mortgage-backed securities, asset-backed securities, including residential and commercial mortgage loans, certain collateralized debt obligations and by corporate loans and lending commitments.

The purchases in Corporate and other debt were primarily related to corporate loans and lending commitments.

During the nine month period ended September 30, 2008, the Company reclassified certain Corporate and other debt from Level 2 to Level 3. The reclassifications were primarily related to residential and commercial mortgage-backed securities, asset-backed securities, collateralized debt obligations, commercial whole loans and corporate loans and lending commitments. The reclassifications were due to a reduction in the volume of recently executed transactions and market price quotations for these instruments, or a lack of available broker quotes, such that unobservable inputs had to be utilized for the valuation of these instruments. These unobservable inputs include, depending upon the position, assumptions to establish comparability to bonds, loans or swaps with observable price/spread levels, default recovery rates, forecasted credit losses and prepayment rates.

Financial instruments owned Net derivative and other contracts. The net gains from Net derivative contracts were primarily driven by widening of credit spreads on underlying reference entities of certain basket, single name and tranche-indexed credit default swaps where the Company was long protection.

The sales from Net derivative and other contracts were primarily driven by single name credit default swaps.

Financial instruments owned Investments. The net losses from investments were primarily related to investments associated with the Company s real estate products.

The Company reclassified investments from Level 3 to Level 2 because certain significant inputs for the fair value measurement were identified and, therefore, became observable.

Other secured financings. The net gains in Other secured financings were primarily due to net gains on liabilities resulting from securitizations recognized on balance sheet. These net gains were offset by net losses in Financial instruments owned corporate and other debt.

The Company reclassified Other secured financings from Level 2 to Level 3 because it was determined that certain significant inputs for the fair value measurement became unobservable.

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

Assets and Liabilities Measured at Fair Value on a Non-Recurring Basis.

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

The following table presents, by caption on the condensed consolidated statement of financial position, the fair value hierarchy for those assets measured at fair value on a non-recurring basis for which the Company recognized an impairment charge for the quarter and nine month period ended September 30, 2009.

		Fair Value Measurements Using:				
	Carrying Value at September 30, 2009(1)	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total (Losses) for the Three Months Ended September 30, 2009(2)	Total (Losses) for the Nine Months Ended September 30, 2009(2)(3)
				(dollars in millions)		
Receivables Other loans	$ 422	$	$	$ 422	$ (27)	$ (208)
Other investments	22			22	(9)	(55)
Premises, equipment and software costs						(5)
Intangible assets	3			3	(6)	(15)
Other assets(4)	461			461	(249)	(409)
Total	$ 908	$	$	$ 908	$ (291)	$ (692)

(1) Carrying values relate only to those assets that incurred impairment losses during the quarter ended September 30, 2009. These amounts do not include assets that incurred impairment losses during the six months ended June 30, 2009, unless the assets also experienced an impairment loss during the quarter ended September 30, 2009.
(2) Impairment losses are recorded within Other expenses in the condensed consolidated statement of income except for impairment losses related to Receivables other loans and Other investments, which are included in Other revenues.
(3) Amounts represent cumulative losses for assets that incurred impairment losses during the nine month period ended September 30, 2009.
(4) These impairment losses relate to buildings and property held in the Asset Management business segment, and are a result of the continued adverse impact of economic conditions on domestic real estate markets. Fair values were generally determined using discounted cash flow models or third-party appraisals and valuations.

There were no liabilities measured at fair value on a non-recurring basis during the quarter and nine month period ended September 30, 2009.

In addition, there were no assets or liabilities measured at fair value on a non-recurring basis for which the Company recognized an impairment charge during the quarter and nine month period ended September 30, 2008.

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

Fair Value Option.

The Company elected the fair value option for certain eligible instruments that are risk managed on a fair value basis. The following tables present net gains or (losses) due to changes in fair value for items measured at fair value pursuant to the fair value option election for the quarters and nine month periods ended September 30, 2009 and September 30, 2008.

	Principal Transactions: Trading	Net Interest Revenue (dollars in millions)	Gains (Losses) Included in Net Revenues
Three Months Ended September 30, 2009			
Commercial paper and other short-term borrowings	$ (86)	$	$ (86)
Deposits	(26)	(78)	(104)
Long-term borrowings	(1,677)	(233)	(1,910)
Three Months Ended September 30, 2008			
Commercial paper and other short-term borrowings	$ 622	$	$ 622
Deposits	34		34
Long-term borrowings	11,701	(257)	11,444
Nine Months Ended September 30, 2009			
Commercial paper and other short-term borrowings	$ (128)	$	$ (128)
Deposits	(103)	(257)	(360)
Long-term borrowings	(6,473)	(727)	(7,200)
Nine Months Ended September 30, 2008			
Commercial paper and other short-term borrowings	$ 818	$ (4)	$ 814
Deposits	39	(29)	10
Long-term borrowings	14,381	(807)	13,574

In addition to the amounts in the above table, as discussed in Note 1, all of the instruments within Financial instruments owned or Financial instruments sold, not yet purchased are measured at fair value, either through the election of the fair value option, or as required by other accounting pronouncements.

The following table presents information on the Company s short-term and long-term borrowings (including structured notes and junior subordinated debentures), loans and unfunded lending commitments for which the fair value option was elected:

(Losses) Gains Due to Changes in Instrument Specific Credit Spreads

	Three Months Ended September 30, 2009	Three Months Ended September 30, 2008	Nine Months Ended September 30, 2009	Nine Months Ended September 30, 2008
	(dollars in millions)			
Short-term and long-term borrowings(1)	$ (878)	$ 9,667	$ (4,913)	$ 11,260
Loans(2)	1,342	(1,289)	5,258	(2,319)
Unfunded lending commitments(3)	(11)	267	(149)	436

(1) Gains or (losses) were attributable to widening or (tightening), respectively, of the Company s credit spreads and were determined based upon observations of the Company s secondary bond market spreads. The remainder of changes in overall fair value of the short-term and long-term borrowings is attributable to changes in foreign currency exchange rates and interest rates and movements in the reference price or index for structured notes.

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

(2) Instrument-specific credit gains or (losses) were determined by excluding the non-credit components of gains and losses, such as those due to changes in interest rates.
(3) Gains or (losses) were generally determined based on the differential between estimated expected client and contractual yields at each respective period end.

Contractual Principal Amount Over Fair Value

	At September 30, 2009	At December 31, 2008	At November 30, 2008
		(dollars in billions)	
Short-term and long-term debt borrowings(1)	$ 2.5	$ 5.7	$ 7.5
Loans(2)	25.7	31.0	30.5
Loans 90 or more days past due(2)(3)	21.8	19.8	19.8

(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 90 or more days past due as of September 30, 2009, December 31, 2008 and November 30, 2008 was $1.8 billion, $2.0 billion and $2.0 billion, respectively.

Financial Instruments Not Measured at Fair Value.

Some of the Company s financial instruments are not measured at fair value on a recurring basis but nevertheless are recorded at amounts that approximate fair value due to their liquid or short-term nature. Such financial assets and financial liabilities include: Cash and due from banks, Interest bearing deposits with banks, Cash deposited with clearing organizations or segregated under federal and other regulations or requirements, Federal funds sold and Securities purchased under agreements to resell, Securities borrowed, Securities sold under agreements to repurchase, Securities loaned, Receivables customers, Receivables brokers, dealers and clearing organizations, Payables customers, Payables brokers, dealers and clearing organizations, certain Commercial paper and other short-term borrowings, and certain Deposits.

The Company s long-term borrowings are recorded at historical amounts unless elected under the fair value option or designated as a hedged item in a fair value hedge. For long-term borrowings not measured at fair value, the fair value of the Company s long-term borrowings was estimated using either quoted market prices or discounted cash flow analyses based on the Company s current borrowing rates for similar types of borrowing arrangements. At September 30, 2009, the carrying value of the Company s long-term borrowings was approximately $4.1 billion higher than fair value. At December 31, 2008 and November 30, 2008, the carrying value of the Company s long-term borrowings was approximately $25.6 billion and $25.0 billion higher than fair value, respectively.

4. Collateralized Transactions.

Securities purchased under agreements to resell (reverse repurchase agreements) and Securities sold under agreements to repurchase (repurchase agreements), principally government and agency securities, are carried at the amounts at which the securities subsequently will be resold or reacquired as specified in the respective agreements; such amounts include accrued interest. Reverse repurchase agreements and repurchase agreements are presented on a net-by-counterparty basis, when appropriate. The Company s policy is generally to take possession of securities purchased under agreements to resell. Securities borrowed and Securities loaned are

40

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

carried at the amounts of cash collateral advanced and received in connection with the transactions. 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-referenced securities and loans where in all instances these liabilities are payable solely from the cash flows of the related assets accounted for as Financial instruments owned (see Note 5).

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

	At September 30, 2009	At December 31, 2008 (dollars in millions)	At November 30, 2008
Financial instruments owned:			
U.S. government and agency securities	$ 26,941	$ 9,134	$ 7,701
Other sovereign government obligations	7,861	2,570	626
Corporate and other debt	12,314	21,850	33,037
Corporate equities	9,776	4,388	5,726
Total	$ 56,892	$ 37,942	$ 47,090

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 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. 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. At September 30, 2009, December 31, 2008 and November 30, 2008, the fair value of financial instruments received as collateral where the Company is permitted to sell or repledge the securities was $388 billion, $290 billion and $294 billion, respectively, and the fair value of the portion that had been sold or repledged was $300 billion, $214 billion and $227 billion, respectively.

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 September 30, 2009, December 31, 2008 and November 30, 2008, $16 billion, $5 billion and $5 billion, respectively, were reported as Securities received as collateral and an Obligation to return securities received as collateral in the condensed consolidated statements of financial condition. Collateral received in connection with these transactions that was subsequently repledged was approximately $15 billion, $4 billion and $5 billion at September 30, 2009, December 31, 2008 and November 30, 2008, respectively.

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

The Company manages credit exposure arising from reverse repurchase agreements, repurchase agreements, securities borrowed and securities loaned transactions by, in appropriate circumstances, entering into master netting agreements and collateral arrangements with counterparties that provide the Company, in the event of a customer default, the right to liquidate collateral and the right to offset a counterparty s rights and obligations. The Company also monitors the fair value of the underlying securities as compared with the related receivable or payable, including accrued interest, and, as necessary, requests additional collateral to ensure such transactions are adequately collateralized. Where deemed appropriate, the Company s agreements with third parties specify its rights to request additional collateral. Customer receivables generated from margin lending activity are collateralized by customer-owned securities held by the Company. 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 September 30, 2009, December 31, 2008 and November 30, 2008, cash and securities deposited with clearing organizations or segregated under federal and other regulations or requirements were as follows:

	September 30, 2009	December 31, 2008	November 30, 2008
		(dollars in millions)	
Cash	$ 21,753	$ 24,039	$ 25,446
Securities(1)	14,347	38,670	33,642
Total	$ 36,100	$ 62,709	$ 59,088

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

5. Securitization Activities and Variable Interest Entities.

Securitization Activities and Qualifying Special Purpose Entities.

Securitization Activities. In a securitization transaction, the Company transfers assets (generally commercial or residential mortgage loans or U.S. agency securities) to a special purpose entity (an SPE), sells to investors most of the beneficial interests, such as notes or certificates, issued by the SPE and in many cases retains other beneficial interests. In many securitization transactions involving commercial mortgage loans, the Company transfers a portion of the assets transferred to the SPE with unrelated parties transferring the remaining assets.

The purchase of the transferred assets by the SPE is financed through the sale of these interests. In some of these transactions, primarily involving residential mortgage loans in the U.S. and Europe and commercial mortgage loans in Europe, the Company serves as servicer for some or all of the transferred loans. In many securitizations, particularly involving residential mortgage loans, the Company also enters into derivative transactions, primarily interest rate swaps or interest rate caps, with the SPE.

In most of these transactions, the SPE meets the criteria to be a QSPE under the accounting guidance for the transfer and servicing of financial assets. The Company does not consolidate QSPEs if they meet certain criteria regarding the types of assets and derivatives they may hold, the activities in which they may engage and the range of discretion they may exercise in connection with the assets they hold. The determination of whether an SPE meets the criteria to be a QSPE requires considerable judgment, particularly in evaluating whether the permitted activities of the

SPE are significantly limited and in determining whether derivatives held by the SPE are passive and not excessive.

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

The primary risk retained by the Company in connection with these transactions generally is limited to the beneficial interests issued by the SPE that are owned by the Company, with the risk highest on the most subordinate class of beneficial interests. Where the QSPE criteria are met, these beneficial interests generally are included in Financial instruments owned corporate and other debt and are measured at fair value. The Company does not provide additional support in these transactions through contractual facilities, such as liquidity facilities, guarantees, or similar derivatives.

Although not obligated, the Company generally makes a market in the securities issued by SPEs in these transactions. As a market maker, the Company offers to buy these securities from, and sell these securities to, investors. Securities purchased through these market-making activities are not considered to be retained interests, although these beneficial interests generally are included in Financial instruments owned corporate and other debt securities and are measured at fair value.

The Company enters into derivatives, generally interest rate swaps and interest rate caps with a senior payment priority in many securitization transactions. The risks associated with these and similar derivatives with SPEs are essentially the same as similar derivatives with non-SPE counterparties and are managed as part of the Company s overall exposure.

See Note 8 for further information on derivative instruments and hedging activities.

QSPEs. The following tables present information as of September 30, 2009 and December 31, 2008 regarding QSPEs to which the Company, acting as principal, has transferred assets and received sales treatment, and QSPEs sponsored by the Company to which the Company has not transferred assets (dollars in millions):

	At September 30, 2009			
	Residential Mortgage Loans	Commercial Mortgage Loans	U.S. Agency Collateralized Mortgage Obligations	Other
QSPE assets (unpaid principal balance)(1)	$ 56,843	$ 111,404	$ 63,748	$ 3,119
Retained interests (fair value):				
Investment grade	$ 54	$ 223	$ 383	$
Non-investment grade	71	287		
Total retained interests (fair value)	$ 125	$ 510	$ 383	$
Interests purchased in the secondary market (fair value):				
Investment grade	$ 100	$ 460	$ 10	$ 79
Non-investment grade	129	38		32
Total interests purchased in the secondary market (fair value)	$ 229	$ 498	$ 10	$ 111
Derivatives (fair value)	$ 249	$ 359	$	$ 903
Assets serviced (unpaid principal balance)	18,901	8,554		

(1) Amounts include $57.0 billion of assets transferred to the QSPEs by unrelated transferors.

43

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

	At December 31, 2008			
	Residential Mortgage Loans	Commercial Mortgage Loans	U.S. Agency Collateralized Mortgage Obligations	Other
QSPE assets (unpaid principal balance)(1)	$ 65,344	$ 112,557	$ 73,136	$ 2,684
Retained interests (fair value):				
Investment grade	$ 500	$ 482	$ 102	$
Non-investment grade	33	100		
Total retained interests (fair value)	$ 533	$ 582	$ 102	$
Interests purchased in the secondary market (fair value):				
Investment grade	$ 42	$ 156	$ 8	$ 23
Non-investment grade	49	14		12
Total interests purchased in the secondary market (fair value)	$ 91	$ 170	$ 8	$ 35
Derivatives (fair value)	$ 488	$ 515	$	$ 1,156
Assets serviced (unpaid principal balance)	23,211	8,196		

(1) Amounts include $57.8 billion of assets transferred to the QSPEs by unrelated transferors.

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. 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 at the time of securitization were not material during the nine month period ended September 30, 2009 and the one month period ended December 31, 2008.

During the nine month periods ended September 30, 2009 and September 30, 2008, the Company received proceeds from new securitization transactions of $3.8 billion and $5.3 billion, respectively. During both the nine month periods ended September 30, 2009 and September 30, 2008, the Company received proceeds from cash flows from retained interests in securitization transactions of $1.6 billion.

The Company provides representations and warranties that certain assets transferred in securitization transactions conform to specific guidelines (see Note 9).

Mortgage Servicing Rights. The Company may retain servicing rights to certain mortgage loans that are sold through its securitization activities. These transactions create an asset referred to as MSRs, which totaled approximately $144 million and $184 million as of September 30, 2009 and December 31, 2008, respectively, and are included within Intangible assets and carried at fair value in the condensed consolidated statements of financial condition.

SPE Mortgage Servicing Activities. The Company services residential mortgage loans in the U.S. and Europe and commercial mortgage loans in Europe owned by SPEs, including SPEs sponsored by the Company and SPEs not sponsored by the Company. Most of these SPEs meet the requirements for QSPEs. The Company generally holds retained interests in Company-sponsored QSPEs. 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.

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

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. Advances as of September 30, 2009 and December 31, 2008 totaled approximately $2.2 billion and $2.4 billion, respectively, net of reserves of $15 million as of September 30, 2009 and $10 million as of December 31, 2008.

The following table presents information about the Company s mortgage servicing activities for SPEs to which the Company transferred loans as of September 30, 2009 and December 31, 2008 (dollars in millions):

	At September 30, 2009			
	Residential Mortgage QSPEs	Residential Mortgage Failed Sales	Commercial Mortgage QSPEs	Commercial Mortgage Consolidated SPEs
Assets serviced (unpaid principal balance)	$ 18,901	$ 1,179	$ 8,554	$ 2,463
Amounts past due 90 days or greater (unpaid principal balance)(1)	$ 7,343	$ 390	$	$ 5
Percentage of amounts past due 90 days or greater(1)	38.8%	33.1%		0.2%
Credit losses	$ 624	$	$ 2	$

(1) Includes 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, 2008			
	Residential Mortgage QSPEs	Residential Mortgage Failed Sales	Commercial Mortgage QSPEs	Commercial Mortgage Consolidated SPEs
Assets serviced (unpaid principal balance)	$ 23,211	$ 890	$ 8,196	$ 2,349
Amounts past due 90 days or greater (unpaid principal balance)(1)	$ 7,586	$ 308	$	$
Percentage of amounts past due 90 days or greater(1)	32.7%	34.6%		
Credit losses	$ 181	$ 11	$	$

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

The Company also serviced residential and commercial mortgage loans for SPEs sponsored by unrelated parties with unpaid principal balances totaling $22 billion and $25 billion as of September 30, 2009 and December 31, 2008, respectively.

Variable Interest Entities. Accounting guidance for consolidation of VIEs applies to certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. QSPEs currently are not subject to consolidation. The primary beneficiary of a VIE is the party that absorbs a majority of the entity s expected losses, receives a majority of its expected residual returns or both, as a result of holding variable interests. The Company consolidates entities of which it is the primary beneficiary.

The Company is involved with various entities in the normal course of business that may be deemed to be VIEs. The Company s variable interests in VIEs include debt and equity interests, commitments, guarantees and derivative instruments. The Company s involvement with VIEs arises primarily from:

Interests purchased in connection with market making and retained interests held as a result of securitization activities.

45

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

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

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

Derivatives entered into with VIEs.

Structuring of credit-linked notes (CLNs) 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. This determination is based upon an analysis of the design of the VIE, including the VIE s structure and activities and the variable interests owned by the Company.

The Company reassesses whether it is the primary beneficiary of a VIE upon the occurrence of certain reconsideration events. If the Company s initial assessment results in a determination that it is not the primary beneficiary of a VIE, then the Company reassesses this determination upon the occurrence of:

Changes to the VIE s governing documents or contractual arrangements in a manner that reallocates the obligation to absorb the expected losses or the right to receive the expected residual returns of the VIE between the current primary beneficiary and the other variable interest holders, including the Company.

Acquisition by the Company of additional variable interests in the VIE.

If the Company s initial assessment results in a determination that it is the primary beneficiary, then the Company reassesses this determination upon the occurrence of:

Changes to the VIE s governing documents or contractual arrangements in a manner that reallocates the obligation to absorb the expected losses or the right to receive the expected residual returns of the VIE between the current primary beneficiary and the other variable interest holders, including the Company.

A sale or disposition by the Company of all or part of its variable interests in the VIE to parties unrelated to the Company.

The issuance of new variable interests by the VIE to parties unrelated to the Company.

Except for consolidated VIEs included in other structured financings in the tables below, the Company accounts for the assets held by the entities primarily in Financial instruments owned and the liabilities of the entities as Other secured financings in the condensed consolidated statements of financial condition. The Company includes assets held by consolidated VIEs included in other structured financings in the tables below primarily in Receivables, Premises, equipment and software costs and Other assets and the liabilities primarily as Other liabilities and accrued expenses and Payables in the condensed consolidated statements of financial condition. Except for consolidated VIEs included in other structured financings, the assets and liabilities are measured at fair value, with changes in fair value reflected in earnings.

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

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

The following tables present information as of September 30, 2009 and December 31, 2008 about VIEs which the Company consolidates (dollars in millions):

	At September 30, 2009				
	Mortgage and Asset-backed Securitizations	Credit and Real Estate	Commodities Financing	Other Structured Financings	Total
VIE assets that the Company consolidates	$ 4,041	$ 2,608	$ 648	$ 1,127	$ 8,424
VIE liabilities	2,004	814	561	325	3,704
Maximum exposure to loss:					
Debt and equity interests	$ 2,034	$ 1,350	$	$ 848	$ 4,232
Derivatives and other contracts	518	836	895		2,249
Commitments and guarantees				205	205
Total maximum exposure to loss	$ 2,552	$ 2,186	$ 895	$ 1,053	$ 6,686

	At December 31, 2008				
	Mortgage and Asset-backed Securitizations	Credit and Real Estate	Commodities Financing	Other Structured Financings	Total
VIE assets that the Company consolidates	$ 4,307	$ 4,121	$ 809	$ 1,664	$ 10,901
VIE liabilities	2,473	1,505	766	801	5,545
Maximum exposure to loss:					
Debt and equity interests	$ 1,834	$ 2,605	$	$ 882	$ 5,321
Derivatives and other contracts	517	2,348	1,307		4,172
Commitments and guarantees				330	330
Total maximum exposure to loss	$ 2,351	$ 4,953	$ 1,307	$ 1,212	$ 9,823

The following tables present information about non-consolidated VIEs in which the Company had significant variable interests or served as the sponsor and had any variable interest as of September 30, 2009 and December 31, 2008 (dollars in millions):

	At September 30, 2009				
	Mortgage and Asset-backed Securitizations	Credit and Real Estate	Municipal Tender Option Bond Trusts	Other Structured Financings	Total
VIE assets that the Company does not consolidate	$ 808	$ 15,994	$ 308	$ 5,891	$ 23,001
Maximum exposure to loss:					
Debt and equity interests	$ 19	$ 3,505	$ 70	$ 898	$ 4,492

Derivatives and other contracts		5,277			5,277
Commitments and guarantees		200	30	657	887
Total maximum exposure to loss	$ 19	$ 8,982	$ 100	$ 1,555	$ 10,656
Carrying value of exposure to loss Assets:					