MORGAN STANLEY
Form 10-Q
May 09, 2011
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 March 31, 2011

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 ¨ (Do not check if a smaller reporting company)	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 April 30, 2011, there were 1,544,658,124 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 March 31, 2011

Table of Contents		Page
Part I Financial Information		
Item 1.	Financial Statements (unaudited)	1
	Condensed Consolidated Statements of Financial Condition March 31, 2011 and December 31, 2010	1
	Condensed Consolidated Statements of Income Three Months Ended March 31, 2011 and 2010	3
	Condensed Consolidated Statements of Comprehensive Income Three Months Ended March 31, 2011 and 2010	4
	Condensed Consolidated Statements of Cash Flows Three Months Ended March 31, 2011 and 2010	5
	Condensed Consolidated Statements of Changes in Total Equity Three Months Ended March 31, 2011 and 2010	6
	Notes to Condensed Consolidated Financial Statements (unaudited)	8
	Note 1. Introduction and Basis of Presentation	8
	Note 2. Significant Accounting Policies	10
	Note 3. Fair Value Disclosures	11
	Note 4. Securities Available for Sale	30
	Note 5. Collateralized Transactions	32
	Note 6. Variable Interest Entities and Securitization Activities	34
	Note 7. Financing Receivables	42
	Note 8. Goodwill and Net Intangible Assets	44
	Note 9. Long-Term Borrowings and Other Secured Financings	45
	Note 10. Derivative Instruments and Hedging Activities	46
	Note 11. Commitments, Guarantees and Contingencies	54
	Note 12. Regulatory Requirements	60
	Note 13. Total Equity	63
	Note 14. Earnings per Common Share	63
	Note 15. Interest Income and Interest Expense	65
	Note 16. Employee Benefit Plans	65
	Note 17. Income Taxes	66
	Note 18. Segment and Geographic Information	67
	Note 19. Equity Method Investments	69
	Note 20. Discontinued Operations	70
	Note 21. Subsequent Events	71
	Report of Independent Registered Public Accounting Firm	72
Item 2.	Management s Discussion and Analysis of Financial Condition and Results of Operations	73
	Introduction	73
	Executive Summary	74
	Business Segments	82
	Accounting Developments	93
	Other Matters	94
	Critical Accounting Policies	97
	Liquidity and Capital Resources	102
Item 3.	Quantitative and Qualitative Disclosures about Market Risk	115

Table of Contents

Table of Contents		Page
Item 4.	Controls and Procedures	127
Financial Data Supplement (Unaudited)		128
Part II Other Information		
Item 1.	Legal Proceedings	131
Item 1A.	Risk Factors	133
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	134
Item 6.	Exhibits	134

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 its Audit Committee; Internal Audit Subcommittee; Compensation, Management Development and Succession Committee; Nominating and Governance Committee; and Risk Committee;
- Corporate Governance Policies;
- Policy Regarding Communication with the Board of Directors;
- Policy Regarding Director Candidates Recommended by Shareholders;
- Policy Regarding Corporate Political Contributions;
- Policy Regarding Shareholder Rights Plan;
- Code of Ethics and Business Conduct;
- Code of Conduct; and

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

Table of Contents

Part I Financial Information.

Item 1. Financial Statements.

MORGAN STANLEY

CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

(dollars in millions, except share data)

(unaudited)

	March 31, 2011	December 31, 2010
Assets		
Cash and due from banks ($310 and $297 at March 31, 2011 and December 31, 2010, respectively, related to consolidated variable interest entities generally not available to the Company)	$ 8,120	$ 7,341
Interest bearing deposits with banks	44,488	40,274
Cash deposited with clearing organizations or segregated under federal and other regulations or requirements	21,932	19,180
Financial instruments owned, at fair value (approximately $132 billion and $130 billion were pledged to various parties at March 31, 2011 and December 31, 2010, respectively):		
U.S. government and agency securities	46,626	48,446
Other sovereign government obligations	38,878	33,908
Corporate and other debt ($4,316 and $3,816 at March 31, 2011 and December 31, 2010, respectively related to consolidated variable interest entities, generally not available to the Company)	88,459	88,154
Corporate equities ($655 and $625 at March 31, 2011 and December 31, 2010, respectively related to consolidated variable interest entities, generally not available to the Company)	67,042	68,416
Derivative and other contracts	49,913	51,292
Investments ($1,881 and $1,873 at March 31, 2011 and December 31, 2010, respectively related to consolidated variable interest entities, generally not available to the Company)	9,068	9,752
Physical commodities	8,126	6,778
Total financial instruments owned, at fair value	308,112	306,746
Securities available for sale, at fair value	27,733	29,649
Securities received as collateral, at fair value	13,161	16,537
Federal funds sold and securities purchased under agreements to resell	162,923	148,253
Securities borrowed	142,937	138,730
Receivables:		
Customers	43,959	35,258
Brokers, dealers and clearing organizations	6,131	9,102
Fees, interest and other	8,840	9,790
Loans (net of allowances of $45 and $82 at March 31, 2011 and December 31, 2010, respectively)	11,882	10,576
Other investments	4,719	5,412
Premises, equipment and software costs (net of accumulated depreciation of $4,259 and $4,476 at March 31, 2011 and December 31, 2010, respectively) ($352 and $321 at March 31, 2011 and December 31, 2010, respectively related to consolidated variable entities, generally not available to the Company)	6,366	6,154
Goodwill	6,743	6,739
Intangible assets (net of accumulated amortization of $692 and $605 at March 31, 2011 and December 31, 2010, respectively) (includes $144 and $157 at fair value at March 31, 2011 and December 31, 2010, respectively)	4,581	4,667
Other assets ($232 and $118 at March 31, 2011 and December 31, 2010, respectively, related to consolidated variable interest entities generally not available to the Company)	13,558	13,290

Total assets	$ 836,185	$ 807,698

See Notes to Condensed Consolidated Financial Statements.

Table of Contents

MORGAN STANLEY

CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION (Continued)

(dollars in millions, except share data)

(unaudited)

	March 31, 2011	December 31, 2010
Liabilities and Equity		
Deposits (includes $2,848 and $3,027 at fair value at March 31, 2011 and December 31, 2010, respectively)	$ 63,495	$ 63,812
Commercial paper and other short-term borrowings (includes $1,657 and $1,799 at fair value at March 31, 2011 and December 31, 2010, respectively)	3,302	3,256
Financial instruments sold, not yet purchased, at fair value:		
U.S. government and agency securities	31,488	27,948
Other sovereign government obligations	23,133	22,250
Corporate and other debt	10,443	10,918
Corporate equities	26,621	19,838
Derivative and other contracts	44,585	47,802
Total financial instruments sold, not yet purchased, at fair value	136,270	128,756
Obligation to return securities received as collateral, at fair value	18,069	21,163
Securities sold under agreements to repurchase (includes $890 and $849 at fair value at March 31, 2011 and December 31, 2010, respectively)	156,891	147,598
Securities loaned	36,084	29,094
Other secured financings (includes $8,052 and $8,490 at fair value at March 31, 2011 and December 31, 2010, respectively) ($2,812 and $2,656 at March 31, 2011 and December 31, 2010, respectively, related to consolidated variable interest entities and are non-recourse to the Company)	12,958	10,453
Payables:		
Customers	121,574	123,249
Brokers, dealers and clearing organizations	8,278	3,363
Interest and dividends	2,659	2,572
Other liabilities and accrued expenses ($177 and $117 at March 31, 2011 and December 31, 2010, respectively, related to consolidated variable interest entities and are non-recourse to the Company)	13,961	16,518
Long-term borrowings (includes $43,575 and $42,709 at fair value at March 31, 2011 and December 31, 2010, respectively)	196,136	192,457
	769,677	742,291
Commitments and contingent liabilities (see Note 11)		
Equity		
Morgan Stanley shareholders equity:		
Preferred stock	9,597	9,597
Common stock, $0.01 par value;		
Shares authorized: 3,500,000,000 at March 31, 2011 and December 31, 2010;		
Shares issued: 1,603,913,074 at March 31, 2011 and December 31, 2010;		
Shares outstanding: 1,545,064,012 at March 31, 2011 and 1,512,022,095 at December 31, 2010	16	16
Paid-in capital	12,185	13,521
Retained earnings	39,269	38,603
Employee stock trust	3,468	3,465
Accumulated other comprehensive loss	(426)	(467)
Common stock held in treasury at cost, $0.01 par value; 58,849,062 shares at March 31, 2011 and 91,890,979 shares at December 31, 2010	(2,455)	(4,059)

Common stock issued to employee trust	(3,468)	(3,465)
Total Morgan Stanley shareholders equity	58,186	57,211
Noncontrolling interests	8,322	8,196
Total equity	66,508	65,407
Total liabilities and equity	$ 836,185	$ 807,698

See Notes to Condensed Consolidated Financial Statements.

Table of Contents

MORGAN STANLEY

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

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

(unaudited)

	Three Months Ended March 31, 2011	Three Months Ended March 31, 2010
Revenues:		
Investment banking	$ 1,214	$ 1,060
Principal transactions:		
Trading	2,977	3,758
Investments	329	369
Commissions	1,449	1,260
Asset management, distribution and administration fees	2,109	1,963
Other	(444)	294
Total non-interest revenues	7,634	8,704
Interest income	1,854	1,736
Interest expense	1,853	1,368
Net interest	1	368
Net revenues	7,635	9,072
Non-interest expenses:		
Compensation and benefits	4,333	4,416
Occupancy and equipment	402	390
Brokerage, clearing and exchange fees	405	348
Information processing and communications	445	395
Marketing and business development	147	134
Professional services	428	395
Other	603	479
Total non-interest expenses	6,763	6,557
Income from continuing operations before income taxes	872	2,515
Provision for (benefit from) income taxes	(256)	436
Income from continuing operations	1,128	2,079
Discontinued operations:		
Loss from discontinued operations		(99)
Benefit from income taxes	(2)	(31)
Net gain (loss) from discontinued operations	2	(68)
Net income	$ 1,130	$ 2,011
Net income applicable to noncontrolling interests	162	235
Net income applicable to Morgan Stanley	$ 968	$ 1,776

Earnings applicable to Morgan Stanley common shareholders	$	736	$	1,411
Amounts applicable to Morgan Stanley:				
Income from continuing operations	$	966	$	1,844
Net gain (loss) from discontinued operations		2		(68)
Net income applicable to Morgan Stanley	$	968	$	1,776
Earnings (loss) per basic common share:				
Income from continuing operations	$	0.50	$	1.12
Net gain (loss) from discontinued operations		0.01		(0.05)
Earnings per basic common share	$	0.51	$	1.07
Earnings per diluted common share:				
Income from continuing operations	$	0.50	$	1.03
Loss from discontinued operations				(0.04)
Earnings per diluted common share	$	0.50	$	0.99
Average common shares outstanding:				
Basic		1,456,015,979		1,314,608,020
Diluted		1,472,307,592		1,626,207,327

See Notes to Condensed Consolidated Financial Statements.

Table of Contents

MORGAN STANLEY

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(dollars in millions)

(unaudited)

	Three Months Ended March 31,	
	2011	**2010**
Net income	$ 1,130	$ 2,011
Other comprehensive income (loss), net of tax:		
Foreign currency translation adjustments(1)	37	2
Amortization of cash flow hedges(2)	1	3
Net unrealized loss on Securities available for sale(3)	(36)	(20)
Pension, postretirement and other related adjustments(4)	5	4
Comprehensive income	$ 1,137	$ 2,000
Net income applicable to noncontrolling interests	162	235
Other comprehensive loss applicable to noncontrolling interests	(34)	(12)
Comprehensive income applicable to Morgan Stanley	$ 1,009	$ 1,777

(1) Amounts are net of provision for (benefit from) income taxes of $(68) million and $89 million for the quarters ended March 31, 2011 and 2010, respectively.
(2) Amounts are net of provision for income taxes of $2 million for both quarters ended March 31, 2011 and 2010.
(3) Amounts are net of benefit from income taxes of $24 million and $14 million for the quarters ended March 31, 2011 and 2010, respectively.
(4) Amounts are net of provision for (benefit from) income taxes of $(4) million and $2 million for the quarters ended March 31, 2011 and 2010, respectively.

See Notes to Condensed Consolidated Financial Statements.

4

Table of Contents

MORGAN STANLEY

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(dollars in millions)

(unaudited)

	Three Months Ended March 31, 2011	Three Months Ended March 31, 2010
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 1,130	$ 2,011
Adjustments to reconcile net income (loss) to net cash provided by (used for) operating activities:		
(Gain) loss on equity method investees	660	(66)
Compensation payable in common stock and options	340	370
Depreciation and amortization	379	154
Loss on business dispositions		932
Gain on sale of securities available for sale	(12)	
Loss on repurchase of long-term debt	23	
Insurance reimbursement		(31)
Impairment charges and other-than-temporary impairment charges	3	10
Changes in assets and liabilities:		
Cash deposited with clearing organizations or segregated under federal and other regulations or requirements	(2,752)	1,345
Financial instruments owned, net of financial instruments sold, not yet purchased	7,568	(5,073)
Securities borrowed	(4,207)	(13,554)
Securities loaned	6,990	5,126
Receivables, loans and other assets	(7,417)	4,618
Payables and other liabilities	1,350	5,494
Federal funds sold and securities purchased under agreements to resell	(14,670)	4,575
Securities sold under agreements to repurchase	9,293	15,190
Net cash provided by (used for) operating activities	(1,322)	21,101
CASH FLOWS FROM INVESTING ACTIVITIES		
Net proceeds from (payments for):		
Premises, equipment and software costs	(409)	(138)
Purchases of securities available for sale	(3,357)	(18,674)
Sales and redemptions of securities available for sale	6,311	
Net cash provided by (used for) investing activities	2,545	(18,812)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net proceeds from (payments for):		
Commercial paper and other short-term borrowings	46	945
Dividends related to noncontrolling interests	(7)	(7)
Derivatives financing activities	89	(39)
Other secured financings	2,312	1,458
Deposits	(317)	1,711
Net proceeds from:		
Excess tax benefits associated with stock-based awards	29	2
Public offerings and other issuances of common stock		1
Issuance of long-term borrowings	14,285	7,755
Payments for:		
Long-term borrowings	(13,046)	(9,693)
Repurchases of common stock for employee tax withholding	(273)	(262)
Cash dividends	(302)	(293)

Net cash provided by financing activities	2,816	1,578
Effect of exchange rate changes on cash and cash equivalents	644	(380)
Effect of cash and cash equivalents related to variable interest entities	310	
Net increase in cash and cash equivalents	4,993	3,487
Cash and cash equivalents, at beginning of period	47,615	31,991
Cash and cash equivalents, at end of period	$ 52,608	$ 35,478
Cash and cash equivalents include:		
Cash and due from banks	$ 8,120	$ 5,979
Interest bearing deposits with banks	44,488	29,499
Cash and cash equivalents, at end of period	$ 52,608	$ 35,478

SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION

Cash payments for interest were $1,697 million and $1,178 million for the quarters ended March 31, 2011 and 2010, respectively.

Cash payments for income taxes were $250 million and $169 million for the quarters ended March 31, 2011 and 2010, respectively.

See Notes to Condensed Consolidated Financial Statements.

MORGAN STANLEY

CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN TOTAL EQUITY

Three Months Ended March 31, 2011

(dollars in millions)

(unaudited)

	Preferred Stock	Common Stock	Paid-in Capital	Retained Earnings	Employee Stock Trust	Accumulated Other Comprehensive Income (Loss)	Common Stock Held in Treasury at Cost	Common Stock Issued to Employee Trust	Non-controlling Interests	Total Equity
BALANCE AT DECEMBER 31, 2010	$ 9,597	$ 16	$ 13,521	$ 38,603	$ 3,465	$ (467)	$ (4,059)	$ (3,465)	$ 8,196	$ 65,407
Net income				968					162	1,130
Dividends				(302)						(302)
Shares issued under employee plans and related tax effects			(1,336)		3		1,877	(3)		541
Repurchases of common stock							(273)			(273)
Net change in cash flow hedges						1				1
Pension, postretirement and other related adjustments						5				5
Foreign currency translation adjustments						71			(34)	37
Change in net unrealized losses on securities available for sale						(36)				(36)
Decrease in noncontrolling interests related to dividends of noncontrolling interests									(7)	(7)
Other increases in noncontrolling interests									5	5
BALANCE AT MARCH 31, 2011	$ 9,597	$ 16	$ 12,185	$ 39,269	$ 3,468	$ (426)	$ (2,455)	$ (3,468)	$ 8,322	$ 66,508

See Notes to Condensed Consolidated Financial Statements.

Table of Contents

MORGAN STANLEY

CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN TOTAL EQUITY (Continued)

Three Months Ended March 31, 2010

(dollars in millions)

(unaudited)

	Preferred Stock	Common Stock	Paid-in Capital	Retained Earnings	Employee Stock Trust	Accumulated Other Comprehensive Income (Loss)	Common Stock Held in Treasury at Cost	Common Stock Issued to Employee Trust	Non-controlling Interests	Total Equity
BALANCE AT DECEMBER 31, 2009	$ 9,597	$ 15	$ 8,619	$ 35,056	$ 4,064	$ (560)	$ (6,039)	$ (4,064)	$ 6,092	$ 52,780
Net income				1,776					235	2,011
Dividends				(293)						(293)
Shares issued under employee plans and related tax effects			(1,869)		(292)		2,223	292		354
Repurchases of common stock							(262)			(262)
Net change in cash flow hedges						3				3
Pension and postretirement adjustments						4				4
Foreign currency translation adjustments						14			(12)	2
Change in net unrealized losses on securities available for sale						(20)				(20)
Increase in noncontrolling interests related to the consolidation of certain real estate partnerships sponsored by the Company									468	468
Decrease in noncontrolling interests related to dividends of noncontrolling interests									(7)	(7)
Other increases in noncontrolling interests									139	139
BALANCE AT MARCH 31, 2010	$ 9,597	$ 15	$ 6,750	$ 36,539	$ 3,772	$ (559)	$ (4,078)	$ (3,772)	$ 6,915	$ 55,179

See Notes to Condensed Consolidated Financial Statements.

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Introduction and Basis of Presentation.

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

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

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

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

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

Discontinued Operations.

Retail Asset Management Business. On June 1, 2010, the Company completed the sale of substantially all of its retail asset management business (Retail Asset Management), including Van Kampen Investments, Inc., to Invesco Ltd. (Invesco). The Company received $800 million in cash and approximately 30.9 million shares of Invesco stock upon the sale. The results of Retail Asset Management are reported as discontinued operations within the Asset Management business segment for all periods presented through the date of sale.

The Company recorded the 30.9 million shares as securities available for sale. In the fourth quarter of 2010, the Company sold its investment in Invesco.

Revel Entertainment Group, LLC. On March 31, 2010, the Board of Directors authorized a plan of disposal by sale for Revel Entertainment Group, LLC (Revel), a development stage enterprise and subsidiary of the Company that was primarily associated with a development property in Atlantic City, New Jersey. On February 17, 2011, the Company completed the sale of Revel to a group of investors led by Revel s chief executive officer. The Company did not retain any stake or ongoing involvement. The sale price approximated the carrying value of Revel and, accordingly, the Company did not recognize any pre-tax gain or loss on the sale. Total assets of Revel included in the Company s condensed consolidated statement of financial condition at December 31, 2010 approximated $28 million. The results of Revel are reported as discontinued operations within the Institutional Securities business segment for all periods presented through the date of sale. The quarter ended March 31, 2010 included losses of approximately $932 million in connection with such planned disposition. See Note 17 for additional information about an income tax benefit related to Revel.

CityMortgage Bank. In the third quarter of 2010, the Company completed the disposal of CityMortgage Bank (CMB), a Moscow-based mortgage bank. The results of CMB are reported as discontinued operations for all periods presented through the date of disposal within the Institutional Securities business segment.

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Other. In the third quarter of 2010, the Company completed a disposal of a real estate property within the Asset Management business segment. The results of operations are reported as discontinued operations for all periods presented through the date of disposal.

Discover. On June 30, 2007, the Company completed the spin-off of its business segment Discover Financial Services (DFS) to its shareholders. On February 11, 2010, DFS paid the Company $775 million in complete satisfaction of its obligations to the Company regarding the sharing of proceeds from a lawsuit against Visa and MasterCard. The payment was recorded as a gain in discontinued operations for the quarter ended March 31, 2010.

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

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

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 the Company s Annual Report on Form 10-K for the year ended December 31, 2010 (the Form 10-K). The condensed consolidated financial statements reflect all adjustments that are, in the opinion of management, necessary for the fair presentation of the results for the interim period. The results of operations for interim periods are not necessarily indicative of results for the entire year.

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

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

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

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

The Company s significant regulated U.S. and international subsidiaries include Morgan Stanley & Co. Incorporated (MS&Co.), Morgan Stanley Smith Barney LLC, Morgan Stanley & Co. International plc (MSIP), Morgan Stanley MUFG Securities, Co., Ltd. (MSMS), Morgan Stanley Bank, N.A. and Morgan Stanley Investment Advisors Inc.

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

2. Significant Accounting Policies.

For a detailed discussion about the Company s significant accounting policies, see Note 2 to the consolidated financial statements for the year ended December 31, 2010 included in the Form 10-K.

During the quarter ended March 31, 2011, other than the following, no other updates were made to the Company s significant accounting policies.

Financial Instruments and Fair Value.

Fair value for many cash instruments and OTC derivative 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, creditworthinness of the counterparty, creditworthiness of the Company, 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, model uncertainty and concentration risk. Adjustments for liquidity risk adjust model derived mid-market levels of Level 2 and Level 3 financial instruments for the bid-mid or mid-ask spread required to properly reflect the exit price of a risk position. Bid-mid and mid-ask spreads are marked to levels observed in trade activity, broker quotes or other external third-party data. Where these spreads are unobservable for the particular position in question, spreads are derived from observable levels of similar positions. The Company applies credit-related valuation adjustments to its short-term and long-term borrowings (primarily structured notes) for which the fair value option was elected and to OTC derivatives. The Company considers the impact of changes in its own credit spreads based upon observations of the Company s secondary bond market spreads when measuring the fair value for short-term and long-term borrowings. For OTC derivatives, the impact of changes in both the Company s and the counterparty s credit standing is considered when measuring fair

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

value. In determining the expected exposure, the Company simulates the distribution of the future exposure to a counterparty, then applies market-based default probabilities to the future exposure, leveraging external third-party credit default swap (CDS) spread data. Where CDS spread data are unavailable for a specific counterparty, bond market spreads, CDS spread data based on the counterparty s credit rating or CDS spread data that reference a comparable counterparty may be utilized. The Company also considers collateral held and legally enforceable master netting agreements that mitigate the Company s exposure to each counterparty. Adjustments for model uncertainty are taken for positions whose underlying models are reliant on significant inputs that are neither directly nor indirectly observable, hence requiring reliance on established theoretical concepts in their derivation. These adjustments are derived by making assessments of the possible degree of variability using statistical approaches and market-based information where possible. The Company generally subjects all valuations and models to a review process initially and on a periodic basis thereafter. The Company may apply a concentration adjustment to certain of its OTC derivatives portfolios to reflect the additional cost of closing out a particularly large risk position. Where possible, these adjustments are based on observable market information but in many instances significant judgment is required to estimate the costs of closing out concentrated risk positions due to the lack of liquidity in the marketplace.

Accounting Developments.

Goodwill Impairment Test.

In December 2010, the Financial Accounting Standards Board (the FASB) issued accounting guidance that modifies Step 1 of the goodwill impairment test for reporting units with zero or negative carrying amounts. For those reporting units, an entity is required to perform Step 2 of the goodwill impairment test if it is more likely than not that a goodwill impairment exists. In determining whether it is more likely than not that a goodwill impairment exists, an entity shall consider whether there are any adverse qualitative factors indicating that an impairment may exist. The qualitative factors are consistent with the existing guidance. This guidance became effective for the Company on January 1, 2011. The adoption of this accounting guidance did not have a material impact on the Company s condensed consolidated financial statements.

3. Fair Value Disclosures.

Fair Value Measurements.

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

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

U.S. Government and Agency Securities.

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

U.S. Agency Securities. U.S. agency securities are composed of three main categories consisting of agency-issued debt, agency mortgage pass-through pool securities and collateralized mortgage obligations. Non-callable agency-issued debt securities are generally valued using quoted market prices. Callable agency-issued debt securities are valued by benchmarking model-derived prices to quoted market prices and trade data for identical or comparable securities. The fair value of agency mortgage

11

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

pass-through pool securities is model-driven based on spreads of the comparable To-be-announced (TBA) security. Collateralized mortgage obligations are valued using indices, quoted market prices and trade data for identical or comparable securities. Actively traded non-callable agency-issued debt securities are generally categorized in Level 1 of the fair value hierarchy. Callable agency-issued debt securities, agency mortgage pass-through pool securities and collateralized mortgage obligations are generally categorized in Level 2 of the fair value hierarchy.

Other Sovereign Government Obligations.

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

Corporate and Other Debt.

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

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

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

Corporate Bonds. The fair value of corporate bonds is determined using recently executed transactions, market price quotations (where observable), bond spreads or credit default swap spreads obtained from independent external parties such as vendors and brokers adjusted for any basis difference between cash and derivative instruments. The spread data used are for the same maturity as the bond. If the spread data do not reference the issuer, then data that reference a comparable issuer are used. When 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 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.

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Collateralized Debt Obligations (CDO). The Company holds cash CDOs that typically reference a tranche of an underlying synthetic portfolio of single name credit default swaps. The collateral is usually ABS or other corporate bonds. Credit correlation, a primary input used to determine the fair value of a cash CDO, is usually unobservable and derived using a benchmarking technique. The other model inputs such as credit spreads, including collateral spreads, and interest rates are typically observable. CDOs are categorized in Level 2 of the fair value hierarchy when the credit correlation input is insignificant. In instances where the credit 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 determined using recently executed transactions, market price quotations (where observable), implied yields from comparable debt, and market observable credit default swap spread levels obtained from independent external parties such as vendors and brokers adjusted for any basis difference between cash and derivative instruments, along with proprietary valuation models and default recovery analysis where such transactions and quotations are unobservable. The fair value of contingent corporate lending commitments is determined by using executed transactions on comparable loans and the anticipated market price based on pricing indications from syndicate banks and customers. The valuation of loans and lending commitments also takes into account fee income that is considered an attribute of the contract. Corporate loans and lending commitments are categorized in Level 2 of the fair value hierarchy except in instances where prices or significant spread inputs are unobservable, in which case they are categorized in Level 3 of the fair value hierarchy.

Mortgage Loans. Mortgage loans are valued using observable prices based on transactional data for identical or comparable instruments, when available. 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 or a methodology that utilizes the capital structure and credit spreads of recent comparable securitization transactions. Mortgage loans valued based on observable transactional data for identical or comparable instruments are categorized in Level 2 of the fair value hierarchy. Where observable prices are not available, due to the subjectivity involved in the comparability assessment related to mortgage loan vintage, geographical concentration, prepayment speed and projected loss assumptions, mortgage loans are categorized in Level 3 of the fair value hierarchy.

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

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

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Corporate Equities.

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

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

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

Derivative interests in complex mortgage-related CDOs and ABS 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 structures (*e.g.*, non-amortizing reference obligations, call features, etc.) and liquidity. While these factors may be supported by historical and actual external observations, the determination of their value as it relates to specific positions nevertheless requires significant judgment.

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

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

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

Investments.

The Company s investments include investments in private equity funds, real estate funds, hedge funds and direct investments in equity securities. Direct investments are presented in the fair value hierarchy table as Principal investments and Other. Initially, the transaction price is generally considered by the Company as the exit price and is the Company s best estimate of fair value.

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

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

Physical Commodities.

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

Securities Available for Sale.

Securities available for sale are composed of U.S. government and agency securities, including U.S. Treasury securities, agency-issued debt, agency mortgage pass-through securities and collateralized mortgage obligations. Actively traded U.S. Treasury securities and non-callable agency-issued debt securities are generally categorized in Level 1 of the fair value hierarchy. Callable agency-issued debt securities, agency mortgage pass-through securities and collateralized mortgage obligations are generally categorized in Level 2 of the fair value hierarchy. For further information on securities available for sale, see Note 4.

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

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

Deposits.

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

Securities Sold under Agreements to Repurchase.

In 2010, the fair value option was elected for certain securities sold under agreements to repurchase. The fair value of a repurchase agreement is computed using a standard cash flow discounting methodology. The inputs to the valuation include contractual cash flows and collateral funding spreads, which are estimated using various benchmarks, interest rate yield curves and option volatilities. In instances where the unobservable inputs are deemed significant, repurchase agreements are categorized in Level 3 of the fair value hierarchy; otherwise, they are categorized in Level 2 of the fair value hierarchy.

The following fair value hierarchy tables present information about the Company s assets and liabilities measured at fair value on a recurring basis at March 31, 2011 and December 31, 2010.

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Assets and Liabilities Measured at Fair Value on a Recurring Basis at March 31, 2011

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Counterparty and Cash Collateral Netting	Balance at March 31, 2011
			(dollars in millions)		
Assets					
Financial instruments owned:					
U.S. government and agency securities:					
U.S. Treasury securities	$ 15,174	$ 21	$	$	$ 15,195
U.S. agency securities	4,253	27,121	57		31,431
Total U.S. government and agency securities	19,427	27,142	57		46,626
Other sovereign government obligations	30,494	8,258	126		38,878
Corporate and other debt:					
State and municipal securities		3,370	4		3,374
Residential mortgage-backed securities		3,572	361		3,933
Commercial mortgage-backed securities		2,782	132		2,914
Asset-backed securities		2,355			2,355
Corporate bonds		40,454	1,366		41,820
Collateralized debt obligations		1,961	1,593		3,554
Loans and lending commitments		16,757	11,218		27,975
Other debt		2,369	165		2,534
Total corporate and other debt		73,620	14,839		88,459
Corporate equities(1)	64,037	2,503	502		67,042
Derivative and other contracts:					
Interest rate contracts	1,578	534,820	5,767		542,165
Credit contracts		85,999	13,012		99,011
Foreign exchange contracts		58,336	389		58,725
Equity contracts	1,577	38,555	1,043		41,175
Commodity contracts	6,829	57,540	1,056		65,425
Other		119	143		262
Netting(2)	(8,337)	(677,036)	(11,186)	(60,291)	(756,850)
Total derivative and other contracts	1,647	98,333	10,224	(60,291)	49,913
Investments:					
Private equity funds			2,006		2,006
Real estate funds		6	1,251		1,257
Hedge funds		666	871		1,537
Principal investments	269	193	3,057		3,519
Other	191	160	398		749
Total investments	460	1,025	7,583		9,068
Physical commodities		8,126			8,126
Total financial instruments owned	116,065	219,007	33,331	(60,291)	308,112
Securities available for sale:					

U.S. government and agency securities	15,157	12,576			27,733
Securities received as collateral	13,007	154			13,161
Intangible assets(3)			144		144
Liabilities					
Deposits	$	$ 2,848	$	$	$ 2,848
Commercial paper and other short-term borrowings		1,653	4		1,657
Financial instruments sold, not yet purchased:					
U.S. government and agency securities:					
U.S. Treasury securities	29,260	4			29,264
U.S. agency securities	2,147	77			2,224
Total U.S. government and agency securities	31,407	81			31,488

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Counterparty and Cash Collateral Netting	Balance at March 31, 2011
			(dollars in millions)		
Other sovereign government obligations	19,784	3,349			23,133
Corporate and other debt:					
State and municipal securities		4			4
Asset-backed securities		7			7
Corporate bonds		9,421	150		9,571
Collateralized debt obligations			2		2
Unfunded lending commitments		435	171		606
Other debt		73	180		253
Total corporate and other debt		9,940	503		10,443
Corporate equities(1)	25,713	899	9		26,621
Derivative and other contracts:					
Interest rate contracts	1,366	508,086	5,825		515,277
Credit contracts		80,208	6,933		87,141
Foreign exchange contracts		60,507	343		60,850
Equity contracts	1,663	43,003	1,688		46,354
Commodity contracts	7,477	59,024	726		67,227
Other		581	651		1,232
Netting(2)	(8,337)	(677,036)	(11,186)	(36,937)	(733,496)
Total derivative and other contracts	2,169	74,373	4,980	(36,937)	44,585
Total financial instruments sold, not yet purchased	79,073	88,642	5,492	(36,937)	136,270
Obligation to return securities received as collateral	17,915	154			18,069
Securities sold under agreements to repurchase		538	352		890
Other secured financings		7,447	605		8,052
Long-term borrowings	21	42,180	1,374		43,575

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

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

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

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

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

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Assets and Liabilities Measured at Fair Value on a Recurring Basis at December 31, 2010

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3) (dollars in millions)	Counterparty and Cash Collateral Netting	Balance at December 31, 2010
Assets					
Financial instruments owned:					
U.S. government and agency securities:					
U.S. Treasury securities	$ 19,226	$	$	$	$ 19,226
U.S. agency securities	3,827	25,380	13		29,220
Total U.S. government and agency securities	23,053	25,380	13		48,446
Other sovereign government obligations	25,334	8,501	73		33,908
Corporate and other debt:					
State and municipal securities		3,229	110		3,339
Residential mortgage-backed securities		3,690	319		4,009
Commercial mortgage-backed securities		2,692	188		2,880
Asset-backed securities		2,322	13		2,335
Corporate bonds		39,569	1,368		40,937
Collateralized debt obligations		2,305	1,659		3,964
Loans and lending commitments		15,308	11,666		26,974
Other debt		3,523	193		3,716
Total corporate and other debt		72,638	15,516		88,154
Corporate equities(1)	65,009	2,923	484		68,416
Derivative and other contracts:					
Interest rate contracts	3,985	616,016	966		620,967
Credit contracts		95,818	14,316		110,134
Foreign exchange contracts	1	61,556	431		61,988
Equity contracts	2,176	36,612	1,058		39,846
Commodity contracts	5,464	57,528	1,160		64,152
Other		108	135		243
Netting(2)	(8,551)	(761,939)	(7,168)	(68,380)	(846,038)
Total derivative and other contracts	3,075	105,699	10,898	(68,380)	51,292
Investments:					
Private equity funds			1,986		1,986
Real estate funds		8	1,176		1,184
Hedge funds		736	901		1,637
Principal investments	286	486	3,131		3,903
Other(3)	403	79	560		1,042
Total investments	689	1,309	7,754		9,752
Physical commodities		6,778			6,778
Total financial instruments owned	117,160	223,228	34,738	(68,380)	306,746
Securities available for sale:					
U.S. government and agency securities	20,792	8,857			29,649
Securities received as collateral	15,646	890	1		16,537
Intangible assets(4)			157		157

Liabilities					
Deposits	$	$ 3,011	$ 16	$	$ 3,027
Commercial paper and other short-term borrowings		1,797	2		1,799
Financial instruments sold, not yet purchased:					
U.S. government and agency securities:					
U.S. Treasury securities	25,225				25,225
U.S. agency securities	2,656	67			2,723
Total U.S. government and agency securities	27,881	67			27,948

19

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Counterparty and Cash Collateral Netting	Balance at December 31, 2010
			(dollars in millions)		
Other sovereign government obligations	19,708	2,542			22,250
Corporate and other debt:					
State and municipal securities		11			11
Asset-backed securities		12			12
Corporate bonds		9,100	44		9,144
Collateralized debt obligations		2			2
Unfunded lending commitments		464	263		727
Other debt		828	194		1,022
Total corporate and other debt		10,417	501		10,918
Corporate equities(1)	19,696	127	15		19,838
Derivative and other contracts:					
Interest rate contracts	3,883	591,378	542		595,803
Credit contracts		87,904	7,722		95,626
Foreign exchange contracts	2	64,301	385		64,688
Equity contracts	2,098	42,242	1,820		46,160
Commodity contracts	5,871	58,885	972		65,728
Other		520	1,048		1,568
Netting(2)	(8,551)	(761,939)	(7,168)	(44,113)	(821,771)
Total derivative and other contracts	3,303	83,291	5,321	(44,113)	47,802
Total financial instruments sold, not yet purchased	70,588	96,444	5,837	(44,113)	128,756
Obligation to return securities received as collateral	20,272	890	1		21,163
Securities sold under agreements to repurchase		498	351		849
Other secured financings		7,474	1,016		8,490
Long-term borrowings		41,393	1,316		42,709

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

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

(3) In June 2010, the Company voluntarily contributed $25 million to certain other investments in funds that it manages in connection with upcoming rule changes regarding net asset value disclosures for money market funds. Based on current liquidity and fund performance, the Company does not expect to provide additional voluntary support to non-consolidated funds that it manages.

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

Transfers Between Level 1 and Level 2 during the Quarter Ended March 31, 2010.

Financial instruments owned Derivative and other contracts and Financial instruments sold, not yet purchased Derivative and other contracts. During the quarter ended March 31, 2010, the Company reclassified approximately $1.3 billion of derivative assets and approximately $1.5 billion of derivative liabilities from Level 2 to Level 1 as these listed derivatives became actively traded and were valued based on quoted prices from the exchange.

Financial instruments owned Corporate equities. During the quarter ended March 31, 2010, the Company reclassified approximately $1.0 billion of certain Corporate equities from Level 2 to Level 1 as transactions in these securities occurred with sufficient frequency and volume to constitute an active market.

The following tables present additional information about Level 3 assets and liabilities measured at fair value on a recurring basis for the quarters ended March 31, 2011 and 2010, respectively. Level 3 instruments may be hedged with instruments classified in Level 1 and Level 2. As a result, the realized and unrealized gains (losses) for assets and liabilities within the Level 3 category presented in the tables below do not reflect the related

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

realized and unrealized gains (losses) on hedging instruments that have been classified by the Company within the Level 1 and/or Level 2 categories.

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

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

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Changes in Level 3 Assets and Liabilities Measured at Fair Value on a Recurring Basis for the Three Months Ended March 31, 2011

	Beginning Balance at December 31, 2010	Total Realized and Unrealized Gains (Losses)(1)	Purchases	Sales	Issuances	Settlements	Net Transfers	Ending Balance at March 31, 2011	Unrealized Gains (Losses) for Level 3 Assets/ Liabilities Outstanding at March 31, 2011(2)
					(dollars in millions)				
Assets									
Financial instruments owned:									
U.S. agency securities	$ 13	$	$ 103	$ (52)	$	$	$ (7)	$ 57	$
Other sovereign government obligations	73		59				(6)	126	
Corporate and other debt:									
State and municipal securities	110	(1)	4	(96)			(13)	4	
Residential mortgage-backed securities	319	(58)	198	(183)		(1)	86	361	(21)
Commercial mortgage-backed securities	188	16	9	(30)			(51)	132	10
Asset-backed securities	13		12	(19)			(6)		
Corporate bonds	1,368	33	255	(215)			(75)	1,366	55
Collateralized debt obligations	1,659	254	355	(595)		(36)	(44)	1,593	93
Loans and lending commitments	11,666	386	1,023	(643)		(1,024)	(190)	11,218	382
Other debt	193	(6)	1	(22)			(1)	165	(16)
Total corporate and other debt	15,516	624	1,857	(1,803)		(1,061)	(294)	14,839	503
Corporate equities	484	(53)	101	(98)			68	502	(18)
Net derivatives and other contracts(3):									
Interest rate contracts	424	169	1		(663)	(114)	125	(58)	100
Credit contracts	6,594	(673)	128		(152)	71	111	6,079	(245)
Foreign exchange contracts	46	(124)				127	(3)	46	(100)
Equity contracts	(762)	75	65	(12)	(85)	15	59	(645)	75
Commodity contracts	188	(9)	161		(132)	85	37	330	(4)
Other	(913)	209			(5)	205	(4)	(508)	203
Total net derivative and other contracts	5,577	(353)	355	(12)	(1,037)	389	325	5,244	29
Investments:									
Private equity funds	1,986	107	32	(190)			71	2,006	95
Real estate funds	1,176	64	14	(3)				1,251	102
Hedge funds	901	(9)	135	(189)			33	871	(9)
Principal investments	3,131	66	202	(301)			(41)	3,057	(85)
Other	560	8	1	(14)			(157)	398	3
Total investments	7,754	236	384	(697)			(94)	7,583	106
Securities received as collateral	1			(1)					
Intangible assets	157	(15)	3	(1)				144	(14)
Liabilities									
Deposits	$ 16	$ 2	$	$	$	$ (14)	$	$	$
Commercial paper and other short-term borrowings	2				4	(2)		4	
Financial instruments sold, not yet purchased:									

Corporate and other debt:									
Corporate bonds	44	1	(27)	155			(21)	150	8
Collateralized debt obligations		1		3				2	1
Unfunded lending commitments	263	92						171	92
Other debt	194						(14)	180	
Total corporate and other debt	501	94	(27)	158			(35)	503	101
Corporate equities	15	(1)	(8)	1				9	
Obligation to return securities received as collateral	1		(1)						
Securities sold under agreements to repurchase	351	(2)				(1)		352	(2)
Other secured financings	1,016	(12)				(117)	(306)	605	(12)
Long-term borrowings	1,316	(84)			141	(180)	13	1,374	(83)

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(1) Total realized and unrealized gains (losses) are primarily included in Principal transactions Trading in the condensed consolidated statements of income except for $236 million related to Financial instruments owned Investments, which is included in Principal transactions Investments.
(2) Amounts represent unrealized gains (losses) for the quarter ended March 31, 2011 related to assets and liabilities still outstanding at March 31, 2011.
(3) Net derivative and other contracts represent Financial instruments owned Derivative and other contracts net of Financial instruments sold, not yet purchased Derivative and other contracts. For further information on Derivative instruments and hedging activities, see Note 10.

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

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

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Changes in Level 3 Assets and Liabilities Measured at Fair Value on a Recurring Basis for the Three Months Ended March 31, 2010

	Beginning Balance at December 31, 2009	Total Realized and Unrealized Gains (Losses)(1)	Purchases, Sales, Other Settlements and Issuances, net	Net Transfers	Ending Balance at March 31, 2010	Unrealized Gains (Losses) for Level 3 Assets/ Liabilities Outstanding at March 31, 2010(2)
	(dollars in millions)					
Assets						
Financial instruments owned:						
U.S. agency securities	$ 36	$	$ (35)	$	$ 1	$
Other sovereign government obligations	3	2	76	(1)	80	1
Corporate and other debt:						
State and municipal securities	713	(18)	(297)		398	1
Residential mortgage-backed securities	818	24	(220)	3	625	19
Commercial mortgage-backed securities	1,573	109	(860)	(43)	779	42
Asset-backed securities	591	1	(440)	(3)	149	10
Corporate bonds	1,038	(55)	128	34	1,145	(48)
Collateralized debt obligations	1,553	133	(171)	(3)	1,512	121
Loans and lending commitments	12,506	155	572	270	13,503	143
Other debt	1,662	252	8	(1)	1,921	244
Total corporate and other debt	20,454	601	(1,280)	257	20,032	532
Corporate equities	536	70	(7)	(63)	536	56
Net derivative and other contracts:						
Interest rate contracts	387	9	7	(19)	384	1
Credit contracts	8,824	(434)	96	(534)	7,952	(352)
Foreign exchange rate contracts	254	(285)	201	36	206	(308)
Equity contracts	(689)	(96)	58	26	(701)	(88)
Commodity contracts	7	(25)	108		90	83
Other	(437)	(147)	4	1	(579)	(113)
Total net derivative and other contracts(3)	8,346	(978)	474	(490)	7,352	(777)
Investments	7,613	56	19	(142)	7,546	50
Securities received as collateral	23		(23)			
Intangible assets	137	38			175	30
Liabilities						
Deposits	$ 24	$ 1	$	$ (8)	$ 15	$ 1
Commercial paper and other short-term borrowings			300		300	
Financial instruments sold, not yet purchased:						
Corporate and other debt:						
Asset-backed securities	4				4	
Corporate bonds	29	(42)	(79)	25	17	(36)
Collateralized debt obligations	3		(3)			
Unfunded lending commitments	252	(32)	(71)		213	(29)
Other debt	431	25	(76)	(13)	317	24
Total corporate and other debt	719	(49)	(229)	12	551	(41)

Corporate equities	4	(1)	5	3	13	
Obligation to return securities received as collateral	23		(23)			
Other secured financings	1,532	(104)	175		1,811	(104)
Long-term borrowings	6,865	5	45	(177)	6,728	5

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(1) Total realized and unrealized gains (losses) are primarily included in Principal transactions Trading in the condensed consolidated statements of income except for $56 million related to Financial instruments owned Investments, which is included in Principal transactions Investments.
(2) Amounts represent unrealized gains (losses) for the quarter ended March 31, 2010 related to assets and liabilities still outstanding at March 31, 2010.
(3) Net derivative and other contracts represent Financial instruments owned Derivative and other contracts net of Financial instruments sold, not yet purchased Derivative and other contracts. For further information on derivative instruments and hedging activities, see Note 10.

Financial instruments owned Corporate and other debt. During the quarter ended March 31, 2010, the Company reclassified approximately $0.6 billion of certain Corporate and other debt, primarily corporate loans, from Level 3 to Level 2. The Company reclassified the corporate loans as external prices and/or spread inputs for these instruments became observable.

The Company also reclassified approximately $0.9 billion of certain Corporate and other debt from Level 2 to Level 3. The reclassifications were primarily related to corporate loans and were generally due to a reduction in market price quotations for these or comparable instruments, or a lack of available broker quotes, such that unobservable inputs had to be utilized for the fair value measurement of these instruments. The Company reclassified the corporate loans as external prices and/or spread inputs became unobservable.

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 bespoke basket credit default swaps.

Fair Value of Investments that Calculate Net Asset Value.

The Company s Investments measured at fair value were $9,068 million and $9,752 million at March 31, 2011 and December 31, 2010, respectively. The following table presents information solely about the Company s investments in private equity funds, real estate funds and hedge funds measured at fair value based on net asset value at March 31, 2011 and December 31, 2010, respectively.

	At March 31, 2011		At December 31, 2010	
	Fair Value	Unfunded Commitment	Fair Value	Unfunded Commitment
	(dollars in millions)			
Private equity funds	$ 1,968	$ 1,111	$ 1,947	$ 1,047
Real estate funds	1,225	552	1,154	500
Hedge funds(1):				
Long-short equity hedge funds	877	4	1,046	4
Fixed income/credit-related hedge funds	304		305	
Event-driven hedge funds	196		143	
Multi-strategy hedge funds	161		140	
Total	$ 4,731	$ 1,667	$ 4,735	$ 1,551

(1) Fixed income/credit-related hedge funds, event-driven hedge funds, and multi-strategy hedge funds are redeemable at least on a six-month period basis primarily with a notice period of 90 days or less. At March 31, 2011, approximately 57% of the fair value amount of long-short equity hedge funds is redeemable at least quarterly, 20% is redeemable every six months and 23% of these funds have a redemption frequency of greater than six months. At December 31, 2010, approximately 49% of the fair value amount of long-short equity hedge funds is redeemable at least quarterly, 24% is redeemable every six months and 27% of these funds have a redemption frequency of greater than six months. The notice period for long-short equity hedge funds is primarily greater than 90 days.

25

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Private Equity Funds. Amount includes several private equity funds that pursue multiple strategies including leveraged buyouts, venture capital, infrastructure growth capital, distressed investments, and mezzanine capital. In addition, the funds may be structured with a focus on specific domestic or foreign geographic regions. These investments are generally not redeemable with the funds. Instead, the nature of the investments in this category is that distributions are received through the liquidation of the underlying assets of the fund. At March 31, 2011, it is estimated that 6% of the fair value of the funds will be liquidated in the next five years, another 36% of the fair value of the funds will be liquidated between five to 10 years and the remaining 58% of the fair value of the funds have a remaining life of greater than 10 years.

Real Estate Funds. Amount includes several real estate funds that invest in real estate assets such as commercial office buildings, retail properties, multi-family residential properties, developments or hotels. In addition, the funds may be structured with a focus on specific geographic domestic or foreign regions. These investments are generally not redeemable with the funds. Distributions from each fund will be received as the underlying investments of the funds are liquidated. At March 31, 2011, it is estimated that 19% of the fair value of the funds will be liquidated within the next five years, another 33% of the fair value of the funds will be liquidated between five to 10 years and the remaining 48% of the fair value of the funds have a remaining life of greater than 10 years.

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

Long-short Equity Hedge Funds. Amount includes investments in hedge funds that invest, long or short, in equities. Equity value and growth hedge funds purchase stocks perceived to be undervalued and sell stocks perceived to be overvalued. Investments representing approximately 22% of the fair value of the investments in this category cannot be redeemed currently because the investments include certain initial period lock-up restrictions. The remaining restriction period for 100% of investments subject to lock-up restrictions ranged from one to three years at March 31, 2011. Investments representing approximately 23% of the fair value of the investments in long-short equity hedge funds cannot be redeemed currently because an exit restriction has been imposed by the hedge fund manager. The restriction period for 100% of investments subject to an exit restriction was primarily two years or less at March 31, 2011.

Fixed Income/Credit-Related Hedge Funds. Amount includes investments in hedge funds that employ long-short, distressed or relative value strategies in order to benefit from investments in undervalued or overvalued securities that are primarily debt or credit related. At March 31, 2011, investments representing approximately 18% of the fair value of the investments in fixed income/credit-related hedge funds cannot be redeemed currently because the investments include certain initial period lock-up restrictions. The remaining restriction period for these investments was two years or less at March 31, 2011.

Event-Driven Hedge Funds. Amount includes investments in hedge funds that invest in event-driven situations such as mergers, hostile takeovers, reorganizations, or leveraged buyouts. This may involve the simultaneous purchase of stock in companies being acquired and the sale of stock in its acquirer, hoping to profit from the spread between the current market price and the ultimate purchase price of the target company. At March 31, 2011, investments representing approximately 37% of the value of the investments in this category cannot be redeemed currently because the investments include certain initial period lock-up restrictions. The remaining restriction period for these investments was two years or less at March 31, 2011.

Multi-strategy Hedge Funds. Amount includes investments in hedge funds that pursue multiple strategies to realize short- and long-term gains. Management of the hedge funds has the ability to

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

overweight or underweight different strategies to best capitalize on current investment opportunities. At March 31, 2011, investments representing approximately 35% of the fair value of the investments in this category cannot be redeemed currently because the investments include certain initial period lock-up restrictions. The remaining restriction period for 72% of investments subject to lock-ups was two years or less at March 31, 2011. The remaining restriction period for the other 28% of investments subject to lock-up restrictions was greater than three years at March 31, 2011. Investments representing approximately 23% of the fair value of investments in multi-strategy hedge funds cannot be redeemed currently because of an exit restriction that has been imposed by the hedge fund manager. The restriction period for 100% of investments subject to an exit restriction was indefinite at March 31, 2011.

Fair Value Option.

The Company elected the fair value option for certain eligible instruments that are risk managed on a fair value basis to mitigate income statement volatility caused by measurement basis differences between the elected instruments and their associated risk management transactions or to eliminate complexities of applying certain accounting models. The following tables present net gains (losses) due to changes in fair value for items measured at fair value pursuant to the fair value option election for the quarters ended March 31, 2011 and 2010, respectively.

	Principal Transactions-Trading	Interest Expense	Gains (Losses) Included in Net Revenues
		(dollars in millions)	
Three Months Ended March 31, 2011			
Deposits	$ 13	$ (30)	$ (17)
Commercial paper and other short-term borrowings	(5)		(5)
Long-term borrowings	(1,266)	(290)	(1,556)
Securities sold under agreements to repurchase	(2)		(2)
Three Months Ended March 31, 2010			
Deposits	$ (25)	$ (47)	$ (72)
Commercial paper and other short-term borrowings	13		13
Long-term borrowings	(366)	(202)	(568)

In addition to the amounts in the above table, as discussed in Note 2 to the consolidated financial statements for the year ended December 31, 2010 included in the Form 10-K, all of the instruments within Financial instruments owned or Financial instruments sold, not yet purchased are measured at fair value, either through the election of the fair value option, or as required by other accounting guidance.

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

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

	Three Months Ended March 31,	
	2011	2010
	(dollars in millions)	
Short-term and long-term borrowings(1)	$ (189)	$ 54
Loans(2)	140	316
Unfunded lending commitments(3)	10	(21)

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

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Amount by Which Contractual Principal Amount Exceeds Fair Value

	At March 31, 2011	At December 31, 2010
	(dollars in billions)	
Short-term and long-term borrowings(1)	$ 1.1	$ 0.6
Loans(2)	23.6	24.3
Loans 90 or more days past due and/or on non-accrual status(2)(3)	21.2	21.2

(1) These amounts do not include structured notes where the repayment of the initial principal amount fluctuates based on changes in the reference price or index.
(2) The majority of this difference between principal and fair value amounts emanates from the Company s distressed debt trading business, which purchases distressed debt at amounts well below par.
(3) The aggregate fair value of loans that were in non-accrual status, which includes all loans 90 or more days past due, was $2.7 billion and $2.2 billion at March 31, 2011 and December 31, 2010, respectively. The aggregate fair value of loans that were 90 or more days past due was $2.0 billion at both March 31, 2011 and December 31, 2010.

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

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

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

The following tables present, by caption on the condensed consolidated statements of financial condition, the fair value hierarchy for those assets measured at fair value on a non-recurring basis for which the Company recognized a non-recurring fair value adjustment for the quarters ended March 31, 2011 and 2010, respectively.

Three Months Ended March 31, 2011.

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

(1) Losses are recorded within Other expenses in the condensed consolidated statement of income except for fair value adjustments related to Loans and losses related to Other investments, which are included in Other revenues.
(2) Non-recurring change in fair value for loans held for investment was calculated based upon the fair value of the underlying collateral. The fair value of the collateral was determined using internal expected recovery models. The non-recurring change in fair value for mortgage loans held for sale is based upon a valuation model incorporating market observable inputs.
(3) Losses recorded were determined primarily using discounted cash flow models.
(4) Losses primarily related to investment management contracts, including contracts associated with FrontPoint, and were determined primarily using discounted cash flow models.

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

Three Months Ended March 31, 2010.

	Carrying Value at March 31, 2010	Fair Value Measurements Using: 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 March 31, 2010(1)
	(dollars in millions)				
Loans(2)	$ 634	$	$	$ 634	$ (3)
Other investments(3)	17			17	(5)
Intangible assets(4)	5			5	(10)
Total	$ 656	$	$	$ 656	$ (18)

(1) Losses are recorded within Other expenses in the condensed consolidated statement of income except for fair value adjustments related to Loans and losses related to Other investments, which are included in Other revenues.
(2) Non-recurring change in fair value for loans held for investment were calculated based upon the fair value of the underlying collateral. The fair value of the collateral was determined using internal expected recovery models.
(3) Losses recorded were determined primarily using discounted cash flow models.
(4) Losses related to management contracts and were determined using discounted cash flow models.

In addition to the losses included in the table above, the Company incurred a loss of approximately $932 million in connection with the planned disposition of Revel, which was included in discontinued operations. The loss primarily related to premises and equipment and was included in discontinued operations (see Note 1). The fair value of Revel, net of estimated costs to sell, included in Premises, equipment and software costs was approximately $240 million at March 31, 2010 and was classified in Level 3. Fair value was determined using discounted cash flow models.

There were no liabilities measured at fair value on a non-recurring basis during the quarter ended March 31, 2010.

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, certain 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, certain Deposits and certain Other secured financings.

The Company s long-term borrowings are recorded at amortized 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

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

arrangements. At March 31, 2011, the carrying value of the Company s long-term borrowings not measured at fair value was less than $0.1 billion lower than fair value. At December 31, 2010, the carrying value of the Company s long-term borrowings not measured at fair value was approximately $1.8 billion higher than fair value.

4. Securities Available for Sale.

The following table presents information about the Company s available for sale (AFS) securities:

	At March 31, 2011				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Other-than-Temporary Impairment	Fair Value
	(dollars in millions)				
Debt securities available for sale:					
U.S. government and agency securities:					
U.S. Treasury securities	$ 13,537	$ 149	$ 40	$	$ 13,646
U.S. agency securities	14,194	15	122		14,087
Total U.S. government and agency securities	$ 27,731	$ 164	$ 162	$	$ 27,733

	At December 31, 2010				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Other-than-Temporary Impairment	Fair Value
	(dollars in millions)				
Debt securities available for sale:					
U.S. government and agency securities:					
U.S. Treasury securities	$ 18,812	$ 199	$ 34	$	$ 18,977
U.S. agency securities	10,774	16	118		10,672
Total U.S. government and agency securities	$ 29,586	$ 215	$ 152	$	$ 29,649

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

At March 31, 2011	Less than 12 Months Fair Value	Less than 12 Months Gross Unrealized Losses	12 Months or Longer Fair Value	12 Months or Longer Gross Unrealized Losses	Total Fair Value	Total Gross Unrealized Losses
	(dollars in millions)					
Debt securities available for sale:						
U.S. government and agency securities:						
U.S. Treasury securities	$ 2,253	$ 40	$	$	$ 2,253	$ 40
U.S. agency securities	9,783	122			9,783	122
Total U.S. government and agency securities	$ 12,036	$ 162	$	$	$ 12,036	$ 162

At December 31, 2010	Less than 12 Months Fair Value	Less than 12 Months Gross Unrealized Losses	12 Months or Longer Fair Value	12 Months or Longer Gross Unrealized Losses	Total Fair Value	Total Gross Unrealized Losses
	(dollars in millions)					
Debt securities available for sale:						
U.S. government and agency securities:						
U.S. Treasury securities	$ 1,960	$ 34	$	$	$ 1,960	$ 34
U.S. agency securities	7,736	118			7,736	118
Total U.S. government and agency securities	$ 9,696	$ 152	$	$	$ 9,696	$ 152

Gross unrealized losses are recorded in Accumulated other comprehensive income.

The Company does not intend to sell these securities or expect to be required to sell these securities prior to recovery of the amortized cost basis. In addition, the Company does not expect these securities to experience a credit loss given the explicit and implicit guarantee provided by the U.S. government. The Company believes that the debt securities with an unrealized loss in Accumulated other comprehensive income were not other-than-temporarily impaired at March 31, 2011 and December 31, 2010.

The following table presents the amortized cost and fair value of debt securities available for sale by contractual maturity dates at March 31, 2011.

	Amortized Cost	Fair Value	Annualized Average Yield
	(dollars in millions)		
U.S. government and agency securities:			
U.S. Treasury securities:			
Due within 1 year	$ 1,857	$ 1,866	0.9%
After 1 year but through 5 years	11,680	11,780	1.5%
Total	$ 13,537	$ 13,646	

U.S. agency securities:			
Due within 1 year	$ 786	$ 792	1.1%
After 1 year but through 5 years	714	719	1.2%
After 5 years	12,694	12,576	1.5%
Total	$ 14,194	$ 14,087	
Total U.S. government and agency securities:	$ 27,731	$ 27,733	1.4%

31

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table presents information pertaining to sales of debt securities available for sale during the three months ended March 31, 2011 (dollars in millions):

Gross realized gains	$ 12
Gross realized losses	$
Proceeds of sales of debt securities	$ 6,121

Gross realized gains and losses are recognized in Other revenues in the condensed consolidated states of income. There were no sales of AFS securities during the three months ended March 31, 2010.

5. Collateralized Transactions.

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

The Company also engages in securities financing transactions for customers through margin lending. Under these agreements and transactions, the Company either receives or provides collateral, including U.S. government and agency securities, other sovereign government obligations, corporate and other debt, and corporate equities. Customer receivables generated from margin lending activity are collateralized by customer-owned securities held by the Company. The Company monitors required margin levels and established credit limits daily and, pursuant to such guidelines, requires customers to deposit additional collateral, or reduce positions, when necessary. Margin loans are extended on a demand basis and are not committed facilities. Factors considered in the review of margin loans are the amount of the loan, the intended purpose, the degree of leverage being employed in the account, and overall evaluation of the portfolio to ensure proper diversification or, in the case of concentrated positions, appropriate liquidity of the underlying collateral or potential hedging strategies to reduce risk. Additionally, transactions relating to concentrated or restricted positions require a review of any legal impediments to liquidation of the underlying collateral. Underlying collateral for margin loans is reviewed with respect to the liquidity of the proposed collateral positions, valuation of securities, historic trading range, volatility analysis and an evaluation of industry concentrations. For these transactions, adherence to the Company s collateral policies significantly limits the Company s credit exposure in the event of customer default. The Company may request additional margin collateral from customers, if appropriate, and, if necessary, may sell securities that have not been paid for or purchase securities sold but not delivered from customers. At March 31, 2011 and December 31, 2010, there were approximately $24.6 billion and $18.0 billion, respectively, of customer margin loans outstanding.

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

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

condition. The carrying value and classification of financial instruments owned by the Company that have been loaned or pledged to counterparties where those counterparties do not have the right to sell or repledge the collateral were as follows:

	At March 31, 2011	At December 31, 2010
	(dollars in millions)	
Financial instruments owned:		
U.S. government and agency securities	$ 9,126	$ 11,513
Other sovereign government obligations	7,988	8,741
Corporate and other debt	12,198	12,333
Corporate equities	24,219	21,919
Total	$ 53,531	$ 54,506

The Company receives collateral in the form of securities in connection with reverse repurchase agreements, securities borrowed and derivative transactions, and customer margin loans. In many cases, the Company is permitted to sell or repledge these securities held as collateral and use the securities to secure repurchase agreements, to enter into securities lending and derivative transactions or for delivery to counterparties to cover short positions. The Company additionally receives securities as collateral in connection with certain securities-for-securities transactions in which the Company is the lender. In instances where the Company is permitted to sell or repledge these securities, the Company reports the fair value of the collateral received and the related obligation to return the collateral in the condensed consolidated statements of financial condition. At March 31, 2011 and December 31, 2010, the fair value of financial instruments received as collateral where the Company is permitted to sell or repledge the securities was $577 billion and $537 billion, respectively, and the fair value of the portion that had been sold or repledged was $430 billion and $390 billion, respectively.

At March 31, 2011 and December 31, 2010, cash and securities deposited with clearing organizations or segregated under federal and other regulations or requirements were as follows:

	At March 31, 2011	At December 31, 2010
	(dollars in millions)	
Cash deposited with clearing organizations or segregated under federal and other regulations or requirements	$ 21,932	$ 19,180
Securities(1)	15,486	18,935
Total	$ 37,418	$ 38,115

(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.

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

33

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

6. Variable Interest Entities and Securitization Activities.
The Company is involved with various SPEs in the normal course of business. In most cases, these entities are deemed to be VIEs.

The Company applies accounting guidance for consolidation of VIEs to certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. Excluding entities subject to the Deferral (as defined in Note 2 to the consolidated financial statements for the year ended December 31, 2010 included in the Form 10-K), the primary beneficiary of a VIE is the party that both (1) has the power to direct the activities of a VIE that most significantly affect the VIE s economic performance and (2) has an obligation to absorb losses or the right to receive benefits that in either case could potentially be significant to the VIE. The Company consolidates entities of which it is the primary beneficiary.

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

- Interests purchased in connection with market-making and retained interests held as a result of securitization activities.
- 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 (CLN) or other asset-repackaged notes designed to meet the investment objectives of clients.
- Other structured transactions designed to provide tax-efficient yields to the Company or its clients.

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

The power to make the most significant economic decisions may take a number of different forms in different types of VIEs. The Company considers servicing or collateral management decisions as representing the power to make the most significant economic decisions in transactions such as securitizations or collateral debt obligations.

For many transactions, such as CLNs and other asset-repackaged notes, there are no significant economic decisions made on an ongoing basis. In these cases, the Company focuses its analysis on decisions made prior to the initial closing of the transaction and at the termination of the transaction. Based upon factors, which include an analysis of the nature of the assets, the number of investors, the standardization of the legal documentation and the level of the continuing involvement by the Company, the Company concluded in most of these transactions that decisions made prior to the initial closing were shared between the Company and the initial investors. The Company focused its control decision on any right held by the Company or investors related to the termination of the VIE.

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

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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 Premises, equipment and software costs, and Other assets in the condensed consolidated statements of financial condition. Except for consolidated VIEs included in other structured financings, the assets and liabilities are measured at fair value, with changes in fair value reflected in earnings.

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

The following tables present information at March 31, 2011 and December 31, 2010 about VIEs that the Company consolidates. Consolidated VIE assets and liabilities are presented after intercompany eliminations and include assets financed on a non-recourse basis.

	At March 31, 2011				
	Mortgage and Asset-backed Securitizations	Collateralized Debt Obligations	Managed Real Estate Partnerships	Other Structured Financings	Other
			(dollars in millions)		
VIE assets	$ 3,154	$ 125	$ 2,078	$ 699	$ 3,467
VIE liabilities	$ 2,332	$ 94	$ 103	$ 2,626	$ 1,122

	At December 31, 2010				
	Mortgage and Asset-Backed Securitizations	Collateralized Debt Obligations	Managed Real Estate Partnerships	Other Structured Financings	Other
			(dollars in millions)		
VIE assets	$ 3,362	$ 129	$ 2,032	$ 643	$ 2,584
VIE liabilities	$ 2,544	$ 68	$ 108	$ 2,571	$ 1,219

In general, the Company s exposure to loss in consolidated VIEs is limited to losses that would be absorbed on the VIE s assets recognized in its financial statements, net of losses absorbed by third-party holders of the VIE s liabilities. At March 31, 2011 and December 31, 2010, managed real estate partnerships reflected noncontrolling interests in the Company s condensed consolidated financial statements of $1,536 million and $1,508 million, respectively. The Company also had additional maximum exposure to losses of approximately $478 million and $884 million at March 31, 2011 and December 31, 2010, respectively. This additional exposure related primarily to certain derivatives (*e.g.*, credit derivatives in which the Company has sold protection to synthetic collateralized debt obligations, typically for the most senior tranche, instead of purchasing senior securities) and commitments, guarantees and other forms of involvement.

35

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following tables present information about certain non-consolidated VIEs in which the Company had variable interests at March 31, 2011 and December 31, 2010, respectively. The tables include all VIEs in which the Company has determined that its maximum exposure to loss is greater than specific thresholds or meets certain other criteria.

	At March 31, 2011				
	Mortgage and Asset-Backed Securitizations	Collateralized Debt Obligations	Municipal Tender Option Bonds	Other Structured Financings	Other
	(dollars in millions)				
VIE assets that the Company does not consolidate (unpaid principal balance)(1)	$ 263,119	$ 40,747	$ 6,946	$ 2,084	$ 6,121
Maximum exposure to loss:					
Debt and equity interests(2)	$ 7,825	$ 1,102	$ 169	$ 1,024	$ 1,748
Derivative and other contracts	120	920	4,346		1,738
Commitments, guarantees and other		456		809	328
Total maximum exposure to loss	$ 7,945	$ 2,478	$ 4,515	$ 1,833	$ 3,814
Carrying value of exposure to loss Assets:					
Debt and equity interests(2)	$ 7,825	$ 1,102	$ 169	$ 726	$ 1,748
Derivative and other contracts	115	731			414
Total carrying value of exposure to loss Assets	$ 7,940	$ 1,833	$ 169	$ 726	$ 2,162
Carrying value of exposure to loss Liabilities:					
Derivative and other contracts	$ 17	$ 108	$	$	$ 23
Commitments, guarantees and other		427		17	302
Total carrying value of exposure to loss Liabilities	$ 17	$ 535	$	$ 17	$ 325

(1) Mortgage and asset-backed securitizations include VIE assets as follows: $40.1 billion of residential mortgages; $173.2 billion of commercial mortgages; $28.8 billion of U.S. agency collateralized mortgage obligations; and $21.0 billion of other consumer or commercial loans.

(2) Mortgage and asset-backed securitizations include VIE debt and equity interests as follows: $1.9 billion of residential mortgages; $2.0 billion of commercial mortgages; $2.7 billion of U.S. agency collateralized mortgage obligations; and $1.2 billion of other consumer or commercial loans.

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	At December 31, 2010				
	Mortgage and Asset-Backed Securitizations	Collateralized Debt Obligations	Municipal Tender Option Bonds	Other Structured Financings	Other
	(dollars in millions)				
VIE assets that the Company does not consolidate (unpaid principal balance)(1)	$ 172,711	$ 38,332	$ 7,431	$ 2,037	$ 11,262
Maximum exposure to loss:					
Debt and equity interests(2)	$ 8,129	$ 1,330	$ 78	$ 1,062	$ 2,678
Derivative and other contracts	113	942	4,709		2,079
Commitments, guarantees and other				791	446
Total maximum exposure to loss	$ 8,242	$ 2,272	$ 4,787	$ 1,853	$ 5,203
Carrying value of exposure to loss Assets:					
Debt and equity interests(2)	$ 8,129	$ 1,330	$ 78	$ 779	$ 2,678
Derivative and other contracts	113	753			551
Total carrying value of exposure to loss Assets	$ 8,242	$ 2,083	$ 78	$ 779	$ 3,229
Carrying value of exposure to loss Liabilities:					
Derivative and other contracts	$ 15	$ 123	$	$	$ 23
Commitments, guarantees and other				44	261
Total carrying value of exposure to loss Liabilities	$ 15	$ 123	$	$ 44	$ 284

(1) Mortgage and asset-backed securitizations include VIE assets as follows: $34.9 billion of residential mortgages; $94.0 billion of commercial mortgages; $28.8 billion of U.S. agency collateralized mortgage obligations; and $15.0 billion of other consumer or commercial loans.

(2) Mortgage and asset-backed securitizations include VIE debt and equity interests as follows: $1.9 billion of residential mortgages; $2.1 billion of commercial mortgages; $3.0 billion of U.S. agency collateralized mortgage obligations; and $1.1 billion of other consumer or commercial loans.

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

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

Securitization transactions generally involve VIEs. The Company owned additional securities issued by securitization SPEs for which the maximum exposure to loss is less than specific thresholds. These additional securities totaled $4.8 billion at March 31, 2011. These securities were either retained in connection with

37

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

transfers of assets by the Company or acquired in connection with secondary market-making activities. Securities issued by securitization SPEs consist of $1.9 billion of securities backed primarily by residential mortgage loans, $0.6 billion of securities backed by U.S. agency collateralized mortgage obligations, $0.8 billion of securities backed by commercial mortgage loans, $0.9 billion of securities backed by collateralized debt obligations or collateralized loan obligations and $0.6 billion backed by other consumer loans, such as credit card receivables, automobile loans and student loans. The Company s primary risk exposure is to the securities issued by the SPE owned by the Company, with the risk highest on the most subordinate class of beneficial interests. These securities generally are included in Financial instruments owned Corporate and other debt and are measured at fair value. The Company does not provide additional support in these transactions through contractual facilities, such as liquidity facilities, guarantees or similar derivatives. The Company s maximum exposure to loss generally equals the fair value of the securities owned.

The Company s transactions with VIEs primarily includes securitizations, municipal tender option bond trusts, credit protection purchased through CLNs, other structured financings, collateralized loan and debt obligations, equity-linked notes, managed real estate partnerships and asset management investment funds. Such activities are described in Note 7 to the consolidated financial statements for the year ended December 31, 2010 included in the Form 10-K.

Transfers of Assets with Continuing Involvement.

The following tables present information at March 31, 2011 regarding transactions with SPEs in which the Company, acting as principal, transferred assets with continuing involvement and received sales treatment.

	At March 31, 2011			
	Residential Mortgage Loans	Commercial Mortgage Loans	U.S. Agency Collateralized Mortgage Obligations	Credit-Linked Notes and Other
	(dollars in millions)			
SPE assets (unpaid principal balance)(1)	$ 47,089	$ 89,033	$ 29,314	$ 19,303
Retained interests (fair value):				
Investment grade	$ 38	$ 110	$ 1,786	$ 3
Non-investment grade	345	56		2,525
Total retained interests (fair value)	$ 383	$ 166	$ 1,786	$ 2,528
Interests purchased in the secondary market (fair value):				
Investment grade	$ 67	$ 307	$ 145	$ 433
Non-investment grade	317	103	86	35
Total interests purchased in the secondary market (fair value)	$ 384	$ 410	$ 231	$ 468
Derivative assets (fair value)	$ 55	$ 1,095	$	$ 295
Derivative liabilities (fair value)	$ 34	$	$	$ 242

(1) Amounts include assets transferred by unrelated transferors.

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	At March 31, 2011			
	Level 1	Level 2	Level 3	Total
	(dollars in millions)			
Retained interests (fair value):				
Investment grade	$	$ 1,921	$ 16	$ 1,937
Non-investment grade		160	2,766	2,926
Total retained interests (fair value)	$	$ 2,081	$ 2,782	$ 4,863
Interests purchased in the secondary market (fair value):				
Investment grade	$	$ 951	$ 1	$ 952
Non-investment grade		324	217	541
Total interests purchased in the secondary market (fair value)	$	$ 1,275	$ 218	$ 1,493
Derivative assets (fair value)	$	$ 902	$ 543	$ 1,445
Derivative liabilities (fair value)	$	$ 244	$ 32	$ 276

The following tables present information at December 31, 2010 regarding transactions with SPEs in which the Company, acting as principal, transferred assets with continuing involvement and received sales treatment.

	At December 31, 2010			
	Residential Mortgage Loans	Commercial Mortgage Loans	U.S. Agency Collateralized Mortgage Obligations	Credit-Linked Notes and Other
	(dollars in millions)			
SPE assets (unpaid principal balance)(1)	$ 48,947	$ 85,974	$ 29,748	$ 11,462
Retained interests (fair value):				
Investment grade	$ 46	$ 64	$ 2,636	$ 8
Non-investment grade	206	81		2,327
Total retained interests (fair value)	$ 252	$ 145	$ 2,636	$ 2,335
Interests purchased in the secondary market (fair value):				
Investment grade	$ 118	$ 643	$ 155	$ 21
Non-investment grade	205	55		11
Total interests purchased in the secondary market (fair value)	$ 323	$ 698	$ 155	$ 32
Derivative assets (fair value)	$ 75	$ 955	$	$ 78
Derivative liabilities (fair value)	$ 29	$ 80	$	$ 314

(1) Amounts include assets transferred by unrelated transferors.

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	At December 31, 2010			
	Level 1	Level 2	Level 3	Total
	(dollars in millions)			
Retained interests (fair value):				
Investment grade	$	$ 2,732	$ 22	$ 2,754
Non-investment grade		241	2,373	2,614
Total retained interests (fair value)	$	$ 2,973	$ 2,395	$ 5,368
Interests purchased in the secondary market (fair value):				
Investment grade	$	$ 929	$ 8	$ 937
Non-investment grade		255	16	271
Total interests purchased in the secondary market (fair value)	$	$ 1,184	$ 24	$ 1,208
Derivative assets (fair value)	$	$ 887	$ 221	$ 1,108
Derivative liabilities (fair value)	$	$ 360	$ 63	$ 423

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

Net gains on sales of assets in securitization transactions at the time of the sale were not material in the quarters ended March 31, 2011 and 2010.

During the quarters ended March 31, 2011 and 2010, the Company received proceeds from new securitization transactions of $7.9 billion and $5 billion, respectively. During the quarters ended March 31, 2011 and 2010, the Company received proceeds from cash flows from retained interests in securitization transactions of $2.4 billion and $1.2 billion, respectively.

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

Failed Sales.

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

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

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table presents information about the carrying value of assets and liabilities resulting from transfers of assets treated by the Company as secured financings:

	At March 31, 2011		At December 31, 2010	
	Assets	Liabilities	Assets	Liabilities
	(dollars in millions)			
Commercial Mortgage Loans	$ 112	$ 112	$ 128	$ 124
Credit-Linked Notes	710	670	784	781
Equity-Linked Transactions	1,896	1,859	1,618	1,583
Other	131	131	62	61

Mortgage Servicing Activities.

Mortgage Servicing Rights. The Company may retain servicing rights to certain mortgage loans that are sold. These transactions create an asset referred to as MSRs, which totaled approximately $144 million and $157 million at March 31, 2011 and December 31, 2010, 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. The Company generally holds retained interests in Company-sponsored SPEs. In some cases, as part of its market-making activities, the Company may own some beneficial interests issued by both Company-sponsored and non-Company sponsored SPEs.

The Company provides no credit support as part of its servicing activities. The Company is required to make servicing advances to the extent that it believes that such advances will be reimbursed. Reimbursement of servicing advances is a senior obligation of the SPE, senior to the most senior beneficial interests outstanding. Outstanding advances are included in Other assets and are recorded at cost. Advances at March 31, 2011 and December 31, 2010 totaled approximately $1.4 billion and $1.5 billion, respectively, net of allowance of $5 million and $10 million at March 31, 2011 and December 31, 2010, respectively.

The following tables present information about the Company s mortgage servicing activities for SPEs to which the Company transferred loans at March 31, 2011 and December 31, 2010:

	At March 31, 2011			
	Residential Mortgage Unconsolidated SPEs	Residential Mortgage Consolidated SPEs	Commercial Mortgage Unconsolidated SPEs	Commercial Mortgage Consolidated SPEs
	(dollars in millions)			
Assets serviced (unpaid principal balance)	$ 10,306	$ 2,287	$ 7,241	$ 2,096
Amounts past due 90 days or greater (unpaid principal balance)(1)	$ 3,568	$ 408	$	$
Percentage of amounts past due 90 days or greater(1)	34.6%	17.9%		
Credit losses	$ 155	$ 9	$	$

(1) Amount 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.

41

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	At December 31, 2010			
	Residential Mortgage Unconsolidated SPEs	Residential Mortgage Consolidated SPEs	Commercial Mortgage Consolidated SPEs	Commercial Mortgage Consolidated SPEs
	(dollars in millions)			
Assets serviced (unpaid principal balance)	$ 10,616	$ 2,357	$ 7,108	$ 2,097
Amounts past due 90 days or greater (unpaid principal balance)(1)	$ 3,861	$ 446	$	$
Percentage of amounts past due 90 days or greater(1)	36.4%	18.9%		
Credit losses	$ 1,098	$ 35	$	$

(1) Amount 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 $13 billion at both March 31, 2011 and December 31, 2010.

7. Financing Receivables.

Loans held for investment.

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

The Company s loans held for investment at March 31, 2011 and December 31, 2010 included the following:

	At March 31, 2011	At December 31, 2010
	(dollars in millions)	
Commercial and industrial	$ 4,133	$ 4,054
Consumer loans	4,093	3,974
Residential real estate loans	2,631	1,915
Wholesale real estate loans	646	468
Total loans held for investment(1)	$ 11,503	$ 10,411

(1) Amounts are net of allowances of $45 million and $82 million at March 31, 2011 and December 31, 2010, respectively.

The above table does not include loans held for sale of $379 million and $165 million at March 31, 2011 and December 31, 2010, respectively.

The Company s Credit Risk Management Department evaluates new obligors before credit transactions are initially approved, and at least annually thereafter for consumer and industrial loans. For corporate and commercial loans, credit evaluations typically involve the evaluation of financial statements, assessment of leverage, liquidity, capital strength, asset composition and quality, market capitalization and access to capital markets, cash flow projections and debt service requirements, and the adequacy of collateral, if applicable. The Company s Credit Risk

Management Department will also evaluate strategy, market position, industry dynamics, obligor s management and other factors that could affect the obligor s risk profile. For residential real estate and consumer loans, the initial credit evaluation includes, but is not limited to review of the obligor s income, net worth, liquidity, collateral, loan-to-value ratio, and credit bureau information. Subsequent credit monitoring for residential real estate loans is performed at the portfolio level and for consumer loans collateral, values are monitored on an ongoing basis.

42

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

At March 31, 2011, the Company collectively evaluated for impairment gross commercial and industrial loans, consumer loans, residential real estate loans and wholesale real estate loans of $3,949 million, $4,020 million, $2,632 million and $324 million, respectively. The Company individually evaluated for impairment gross commercial and industrial loans, consumer and wholesale real estate loans of $210 million, $74 million and $339 million, respectively. Commercial and industrial loans of approximately $80 million and wholesale real estate loans of approximately $76 million were impaired at March 31, 2011. Approximately 99% of the Company s loan portfolio was current at March 31, 2011.

At December 31, 2010, the Company collectively evaluated for impairment gross commercial and industrial loans, consumer loans, residential real estate loans and wholesale real estate loans of $3,791 million, $3,890 million, $1,915 million and $90 million, respectively. The Company individually evaluated for impairment gross commercial and industrial loans, consumer and wholesale real estate loans of $307 million, $85 million and $415 million, respectively. Commercial and industrial loans of approximately $170 million and wholesale real estate loans of approximately $108 million were impaired at December 31, 2010. Approximately 99% of the Company s loan portfolio was current at December 31, 2010.

The Company assigned an internal grade of doubtful to certain commercial asset-backed and wholesale real estate loans totaling $249 million and $500 million at March 31, 2011 and December 31, 2010, respectively. Doubtful loans can be classified as current if the borrower is making payments in accordance with the loan agreement. The Company assigned an internal grade of pass to the majority of the remaining loans.

For a description of the Company s loan portfolio and credit quality indicators utilized in its credit monitoring process, see Note 8 to the consolidated financial statements for the year ended December 31, 2010 included in the Form 10-K.

Employee Loans.

Employee loans are granted primarily in conjunction with a program established in the Global Wealth Management Group business segment to retain and recruit certain employees. These loans are recorded in Receivables Fees, interest and other in the condensed consolidated statements of financial condition. These loans are full recourse, require periodic payments and have repayment terms ranging from four to 12 years. The Company establishes a reserve for loan amounts it does not consider recoverable from terminated employees, which is recorded in Compensation and benefits expense. At March 31, 2011, the Company had $5,488 million of employee loans, net of an allowance of approximately $100 million. At December 31, 2010, the Company had $5,831 million of employee loans, net of an allowance of approximately $111 million.

Collateralized Transactions.

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

Servicing Advances.

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

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

8. Goodwill and Net Intangible Assets.

The Company tests goodwill for impairment on an annual basis and on an interim basis when certain events or circumstances exist. The Company tests for impairment at the reporting unit level, which is generally at the level of or one level below its business segments. Goodwill impairment is determined by comparing the estimated fair value of a reporting unit with its respective book value. If the estimated fair value exceeds the book value, goodwill at the reporting unit level is not deemed to be impaired. If the estimated fair value is below book value, however, further analysis is required to determine the amount of the impairment. Additionally, if the book value of a reporting unit is zero or a negative value and it is determined that it is more likely than not the goodwill is impaired, further analysis is required.

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

The Company completed its annual goodwill impairment testing as of July 1, 2010. The Company s testing did not indicate any goodwill impairment. Due to the volatility in the equity markets, the economic outlook and the Company s common shares trading below book value during the quarters ended December 31, 2010 and March 31, 2011, the Company performed additional impairment testing at December 31, 2010 and March 31, 2011, which did not result in any goodwill impairment. Adverse market or economic events could result in impairment charges in future periods.

Goodwill.

Changes in the carrying amount of the Company s goodwill, net of accumulated impairment losses for the quarter ended March 31, 2011, were as follows:

	Institutional Securities	Global Wealth Management Group	Asset Management	Total
		(dollars in millions)		
Goodwill at December 31, 2010(1)	$ 383	$ 5,616	$ 740	$ 6,739
Foreign currency translation adjustments and other	4			4
Goodwill at March 31, 2011(1)	$ 387	$ 5,616	$ 740	$ 6,743

(1) The amount of the Company s goodwill before accumulated impairments of $700 million at both March 31, 2011 and December 31, 2010, was $7,443 million and $7,439 million, respectively.

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Net Intangible Assets.

Changes in the carrying amount of the Company s intangible assets for the quarter ended March 31, 2011 were as follows:

	Institutional Securities	Global Wealth Management Group	Asset Management	Total
		(dollars in millions)		
Amortizable net intangible assets at December 31, 2010	$ 262	$ 3,963	$ 5	$ 4,230
Mortgage servicing rights (see Note 6)	151	6		157
Indefinite-lived intangible assets		280		280
Net intangible assets at December 31, 2010	$ 413	$ 4,249	$ 5	$ 4,667
Amortizable net intangible assets at December 31, 2010	$ 262	$ 3,963	$ 5	$ 4,230
Foreign currency translation adjustments and other	17			17
Amortization expense	(6)	(81)		(87)
Impairment losses			(3)	(3)
Amortizable net intangible assets at March 31, 2011	273	3,882	2	4,157
Mortgage servicing rights (see Note 6)	132	12		144
Indefinite-lived intangible assets		280		280
Net intangible assets at March 31, 2011	$ 405	$ 4,174	$ 2	$ 4,581

9. Long-Term Borrowings and Other Secured Financings.

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

	At March 31, 2011	At December 31, 2010
	(dollars in millions)	
Senior debt	$ 187,319	$ 183,514
Subordinated debt	3,972	4,126
Junior subordinated debentures	4,845	4,817