

MORGAN STANLEY
Form 10-Q
May 09, 2011
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 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 No

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

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

Large Accelerated Filer <input checked="" type="checkbox"/>	Accelerated Filer <input type="checkbox"/>
Non-Accelerated Filer <input type="checkbox"/>	Smaller reporting company <input type="checkbox"/>

(Do not check if a smaller reporting company)

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

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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.

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QUARTERLY REPORT ON FORM 10-Q

For the quarter ended March 31, 2011

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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

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Integrity Hotline information.

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

Table of Contents**Part I Financial Information.****Item 1. Financial Statements.****MORGAN STANLEY****CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION****(dollars in millions, except share data)****(unaudited)**

	March 31, 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

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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)

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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	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

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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.

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(dollars in millions)

(unaudited)

	Three Months Ended March 31,	
	2011	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)

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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.

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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.

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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.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Introduction and Basis of Presentation.

The Company. Morgan Stanley, a financial holding company, is a global financial services firm that maintains significant market positions in each of its business segments Institutional Securities, 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.

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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.

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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, creditworthiness 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

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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

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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.

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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.

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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.

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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.

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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:					

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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

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	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3) (dollars in millions)	Counterparty and Cash Collateral Netting	Balance at March 31, 2011
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

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Liabilities						
Deposits	\$	\$	3,011	\$	\$	3,027
Commercial paper and other short-term borrowings			1,797			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

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.

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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

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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)
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:									

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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
Long-term borrowings	1,316	(84)		141	(180)	13	1,374

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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.

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, 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)
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)

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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

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 \$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.

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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 (dollars in millions)	Gains (Losses) Included in Net Revenues
<i>Three Months Ended March 31, 2011</i>			
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)
<i>Three Months Ended March 31, 2010</i>			
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)

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- (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.

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

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- (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.

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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.

	Fair Value Measurements Using:				Total Losses for the Three Months Ended March 31, 2010(1)
	Carrying Value at March 31, 2010	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2) (dollars in millions)	Significant Unobservable Inputs (Level 3)	
Loans(2)	\$ 634	\$	\$	\$ 634	\$ (3)
Other investments(3)	17			17	(5)
Intangible assets(4)	5			5	(10)