MORGAN STANLEY
Form 10-Q
August 06, 2012
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2012

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** (Address of principal executive offices, including zip code)	(I.R.S. Employer Identification No.)	(Registrant s telephone number, including area code)

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

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

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

Large Accelerated Filer x	Accelerated Filer ¨

Non-Accelerated Filer ¨ Smaller reporting company ¨
(Do not check if a smaller reporting company)
Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

As of July 31, 2012, there were 1,975,507,265 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 June 30, 2012

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

Integrity Hotline information.

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

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Part I Financial Information.

Item 1. Financial Statements.

MORGAN STANLEY

Condensed Consolidated Statements of Financial Condition

(dollars in millions, except share data)

(unaudited)

	June 30, 2012	December 31, 2011
Assets		
Cash and due from banks ($477 and $511 at June 30, 2012 and December 31, 2011, respectively, related to consolidated variable interest entities generally not available to the Company)	$ 12,408	$ 13,165
Interest bearing deposits with banks	29,598	34,147
Cash deposited with clearing organizations or segregated under federal and other regulations or requirements	29,418	29,454
Financial instruments owned, at fair value (approximately $131,397 and $140,749 were pledged to various parties at June 30, 2012 and December 31, 2011, respectively):		
U.S. government and agency securities	54,138	63,449
Other sovereign government obligations	33,628	29,059
Corporate and other debt ($2,734 and $3,007 at June 30, 2012 and December 31, 2011, respectively, related to consolidated variable interest entities, generally not available to the Company)	57,757	68,923
Corporate equities	46,346	47,966
Derivative and other contracts	34,343	48,064
Investments ($1,809 and $1,666 at June 30, 2012 and December 31, 2011, respectively, related to consolidated variable interest entities, generally not available to the Company)	8,229	8,195
Physical commodities	6,141	9,697
Total financial instruments owned, at fair value	240,582	275,353
Securities available for sale, at fair value	31,442	30,495
Securities received as collateral, at fair value	12,150	11,651
Federal funds sold and securities purchased under agreements to resell (includes $622 and $112 at fair value at June 30, 2012 and December 31, 2011, respectively)	147,988	130,155
Securities borrowed	134,263	127,074
Receivables:		
Customers	37,666	33,977
Brokers, dealers and clearing organizations	9,107	5,248
Fees, interest and other	10,208	9,444
Loans (net of allowances of $77 and $17 at June 30, 2012 and December 31, 2011, respectively)	21,394	15,369
Other investments	4,730	4,832
Premises, equipment and software costs (net of accumulated depreciation of $5,311 and $4,852 at June 30, 2012 and December 31, 2011, respectively) ($229 and $234 at June 30, 2012 and December 31, 2011, respectively, related to consolidated variable interest entities, generally not available to the Company)	6,343	6,457
Goodwill	6,610	6,686
Intangible assets (net of accumulated amortization of $1,078 and $910 at June 30, 2012 and December 31, 2011, respectively) (includes $8 and $133 at fair value at June 30, 2012 and December 31, 2011, respectively)	3,987	4,285
Other assets ($355 and $446 at June 30, 2012 and December 31, 2011, respectively, related to consolidated variable interest entities, generally not available to the Company)	10,623	12,106

Total assets	$ 748,517	$ 749,898

See Notes to Condensed Consolidated Financial Statements.

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MORGAN STANLEY

Condensed Consolidated Statements of Financial Condition (Continued)

(dollars in millions, except share data)

(unaudited)

	June 30, 2012	December 31, 2011
Liabilities and Equity		
Deposits (includes $1,965 and $2,101 at fair value at June 30, 2012 and December 31, 2011, respectively)	$ 68,252	$ 65,662
Commercial paper and other short-term borrowings (includes $840 and $1,339 at fair value at June 30, 2012 and December 31, 2011, respectively)	1,988	2,843
Financial instruments sold, not yet purchased, at fair value:		
U.S. government and agency securities	27,770	19,630
Other sovereign government obligations	22,208	17,141
Corporate and other debt	9,041	8,410
Corporate equities	29,521	24,497
Derivative and other contracts	34,935	46,453
Physical commodities		16
Total financial instruments sold, not yet purchased, at fair value	123,475	116,147
Obligation to return securities received as collateral, at fair value	17,078	15,394
Securities sold under agreements to repurchase (includes $346 and $348 at fair value at June 30, 2012 and December 31, 2011, respectively)	108,678	104,800
Securities loaned	30,762	30,462
Other secured financings (includes $9,236 and $14,594 at fair value at June 30, 2012 and December 31, 2011, respectively) ($1,419 and $2,316 at June 30, 2012 and December 31, 2011, respectively, related to consolidated variable interest entities and are non-recourse to the Company)	17,323	20,719
Payables:		
Customers	119,455	117,241
Brokers, dealers and clearing organizations	4,158	4,082
Interest and dividends	3,166	2,292
Other liabilities and accrued expenses ($55 and $121 at June 30, 2012 and December 31, 2011, respectively, related to consolidated variable interest entities and are non-recourse to the Company)	14,717	15,944
Long-term borrowings (includes $42,482 and $39,663 at fair value at June 30, 2012 and December 31, 2011, respectively)	167,828	184,234
	676,880	679,820
Commitments and contingent liabilities (see Note 11)		
Equity		
Morgan Stanley shareholders equity:		
Preferred stock	1,508	1,508
Common stock, $0.01 par value;		
Shares authorized: 3,500,000,000 at June 30, 2012 and December 31, 2011;		
Shares issued: 2,038,893,979 at June 30, 2012 and 1,989,377,171 at December 31, 2011;		
Shares outstanding: 1,977,402,742 at June 30, 2012 and 1,926,986,130 at December 31, 2011	20	20
Paid-in capital	23,151	22,836
Retained earnings	40,586	40,341
Employee stock trust	3,198	3,166
Accumulated other comprehensive loss	(220)	(157)
Common stock held in treasury, at cost, $0.01 par value; 61,491,237 shares at June 30, 2012 and 62,391,041 shares at December 31, 2011	(2,204)	(2,499)

Common stock issued to employee trust	(3,198)	(3,166)
Total Morgan Stanley shareholders equity	62,841	62,049
Noncontrolling interests	8,796	8,029
Total equity	71,637	70,078
Total liabilities and equity	$ 748,517	$ 749,898

See Notes to Condensed Consolidated Financial Statements.

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MORGAN STANLEY

Condensed Consolidated Statements of Income

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

(unaudited)

	Three Months Ended June 30, 2012	Three Months Ended June 30, 2011	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011
Revenues:				
Investment banking	$ 1,104	$ 1,695	$ 2,167	$ 2,909
Principal transactions:				
Trading	2,469	3,484	4,876	6,461
Investments	63	402	148	731
Commissions and fees	1,040	1,283	2,217	2,722
Asset management, distribution and administration fees	2,268	2,174	4,420	4,257
Other	170	237	280	(237)
Total non-interest revenues	7,114	9,275	14,108	16,843
Interest income	1,323	1,961	2,865	3,820
Interest expense	1,484	2,029	3,085	3,882
Net interest	(161)	(68)	(220)	(62)
Net revenues	6,953	9,207	13,888	16,781
Non-interest expenses:				
Compensation and benefits	3,633	4,622	8,064	8,907
Occupancy and equipment	380	395	772	792
Brokerage, clearing and exchange fees	405	410	808	811
Information processing and communications	487	444	946	884
Marketing and business development	156	151	302	293
Professional services	478	467	890	870
Other	474	748	963	1,353
Total non-interest expenses	6,013	7,237	12,745	13,910
Income from continuing operations before income taxes	940	1,970	1,143	2,871
Provision for income taxes	226	538	280	294
Income from continuing operations	714	1,432	863	2,577
Discontinued operations:				
Gain (loss) from discontinued operations	49	(22)	76	(51)
Provision for (benefit from) income taxes	13	4	55	(10)
Net gain (loss) from discontinued operations	36	(26)	21	(41)
Net income	$ 750	$ 1,406	$ 884	$ 2,536
Net income applicable to noncontrolling interests	159	213	387	375
Net income applicable to Morgan Stanley	$ 591	$ 1,193	$ 497	$ 2,161

Earnings (loss) applicable to Morgan Stanley common shareholders	$ 564	$ (558)	$ 446	$ 188
Amounts applicable to Morgan Stanley:				
Income from continuing operations	$ 563	$ 1,221	$ 485	$ 2,205
Net gain (loss) from discontinued operations	28	(28)	12	(44)
Net income applicable to Morgan Stanley	$ 591	$ 1,193	$ 497	$ 2,161
Earnings (loss) per basic common share:				
Income (loss) from continuing operations	$ 0.28	$ (0.36)	$ 0.23	$ 0.16
Net gain (loss) from discontinued operations	0.02	(0.02)	0.01	(0.03)
Earnings (loss) per basic common share	$ 0.30	$ (0.38)	$ 0.24	$ 0.13
Earnings (loss) per diluted common share:				
Income (loss) from continuing operations	$ 0.28	$ (0.36)	$ 0.23	$ 0.16
Net gain (loss) from discontinued operations	0.01	(0.02)		(0.03)
Earnings (loss) per diluted common share	$ 0.29	$ (0.38)	$ 0.23	$ 0.13
Average common shares outstanding:				
Basic	1,885,179,182	1,464,295,984	1,881,070,509	1,460,155,981
Diluted	1,911,709,377	1,464,295,984	1,907,107,639	1,477,572,132

See Notes to Condensed Consolidated Financial Statements.

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MORGAN STANLEY

Condensed Consolidated Statements of Comprehensive Income

(dollars in millions)

(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Net income	$ 750	$ 1,406	$ 884	$ 2,536
Other comprehensive income (loss), net of tax:				
Foreign currency translation adjustments(1)	$ (151)	$ 94	$ (131)	$ 131
Amortization of cash flow hedges(2)	1	3	3	4
Net unrealized gain (loss) on Securities available for sale(3)	41	50	22	14
Pension, postretirement and other related adjustments(4)	17	2	19	7
Total other comprehensive income (loss)	$ (92)	$ 149	$ (87)	$ 156
Comprehensive income	$ 658	$ 1,555	$ 797	$ 2,692
Net income applicable to noncontrolling interests	159	213	387	375
Other comprehensive income (loss) applicable to noncontrolling interests	68	43	(24)	9
Comprehensive income applicable to Morgan Stanley	$ 431	$ 1,299	$ 434	$ 2,308

(1) Amounts are net of provision for (benefit from) income taxes of $172 million and $(68) million for the quarters ended June 30, 2012 and 2011, respectively, and $176 million and $(136) million for the six months ended June 30, 2012 and 2011, respectively.
(2) Amounts are net of provision for income taxes of $1 million for the quarter ended June 30, 2012, and $2 million and $2 million for the six months ended June 30, 2012 and 2011, respectively.
(3) Amounts are net of provision for income taxes of $30 million and $34 million for the quarters ended June 30, 2012 and 2011, respectively, and $17 million and $10 million for the six months ended June 30, 2012 and 2011, respectively.
(4) Amounts are net of provision for income taxes of $8 million and $4 million for the quarters ended June 30, 2012 and 2011, respectively, and $10 million for the six months ended June 30, 2012.

See Notes to Condensed Consolidated Financial Statements.

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MORGAN STANLEY

Condensed Consolidated Statements of Cash Flows

(dollars in millions)

(unaudited)

	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 884	$ 2,536
Adjustments to reconcile net income to net cash provided by (used for) operating activities:		
Loss on equity method investees	20	725
Compensation payable in common stock and options	618	728
Depreciation and amortization	793	759
Gain on business dispositions	(108)	
Gain on sale of securities available for sale	(23)	(94)
(Gain) loss on retirement of long-term debt	(27)	31
Impairment charges and other-than-temporary impairment charges	33	3
Changes in assets and liabilities:		
Cash deposited with clearing organizations or segregated under federal and other regulations or requirements	36	(6,324)
Financial instruments owned, net of financial instruments sold, not yet purchased	41,351	22,984
Securities borrowed	(7,189)	6,638
Securities loaned	300	6,281
Receivables, loans and other assets	(15,192)	(6,271)
Payables and other liabilities	5,318	13,458
Federal funds sold and securities purchased under agreements to resell	(17,833)	(32,737)
Securities sold under agreements to repurchase	6,885	(13,891)
Net cash provided by (used for) operating activities	15,866	(5,174)
CASH FLOWS FROM INVESTING ACTIVITIES		
Net proceeds from (payments for):		
Premises, equipment and software costs	(436)	(725)
Business dispositions, net of cash disposed	1,536	
Purchases of securities available for sale	(6,418)	(8,632)
Sales, maturities and redemptions of securities available for sale	5,439	14,245
Net cash provided by investing activities	121	4,888
CASH FLOWS FROM FINANCING ACTIVITIES		
Net proceeds from (payments for):		
Commercial paper and other short-term borrowings	(855)	310
Distributions related to noncontrolling interests	(178)	(153)
Derivatives financing activities	128	146
Other secured financings	(4,822)	3,176
Deposits	2,590	1,713
Net proceeds from:		
Excess tax benefits associated with stock-based awards	42	29
Issuance of long-term borrowings	9,422	22,596
Payments for:		
Long-term borrowings	(26,445)	(24,192)
Repurchases of common stock for employee tax withholding	(191)	(283)
Cash dividends	(230)	(594)
Net cash provided by (used for) financing activities	(20,539)	2,748

Effect of exchange rate changes on cash and cash equivalents	(307)	416
Effect of cash and cash equivalents related to variable interest entities	(447)	254
Net increase (decrease) in cash and cash equivalents	(5,306)	3,132
Cash and cash equivalents, at beginning of period	47,312	47,615
Cash and cash equivalents, at end of period	$ 42,006	$ 50,747
Cash and cash equivalents include:		
Cash and due from banks	$ 12,408	$ 9,066
Interest bearing deposits with banks	29,598	41,681
Cash and cash equivalents, at end of period	$ 42,006	$ 50,747

SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION

Cash payments for interest were $2,404 million and $3,144 million for the six months ended June 30, 2012 and 2011, respectively.

Cash payments for income taxes were $220 million and $530 million for the six months ended June 30, 2012 and 2011, respectively.

See Notes to Condensed Consolidated Financial Statements.

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MORGAN STANLEY

Condensed Consolidated Statements of Changes in Total Equity

Six Months Ended June 30, 2012

(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, 2011	$ 1,508	$ 20	$ 22,836	$ 40,341	$ 3,166	$ (157)	$ (2,499)	$ (3,166)	$ 8,029	$ 70,078
Net income				497					387	884
Dividends				(252)						(252)
Shares issued under employee plans and related tax effects			315		32		486	(32)		801
Repurchases of common stock							(191)			(191)
Net change in cash flow hedges						3				3
Pension, postretirement and other related adjustments						14			5	19
Foreign currency translation adjustments						(102)			(29)	(131)
Change in net unrealized gains on securities available for sale						22				22
Other net increases in noncontrolling interests									404	404
BALANCE AT JUNE 30, 2012	$ 1,508	$ 20	$ 23,151	$ 40,586	$ 3,198	$ (220)	$ (2,204)	$ (3,198)	$ 8,796	$ 71,637

See Notes to Condensed Consolidated Financial Statements.

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MORGAN STANLEY

Condensed Consolidated Statements of Changes in Total Equity (Continued)

Six Months Ended June 30, 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				2,161					375	2,536
Dividends				(401)						(401)
Shares issued under employee plans and related tax effects			(1,072)		(80)		1,858	80		786
Repurchases of common stock							(283)			(283)
Net change in cash flow hedges						4				4
Pension, postretirement and other related adjustments						7				7
Foreign currency translation adjustments						122			9	131
Change in net unrealized gains on securities available for sale						14				14
Other increase in equity method investments			86							86
MUFG stock conversion	(8,089)	4	9,811	(1,726)						
Other net decreases in noncontrolling interests									(144)	(144)
BALANCE AT JUNE 30, 2011	$ 1,508	$ 20	$ 22,346	$ 38,637	$ 3,385	$ (320)	$ (2,484)	$ (3,385)	$ 8,436	$ 68,143

See Notes to Condensed Consolidated Financial Statements.

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MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Introduction and Basis of Presentation.

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

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.

Discontinued Operations.

Saxon. On October 24, 2011, the Company announced that it had reached an agreement to sell Saxon, a provider of servicing and subservicing of residential mortgage loans, to Ocwen Financial Corporation. During the first quarter of 2012, the transaction was restructured as a sale of Saxon s assets, which was substantially completed in the second quarter of 2012. The remaining operations of Saxon are expected to be wound down within the year. The Company expects to incur incremental wind-down costs in future periods. The results of Saxon are reported as discontinued operations within the Institutional Securities business segment for all periods presented.

Quilter. On April 2, 2012, the Company completed the sale of Quilter & Co. Ltd. (Quilter), its retail wealth management business in the United Kingdom (U.K.). The results of Quilter are reported as discontinued operations within the Global Wealth Management Group business segment for all periods presented.

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 and intangible assets, compensation, deferred tax assets, the outcome of litigation and tax matters, and other matters that affect the condensed consolidated financial statements and related disclosures. The Company believes that the estimates utilized in the preparation of the condensed consolidated financial statements are prudent and reasonable. Actual results could differ materially from these estimates.

Intercompany balances and transactions have been eliminated.

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MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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, 2011 (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 condensed 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 in 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 VIEs (i.e., entities that do not meet these criteria), the Company consolidates those entities where the Company has the power to make the decisions that most significantly affect the economic performance of the VIE and has the obligation to absorb losses or the right to receive benefits that could potentially be significant to the VIE, except for certain VIEs that are money market funds, investment companies or are entities qualifying for accounting purposes as investment companies. Generally, the Company consolidates those entities when it absorbs a majority of the expected losses or a majority of the expected residual returns, or both, of the entities.

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

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 fees and interest income, along with the associated interest expense, as one integrated activity.

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MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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, 2011 included in the Form 10-K.

During the six months ended June 30, 2012, other than the following, no other updates were made to the Company s significant accounting policies.

Financial Instruments and Fair Value Valuation Process.

The Valuation Review Group (VRG) within the Financial Control Group (FCG) is responsible for the Company s fair value valuation policies, processes and procedures. VRG is independent of the business units and reports to the Chief Financial Officer (CFO), who has final authority over the valuation of the Company s financial instruments. VRG implements valuation control processes to validate the fair value of the Company s financial instruments measured at fair value including those derived from pricing models. These control processes are designed to assure that the values used for financial reporting are based on observable inputs wherever possible. In the event that observable inputs are not available, the control processes are designed to assure that the valuation approach utilized is appropriate and consistently applied and the assumptions are reasonable.

The Company s control processes apply to financial instruments categorized in Level 1, Level 2 or Level 3 of the fair value hierarchy, unless otherwise noted. These control processes include:

Model Review. VRG, in conjunction with the Market Risk Department (MRD) and, where appropriate, the Credit Risk Management Department, both of which report to the Chief Risk Officer, independently review the valuation model s theoretical soundness, the appropriateness of the valuation methodology and calibration techniques developed by the business units using observable inputs. Where inputs are not observable, VRG reviews the appropriateness of the proposed valuation methodology to ensure it is consistent with how a market participant would arrive at the unobservable input. The valuation methodologies utilized in the absence of observable inputs may include extrapolation techniques and the use of comparable observable inputs. As part of the review, VRG develops a methodology to independently verify the fair value generated by the business unit s valuation model. Before trades are executed using new valuation models, those models are required to be independently reviewed. All of the Company s valuation models are subject to an independent annual VRG review.

Independent Price Verification. The business units are responsible for determining the fair value of financial instruments using approved valuation models and valuation methodologies. Generally on a monthly basis, VRG independently validates the fair values of financial instruments determined using valuation models by determining the appropriateness of the inputs used by the business units and testing compliance with the documented valuation methodologies approved in the model review process described above.

VRG uses recently executed transactions, other observable market data such as exchange data, broker/dealer quotes, third-party pricing vendors and aggregation services for validating the fair values of financial instruments generated using valuation models. VRG assesses the external sources and their valuation methodologies to determine if the external providers meet the minimum standards expected of a third-party pricing source. Pricing data provided by approved external sources is evaluated using a number of approaches; for example, by corroborating the external sources prices to executed trades, analyzing the methodology and assumptions used by the external source to generate a price and/or by evaluating how active the third-party pricing source (or originating sources used by the third-party pricing source) is in the market. Based on this analysis, VRG generates a ranking of the observable market data to ensure that the highest-ranked market data source is used to validate the business unit s fair value of financial instruments.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

For financial instruments categorized within Level 3 of the fair value hierarchy, VRG reviews the business unit s valuation techniques to ensure these are consistent with market participant assumptions.

The results of this independent price verification and any adjustments made by VRG to the fair value generated by the business units are presented to management of the three business segments (*i.e.*, Institutional Securities, Global Wealth Management Group and Asset Management), the CFO and the Chief Risk Officer on a regular basis.

Review of New Level 3 Transactions. VRG reviews the model and valuation methodology used to price all new material Level 3 transactions and both FCG and MRD management must approve the fair value of the trade that is initially recognized.

Securities Available for Sale Other-than-temporary Impairment.

For available for sale (AFS) debt securities, a credit loss exists if the present value of cash flows expected to be collected is less than the amortized cost basis of the security. When determining if a credit loss exists, the Company considers all relevant information including the length of time and the extent to which the fair value has been less than the amortized cost basis; adverse conditions specifically related to the security, an industry, or geographic area; changes in the financial condition of the issuer of the security, or in the case of an asset-backed debt security, changes in the financial condition of the underlying loan obligors; the historical and implied volatility of the fair value of the security; the payment structure of the debt security and the likelihood of the issuer being able to make payments that increase in the future; failure of the issuer of the security to make scheduled interest or principal payments; any changes to the rating of the security by a rating agency and recoveries or additional declines in fair value after the balance sheet date. When estimating the present value of expected cash flows, information shall include the remaining payment terms of the security, prepayment speeds, financial condition of the issuer(s), expected defaults and the value of any underlying collateral.

For AFS equity securities, the Company considers various factors including the intent and ability to hold the equity security for a period of time sufficient to allow for any anticipated recovery in market value in evaluating whether an other-than-temporary impairment (OTTI) exists. If the equity security is considered other-than-temporarily impaired, the security will be written down to fair value, with the full difference between fair value and cost recognized in earnings.

Condensed Consolidated Statements of Cash Flows.

For purposes of the condensed consolidated statements of cash flows, cash and cash equivalents consist of Cash and due from banks and Interest bearing deposits with banks, which are highly liquid investments with original maturities of three months or less and readily convertible to known amounts of cash, and are held for investment purposes. In the six months ended June 30, 2012, the Company s significant non-cash activities include approximately $2.4 billion and $1.0 billion, respectively of assets and liabilities disposed of, in connection with business dispositions. At June 30, 2011, Mitsubishi UFJ Financial Group, Inc. (MUFG) and the Company converted MUFG s outstanding Series B Non-Cumulative Non-Voting Perpetual Convertible Preferred Stock (Series B Preferred Stock) in the Company with a face value of $7.8 billion (carrying value $8.1 billion) into the Company s common stock. As a result of the adjustment to the conversion ratio, pursuant to the transaction agreement, the Company incurred a one-time, non-cash negative adjustment of approximately $1.7 billion in its calculation of basic and diluted earnings per share during the quarter and six months ended June 30, 2011 (see Note 14).

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Accounting Developments.

Reconsideration of Effective Control for Repurchase Agreements.

In April 2011, the Financial Accounting Standards Board (the FASB) issued accounting guidance that modifies the criteria that must be satisfied for a transfer of financial assets to be accounted for as a sale. If the transferor maintains effective control over the transferred assets, the transaction is to be accounted for as a financing. This guidance eliminates from the assessment of effective control (1) the criterion requiring the transferor to have the ability to repurchase or redeem the financial assets on substantially the agreed terms, even in the event of default by the transferee, and (2) the collateral maintenance implementation guidance related to that criterion. This guidance is effective for transfers occurring on and after January 1, 2012. The adoption of this accounting guidance did not have a material impact on the Company s condensed consolidated financial statements.

Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS.

In May 2011, the FASB issued an accounting update that clarifies existing fair value measurement guidance and changes certain principles or requirements for measuring fair value or disclosing information about fair value measurements. This update results in common principles and requirements for measuring fair value and for disclosing information about fair value measurement in accordance with U.S. GAAP and International Financial Reporting Standards (IFRS). The guidance became effective for the Company beginning on January 1, 2012. See Note 3 for additional disclosures as required by this accounting guidance.

Goodwill Impairment Test.

In September 2011, the FASB issued accounting guidance that simplifies how entities test goodwill for impairment. This guidance allows entities an option to first assess qualitative factors to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. Under that option, an entity no longer would be required to calculate the fair value of a reporting unit unless the entity determines, based on that qualitative assessment, that it is more likely than not that its fair value is less than its carrying amount. This guidance became effective for the Company beginning on January 1, 2012. 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

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

Other Sovereign Government Obligations.

Foreign sovereign government obligations are valued using quoted prices in active markets when available. These bonds are generally categorized in Level 1 of the fair value hierarchy. If the market is less active or prices are dispersed, these bonds are categorized in Level 2 of the fair value hierarchy.

Corporate and Other Debt.

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

Residential Mortgage-Backed Securities (RMBS), Commercial Mortgage-Backed Securities (CMBS) and other Asset-Backed Securities (ABS). RMBS, CMBS and other ABS may be valued based on price or spread data obtained from observed transactions or independent external parties such as vendors or brokers. When position-specific external price data are not observable, the fair value determination may require benchmarking to similar instruments and/or analyzing expected credit losses, default and recovery rates. 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 position-specific external price data are not observable, fair value is determined based on either benchmarking to similar instruments or cash flow models with yield curves, bond or single name credit default swap spreads and recovery rates as significant inputs. Corporate bonds are generally categorized in Level 2 of the fair value hierarchy; in instances where prices, spreads or any of the other aforementioned key inputs are unobservable, they are categorized in Level 3 of the fair value hierarchy.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Collateralized Debt Obligations (CDO). The Company holds cash CDOs that typically reference a tranche of an underlying synthetic portfolio of single name credit default swaps collateralized by corporate bonds (credit-linked notes) or cash portfolio of asset-backed securities (asset-backed CDOs). Credit correlation, a primary input used to determine the fair value of credit-linked notes, is usually unobservable and derived using a benchmarking technique. The other credit-linked note model inputs such as credit spreads, including collateral spreads, and interest rates are typically observable. Asset-backed CDOs are valued based on an evaluation of the market and model input parameters sourced from similar positions as indicated by primary and secondary market activity. Each asset-backed CDO position is evaluated independently taking into consideration available comparable market levels, underlying collateral performance and pricing, deal structures, as well as liquidity. Cash CDOs are categorized in Level 2 of the fair value hierarchy when either the credit correlation input is insignificant or comparable market transactions are observable. In instances where the credit correlation input is deemed to be significant or comparable market transactions are unobservable, cash CDOs are categorized in Level 3 of the fair value hierarchy.

Corporate Loans and Lending Commitments. The fair value of corporate loans is determined using recently executed transactions, market price quotations (where observable), implied yields from comparable debt, and market observable credit default swap spread levels obtained from independent external parties such as vendors and brokers adjusted for any basis difference between cash and derivative instruments, along with proprietary valuation models and default recovery analysis where such transactions and quotations are unobservable. The fair value of contingent corporate lending commitments is determined by using executed transactions on comparable loans and the anticipated market price based on pricing indications from syndicate banks and customers. The valuation of loans and lending commitments also takes into account fee income that is considered an attribute of the contract. Corporate loans and lending commitments are categorized in Level 2 of the fair value hierarchy except in instances where prices or significant spread inputs are unobservable, in which case they are categorized in Level 3 of the fair value hierarchy. Corporate loans and lending commitments are presented within Loans and lending commitments in the fair value hierarchy table.

Mortgage Loans. Mortgage loans are valued using observable prices based on transactional data or third party pricing for identical or comparable instruments, when available. Where position-specific external prices are not observable, the Company estimates fair value based on benchmarking to prices and rates observed in the primary market for similar loan or borrower types or based on the present value of expected future cash flows using its best estimates of the key assumptions, including forecasted credit losses, prepayment rates, forward yield curves and discount rates commensurate with the risks involved or a methodology that utilizes the capital structure and credit spreads of recent comparable securitization transactions. Mortgage loans valued based on observable market data for identical or comparable instruments are categorized in Level 2 of the fair value hierarchy. Where observable prices are not available, due to the subjectivity involved in the comparability assessment related to mortgage loan vintage, geographical concentration, prepayment speed and projected loss assumptions, mortgage loans are categorized in Level 3 of the fair value hierarchy. Mortgage loans are presented within Loans and lending commitments in the fair value hierarchy table.

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

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

ARS is determined using independent external market data where available and an internally developed methodology to discount for the lack of liquidity and non-performance risk.

Inputs that impact the valuation of SLARS are independent external market data, the underlying collateral types, level of seniority in the capital structure, amount of leverage in each structure, credit rating and liquidity considerations. Inputs that impact the valuation of MARS are recently executed transactions, the maximum rate, quality of underlying issuers/insurers and evidence of issuer calls/prepayment. ARS are generally categorized in Level 2 of the fair value hierarchy as the valuation technique relies on observable external data. SLARS and MARS are presented within Asset-backed securities and State and municipal securities, respectively, in the fair value hierarchy table.

Corporate Equities.

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

Unlisted Equity Securities. Unlisted equity securities are valued based on an assessment of each underlying security, considering rounds of financing and third-party transactions, discounted cash flow analyses and market-based information, including comparable company transactions, trading multiples and changes in market outlook, among other factors. These securities are generally categorized in Level 3 of the fair value hierarchy.

Fund Units. Listed fund units are generally marked to the exchange-traded price or net asset value (NAV) and are categorized in Level 1 of the fair value hierarchy if actively traded on an exchange or in Level 2 of the fair value hierarchy if trading is not active. Unlisted fund units are generally marked to NAV and categorized as Level 2; however, positions which are not redeemable at the measurement date or in the near future are categorized in Level 3 of the fair value hierarchy.

Derivative and Other Contracts.

Listed Derivative Contracts. Listed derivatives that are actively traded are valued based on quoted prices from the exchange and are categorized in Level 1 of the fair value hierarchy. Listed derivatives that are not actively traded are valued using the same approaches as those applied to over-the-counter (OTC) derivatives; they are generally categorized in Level 2 of the fair value hierarchy.

OTC Derivative Contracts. OTC derivative contracts include forward, swap and option contracts related to interest rates, foreign currencies, credit standing of reference entities, equity prices or commodity prices.

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

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

Derivative interests in credit default swaps on certain mortgage-backed or asset-backed securities, for which observability of external price data is limited, are valued based on an evaluation of the market and model input parameters sourced from similar positions as indicated by primary and secondary market activity. Each position is evaluated independently taking into consideration available comparable market levels as well as cash-synthetic basis, or the underlying collateral performance and pricing, behavior of the tranche under various cumulative loss and prepayment scenarios, deal structures (*e.g.*, non-amortizing reference obligations, call features, etc.) and liquidity. While these factors may be supported by historical and actual external observations, the determination of their value as it relates to specific positions nevertheless requires significant judgment.

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

The Company trades various derivative structures with commodity underlyings. Depending on the type of structure, the model inputs generally include interest rate yield curves, commodity underlier price curves, implied volatility of the underlying commodities and, in some cases, the implied correlation between these inputs. The fair value of these products is determined using executed trades and broker and consensus data to provide values for the aforementioned inputs. Where these inputs are unobservable, relationships to observable commodities and data points, based on historic and/or implied observations, are employed as a technique to estimate the model input values. Commodity derivatives are generally 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 direct investments in equity securities as well as investments in private equity funds, real estate funds and hedge funds, which include investments made in connection with certain employee deferred compensation plans. Direct investments are presented in the fair value hierarchy table as Principal investments and Other. Initially, the transaction price is generally considered by the Company as the exit price and is the Company s best estimate of fair value.

After initial recognition, in determining the fair value of non-exchange-traded internally and externally managed funds, the Company generally considers the NAV of the fund provided by the fund manager to be the best estimate of fair value. For non-exchange-traded investments either held directly or held within internally managed funds, fair value after initial recognition is based on an assessment of each underlying

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

investment, considering rounds of financing and third-party transactions, discounted cash flow analyses and market-based information, including comparable company transactions, trading multiples and changes in market outlook, among other factors. Exchange-traded direct equity investments are generally valued based on quoted prices from the exchange.

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

Physical Commodities.

The Company trades various physical commodities, including crude oil and refined products, natural gas, base and precious metals and agricultural products. Fair value for physical commodities is determined using observable inputs, including broker quotations and published indices. Physical commodities are categorized in Level 2 of the fair value hierarchy; in instances where significant inputs are unobservable, they are categorized in Level 3 of the fair value hierarchy.

Securities Available for Sale.

Securities available for sale are composed of U.S. government and agency securities (*e.g.*, U.S. Treasury securities, agency-issued debt, agency mortgage pass-through securities and collateralized mortgage obligations), Federal Family Education Loan Program (FFELP) student loan asset-backed securities, auto loan asset-backed securities, corporate bonds and equity securities. Actively traded U.S. Treasury securities, non-callable agency-issued debt securities and equity securities are generally categorized in Level 1 of the fair value hierarchy. Callable agency-issued debt securities, agency mortgage pass-through securities, collateralized mortgage obligations and FFELP student loan asset-backed securities, auto loan asset-backed securities and corporate bonds are generally categorized in Level 2 of the fair value hierarchy. For further information on securities available for sale, see Note 4.

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.

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 fixed income 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 prices. 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.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Securities Purchased under Agreements to Resell, and Securities Sold under Agreements to Repurchase.

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

The following fair value hierarchy tables present information about the Company s assets and liabilities measured at fair value on a recurring basis at June 30, 2012 and December 31, 2011.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Assets and Liabilities Measured at Fair Value on a Recurring Basis at June 30, 2012.

	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 June 30, 2012
Assets at Fair Value					
Financial instruments owned:					
U.S. government and agency securities:					
U.S. Treasury securities	$ 25,656	$	$	$	$ 25,656
U.S. agency securities	3,985	24,497			28,482
Total U.S. government and agency securities	29,641	24,497			54,138
Other sovereign government obligations	28,744	4,883	1		33,628
Corporate and other debt:					
State and municipal securities		2,799	3		2,802
Residential mortgage-backed securities		1,500	24		1,524
Commercial mortgage-backed securities		1,240	256		1,496
Asset-backed securities		965	9		974
Corporate bonds		18,142	745		18,887
Collateralized debt obligations		682	1,457		2,139
Loans and lending commitments		12,771	7,794		20,565
Other debt		9,357	13		9,370
Total corporate and other debt		47,456	10,301		57,757
Corporate equities(1)	44,200	1,664	482		46,346
Derivative and other contracts:					
Interest rate contracts	807	870,435	4,597		875,839
Credit contracts		92,251	9,213		101,464
Foreign exchange contracts	11	49,876	337		50,224
Equity contracts	1,493	42,578	834		44,905
Commodity contracts	6,324	24,654	2,539		33,517
Other		126			126
Netting(2)	(3,943)	(980,633)	(9,430)	(77,726)	(1,071,732)
Total derivative and other contracts	4,692	99,287	8,090	(77,726)	34,343
Investments:					
Private equity funds			2,005		2,005
Real estate funds		6	1,326		1,332
Hedge funds		349	533		882
Principal investments	118	93	3,047		3,258
Other	143	66	543		752
Total investments	261	514	7,454		8,229
Physical commodities		6,141			6,141

Total financial instruments owned	107,538	184,442	26,328	(77,726)	240,582
Securities available for sale	11,561	19,881			31,442
Securities received as collateral	12,126	24			12,150
Federal funds sold and securities purchased under agreements to resell		622			622
Intangible assets(3)			8		8
Total assets measured at fair value	$ 131,225	$ 204,969	$ 26,336	$ (77,726)	$ 284,804

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3) (dollars in millions)	Counterparty and Cash Collateral Netting	Balance at June 30, 2012
Liabilities at Fair Value					
Deposits	$	$ 1,965	$	$	$ 1,965
Commercial paper and other short-term borrowings		838	2		840
Financial instruments sold, not yet purchased:					
U.S. government and agency securities:					
U.S. Treasury securities	26,197				26,197
U.S. agency securities	1,421	152			1,573
Total U.S. government and agency securities	27,618	152			27,770
Other sovereign government obligations	20,863	1,345			22,208
Corporate and other debt:					
State and municipal securities		7			7
Residential mortgage-backed securities		8	4		12
Corporate bonds		7,570	127		7,697
Collateralized debt obligations		159	1		160
Unfunded lending commitments		866	51		917
Other debt		185	63		248
Total corporate and other debt		8,795	246		9,041
Corporate equities(1)	28,695	779	47		29,521
Derivative and other contracts:					
Interest rate contracts	859	840,040	4,769		845,668
Credit contracts		90,845	5,371		96,216
Foreign exchange contracts	14	53,049	561		53,624
Equity contracts	1,530	45,501	2,007		49,038
Commodity contracts	7,352	24,582	1,602		33,536
Other		43	27		70
Netting(2)	(3,943)	(980,633)	(9,430)	(49,211)	(1,043,217)
Total derivative and other contracts	5,812	73,427	4,907	(49,211)	34,935
Total financial instruments sold, not yet purchased	82,988	84,498	5,200	(49,211)	123,475
Obligation to return securities received as collateral	17,047	31			17,078
Securities sold under agreements to repurchase		161	185		346
Other secured financings		8,766	470		9,236
Long-term borrowings	1	40,271	2,210		42,482
Total liabilities measured at fair value	$ 100,036	$ 136,530	$ 8,067	$ (49,211)	$ 195,422

(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 June 30, 2012.

For assets and liabilities that were transferred between Level 1 and Level 2 during the period, fair values are ascribed as if the assets or liabilities had been transferred as of the beginning of the period.

Financial instruments owned Derivative and other contracts and Financial instruments sold, not yet purchased Derivative and other contracts. During the quarter ended June 30, 2012, the Company reclassified approximately $1.5 billion of derivative assets and approximately $1.7 billion of derivative liabilities from Level 2 to Level 1 as these listed derivatives became actively traded and were valued based on quoted prices from the exchange. Also during the quarter ended June 30, 2012, the Company reclassified approximately $0.5

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

billion of derivative assets and approximately $0.7 billion of derivative liabilities from Level 1 to Level 2 as transactions in these contracts did not occur with sufficient frequency and volume to constitute an active market.

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

Financial instruments owned Derivative and other contracts and Financial instruments sold, not yet purchased Derivative and other contracts. During the six months ended June 30, 2012, the Company reclassified approximately $2.0 billion of derivative assets and approximately $1.8 billion of derivative liabilities from Level 2 to Level 1 as these listed derivatives became actively traded and were valued based on quoted prices from the exchange. Also during the six months ended June 30, 2012, the Company reclassified approximately $0.4 billion of derivative assets and approximately $0.4 billion of derivative liabilities from Level 1 to Level 2 as transactions in these contracts did not occur with sufficient frequency and volume to constitute an active market.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Assets and Liabilities Measured at Fair Value on a Recurring Basis at December 31, 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 December 31, 2011
			(dollars in millions)		
Assets at Fair Value					
Financial instruments owned:					
U.S. government and agency securities:					
U.S. Treasury securities	$ 38,769	$ 1	$	$	$ 38,770
U.S. agency securities	4,332	20,339	8		24,679
Total U.S. government and agency securities	43,101	20,340	8		63,449
Other sovereign government obligations	22,650	6,290	119		29,059
Corporate and other debt:					
State and municipal securities		2,261			2,261
Residential mortgage-backed securities		1,304	494		1,798
Commercial mortgage-backed securities		1,686	134		1,820
Asset-backed securities		937	31		968
Corporate bonds		25,873	675		26,548
Collateralized debt obligations		1,711	980		2,691
Loans and lending commitments		14,854	9,590		24,444
Other debt		8,265	128		8,393
Total corporate and other debt		56,891	12,032		68,923
Corporate equities(1)	45,173	2,376	417		47,966
Derivative and other contracts:					
Interest rate contracts	1,493	906,082	5,301		912,876
Credit contracts		123,689	15,102		138,791
Foreign exchange contracts		61,770	573		62,343
Equity contracts	929	44,558	800		46,287
Commodity contracts	6,356	31,246	2,176		39,778
Other		292	306		598
Netting(2)	(7,596)	(1,045,912)	(11,837)	(87,264)	(1,152,609)
Total derivative and other contracts	1,182	121,725	12,421	(87,264)	48,064
Investments:					
Private equity funds		7	1,936		1,943
Real estate funds		5	1,213		1,218
Hedge funds		473	696		1,169
Principal investments	161	104	2,937		3,202
Other	141	21	501		663
Total investments	302	610	7,283		8,195
Physical commodities		9,651	46		9,697

Total financial instruments owned	112,408	217,883	32,326	(87,264)	275,353
Securities available for sale	13,437	17,058			30,495
Securities received as collateral	11,530	121			11,651
Federal funds sold and securities purchased under agreements to resell		112			112
Intangible assets(3)			133		133
Total assets measured at fair value	$ 137,375	$ 235,174	$ 32,459	$ (87,264)	$ 317,744

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Counterparty and Cash Collateral Netting	Balance at December 31, 2011
			(dollars in millions)		
Liabilities at Fair Value					
Deposits	$	$ 2,101	$	$	$ 2,101
Commercial paper and other short-term borrowings		1,337	2		1,339
Financial instruments sold, not yet purchased:					
U.S. government and agency securities:					
U.S. Treasury securities	17,776				17,776
U.S. agency securities	1,748	106			1,854
Total U.S. government and agency securities	19,524	106			19,630
Other sovereign government obligations	14,981	2,152	8		17,141
Corporate and other debt:					
State and municipal securities		3			3
Residential mortgage-backed securities			355		355
Commercial mortgage-backed securities		14			14
Corporate bonds		6,217	219		6,436
Collateralized debt obligations		3			3
Unfunded lending commitments		1,284	85		1,369
Other debt		157	73		230
Total corporate and other debt		7,678	732		8,410
Corporate equities(1)	24,347	149	1		24,497
Derivative and other contracts:					
Interest rate contracts	1,680	873,466	4,881		880,027
Credit contracts		121,438	9,288		130,726
Foreign exchange contracts		64,218	530		64,748
Equity contracts	877	45,375	2,034		48,286
Commodity contracts	7,144	31,248	1,606		39,998
Other		879	1,396		2,275
Netting(2)	(7,596)	(1,045,912)	(11,837)	(54,262)	(1,119,607)
Total derivative and other contracts	2,105	90,712	7,898	(54,262)	46,453
Physical commodities		16			16
Total financial instruments sold, not yet purchased	60,957	100,813	8,639	(54,262)	116,147
Obligation to return securities received as collateral	15,267	127			15,394
Securities sold under agreements to repurchase		8	340		348
Other secured financings		14,024	570		14,594
Long-term borrowings	10	38,050	1,603		39,663
Total liabilities measured at fair value	$ 76,234	$ 156,460	$ 11,154	$ (54,262)	$ 189,586

(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 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 June 30, 2011.

Financial instruments owned Derivative and other contracts and Financial instruments sold, not yet purchased Derivative and other contracts. During the quarter ended June 30, 2011, the Company reclassified approximately $0.9 billion of derivative assets and approximately $1.3 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.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Transfers Between Level 1 and Level 2 During the Six Months Ended June 30, 2011.

Financial instruments owned Derivative and other contracts and Financial instruments sold, not yet purchased Derivative and other contracts. During the six months ended June 30, 2011, the Company reclassified approximately $1.1 billion of derivative assets and approximately $0.9 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.

Level 3 Assets and Liabilities Measured at Fair Value on a Recurring Basis.

The following tables present additional information about Level 3 assets and liabilities measured at fair value on a recurring basis for the quarter and six months ended June 30, 2012 and 2011, respectively. Level 3 instruments may be hedged with instruments classified in Level 1 and Level 2. As a result, the realized and unrealized gains (losses) for assets and liabilities within the Level 3 category presented in the tables below do not reflect the related realized and unrealized gains (losses) on hedging instruments that have been classified by the Company within the Level 1 and/or Level 2 categories.

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

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

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

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

Financial instruments sold, not yet purchased:									
Corporate and other debt:									
Residential mortgage-backed securities	61	57						4	57
Corporate bonds	193	32	(164)	139			(9)	127	59
Collateralized debt obligations			(1)	2				1	
Unfunded lending commitments	60	9						51	9
Other debt	33	16	(2)	48				63	16
Total corporate and other debt	347	114	(167)	189			(9)	246	141
Corporate equities	2	(27)	(13)	25			6	47	(26)
Obligation to return securities									
Securities sold under agreements to repurchase	186	1						185	1
Other secured financings	594	(4)			41	(152)	(17)	470	(4)
Long-term borrowings	2,143	(59)			315	(284)	(23)	2,210	(146)

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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 $18 million related to Financial instruments owned Investments, which is included in Principal transactions Investments.
(2) Amounts represent unrealized gains (losses) for the quarter ended June 30, 2012 related to assets and liabilities still outstanding at June 30, 2012.
(3) Net derivative and other contracts represent 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.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

(dollars in millions)

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

Intangible assets	133	(39)	(84)	(2)	8	(8)

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	Beginning Balance at December 31, 2011	Total Realized and Unrealized Gains (Losses)(1)	Purchases	Sales	Issuances	Settlements	Net Transfers	Ending Balance at June 30, 2012	Unrealized Gains (Losses) for Level 3 Assets/ Liabilities Outstanding at June 30, 2012(2)
					(dollars in millions)				
Liabilities at Fair Value									
Commercial paper and other short-term borrowings	$ 2	$	$	$	$	$	$	$ 2	$
Financial instruments sold, not yet purchased:									
Other sovereign government obligations	8		(8)	1			(1)		
Corporate and other debt:									
Residential mortgage-backed securities	355	(4)	(355)					4	(4)
Corporate bonds	219	(25)	(203)	111			(25)	127	49
Collateralized debt obligations							1	1	
Unfunded lending commitments	85	34						51	34
Other debt	73	11	(1)	46		(55)	11	63	13
Total corporate and other debt	732	16	(559)	157		(55)	(13)	246	92
Corporate equities	1	(21)		27			(2)	47	(53)
Securities sold under agreements to repurchase	340	3					(152)	185	3
Other secured financings	570	(19)			52	(149)	(22)	470	(19)
Long-term borrowings	1,603	(190)			444	(102)	75	2,210	(214)

(1) Total realized and unrealized gains (losses) are primarily included in Principal transactions Trading in the condensed consolidated statements of income except for $90 million related to Financial instruments owned Investments, which is included in Principal transactions Investments.
(2) Amounts represent unrealized gains (losses) for the six months ended June 30, 2012 related to assets and liabilities still outstanding at June 30, 2012.
(3) Net derivative and other contracts represent 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 Net derivative and other contracts. The net loss in Net derivative and other contracts was primarily driven by tightening of credit spreads on underlying reference entities of basket credit default swaps.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Changes in Level 3 Assets and Liabilities Measured at Fair Value on a Recurring Basis for the Quarter Ended June 30, 2011.

	Beginning Balance at March 31, 2011	Total Realized and Unrealized Gains (Losses)(1)	Purchases	Sales	Issuances	Settlements	Net Transfers	Ending Balance at June 30, 2011	Unrealized Gains (Losses) for Level 3 Assets/ Liabilities Outstanding at June 30, 2011(2)
					(dollars in millions)				
Assets at Fair Value									
Financial instruments owned:									
U.S. agency securities	$ 57	$ 1	$ 29	$ (72)	$	$	$ (13)	$ 2	$
Other sovereign government obligations	126	9		(4)			1	132	9
Corporate and other debt:									
State and municipal securities	4		21	(25)					
Residential mortgage-backed securities	361	(10)	101	(54)			111	509	
Commercial mortgage-backed securities	132	(21)	81	(10)			(46)	136	(1)
Asset-backed securities		259	4				35	298	259
Corporate bonds	1,366	(93)	216	(353)			43	1,179	(57)
Collateralized debt obligations	1,593	17	357	(352)		(19)	54	1,650	14
Loans and lending commitments	11,218	(168)	1,898	(676)		(1,285)	(567)	10,420	(236)
Other debt	165	5	6	(13)				163	1
Total corporate and other debt	14,839	(11)	2,684	(1,483)		(1,304)	(370)	14,355	(20)
Corporate equities	502	11	127	(144)			(35)	461	24
Net derivative and other contracts(3):									
Interest rate contracts	(58)	472	22		(45)	(62)	(12)	317	376
Credit contracts	6,079	1,002	1,089		(109)	(737)	68	7,392	958
Foreign exchange contracts	46	(34)	2			30		44	(39)
Equity contracts	(645)	58	77	(7)	(1,163)	52	(33)	(1,661)	60
Commodity contracts	330	(129)	330		(146)	(99)	30	316	(139)
Other	(508)	(74)	2		(112)	296	(1)	(397)	(81)
Total net derivative and other contracts	5,244	1,295	1,522	(7)	(1,575)	(520)	52	6,011	1,135
Investments:									
Private equity funds	2,006	153	91	(90)				2,160	129
Real estate funds	1,251	81	17	(59)				1,290	148
Hedge funds	871	(17)	20	(120)			73	827	(17)
Principal investments	3,057	182	75	(108)			(86)	3,120	(15)
Other	398	2	2	(3)			126	525	(2)
Total investments	7,583	401	205	(380)			113	7,922	243

Physical commodities		(48)	721		673	(48)
Intangible assets	144	(11)	1	(1)	133	(11)

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	Beginning Balance at March 31, 2011	Total Realized and Unrealized Gains (Losses)(1)	Purchases	Sales	Issuances	Settlements	Net Transfers	Ending Balance at June 30, 2011	Unrealized Gains (Losses) for Level 3 Assets/ Liabilities Outstanding at June 30, 2011(2)
					(dollars in millions)				
Liabilities at Fair Value									
Commercial paper and other short-term borrowings	$ 4	$ 7	$	$	$ 29	$ (3)	$	$ 23	$ 7
Financial instruments sold, not yet purchased:									
Corporate and other debt:									
Residential mortgage-backed securities		(13)	(13)	41				41	(13)
Corporate bonds	150	49	(324)	336			(78)	35	60
Collateralized debt obligations	2		(1)				(1)		
Unfunded lending commitments	171	(69)						240	(69)
Other debt	180	13		13			(2)	178	13
Total corporate and other debt	503	(20)	(338)	390			(81)	494	(9)
Corporate equities	9	13	(8)	12			1	1	3
Securities sold under agreements to repurchase	352	(5)			1			358	(5)
Other secured financings	605	(9)			145	(17)		742	(9)
Long-term borrowings	1,374	38			215	(175)	(125)	1,251	20

(1) Total realized and unrealized gains (losses) are primarily included in Principal transactions Trading in the condensed consolidated statements of income except for $401 million related to Financial instruments owned Investments, which is included in Principal transactions Investments.

(2) Amounts represent unrealized gains (losses) for the quarter ended June 30, 2011 related to assets and liabilities still outstanding at June 30, 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 June 30, 2011, the Company reclassified approximately $1.2 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 $0.8 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.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Changes in Level 3 Assets and Liabilities Measured at Fair Value on a Recurring Basis for the Six Months Ended June 30, 2011.

	Beginning Balance at December 31, 2010	Total Realized and Unrealized Gains (Losses)(1)	Purchases	Sales	Issuances	Settlements	Net Transfers	Ending Balance at June 30, 2011	Unrealized Gains (Losses) for Level 3 Assets/ Liabilities Outstanding at June 30, 2011(2)
	(dollars in millions)								
Assets at Fair Value									
Financial instruments owned:									
U.S. agency securities	$ 13	$	$ 34	$ (40)	$	$	$ (5)	$ 2	$
Other sovereign government obligations	73	8	56				(5)	132	8
Corporate and other debt:									
State and municipal securities	110	(1)		(96)			(13)		
Residential mortgage-backed securities	319	(62)	279	(193)		(1)	167	509	(71)
Commercial mortgage-backed securities	188	(19)	96	(30)			(99)	136	(18)
Asset-backed securities	13	259	13	(17)			30	298	258
Corporate bonds	1,368	(26)	273	(409)		34	(61)	1,179	42
Collateralized debt obligations	1,659	273	641	(862)		(55)	(6)	1,650	70
Loans and lending commitments	11,666	213	2,321	(537)		(2,038)	(1,205)	10,420	212
Other debt	193		5	(33)			(2)	163	(9)
Total corporate and other debt	15,516	637	3,628	(2,177)		(2,060)	(1,189)	14,355	484
Corporate equities	484	(207)	219	(176)			141	461	1
Net derivative and other contracts(3):									
Interest rate contracts	424	702	19		(704)	(192)	68	317	600
Credit contracts	6,594	388	1,148		(197)	(614)	73	7,392	772
Foreign exchange contracts	46	(159)	1			159	(3)	44	(130)
Equity contracts	(762)	105	119		(1,236)	98	15	(1,661)	96
Commodity contracts	188	165	455		(321)	(281)	110	316	153
Other	(913)	117	2		(116)	428	85	(397)	110
Total net derivative and other contracts	5,577	1,318	1,744		(2,574)	(402)	348	6,011	1,601
Investments:									
Private equity funds	1,986	260	88	(245)			71	2,160	209
Real estate funds	1,176	145	31	(62)				1,290	255
Hedge funds	901	(25)	15	(172)			108	827	(25)
Principal investments	3,131	242	(26)	(195)			(32)	3,120	(105)
Other	560	51	(4)	(11)			(71)	525	41
Total investments	7,754	673	104	(685)			76	7,922	375
Physical commodities		(48)	721					673	(48)

Securities received as collateral	1			(1)					
Intangible assets	157	(26)	5	(1)	(1)	(1)		133	(26)

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	Beginning Balance at December 31, 2010	Total Realized and Unrealized Gains (Losses)(1)	Purchases	Sales	Issuances	Settlements	Net Transfers	Ending Balance at June 30, 2011	Unrealized Gains (Losses) for Level 3 Assets/ Liabilities Outstanding at June 30, 2011(2)
					(dollars in millions)				
Liabilities at Fair Value									
Deposits	$ 16	$ 2	$	$	$	$ (14)	$	$	$
Commercial paper and other short-term borrowings	2	7			29	(1)		23	7
Financial instruments sold, not yet purchased:									
Corporate and other debt:									
Residential mortgage-backed securities		(13)	(12)	40				41	(13)
Commercial mortgage-backed securities		1		1					
Corporate bonds	44	40	(367)	426			(28)	35	30
Unfunded lending commitments	263	23						240	23
Other debt	194	4	(10)	14			(16)	178	4
Total corporate and other debt	501	55	(389)	481			(44)	494	44
Corporate equities	15	5	(19)	6			4	1	3
Obligation to return securities received as collateral	1		(1)						
Securities sold under agreements to repurchase	351	(6)	1					358	(8)
Other secured financings	1,016	(12)			142	(122)	(306)	742	(12)
Long-term borrowings	1,316	(28)			388	(342)	(139)	1,251	(22)

(1) Total realized and unrealized gains (losses) are primarily included in Principal transactions Trading in the condensed consolidated statements of income except for $673 million related to Financial instruments owned Investments, which is included in Principal transactions Investments.
(2) Amounts represent unrealized gains (losses) for the six months ended June 30, 2011 related to assets and liabilities still outstanding at June 30, 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 six months ended June 30, 2011, the Company reclassified approximately $1.8 billion of certain Corporate and other debt, primarily corporate loans, from Level 3 to Level 2. The Company reclassified these corporate loans as external prices and/or spread inputs for these instruments became observable.

The Company also reclassified approximately $0.6 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.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Quantitative Information about and Sensitivity of Significant Unobservable Inputs used in Recurring Level 3 Fair Value Measurements at June 30, 2012

The disclosures below provide information on the valuation techniques, significant unobservable inputs and their ranges for each major category of assets and liabilities measured at fair value on a recurring basis with a significant Level 3 balance. The level of aggregation and breadth of products cause the range of inputs to be wide and not evenly distributed across the inventory. Further, the range of unobservable inputs may differ across firms in the financial services industry because of diversity in the types of products included in each firm s inventory. The disclosures below also include qualitative information on the sensitivity of the fair value measurements to changes in the significant unobservable inputs.

	Balance at June 30, 2012 (dollars in millions)	Valuation Technique(s)	Significant Unobservable Input(s) / Sensitivity of the Fair Value to Changes in the Unobservable Inputs	Range(1)
Assets				
Financial instruments owned:				
Corporate and other debt:				
Commercial mortgage-backed securities	$ 256	Comparable pricing(2)	Comparable bond price / (A)	40 to 98 points
Corporate bonds	745	Comparable pricing(2)	Comparable bond price / (A)	2 to 138 points
Collateralized debt obligations	1,457	Comparable pricing(2)	Comparable bond price / (A)	16 to 84 points
		Correlation model	Credit correlation / (B)	25 to 58%
Loans and lending commitments	7,794	Corporate loan model	Credit spread / (C)	33 to 1,255 basis points
		Option model	At the money volatility / (C)	45 to 47%
		Comparable pricing(2)	Comparable loan price / (A)	55 to 100 points
Corporate equities(3)	482	Net asset value	Discount to net asset value /(C)	0 to 33%
		Discounted cash flow	Implied weighted average cost of capital / (C)	10 to 18%
		Market approach	Earnings before interest, taxes, depreciation and amortization (EBITDA) multiple / (A)	3 to 21 times
Net derivative and other contracts:				
Interest rate contracts	(172)	Option model	Interest rate volatility concentration liquidity multiple / (C)(D)	0 to 12 times
			Interest rate volatility skew / (A)(D)	15 to 90%
Credit contracts	3,842	Comparable pricing(2)	Cash synthetic basis / (C)	2 to 10 points
			Comparable bond price / (C)	3 to 75 points
		Correlation model	Credit correlation / (B)	21 to 94%
Foreign exchange contracts(4)	(224)	Option model	Comparable bond price / (A)(D)	5 to 96 points
			Interest rate quanto correlation / (A)(D)	-14 to 24%
			Interest rate - credit spread correlation / (A)(D)	-2 to 46%
			Interest rate - Foreign exchange correlation / (A)(D)	25 to 67%
			Interest rate volatility skew / (A)(D)	15 to 90%
Equity contracts(4)	(1,173)	Option model	At the money volatility / (C)(D)	2 to 32%
			Volatility skew / (C)(D)	-5 to 0%
			Equity - Equity correlation / (C)(D)	40 to 96%
			Equity - Foreign exchange correlation / (C)(D)	-45 to 50%
			Equity - Interest rate correlation / (C)(D)	-62 to 79%
Commodity contracts	937	Option model	Forward power price / (C)(D)	$34 to $ 80 per Megawatt hour
			Commodity volatility / (A)(D)	20 to 100%
			Cross commodity correlation / (C)(D)	49 to 91%

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	Balance at June 30, 2012 (dollars in millions)	Valuation Technique(s)	Significant Unobservable Input(s) / Sensitivity of the Fair Value to Changes in the Unobservable Inputs	Range(1)
Investments (3):				
Principal investments	3,047	Discounted cash flow	Implied weighted average cost of capital / (C)(D)	9 to 18%
			Exit multiple / (A)(D)	5 to 10 times
		Discounted cash flow	Capitalization rate / (C)(D)	5 to 10%
			Equity discount rate / (C)(D)	15 to 35%
		Market approach	EBITDA multiple / (A)	3 to 10 times
Other	543	Discounted cash flow	Implied weighted average cost of capital / (C)(D)	12 to 17%
			Exit multiple / (A)(D)	5 to 10 times
		Market approach	EBITDA multiple / (A)	3 to 14 times
Liabilities				
Financial instruments sold, not yet purchased:				
Corporate and other debt:				
Corporate bonds	$ 127	Comparable pricing(2)	Comparable bond price /(A)	5 to 125 points
Unfunded lending commitments	51	Corporate loan model	Credit spread / (C)	43 to 887 basis points
Other debt	63	Comparable pricing(2)	Comparable bond price /(A)	100 points
			Comparable bond price /(C)	2 to 10 points
Securities sold under agreements to repurchase	185	Discounted cash flow	Funding spread / (A)	95 to 362 basis points
Other secured financings	470	Comparable pricing(2)	Comparable bond price /(A)	86 to 138 points
		Discounted cash flow	Funding spread / (A)	314 to 325 basis points
Long-term borrowings	2,210	Option model	At the money volatility /(A)(D)	10 to 15%
			Volatility skew / (A)(D)	-2 to 0%
			Equity - Equity correlation / (C)(D)	50 to 97%
			Equity - Foreign exchange correlation / (A)(D)	-70 to -15%

(1) The ranges of significant unobservable inputs are represented in points, percentages, basis points, times or megawatt hours. Points are a percentage of par; for example, 98 points would be 98% of par. A basis point equals 1/100th of 1%; for example, 1,255 basis points would equal 12.55%.
(2) Prices for the identical instrument are not available and significant subjectivity may be involved when fair value is determined using pricing data available for comparable instruments.
(3) Investments in funds measured using an unadjusted net asset value are excluded.
(4) Includes derivative contracts with multiple risks (i.e., hybrid products).

Sensitivity of the fair value to changes in the unobservable inputs:

(A) Significant increase (decrease) in the unobservable input in isolation would result in a significantly higher (lower) fair value measurement.
(B) Significant changes in credit correlation may result in a significantly higher or lower fair value measurement. Increasing (decreasing) correlation drives a redistribution of risk within the capital structure such that junior tranches become less (more) risky and senior tranches become more (less) risky.
(C) Significant increase (decrease) in the unobservable input in isolation would result in a significantly lower (higher) fair value measurement.
(D) There are no predictable relationships between the significant unobservable inputs.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Fair Value of Investments that Calculate Net Asset Value.

The Company s Investments measured at fair value were $8,229 million and $8,195 million at June 30, 2012 and December 31, 2011, 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 June 30, 2012 and December 31, 2011, respectively.

	At June 30, 2012		At December 31, 2011	
	Fair Value	Unfunded Commitment	Fair Value	Unfunded Commitment
	(dollars in millions)			
Private equity funds	$ 2,005	$ 765	$ 1,906	$ 938
Real estate funds	1,332	261	1,188	448
Hedge funds(1):				
Long-short equity hedge funds	472		545	5
Fixed income/credit-related hedge funds	22		124	
Event-driven hedge funds	62		163	
Multi-strategy hedge funds	326	2	335	
Total	$ 4,219	$ 1,028	$ 4,261	$ 1,391

(1) Fixed income/credit-related hedge funds, event-driven hedge funds, and multi-strategy hedge funds are redeemable at least on a six-month period basis primarily with a notice period of 90 days or less. At June 30, 2012, approximately 37% of the fair value amount of long-short equity hedge funds is redeemable at least quarterly, 36% 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 at June 30, 2012 is primarily greater than six months. At December 31, 2011, approximately 38% of the fair value amount of long-short equity hedge funds is redeemable at least quarterly, 32% is redeemable every six months and 30% of these funds have a redemption frequency of greater than six months. The notice period for long-short equity hedge funds at December 31, 2011 is primarily greater than six months.

Private Equity Funds. Amount includes several private equity funds that pursue multiple strategies including leveraged buyouts, venture capital, infrastructure growth capital, distressed investments, and mezzanine capital. In addition, the funds may be structured with a focus on specific domestic or foreign geographic regions. These investments are generally not redeemable with the funds. Instead, the nature of the investments in this category is that distributions are received through the liquidation of the underlying assets of the fund. At June 30, 2012, it is estimated that 6% of the fair value of the funds will be liquidated in the next five years, another 31% of the fair value of the funds will be liquidated between five to 10 years and the remaining 63% 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 June 30, 2012, it is estimated that 4% of the fair value of the funds will be liquidated within the next five years, another 41% of the fair value of the funds will be liquidated between five to 10 years and the remaining 55% 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.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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 9% of the fair value of the investments in this category cannot be redeemed currently because the investments include certain initial period lock-up restrictions. The remaining restriction period for these investments subject to lock-up restrictions was three years or less at June 30, 2012. Investments representing approximately 7% of the fair value of the investments in long-short equity hedge funds cannot be redeemed currently because an exit restriction has been imposed by the hedge fund manager. The restriction period for these investments subject to an exit restriction was primarily one year or less at June 30, 2012.

Fixed Income/Credit-Related Hedge Funds. Amount includes investments in hedge funds that employ long-short, distressed or relative value strategies in order to benefit from investments in undervalued or overvalued securities that are primarily debt or credit related. At June 30, 2012, 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 subject to lock-up restrictions was primarily one year or less at June 30, 2012.

Event-Driven Hedge Funds. Amount includes investments in hedge funds that invest in event-driven situations such as mergers, hostile takeovers, reorganizations, or leveraged buyouts. This may involve the simultaneous purchase of stock in companies being acquired and the sale of stock in its acquirer, with the expectation to profit from the spread between the current market price and the ultimate purchase price of the target company. At June 30, 2012, there were no restrictions on redemptions.

Multi-strategy Hedge Funds. Amount includes investments in hedge funds that pursue multiple strategies to realize short- and long-term gains. Management of the hedge funds has the ability to overweight or underweight different strategies to best capitalize on current investment opportunities. At June 30, 2012, investments representing approximately 70% of the fair value of the investments in this category cannot be redeemed currently because the investments include certain initial period lock-up restrictions. The remaining restriction period for these investments subject to lock-up restrictions was primarily two years or less at June 30, 2012.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Fair Value Option.

The Company elected the fair value option for certain eligible instruments that are risk managed on a fair value basis to mitigate income statement volatility caused by measurement basis differences between the elected instruments and their associated risk management transactions or to eliminate complexities of applying certain accounting models. The following tables present net gains (losses) due to changes in fair value for items measured at fair value pursuant to the fair value option election for the quarters and six months ended June 30, 2012 and 2011, respectively.

	Principal Transactions-Trading	Interest Income (Expense) (dollars in millions)	Gains (Losses) Included in Net Revenues
Three Months Ended June 30, 2012			
Federal funds sold and securities purchased under agreements to resell	$ 12	$ 1	$ 13
Deposits	15	(22)	(7)
Commercial paper and other short-term borrowings(1)	211		211
Securities sold under agreements to repurchase	5	(1)	4
Long-term borrowings(1)	1,300	(325)	975
Six Months Ended June 30, 2012			
Federal funds sold and securities purchased under agreements to resell	$ 8	$ 2	$ 10
Deposits	25	(44)	(19)
Commercial paper and other short-term borrowings(1)	82		82
Securities sold under agreements to repurchase	3	(2)	1
Long-term borrowings(1)	(1,651)	(669)	(2,320)
Three Months Ended June 30, 2011			
Deposits	$ 18	$ (30)	$ (12)
Commercial paper and other short-term borrowings(2)	49		49
Securities sold under agreements to repurchase	2		2
Long-term borrowings(2)	(42)	(270)	(312)
Six Months Ended June 30, 2011			
Deposits	$ 31	$ (60)	$ (29)
Commercial paper and other short-term borrowings(2)	44		44
Securities sold under agreements to repurchase			
Long-term borrowings(2)	(1,308)	(560)	(1,868)

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

(2) Of the total gains (losses) recorded in Principal Transactions Trading for short-term and long-term borrowings for the quarter and six months ended June 30, 2011, $244 million and $55 million, respectively, are attributable to changes in the credit quality of the Company and the respective remainder is attributable to changes in foreign currency rates or interest rates or movements in the reference price or index for structured notes, before the impact of related hedges.

In addition to the amounts in the above table, as discussed in Note 2 to the consolidated financial statements for the year ended December 31, 2011 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 amounts in the above table are included within Net revenues and do not reflect gains or losses on related hedging instruments, if any.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
	(dollars in millions)			
Short-term and long-term borrowings(1)	$ 350	$ 244	$ (1,628)	$ 55
Loans(2)	(119)	(146)	174	(108)
Unfunded lending commitments(3)	78	(223)	485	(213)

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

Net Difference between Contractual Principal Amount and Fair Value.

	Contractual Principal Amount Exceeds Fair Value	
	At June 30, 2012	At December 31, 2011
	(dollars in billions)	
Short-term and long-term borrowings(1)	$ 1.4	$ 2.5
Loans(2)	26.7	27.2
Loans 90 or more days past due and/or on non-accrual status(2)(3)	21.9	22.1

(1) These amounts do not include structured notes where the repayment of the initial principal amount fluctuates based on changes in the reference price or index.
(2) The majority of this difference between principal and fair value amounts emanates from the Company s distressed debt trading business, which purchases distressed debt at amounts well below par.
(3) The aggregate fair value of loans that were in non-accrual status, which includes all loans 90 or more days past due, was $1.3 billion and $2.0 billion at June 30, 2012 and December 31, 2011, respectively. The aggregate fair value of loans that were 90 or more days past due was $0.8 billion and $1.5 billion at June 30, 2012 and December 31, 2011, respectively.

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

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

Certain assets were measured at fair value on a non-recurring basis and are not included in the tables above. These assets may include loans, 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 and six months ended June 30, 2012 and 2011, respectively.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Three and Six Months Ended June 30, 2012.

	Carrying Value At June 30, 2012(1)	Fair Value Measurements Using: Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Gains (Losses) for the Three Months Ended June 30, 2012(2)	Total Gains (Losses) for the Six Months Ended June 30, 2012(2)
			(dollars in millions)			
Loans(3)	$ 762	$	$ 146	$ 616	$ (13)	$ (19)
Other investments(4)	86			86	(7)	(8)
Premises, equipment and software costs(4)	1			1		(2)
Intangible assets(4)					(2)	(4)
Total	$ 849	$	$ 146	$ 703	$ (22)	$ (33)

(1) Carrying values relate only to those assets that had fair value adjustments during the quarter ended June 30, 2012. These amounts do not include assets that had fair value adjustments during the six months ended June 30, 2012, unless the assets also had a fair value adjustment during the quarter ended June 30, 2012.
(2) Losses are recorded within Other expenses in the condensed consolidated statement of income except for fair value adjustments related to Loans and losses related to Other investments, which are included in Other revenues.
(3) Non-recurring changes in fair value for loans held for investment were calculated based upon the fair value of the underlying collateral. The fair value of the collateral was determined using internal expected recovery models. The non-recurring change in fair value for mortgage loans held for sale is based upon a valuation model incorporating market observable inputs.
(4) Losses recorded were determined primarily using discounted cash flow models.

In addition to the losses included in the table above, there was a pre-tax gain of approximately $51 million (related to Other assets) included in discontinued operations in the six months ended June 30, 2012 in connection with the disposition of Saxon (see Notes 1 and 20). This pre-tax gain was primarily due to the subsequent increase in fair value of Saxon, which had incurred impairment losses of $98 million in the quarter ended December 31, 2011. The fair value of Saxon was determined based on the revised purchase price agreed upon with the buyer.

There were no liabilities measured at fair value on a non-recurring basis during the quarter and six months ended June 30, 2012.

Three Months and Six Month Ended June 30, 2011.

	Carrying Value At June 30, 2011(1)	Fair Value Measurements Using: Quoted Prices in Active Markets for Identical	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Gains (Losses) for the Three Months Ended June 30,	Total Gains (Losses) for the Six Months Ended June 30,

		Assets (Level 1)			2011(2)	2011(2)
	(dollars in millions)					
Loans(3)	$ 183	$	$ 92	$ 91	$ 3	$ 18
Other investments(4)	84			84	(20)	(28)
Intangible assets(5)						(3)
Total	$ 267	$	$ 92	$ 175	$ (17)	$ (13)

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(1) Carrying values relate only to those assets that had fair value adjustments during the quarter ended June 30, 2011. These amounts do not include assets that had fair value adjustments during the six months ended June 30, 2011, unless the assets also had a fair value adjustment during the quarter ended June 30, 2011.
(2) 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.
(3) Non-recurring changes in fair value for loans held for investment were calculated based upon the fair value of the underlying collateral. The fair value of the collateral was determined using internal expected recovery models. The non-recurring change in fair value for mortgage loans held for sale is based upon a valuation model incorporating market observable inputs.
(4) Losses recorded were determined primarily using discounted cash flow models.
(5) Losses primarily related to investment management contracts and were determined primarily using discounted cash flow models.

There were no liabilities measured at fair value on a non-recurring basis during the quarter and six months ended June 30, 2011.

Financial Instruments Not Measured at Fair Value.

The table below presents the carrying value, fair value and fair value hierarchy category of certain financial instruments that are not measured at fair value in the condensed consolidated statements of financial condition. The table below excludes certain financial instruments such as equity method investments and all non-financial assets and liabilities such as the value of the long-term relationships with our deposit customers.

The carrying value of cash and cash equivalents, including Interest bearing deposits with banks, and other short-term financial instruments such as Federal funds sold and securities purchased under agreements to resell, Securities borrowed, Securities sold under agreements to repurchase, Securities loaned, certain receivables and payables arising in the ordinary course of business, certain Deposits, Commercial paper and other short-term borrowings and Other secured financings approximate fair value because of the relatively short period of time between their origination and expected maturity.

The fair value of sweep facilities whereby cash balances are swept into separate money market savings deposits and transaction accounts included within Deposits is determined using a standard cash flow discounting methodology.

For longer-dated Federal funds sold and securities purchased under agreements to resell, Securities borrowed, Securities sold under agreements to repurchase, Securities loaned and Other secured financings, fair value is determined using a standard cash flow discounting methodology. The inputs to the valuation include contractual cash flows and collateral funding spreads, which are estimated using various benchmarks and interest rate yield curves.

For consumer and residential real estate loans where position-specific external price data is not observable, the fair value is based on the credit risks of the borrower using a probability of default and loss given default method, discounted at the estimated external cost of funding level. The fair value of corporate loans is determined using recently executed transactions, market price quotations (where observable), implied yields from comparable debt, and market observable credit default swap spread levels along with proprietary valuation models and default recovery analysis where such transactions and quotations are unobservable.

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

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Financial Instruments Not Measured at Fair Value at June 30, 2012.

	At June 30, 2012		Fair Value Measurements using:		
	Carrying Value	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
			(dollars in millions)		
Financial Assets:					
Cash and due from banks	$ 12,408	$ 12,408	$ 12,408	$	$
Interest bearing deposits with banks	29,598	29,598	29,598		
Cash deposited with clearing organizations or segregated under federal and other regulations or requirements	29,418	29,418	29,418		
Federal funds sold and securities purchased under agreements to resell	147,366	147,388		145,704	1,684
Securities borrowed	134,263	134,261		134,252	9
Receivables:(1)					
Customers	37,666	37,666		37,666	
Brokers, dealers and clearing organizations	9,107	9,107		9,107	
Fees, interest and other	6,256	6,074			6,074
Loans(2)	21,394	21,446		2,808	18,638
Financial Liabilities:					
Deposits	$ 66,287	$ 66,413	$	$ 66,413	$
Commercial paper and other short-term borrowings	1,148	1,148		860	288
Securities sold under agreements to repurchase	108,332	108,397		100,698	7,699
Securities loaned	30,762	29,896		28,890	1,006
Other secured financings	8,087	7,963		6,342	1,621
Payables:(1)					
Customers	119,455	119,455		119,455	
Brokers, dealers and clearing organizations	4,158	4,158		4,158	
Long-term borrowings	125,346	117,698		105,971	11,727

(1) Accrued interest, fees and dividend receivables and payables where carrying value approximates fair value have been excluded.
(2) Includes all loans measured at fair value on a non-recurring basis.

The fair value of the Company s unfunded lending commitments, primarily related to corporate lending in the Institutional Securities business segment, that are not carried at fair value at June 30, 2012 was $747 million, of which $560 million and $187 million would be categorized in Level 2 and Level 3 of the fair value hierarchy, respectively. The carrying value of these commitments, if fully funded, would be $39.5 billion. For a description of the Company s lending commitments, see Note 13 to the consolidated financial statements for the year ended December 31, 2011 included in the Form 10-K.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

4. Securities Available for Sale.

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

	At June 30, 2012				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Other-than-Temporary Impairment	Fair Value
	(dollars in millions)				
Debt securities available for sale:					
U.S. government and agency securities:					
U.S. Treasury securities	$ 11,415	$ 142	$	$	$ 11,557
U.S. agency securities	15,450	112	6		15,556
Total U.S. government and agency securities	26,865	254	6		27,113
Corporate and other debt:					
Auto loan asset-backed securities	914	2			916
Corporate bonds	1,467	5	1		1,471
FFELP student loan asset-backed securities(1)	1,928	9			1,937
Total Corporate and other debt	4,309	16	1		4,324
Total debt securities available for sale	31,174	270	7		31,437
Equity securities available for sale	15		10		5
Total	$ 31,189	$ 270	$ 17	$	$ 31,442

(1) Amounts are backed by a guarantee from the U.S. Department of Education of at least 95% of the principal balance and interest on such loans.

	At December 31, 2011				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Other-than-Temporary Impairment	Fair Value
	(dollars in millions)				
Debt securities available for sale:					
U.S. government and agency securities:					
U.S. Treasury securities	$ 13,240	$ 182	$	$	$ 13,422
U.S. agency securities	16,083	54	20		16,117
Corporate and other debt(1)	944		3		941
Total debt securities available for sale	30,267	236	23		30,480
Equity securities available for sale	15				15
Total	$ 30,282	$ 236	$ 23	$	$ 30,495

(1) Amounts represent FFELP student loan asset-backed securities, in which the loans are backed by a guarantee from the U.S. Department of Education of at least 95% of the principal balance and interest on such loans.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

At June 30, 2012	Less than 12 Months Fair Value	Less than 12 Months Gross Unrealized Losses	12 Months or Longer Fair Value	12 Months or Longer Gross Unrealized Losses	Total Fair Value	Total Gross Unrealized Losses
	(dollars in millions)					
Debt securities available for sale:						
U.S. government and agency securities:						
U.S. agency securities	$ 2,238	$ 4	$ 525	$ 2	$ 2,763	$ 6
Total U.S. government and agency securities	2,238	4	525	2	2,763	6
Corporate and other debt:						
Corporate bonds	522	1			522	1
Total Corporate and other debt	522	1			522	1
Total debt securities available for sale	2,760	5	525	2	3,285	7
Equity securities available for sale	5	10			5	10
Total	$ 2,765	$ 15	$ 525	$ 2	$ 3,290	$ 17

At December 31, 2011	Less than 12 Months Fair Value	Less than 12 Months Gross Unrealized Losses	12 Months or Longer Fair Value	12 Months or Longer Gross Unrealized Losses	Total Fair Value	Total Gross Unrealized Losses
	(dollars in millions)					
Debt securities available for sale:						
U.S. government and agency securities:						
U.S. agency securities	$ 6,250	$ 15	$ 1,492	$ 5	$ 7,742	$ 20
Corporate and other debt	679	3			679	3
Total	$ 6,929	$ 18	$ 1,492	$ 5	$ 8,421	$ 23

Gross unrealized losses are recorded in Accumulated other comprehensive income.

For debt securities available for sale in an unrealized loss position, the Company does not intend to sell these securities or expect to be required to sell these securities prior to recovery of the amortized cost basis. In addition, the Company does not expect the U.S. government and agency securities to experience a credit loss given the explicit and implicit guarantee provided by the U.S. government. The Company believes that the debt securities with an unrealized loss in Accumulated other comprehensive income were not other-than-temporarily impaired at June 30, 2012 and December 31, 2011.

For equity securities available for sale in an unrealized loss position, the Company does not intend to sell these securities or expect to be required to sell these securities prior to the recovery of the amortized cost basis. The Company believes that the equity securities with an unrealized loss in Accumulated other comprehensive income were not other-than-temporarily impaired at June 30, 2012.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table presents the amortized cost and fair value of debt securities available for sale by contractual maturity dates at June 30, 2012.

At June 30, 2012	Amortized Cost	Fair Value	Annualized Average Yield
	(dollars in millions)		
U.S. government and agency securities:			
U.S. Treasury securities:			
Due within 1 year	$ 1,151	$ 1,160	1.4%
After 1 year but through 5 years	9,691	9,807	0.9%
After 5 years	572	589	1.4%
Total	11,414	11,556	
U.S. agency securities:			
After 5 years	15,450	15,556	
Total	15,450	15,556	1.1%
Total U.S. government and agency securities	26,864	27,112	1.0%
Corporate and other debt:			
Auto loan asset-backed securities:			
After 1 year but through 5 years	895	897	0.8%
After 5 years	19	19	1.0%
Total	914	916	
Corporate bonds:			
Due within 1 year	81	81	0.6%
After 1 year but through 5 years	1,366	1,370	1.1%
After 5 years	21	21	1.7%
Total	1,468	1,472	
FFELP student loan asset-backed securities:			
After 1 year but through 5 years	23	23	0.8%
After 5 years	1,905	1,914	1.2%
Total	1,928	1,937	
Total Corporate and other debt	4,310	4,325	1.1%
Total debt securities available for sale	$ 31,174	$ 31,437	1.0%

See Note 6 for additional information on securities issued by VIEs, including U.S. agency mortgage-backed securities, auto loan asset-backed securities and FFELP student loan asset-backed securities.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table presents information pertaining to sales of securities available for sale during the three and six months ended June 30, 2012 and 2011:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
	(dollars in millions)			
Gross realized gains	$ 24	$ 84	$ 25	$ 96
Gross realized losses	$ 2	$ 2	$ 2	$ 2
Proceeds of sales of securities available for sale	$	$ 7,021	$	$ 13,142

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

5. Collateralized Transactions.

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

The Company also engages in securities financing transactions for customers through margin lending. Under these agreements and transactions, the Company either receives or provides collateral, including U.S. government and agency securities, other sovereign government obligations, corporate and other debt, and corporate equities. Customer receivables generated from margin lending activity are collateralized by customer-owned securities held by the Company. The Company monitors required margin levels and established credit limits daily and, pursuant to such guidelines, requires customers to deposit additional collateral, or reduce positions, when necessary. Margin loans are extended on a demand basis and are not committed facilities. Factors considered in the review of margin loans are the amount of the loan, the intended purpose, the degree of leverage being employed in the account, and overall evaluation of the portfolio to ensure proper diversification or, in the case of concentrated positions, appropriate liquidity of the underlying collateral or potential hedging strategies to reduce risk. Additionally, transactions relating to concentrated or restricted positions require a review of any legal impediments to liquidation of the underlying collateral. Underlying collateral for margin loans is reviewed with respect to the liquidity of the proposed collateral positions, valuation of securities, historic trading range, volatility analysis and an evaluation of industry concentrations. For these transactions, adherence to the Company s collateral policies significantly limits the Company s credit exposure in the event of customer default. The Company may request additional margin collateral from customers, if appropriate, and, if necessary, may sell securities that have not been paid for or purchase securities sold but not delivered from customers. At June 30, 2012 and December 31, 2011, there were approximately $17.2 billion and $16.2 billion, respectively, of customer margin loans outstanding.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

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

	At June 30, 2012	At December 31, 2011
	(dollars in millions)	
Financial instruments owned:		
U.S. government and agency securities	$ 11,825	$ 9,263
Other sovereign government obligations	3,951	4,047
Corporate and other debt	12,173	17,024
Corporate equities	26,091	21,664
Total	$ 54,040	$ 51,998

The Company receives collateral in the form of securities in connection with reverse repurchase agreements, securities borrowed and derivative transactions, and customer margin loans. In many cases, the Company is permitted to sell or repledge these securities held as collateral and use the securities to secure repurchase agreements, to enter into securities lending and derivative transactions or for delivery to counterparties to cover short positions. The Company additionally receives securities as collateral in connection with certain securities-for-securities transactions in which the Company is the lender. In instances where the Company is permitted to sell or repledge these securities, the Company reports the fair value of the collateral received and the related obligation to return the collateral in the condensed consolidated statements of financial condition. At June 30, 2012 and December 31, 2011, the fair value of financial instruments received as collateral where the Company is permitted to sell or repledge the securities was $577 billion and $488 billion, respectively, and the fair value of the portion that had been sold or repledged was $420 billion and $335 billion, respectively.

At June 30, 2012 and December 31, 2011, cash and securities deposited with clearing organizations or segregated under federal and other regulations or requirements were as follows:

	At June 30, 2012	At December 31, 2011
	(dollars in millions)	
Cash deposited with clearing organizations or segregated under federal and other regulations or requirements	$ 29,418	$ 29,454
Securities(1)	11,584	15,120
Total	$ 41,002	$ 44,574

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

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

6. Variable Interest Entities and Securitization Activities.

The Company is involved with various special purpose entities (SPEs) in the normal course of business. In most cases, these entities are deemed to be VIEs.

The Company applies accounting guidance for consolidation of VIEs to certain entities in which equity investors do not have the characteristics of a controlling financial interest. Excluding entities subject to the Deferral (as defined in Note 2 to the consolidated financial statements included in the Form 10-K), the primary beneficiary of a VIE is the party that both (1) has the power to direct the activities of a VIE that most significantly affect the VIE s economic performance and (2) has an obligation to absorb losses or the right to receive benefits that in either case could potentially be significant to the VIE. The Company consolidates entities of which it is the primary beneficiary.

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

Interests purchased in connection with market-making activities, securities held in its available for sale portfolio and retained interests held as a result of securitization activities, including re-securitization transactions.

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

Servicing residential and commercial mortgage loans held by VIEs.

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

Derivatives entered into with VIEs.

Structuring of credit-linked notes (CLN) or other asset-repackaged notes designed to meet the investment objectives of clients.

Other structured transactions designed to provide tax-efficient yields to the Company or its clients.

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

The power to make the most significant economic decisions may take a number of different forms in different types of VIEs. The Company considers servicing or collateral management decisions as representing the power to make the most significant economic decisions in transactions such as securitizations or CDOs. As a result, the Company does not consolidate securitizations or CDOs for which it does not act as the servicer or collateral manager unless it holds certain other rights to replace the servicer or collateral manager or to require the liquidation of the entity. If the Company serves as servicer or collateral manager, or has certain other rights described in the previous sentence, the Company analyzes the interests in the VIE that it holds and consolidates only those VIEs for which it holds a potentially significant interest of the VIE.

The structure of securitization vehicles and CDOs are driven by several parties, including loan seller(s) in securitization transactions, the collateral manager in a CDO, one or more rating agencies, a financial guarantor in some transactions and the underwriter(s) of the transactions, who serve to reflect specific investor demand. In addition, subordinate investors, such as the B-piece buyer in commercial mortgage backed securitizations or equity investors in CDOs, can influence whether specific loans are excluded from a CMBS transaction or investment criteria in a CDO.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

Except for consolidated VIEs included in other structured financings and managed real estate partnerships in the tables below, the Company accounts for the assets held by the entities primarily in Financial instruments owned and the liabilities of the entities as Other secured financings in the condensed consolidated statements of financial condition. For consolidated VIEs included in other structured financings, the Company accounts for the assets held by the entities primarily in Premises, equipment and software costs, and Other assets in the condensed consolidated statements of financial condition. For consolidated VIEs included in managed real estate partnerships, the Company accounts for the assets held by the entities primarily in Financial instruments owned Investments in the condensed consolidated statements of financial condition. Except for consolidated VIEs included in other structured financings, the assets and liabilities are measured at fair value, with changes in fair value reflected in earnings.

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

The following tables present information at June 30, 2012 and December 31, 2011 about VIEs that the Company consolidates. Consolidated VIE assets and liabilities are presented after intercompany eliminations and include assets financed on a non-recourse basis.

	At June 30, 2012				
	Mortgage and Asset-backed Securitizations	Collateralized Debt Obligations	Managed Real Estate Partnerships	Other Structured Financings	Other
	(dollars in millions)				
VIE assets	$ 1,594	$ 237	$ 2,255	$ 833	$ 2,366
VIE liabilities	$ 967	$ 87	$ 81	$ 2,571	$ 304

	At December 31, 2011				
	Mortgage and Asset-Backed Securitizations	Collateralized Debt Obligations	Managed Real Estate Partnerships	Other Structured Financings	Other
	(dollars in millions)				
VIE assets	$ 2,414	$ 102	$ 2,207	$ 918	$ 1,937
VIE liabilities	$ 1,699	$ 69	$ 102	$ 2,576	$ 556

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

In general, the Company s exposure to loss in consolidated VIEs is limited to losses that would be absorbed on the VIE s assets recognized in its financial statements, net of losses absorbed by third-party holders of the VIE s liabilities. At June 30, 2012 and December 31, 2011, managed real estate partnerships reflected noncontrolling interests in the Company s condensed consolidated financial statements of $1,734 million and $1,653 million, respectively. The Company also had additional maximum exposure to losses of approximately $120 million and $200 million at June 30, 2012 and December 31, 2011, respectively. This additional exposure related primarily to certain derivatives (*e.g.*, instead of purchasing senior securities, the Company has sold credit protection to synthetic CDOs through credit derivatives that are typically related to the most senior tranche of the CDO) and commitments, guarantees and other forms of involvement.

The following tables present information about certain non-consolidated VIEs in which the Company had variable interests at June 30, 2012 and December 31, 2011. The tables include all VIEs in which the Company has determined that its maximum exposure to loss is greater than specific thresholds or meets certain other criteria. Most of the VIEs included in the tables below are sponsored by unrelated parties; the Company s involvement generally is the result of the Company s secondary market-making activities and securities held in its available for sale portfolio (see Note 4).

	At June 30, 2012				
	Mortgage and Asset-Backed Securitizations	Collateralized Debt Obligations	Municipal Tender Option Bonds	Other Structured Financings	Other
	(dollars in millions)				
VIE assets that the Company does not consolidate (unpaid principal balance)(1)	$ 210,595	$ 20,491	$ 6,386	$ 1,865	$ 17,287
Maximum exposure to loss:					
Debt and equity interests(2)	$ 17,797	$ 1,118	$ 359	$ 896	$ 2,512
Derivative and other contracts	108	47	3,705		863
Commitments, guarantees and other	315			777	1,007
Total maximum exposure to loss	$ 18,220	$ 1,165	$ 4,064	$ 1,673	$ 4,382
Carrying value of exposure to loss Assets:					
Debt and equity interests(2)	$ 17,797	$ 1,118	$ 359	$ 538	$ 2,507
Derivative and other contracts	109	2	6		308
Total carrying value of exposure to loss Assets	$ 17,906	$ 1,120	$ 365	$ 538	$ 2,815
Carrying value of exposure to loss Liabilities:					
Derivative and other contracts	$ 12	$ 2	$	$	$ 122
Commitments, guarantees and other				12	159
Total carrying value of exposure to loss Liabilities	$ 12	$ 2	$	$ 12	$ 281

(1) Mortgage and asset-backed securitizations include VIE assets as follows: $10.5 billion of residential mortgages; $58.6 billion of commercial mortgages; $103.7 billion of U.S. agency collateralized mortgage obligations; and $37.8 billion of other consumer or commercial loans.

(2) Mortgage and asset-backed securitizations include VIE debt and equity interests as follows: $0.6 billion of residential mortgages; $0.6 billion of commercial mortgages; $13.5 billion of U.S. agency collateralized mortgage obligations; and $3.1 billion of other consumer or commercial loans.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	At December 31, 2011				
	Mortgage and Asset-Backed Securitizations	Collateralized Debt Obligations	Municipal Tender Option Bonds	Other Structured Financings	Other
	(dollars in millions)				
VIE assets that the Company does not consolidate (unpaid principal balance)(1)	$ 231,110	$ 7,593	$ 6,833	$ 1,944	$ 20,997
Maximum exposure to loss:					
Debt and equity interests(2)	$ 16,469	$ 491	$ 201	$ 978	$ 2,413
Derivative and other contracts	103	843	4,141		1,209
Commitments, guarantees and other	208			804	561
Total maximum exposure to loss	$ 16,780	$ 1,334	$ 4,342	$ 1,782	$ 4,183
Carrying value of exposure to loss Assets:					
Debt and equity interests(2)	$ 16,469	$ 491	$ 201	$ 640	$ 2,413
Derivative and other contracts	101	657	24		338
Total carrying value of exposure to loss Assets	$ 16,570	$ 1,148	$ 225	$ 640	$ 2,751
Carrying value of exposure to loss Liabilities:					
Derivative and other contracts	$ 13	$ 159	$	$	$ 114
Commitments, guarantees and other				14	176
Total carrying value of exposure to loss Liabilities	$ 13	$ 159	$	$ 14	$ 290

(1) Mortgage and asset-backed securitizations include VIE assets as follows: $9.1 billion of residential mortgages; $81.7 billion of commercial mortgages; $121.6 billion of U.S. agency collateralized mortgage obligations; and $18.7 billion of other consumer or commercial loans. Prior period amounts were adjusted to conform to the current period s presentation.

(2) Mortgage and asset-backed securitizations include VIE debt and equity interests as follows: $0.6 billion of residential mortgages; $1.1 billion of commercial mortgages; $13.5 billion of U.S. agency collateralized mortgage obligations; and $1.3 billion of other consumer or commercial loans. Prior period amounts were adjusted to conform to the current period s presentation.

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

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

Securitization transactions generally involve VIEs. Primarily as a result of its secondary market-making activities, the Company owned additional securities issued by securitization SPEs for which the maximum exposure to loss is less than specific thresholds. These additional securities totaled $3.8 billion at June 30, 2012. These securities were either retained in connection with transfers of assets by the Company, acquired in

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

connection with secondary market-making activities or held in the Company s available for sale portfolio. Securities issued by securitization SPEs consist of $0.9 billion of securities backed primarily by residential mortgage loans, $0.9 billion of securities backed by U.S. agency collateralized mortgage obligations, $0.7 billion of securities backed by commercial mortgage loans, $0.5 billion of securities backed by collateralized debt obligations or collateralized loan obligations and $0.8 billion backed by other consumer loans, such as credit card receivables, automobile loans and student loans. The Company s primary risk exposure is to the securities issued by the SPE owned by the Company, with the risk highest on the most subordinate class of beneficial interests. These securities generally are included in Financial instruments owned Corporate and other debt or Securities available for sale and are measured at fair value. The Company does not provide additional support in these transactions through contractual facilities, such as liquidity facilities, guarantees or similar derivatives. The Company s maximum exposure to loss generally equals the fair value of the securities owned. Included in the amounts above are certain securitization securities held in the Company s available for sale portfolio (see Note 4).

The Company s transactions with VIEs primarily include securitizations, municipal tender option bond trusts, credit protection purchased through CLNs, other structured financings, collateralized loan and debt obligations, equity-linked notes, managed real estate partnerships and asset management investment funds. The Company s continuing involvement in VIEs that it does not consolidate can include ownership of retained interests in Company-sponsored transactions, interests purchased in the secondary market (both for Company-sponsored transactions and transactions sponsored by third parties), derivatives with securitization SPEs (primarily interest rate derivatives in commercial mortgage and residential mortgage securitizations and credit derivatives in which the Company has purchased protection in synthetic CDOs), and as servicer in residential mortgage securitizations in the U.S. and Europe and commercial mortgage securitizations in Europe. Such activities are further described in Note 7 to the consolidated financial statements for the year ended December 31, 2011 included in the Form 10-K.

Transfers of Assets with Continuing Involvement.

The following tables present information at June 30, 2012 regarding transactions with SPEs in which the Company, acting as principal, transferred financial assets with continuing involvement and received sales treatment.

	At June 30, 2012			
	Residential Mortgage Loans	Commercial Mortgage Loans	U.S. Agency Collateralized Mortgage Obligations	Credit-Linked Notes and Other
	(dollars in millions)			
SPE assets (unpaid principal balance)(1)	$ 39,902	$ 70,531	$ 12,993	$ 13,195
Retained interests (fair value):				
Investment grade	$	$	$ 1,442	$
Non-investment grade	93	62		1,458
Total retained interests (fair value)	$ 93	$ 62	$ 1,442	$ 1,458
Interests purchased in the secondary market (fair value):				
Investment grade	$	$	$ 31	$ 32
Non-investment grade	112	206		355
Total interests purchased in the secondary market (fair value)	$ 112	$ 206	$ 31	$ 387
Derivative assets (fair value)	$ 9	$ 970	$	$ 165
Derivative liabilities (fair value)	$ 24	$ 1	$	$ 395

(1) Amounts include assets transferred by unrelated transferors.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	At June 30, 2012			
	Level 1	Level 2	Level 3	Total
	(dollars in millions)			
Retained interests (fair value):				
Investment grade	$	$ 1,442	$	$ 1,442
Non-investment grade		138	1,475	1,613
Total retained interests (fair value)	$	$ 1,580	$ 1,475	$ 3,055
Interests purchased in the secondary market (fair value):				
Investment grade	$	$ 63	$	$ 63
Non-investment grade		654	19	673
Total interests purchased in the secondary market (fair value)	$	$ 717	$ 19	$ 736
Derivative assets (fair value)	$	$ 656	$ 488	$ 1,144
Derivative liabilities (fair value)	$	$ 395	$ 25	$ 420

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

	At December 31, 2011			
	Residential Mortgage Loans	Commercial Mortgage Loans	U.S. Agency Collateralized Mortgage Obligations	Credit-Linked Notes and Other
	(dollars in millions)			
SPE assets (unpaid principal balance)(1)	$ 41,977	$ 85,333	$ 33,728	$ 14,315
Retained interests (fair value):				
Investment grade	$ 14	$ 22	$ 1,151	$ 2
Non-investment grade	106	44		1,545
Total retained interests (fair value)	$ 120	$ 66	$ 1,151	$ 1,547
Interests purchased in the secondary market (fair value):				
Investment grade	$ 45	$ 164	$ 20	$ 411
Non-investment grade	149	82		11
Total interests purchased in the secondary market (fair value)	$ 194	$ 246	$ 20	$ 422
Derivative assets (fair value)	$ 18	$ 1,200	$	$ 223
Derivative liabilities (fair value)	$ 30	$ 31	$	$ 510

(1) Amounts include assets transferred by unrelated transferors.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	At December 31, 2011			
	Level 1	Level 2	Level 3	Total
	(dollars in millions)			
Retained interests (fair value):				
Investment grade	$	$ 1,186	$ 3	$ 1,189
Non-investment grade		74	1,621	1,695
Total retained interests (fair value)	$	$ 1,260	$ 1,624	$ 2,884
Interests purchased in the secondary market (fair value):				
Investment grade	$	$ 638	$ 2	$ 640
Non-investment grade		126	116	242
Total interests purchased in the secondary market (fair value)	$	$ 764	$ 118	$ 882
Derivative assets (fair value)	$	$ 869	$ 572	$ 1,441
Derivative liabilities (fair value)	$	$ 541	$ 30	$ 571

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

Net gains on sales of assets in securitization transactions at the time of the sale were not material in the six months ended June 30, 2012 and 2011.

During the six months ended June 30, 2012 and 2011, the Company received proceeds from new securitization transactions of $9.2 billion and $15.0 billion, respectively. During the six months ended June 30, 2012 and 2011, the Company received proceeds from cash flows from retained interests in securitization transactions of $1.7 billion and $3.9 billion, respectively.

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

Failed Sales.

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

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

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table presents information about the carrying value (equal to fair value) of assets and liabilities resulting from transfers of financial assets treated by the Company as secured financings:

	At June 30, 2012 Carrying Value of		At December 31, 2011 Carrying Value of	
	Assets	Liabilities	Assets	Liabilities
	(dollars in millions)			
Commercial mortgage loans	$	$	$ 121	$ 121
Credit-linked notes	337	269	383	339
Equity-linked transactions	376	344	1,243	1,214
Other	97	97	75	74

Mortgage Servicing Activities.

Mortgage Servicing Rights. The Company may retain servicing rights to certain mortgage loans that are sold. These transactions create an asset referred to as MSRs, which totaled approximately $8 million and $133 million at June 30, 2012 and December 31, 2011, respectively, and are included within Intangible assets and carried at fair value in the condensed consolidated statements of financial condition. On April 2, 2012, the Company sold MSRs which totaled approximately $84 million and approximately $119 million at April 2, 2012 and December 31, 2011, respectively (see Notes 1 and 20).

SPE Mortgage Servicing Activities. The Company services residential mortgage loans in the U.S. and commercial mortgage loans in Europe owned by SPEs, including SPEs sponsored by the Company and SPEs not sponsored by the Company. The Company generally holds retained interests in Company-sponsored SPEs. In some cases, as part of its market-making activities, the Company may own some beneficial interests issued by both Company-sponsored and non-Company sponsored SPEs.

The Company provides no credit support as part of its servicing activities. The Company is required to make servicing advances to the extent that it believes that such advances will be reimbursed. Reimbursement of servicing advances is a senior obligation of the SPE, senior to the most senior beneficial interests outstanding. Outstanding advances are included in Other assets and are recorded at cost, net of allowances. Advances at June 30, 2012 and December 31, 2011 totaled approximately $24 million and $1,296 million, respectively, net of allowances of $7 million and $14 million at June 30, 2012 and December 31, 2011, respectively. The decline in servicing advances is largely the result of the sale in MSRs discussed above.

The following tables present information about the Company s mortgage servicing activities for SPEs to which the Company transferred loans at June 30, 2012 and December 31, 2011:

	At June 30, 2012			
	Residential Mortgage Unconsolidated SPEs	Residential Mortgage Consolidated SPEs	Commercial Mortgage Unconsolidated SPEs	Commercial Mortgage Consolidated SPEs
	(dollars in millions)			
Assets serviced (unpaid principal balance)	$ 805	$ 1,187	$ 5,923	$ 878
Amounts past due 90 days or greater (unpaid principal balance)(1)	$ 85	$ 34	$	$
Percentage of amounts past due 90 days or greater(1)	10.6%	2.9%		
Credit losses	$	$ 5	$	$

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

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	At December 31, 2011			
	Residential Mortgage Unconsolidated SPEs	Residential Mortgage Consolidated SPEs	Commercial Mortgage Unconsolidated SPEs	Commercial Mortgage Consolidated SPEs
	(dollars in millions)			
Assets serviced (unpaid principal balance)	$ 9,821	$ 2,180	$ 5,750	$ 1,596
Amounts past due 90 days or greater (unpaid principal balance)(1)	$ 3,087	$ 354	$	$
Percentage of amounts past due 90 days or greater(1)	31.4%	16.2%		
Credit losses	$ 631	$ 81	$	$

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

7. Financing Receivables.

Loans held for investment.

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

The Company s loans held for investment at June 30, 2012 and December 31, 2011 included the following:

	At June 30, 2012	At December 31, 2011
	(dollars in millions)	
Commercial and industrial	$ 7,457	$ 5,083
Consumer loans	6,200	5,170
Residential real estate loans	5,489	4,674
Wholesale real estate loans	401	328
Total loans held for investment(1)	$ 19,547	$ 15,255

(1) Amounts are net of allowances of $77 million and $17 million at June 30, 2012 and December 31, 2011, respectively.

The above table does not include loans held for sale of $1,847 million and $114 million at June 30, 2012 and December 31, 2011, respectively.

The Company s Credit Risk Management Department evaluates new obligors before credit transactions are initially approved, and at least annually thereafter for consumer and industrial loans. For corporate and commercial loans, credit evaluations typically involve the evaluation of financial statements, assessment of leverage, liquidity, capital strength, asset composition and quality, market capitalization and access to capital markets, cash flow projections and debt service requirements, and the adequacy of collateral, if applicable. The Company s Credit Risk Management Department will also evaluate strategy, market position, industry dynamics, obligor s management and other factors that could affect the obligor s risk profile. For residential real estate and consumer loans, the initial credit evaluation includes, but is not limited to, review of the obligor s income, net worth, liquidity, collateral, loan-to-value ratio, and credit bureau information. Subsequent credit monitoring for residential real estate loans is performed at the portfolio level. Consumer loan collateral values are monitored on an ongoing basis.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

At June 30, 2012, the Company collectively evaluated for impairment, gross of the allowance, commercial and industrial loans, consumer loans, residential real estate loans and wholesale real estate loans of $7,470 million, $6,201 million, $5,493 million and $372 million, respectively. The Company individually evaluated for impairment, gross of the allowance, commercial and industrial loans, consumer and wholesale real estate loans of $52 million, $4 million and $32 million respectively. Commercial and industrial loans of approximately $31 million and wholesale real estate loans of approximately $32 million were impaired at June 30, 2012. Approximately 99% of the Company s loan portfolio was current at June 30, 2012.

At December 31, 2011, the Company collectively evaluated for impairment gross commercial and industrial loans, consumer loans, residential real estate loans and wholesale real estate loans of $4,934 million, $5,072 million, $4,675 million and $278 million, respectively. The Company individually evaluated for impairment gross commercial and industrial loans, consumer and wholesale real estate loans of $163 million, $100 million and $50 million, respectively. Commercial and industrial loans of approximately $33 million and wholesale real estate loans of approximately $50 million were impaired at December 31, 2011. Approximately 99% of the Company s loan portfolio was current at December 31, 2011.

The Company assigned an internal grade of doubtful to certain commercial asset-backed and wholesale real estate loans totaling $35 million and $87 million at June 30, 2012 and December 31, 2011, respectively. Doubtful loans can be classified as current if the borrower is making payments in accordance with the loan agreement. The Company assigned an internal grade of pass to the majority of its remaining loan portfolio.

For a description of the Company s loan portfolio and credit quality indicators utilized in its credit monitoring process, see Note 8 to the consolidated financial statements for the year ended December 31, 2011 included in the Form 10-K.

Employee Loans.

Employee loans are granted primarily in conjunction with a program established in the Global Wealth Management Group business segment to retain and recruit certain employees. These loans are recorded in Receivables Fees, interest and other in the condensed consolidated statements of financial condition. These loans are full recourse, generally require periodic payments and have repayment terms ranging from one to 12 years. The Company establishes a reserve for loan amounts it does not consider recoverable from terminated employees, which is recorded in Compensation and benefits expense. At June 30, 2012, the Company had $6,089 million of employee loans, net of an allowance of approximately $128 million. At December 31, 2011, the Company had $5,610 million of employee loans, net of an allowance of approximately $119 million.

The Company has also granted loans to other employees primarily in conjunction with certain after-tax leveraged investment arrangements. At June 30, 2012, the balance of these loans was $167 million, net of an allowance of approximately $132 million. At December 31, 2011, the balance of these loans was $162 million, net of an allowance of approximately $133 million. The Company establishes a reserve for non-recourse loan amounts not recoverable from employees, which is recorded in Other expense.

Collateralized Transactions.

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

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Servicing Advances.

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

8. Goodwill and Net Intangible Assets.

The Company tests goodwill for impairment on an annual basis and on an interim basis when certain events or circumstances exist. The Company tests for impairment at the reporting unit level, which is generally at the level of or one level below its business segments. For both the annual and interim tests, the Company has the option to first assess qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If after assessing the totality of events or circumstances, the Company determines it is more likely than not that the fair value of a reporting unit is greater than its carrying amount, then performing the two-step impairment test is not required. However, if the Company concludes otherwise, then it is required to perform the first step of the two-step impairment test. Goodwill impairment is determined by comparing the estimated fair value of a reporting unit with its respective carrying value. If the estimated fair value exceeds the carrying value, goodwill at the reporting unit level is not deemed to be impaired. If the estimated fair value is below carrying value, however, further analysis is required to determine the amount of the impairment. Additionally, if the carrying value of a reporting unit is zero or a negative value and it is determined that it is more likely than not the goodwill is impaired, further analysis is required. The estimated fair values of the reporting units are derived based on valuation techniques the Company believes market participants would use for each of the reporting units.

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

Due to the volatility in the equity markets, the economic outlook and the Company s common shares trading below book value during the quarters ended December 31, 2011 and June 30, 2012, the Company performed additional impairment testing, which did not result in any goodwill impairment. Adverse market or economic events could result in impairment charges in future periods. At June 30, 2012 and December 31, 2011, each of the Company s reporting units with goodwill had a fair value that was substantially in excess of its carrying value.

Goodwill.

Changes in the carrying amount of the Company s goodwill, net of accumulated impairment losses for the six months ended June 30, 2012, were as follows:

	Institutional Securities	Global Wealth Management Group	Asset Management	Total
		(dollars in millions)		
Goodwill at December 31, 2011(1)	$ 330	$ 5,616	$ 740	$ 6,686
Foreign currency translation adjustments and other	(11)			(11)
Goodwill disposed of during the period(2)		(65)		(65)
Goodwill at June 30, 2012(1)	$ 319	$ 5,551	$ 740	$ 6,610

(1) The amount of the Company s goodwill before accumulated impairments of $700 million, which included $673 million related to the Institutional Securities business segment and $27 million related to the Asset Management business segment, was $7,310 million and $7,386 million at June 30, 2012 and December 31, 2011, respectively.

(2) The Global Wealth Management Group activity represents goodwill disposed of in connection with the sale of Quilter (see Notes 1 and 20).

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Net Intangible Assets.

Changes in the carrying amount of the Company s intangible assets for the six months ended June 30, 2012 were as follows:

	Institutional Securities	Global Wealth Management Group	Asset Management	Total
		(dollars in millions)		
Amortizable net intangible assets at December 31, 2011	$ 229	$ 3,641	$ 2	$ 3,872
Mortgage servicing rights (see Note 6)	122	11		133
Indefinite-lived intangible assets		280		280
Net intangible assets at December 31, 2011	$ 351	$ 3,932	$ 2	$ 4,285
Amortizable net intangible assets at December 31, 2011	$ 229	$ 3,641	$ 2	$ 3,872
Foreign currency translation adjustments and other	(6)	1		(5)
Amortization expense	(8)	(160)		(168)
Impairment losses(1)	(4)			(4)
Intangible assets acquired during the period	4			4
Amortizable net intangible assets at June 30, 2012	215	3,482	2	3,699
Mortgage servicing rights (see Note 6)		8		8
Indefinite-lived intangible assets		280		280
Net intangible assets at June 30, 2012	$ 215	$ 3,770	$ 2	$ 3,987

(1) Impairment losses are recorded within Other expenses.

9. Long-Term Borrowings and Other Secured Financings.

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

	At June 30, 2012	At December 31, 2011
	(dollars in millions)	
Senior debt	$ 159,099	$ 175,471
Subordinated debt	3,878	3,910
Junior subordinated debentures	4,851	4,853
Total	$ 167,828	$ 184,234

During the six months ended June 30, 2012, the Company issued and reissued notes with a principal amount of approximately $9 billion. During the six months ended June 30, 2012, approximately $26 billion of notes matured or were retired.

The weighted average maturity of the Company s long-term borrowings, based upon stated maturity dates, was approximately 5.3 years and 5.0 years at June 30, 2012 and December 31, 2011, respectively.

FDIC s Temporary Liquidity Guarantee Program.

At December 31, 2011, the Company had long-term debt outstanding of $12.1 billion, under the Temporary Liquidity Guarantee Program (TLGP). There was no TLGP debt outstanding at June 30, 2012. The issuance of

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

debt under the TLPG expired on December 31, 2010, but the existing long-term debt outstanding was guaranteed until June 30, 2012. These borrowings were senior unsecured debt obligations of the Company and guaranteed by the FDIC under the TLGP. The FDIC has concluded that the guarantee is backed by the full faith and credit of the U.S. government.

Other Secured Financings.

Other secured financings include the liabilities related to transfers of financial assets that are accounted for as financings rather than sales, consolidated VIEs where the Company is deemed to be the primary beneficiary, pledged commodities, certain equity-linked notes and other secured borrowings. See Note 6 for further information on other secured financings related to variable interest entities and securitization activities.

The Company s other secured financings consisted of the following:

	At June 30, 2012	At December 31, 2011
	(dollars in millions)	
Secured financings with original maturities greater than one year	$ 16,400	$ 18,696
Secured financings with original maturities one year or less	213	275
Failed sales(1)	710	1,748
Total(2)	$ 17,323	$ 20,719

(1) For more information on failed sales, see Note 6.
(2) Amounts include $9,236 million and $14,594 million at fair value at June 30, 2012 and December 31, 2011, respectively.

10. Derivative Instruments and Hedging Activities.

The Company trades, makes markets and takes proprietary positions globally in listed futures, OTC swaps, forwards, options and other derivatives referencing, among other things, interest rates, currencies, investment grade and non-investment grade corporate credits, loans, bonds, U.S. and other sovereign securities, emerging market bonds and loans, credit indices, asset-backed security indices, property indices, mortgage-related and other asset-backed securities, and real estate loan products. The Company uses these instruments for trading, foreign currency exposure management and asset and liability management.

The Company manages its trading positions by employing a variety of risk mitigation strategies. These strategies include diversification of risk exposures and hedging. Hedging activities consist of the purchase or sale of positions in related securities and financial instruments, including a variety of derivative products (*e.g.*, futures, forwards, swaps and options). The Company manages the market risk associated with its trading activities on a Company-wide basis, on a worldwide trading division level and on an individual product basis.

The Company s derivative products consist of the following:

	At June 30, 2012	At December 31, 2011

	Assets	Liabilities	Assets	Liabilities
		(dollars in millions)		
Exchange traded derivative products	$ 4,589	$ 6,117	$ 4,103	$ 4,969
OTC derivative products	29,754	28,818	43,961	41,484
Total	$ 34,343	$ 34,935	$ 48,064	$ 46,453

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The Company incurs credit risk as a dealer in OTC derivatives. Credit risk with respect to derivative instruments arises from the failure of a counterparty to perform according to the terms of the contract. The Company s exposure to credit risk at any point in time is represented by the fair value of the derivative contracts reported as assets. The fair value of a derivative represents the amount at which the derivative could be exchanged in an orderly transaction between market participants and is further described in Notes 2 and 3.

In connection with its OTC derivative activities, the Company generally enters into master netting agreements and collateral arrangements with counterparties. These agreements provide the Company with the ability to offset a counterparty s rights and obligations, request additional collateral when necessary or liquidate the collateral in the event of counterparty default.

The tables below present a summary by counterparty credit rating and remaining contract maturity of the fair value of OTC derivatives in a gain position at June 30, 2012 and December 31, 2011, respectively. Fair value is presented in the final column, net of collateral received (principally cash and U.S. government and agency securities):

OTC Derivative Products Financial Instruments Owned at June 30, 2012(1)

	Years to Maturity						
Credit Rating(2)	Less than 1	1 - 3	3 - 5	Over 5	Cross-Maturity and Cash Collateral Netting(3)	Net Exposure Post-Cash Collateral	Net Exposure Post-Collateral
	(dollars in millions)						
AAA	$ 456	$ 752	$ 1,813	$ 6,458	$ (5,752)	$ 3,727	$ 3,516
AA	1,774	3,903	5,389	9,821	(14,375)	6,512	4,232
A	6,744	9,505	11,425	29,480	(51,597)	5,557	3,706
BBB	3,349	3,717	3,699	18,817	(21,981)	7,601	5,759
Non-investment grade	2,800	2,605	1,715	4,969	(5,732)	6,357	3,287
Total	$ 15,123	$ 20,482	$ 24,041	$ 69,545	$ (99,437)	$ 29,754	$ 20,500

(1) Fair values shown represent the Company s net exposure to counterparties related to the Company s OTC derivative products. Amounts include centrally cleared derivatives. The table does not include listed derivatives and the effect of any related hedges utilized by the Company.
(2) Obligor credit ratings are determined by the Company s Credit Risk Management Department.
(3) Amounts represent the netting of receivable balances with payable balances for the same counterparty across maturity categories. Receivable and payable balances with the same counterparty in the same maturity category are netted within such maturity category, where appropriate. Cash collateral received is netted on a counterparty basis, provided legal right of offset exists.

OTC Derivative Products Financial Instruments Owned at December 31, 2011(1)

	Years to Maturity						
Credit Rating(2)	Less than 1	1 - 3	3 - 5	Over 5	Cross-Maturity and Cash Collateral Netting(3)	Net Exposure Post-Cash Collateral	Net Exposure Post-Collateral
	(dollars in millions)						
AAA	$ 621	$ 1,615	$ 1,586	$ 10,375	$ (7,513)	$ 6,684	$ 6,389
AA	5,578	7,547	5,972	21,068	(31,074)	9,091	7,048
A	7,576	5,538	10,224	27,417	(41,608)	9,147	7,117

BBB	4,437	4,448	3,231	17,758	(17,932)	11,942	10,337
Non-investment grade	2,819	2,949	2,703	5,084	(6,458)	7,097	4,158
Total	$ 21,031	$ 22,097	$ 23,716	$ 81,702	$ (104,585)	$ 43,961	$ 35,049

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(1) Fair values shown represent the Company s net exposure to counterparties related to the Company s OTC derivative products. Amounts include centrally cleared derivatives. The table does not include listed derivatives and the effect of any related hedges utilized by the Company.
(2) Obligor credit ratings are determined by the Company s Credit Risk Management Department.
(3) Amounts represent the netting of receivable balances with payable balances for the same counterparty across maturity categories. Receivable and payable balances with the same counterparty in the same maturity category are netted within such maturity category, where appropriate. Cash collateral received is netted on a counterparty basis, provided legal right of offset exists.

Hedge Accounting.

The Company applies hedge accounting using various derivative financial instruments to hedge interest rate and foreign exchange risk arising from assets and liabilities not held at fair value as part of asset and liability management and foreign currency exposure management.

The Company s hedges are designated and qualify for accounting purposes as one of the following types of hedges: hedges of exposure to changes in fair value of assets and liabilities being hedged (fair value hedges) and hedges of net investments in foreign operations whose functional currency is different from the reporting currency of the parent company (net investment hedges).

For all hedges where hedge accounting is being applied, effectiveness testing and other procedures to ensure the ongoing validity of the hedges are performed at least monthly.

Fair Value Hedges Interest Rate Risk. The Company s designated fair value hedges consisted primarily of interest rate swaps designated as fair value hedges of changes in the benchmark interest rate of fixed rate senior long-term borrowings. The Company uses regression analysis to perform an ongoing prospective and retrospective assessment of the effectiveness of these hedging relationships (*i.e.*, the Company applies the long-haul method of hedge accounting). A hedging relationship is deemed effective if the fair values of the hedging instrument (derivative) and the hedged item (debt liability) change inversely within a range of 80% to 125%. The Company considers the impact of valuation adjustments related to the Company s own credit spreads and counterparty credit spreads to determine whether they would cause the hedging relationship to be ineffective.

For qualifying fair value hedges of benchmark interest rates, the changes in the fair value of the derivative and the changes in the fair value of the hedged liability provide offset of one another and, together with any resulting ineffectiveness, are recorded in Interest expense. When a derivative is de-designated as a hedge, any basis adjustment remaining on the hedged liability is amortized to Interest expense over the remaining life of the liability using the effective interest method.

Net Investment Hedges. The Company may utilize forward foreign exchange contracts to manage the currency exposure relating to its net investments in non-U.S. dollar functional currency operations. No hedge ineffectiveness is recognized in earnings since the notional amounts of the hedging instruments equal the portion of the investments being hedged and the currencies being exchanged are the functional currencies of the parent and investee. The gain or loss from revaluing hedges of net investments in foreign operations at the spot rate is deferred and reported within Accumulated other comprehensive income (loss) in Total Equity, net of tax effects. The forward points on the hedging instruments are recorded in Interest income.

The Company recognized an out of period pre-tax gain of approximately $300 million in the Institutional Securities business segment s Other sales and trading net revenues for the quarter ended June 30, 2012, related to the reversal of amounts recorded in cumulative other comprehensive income due to the incorrect application of hedge accounting on certain derivative contracts previously designated as net investment hedges of certain

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foreign, non-US dollar denominated subsidiaries. This amount included a pre-tax gain of approximately $191 million related to the quarter ended March 31, 2012, with the remainder impacting prior periods. The Company has evaluated the effects of the incorrect application of hedge accounting, both qualitatively and quantitatively, and concluded that it did not have a material impact on any prior annual or quarterly consolidated results. In addition, the Company has recognized a partially offsetting pre-tax loss of approximately $224 million for the quarter ended June 30, 2012 resulting from fair value changes within the quarter of the related derivative positions not qualifying for net investment hedge accounting. Subsequent to the identification of the incorrect application of net investment hedge accounting, and during the quarter ended June 30, 2012, the Company has appropriately redesignated the forward foreign exchange contracts and reapplied hedge accounting.

The following tables summarize the fair value of derivative instruments designated as accounting hedges and the fair value of derivative instruments not designated as accounting hedges by type of derivative contract on a gross basis. Fair values of derivative contracts in an asset position are included in Financial instruments owned Derivative and other contracts. Fair values of derivative contracts in a liability position are reflected in Financial instruments sold, not yet purchased Derivative and other contracts.

	Assets at June 30, 2012		Liabilities at June 30, 2012	
	Fair Value	Notional	Fair Value	Notional
	(dollars in millions)			
Derivatives designated as accounting hedges:				
Interest rate contracts	$ 8,518	$ 72,810	$	$
Foreign exchange contracts	317	9,344	147	12,581
Total derivatives designated as accounting hedges	8,835	82,154	147	12,581
Derivatives not designated as accounting hedges(1):				
Interest rate contracts	867,321	19,052,076	845,668	19,100,997
Credit contracts	101,464	2,175,722	96,216	2,126,827
Foreign exchange contracts	49,907	1,814,083	53,477	1,892,732
Equity contracts	44,905	671,162	49,038	654,605
Commodity contracts	33,517	410,648	33,536	384,360
Other	126	2,139	70	4,402
Total derivatives not designated as accounting hedges	1,097,240	24,125,830	1,078,005	24,163,923
Total derivatives	$ 1,106,075	$ 24,207,984	$ 1,078,152	$ 24,176,504
Cash collateral netting	(75,370)		(46,855)	
Counterparty netting	(996,362)		(996,362)	
Total derivatives	$ 34,343	$ 24,207,984	$ 34,935	$ 24,176,504

(1) Notional amounts include gross notionals related to open long and short futures contracts of $77 billion and $67 billion, respectively. The unsettled fair value on these futures contracts (excluded from the table above) of $445 million and $150 million is included in Receivables Brokers, dealers and clearing organizations and Payables Brokers, dealers and clearing organizations, respectively, on the condensed consolidated statements of financial condition.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	Assets at December 31, 2011		Liabilities at December 31, 2011	
	Fair Value	Notional	Fair Value	Notional
	(dollars in millions)			
Derivatives designated as accounting hedges:				
Interest rate contracts	$ 8,151	$ 71,706	$	$
Foreign exchange contracts	348	12,222	57	7,111
Total derivatives designated as accounting hedges	8,499	83,928	57	7,111
Derivatives not designated as accounting hedges(1):				
Interest rate contracts	904,725	21,099,876	880,027	21,005,733
Credit contracts	138,791	2,466,623	130,726	2,428,042
Foreign exchange contracts	61,995	1,582,364	64,691	1,604,493
Equity contracts	46,287	603,290	48,286	595,146
Commodity contracts	39,778	411,661	39,998	374,594
Other	598	11,662	2,275	24,905
Total derivatives not designated as accounting hedges	1,192,174	26,175,476	1,166,003	26,032,913
Total derivatives	$ 1,200,673	$ 26,259,404	$ 1,166,060	$ 26,040,024
Cash collateral netting	(77,938)		(44,936)	
Counterparty netting	(1,074,671)		(1,074,671)	
Total derivatives	$ 48,064	$ 26,259,404	$ 46,453	$ 26,040,024

(1) Notional amounts include gross notionals related to open long and short futures contracts of $77 billion and $66 billion, respectively. The unsettled fair value on these futures contracts (excluded from the table above) of $605 million and $37 million is included in Receivables Brokers, dealers and clearing organizations and Payables Brokers, dealers and clearing organizations, respectively, on the condensed consolidated statements of financial condition.

The following tables summarize the gains or losses reported on derivative instruments designated and qualifying as accounting hedges for the quarters and six months ended June 30, 2012 and 2011, respectively.

Derivatives Designated as Fair Value Hedges.

The following table presents gains (losses) reported on derivative instruments and the related hedge item as well as the hedge ineffectiveness included in Interest expense in the condensed consolidated statements of income from interest rate contracts:

	Gains (Losses) Recognized			
	Three Months Ended June 30,		Six Months Ended June 30,	
Product Type	2012	2011	2012	2011
	(dollars in millions)			
Derivatives	$ 979	$ 1,165	$ 432	$ 70
Borrowings	(753)	(1,013)	(54)	245
Total	$ 226	$ 152	$ 378	$ 315

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Derivatives Designated as Net Investment Hedges.

	Gains (Losses) Recognized in OCI (effective portion)			
	Three Months Ended June 30,		Six Months Ended June 30,	
Product Type	**2012(2)**	**2011**	**2012(2)**	**2011**
	(dollars in millions)			
Foreign exchange contracts(1)	$ 130	$ (157)	$ 150	$ (283)
Total	$ 130	$ (157)	$ 150	$ (283)

(1) Losses of $63 million and $128 million were recognized in income related to amounts excluded from hedge effectiveness testing during the quarter and six months ended June 30, 2012, respectively. Losses of $62 million and $109 million were recognized in income related to amounts excluded from hedge effectiveness testing during the quarter and six months ended June 30, 2011, respectively.

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

The table below summarizes gains (losses) on derivative instruments not designated as accounting hedges for the quarters and six months ended June 30, 2012 and 2011, respectively:

	Gains (Losses) Recognized in Income(1)(2)			
	Three Months Ended June 30,		Six Months Ended June 30,	
Product Type	**2012**	**2011**	**2012**	**2011**
	(dollars in millions)			
Interest rate contracts	$ (594)	$ 4,410	$ 961	$ 5,281
Credit contracts	1,293	1,551	621	753
Foreign exchange contracts	(208)	(3,329)	427	(3,584)
Equity contracts	188	38	(628)	(942)
Commodity contracts	908	721	302	449
Other contracts	(32)	(14)	24	222
Total derivative instruments	$ 1,555	$ 3,377	$ 1,707	$ 2,179

(1) Gains (losses) on derivative contracts not designated as hedges are primarily included in Principal transactions Trading.

(2) Gains (losses) associated with certain derivative contracts that have physically settled are excluded from the table above. Gains (losses) on these contracts are reflected with the associated cash instruments, which are also included in Principal transactions Trading.

The Company also has certain embedded derivatives that have been bifurcated from the related structured borrowings. Such derivatives are classified in Long-term borrowings and had a net fair value of $25 million and $53 million at June 30, 2012 and December 31, 2011, respectively, and a notional value of $2,334 million and $3,312 million at June 30, 2012 and December 31, 2011, respectively. The Company recognized losses of $13 million and $6 million related to changes in the fair value of its bifurcated embedded derivatives for the quarter and six months ended June 30, 2012, respectively. The Company recognized gains of $21 million and $2 million related to changes in the fair value of its bifurcated embedded derivatives for the quarter and six months ended June 30, 2011, respectively.

At June 30, 2012 and December 31, 2011, the amount of payables associated with cash collateral received that was netted against derivative assets was $75.4 billion and $77.9 billion, respectively, and the amount of receivables in respect of cash collateral paid that was netted against derivative liabilities was $46.9 billion and

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

$44.9 billion, respectively. Cash collateral receivables and payables of $110 million and $47 million, respectively, at June 30, 2012 and $268 million and $9 million, respectively, at December 31, 2011, were not offset against certain contracts that did not meet the definition of a derivative.

Credit-Risk-Related Contingencies.

In connection with certain OTC trading agreements, the Company may be required to provide additional collateral or immediately settle any outstanding liability balances with certain counterparties in the event of a credit ratings downgrade. At June 30, 2012, the aggregate fair value of OTC derivative contracts that contain credit-risk-related contingent features that are in a net liability position totaled $38,619 million, for which the Company has posted collateral of $34,602 million, in the normal course of business. The long-term credit ratings on the Company by Moody s Investors Service (Moody s) and Standard & Poor s Ratings Services (S&P) are currently at different levels (commonly referred to as split ratings). At June 30, 2012, the future potential collateral amounts, termination payments or other contractual amounts that could be called by counterparties in the event of a downgrade of the Company s long-term credit rating under various scenarios are: $374 million (Baa1 Moody s/BBB+ S&P) and $2,161 million (Baa2 Moody s/BBB S&P). Of these amounts, $1,947 million at June 30, 2012 related to bilateral arrangements between the Company and other parties where upon the downgrade of one party, the downgraded party must deliver collateral to the other party. These bilateral downgrade arrangements are a risk management tool used extensively by the Company as credit exposures are reduced if counterparties are downgraded.

Credit Derivatives and Other Credit Contracts.

The Company enters into credit derivatives, principally through credit default swaps, under which it receives or provides protection against the risk of default on a set of debt obligations issued by a specified reference entity or entities. A majority of the Company s counterparties are banks, broker-dealers, insurance and other financial institutions, and monoline insurers.

The tables below summarize the notional and fair value of protection sold and protection purchased through credit default swaps at June 30, 2012 and December 31, 2011:

	At June 30, 2012 Maximum Potential Payout/Notional			
	Protection Sold		Protection Purchased	
	Notional	Fair Value (Asset)/Liability	Notional	Fair Value (Asset)/Liability
	(dollars in millions)			
Single name credit default swaps	$ 1,180,417	$ 26,932	$ 1,149,999	$ (24,814)
Index and basket credit default swaps	648,157	17,996	498,966	(15,738)
Tranched index and basket credit default swaps	328,979	11,736	496,031	(21,360)
Total	$ 2,157,553	$ 56,664	$ 2,144,996	$ (61,912)

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	At December 31, 2011 Maximum Potential Payout/Notional			
	Protection Sold		Protection Purchased	
	Notional	Fair Value (Asset)/Liability	Notional	Fair Value (Asset)/Liability
	(dollars in millions)			
Single name credit default swaps	$ 1,325,045	$ 47,045	$ 1,315,333	$ (45,345)
Index and basket credit default swaps	787,228	29,475	601,452	(24,373)
Tranched index and basket credit default swaps	320,131	17,109	545,476	(31,976)
Total	$ 2,432,404	$ 93,629	$ 2,462,261	$ (101,694)

The table below summarizes the credit ratings and maturities of protection sold through credit default swaps and other credit contracts at June 30, 2012:

	Protection Sold Maximum Potential Payout/Notional Years to Maturity					Fair Value
Credit Ratings of the Reference Obligation	Less than 1	1-3	3-5	Over 5	Total	(Asset)/ Liability(1)(2)
	(dollars in millions)					
Single name credit default swaps:						
AAA	$ 1,933	$ 5,849	$ 19,634	$ 9,974	$ 37,390	$ 883
AA	10,304	14,727	23,726	8,146	56,903	303
A	75,045	98,321	76,287	32,078	281,731	4,949
BBB	141,081	187,707	135,210	41,975	505,973	4,003
Non-investment grade	84,407	105,363	81,343	27,307	298,420	16,794
Total	312,770	411,967	336,200	119,480	1,180,417	26,932
Index and basket credit default swaps(3):						
AAA	73,314	50,652	49,310	15,326	188,602	(1,063)
AA	4,525	13,256	7,910	14,185	39,876	740
A	6,115	6,440	34,045	2,380	48,980	2,585
BBB	33,683	101,638	171,423	29,284	336,028	4,861
Non-investment grade	91,508	97,275	138,266	36,601	363,650	22,609
Total	209,145	269,261	400,954	97,776	977,136	29,732
Total credit default swaps sold	$ 521,915	$ 681,228	$ 737,154	$ 217,256	$ 2,157,553	$ 56,664
Other credit contracts(4)(5)	$ 704	$ 564	$ 815	$ 2,301	$ 4,384	$ (1,744)
Total credit derivatives and other credit contracts	$ 522,619	$ 681,792	$ 737,969	$ 219,557	$ 2,161,937	$ 54,920

(1) Fair value amounts are shown on a gross basis prior to cash collateral or counterparty netting.

(2) Fair value amounts of certain credit default swaps where the Company sold protection have an asset carrying value because credit spreads of the underlying reference entity or entities tightened during the terms of the contracts.
(3) Credit ratings are calculated internally.
(4) Other credit contracts include CLNs, CDOs and credit default swaps that are considered hybrid instruments.
(5) Fair value amount shown represents the fair value of the hybrid instruments.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The table below summarizes the credit ratings and maturities of protection sold through credit default swaps and other credit contracts at December 31, 2011:

Credit Ratings of the Reference Obligation	Protection Sold Maximum Potential Payout/Notional Years to Maturity Less than 1	1-3	3-5	Over 5	Total	Fair Value (Asset)/ Liability(1)(2)
	(dollars in millions)					
Single name credit default swaps:						
AAA	$ 1,290	$ 5,681	$ 24,087	$ 12,942	$ 44,000	$ 1,536
AA	12,416	22,043	23,341	10,986	68,786	1,597
A	67,344	124,445	85,543	47,640	324,972	8,683
BBB	131,588	218,262	115,320	64,347	529,517	4,789
Non-investment grade	94,105	133,867	82,163	47,635	357,770	30,440
Total	306,743	504,298	330,454	183,550	1,325,045	47,045
Index and basket credit default swaps(3):						
AAA	48,115	49,997	33,584	19,110	150,806	(907)
AA	6,584	15,349	9,498	15,745	47,176	1,053
A	5,202	18,996	17,396	12,286	53,880	2,470
BBB	8,525	99,004	235,888	32,057	375,474	8,365
Non-investment grade	112,451	141,042	160,537	65,993	480,023	35,603
Total	180,877	324,388	456,903	145,191	1,107,359	46,584
Total credit default swaps sold	$ 487,620	$ 828,686	$ 787,357	$ 328,741	$ 2,432,404	$ 93,629
Other credit contracts(4)(5)	$ 65	$ 2,356	$ 717	$ 2,469	$ 5,607	$ (1,146)
Total credit derivatives and other credit contracts	$ 487,685	$ 831,042	$ 788,074	$ 331,210	$ 2,438,011	$ 92,483

(1) Fair value amounts are shown on a gross basis prior to cash collateral or counterparty netting.
(2) Fair value amounts of certain credit default swaps where the Company sold protection have an asset carrying value because credit spreads of the underlying reference entity or entities tightened during the terms of the contracts.
(3) Credit ratings are calculated internally.
(4) Other credit contracts include CLNs, CDOs and credit default swaps that are considered hybrid instruments.
(5) Fair value amount shown represents the fair value of the hybrid instruments.

Single Name Credit Default Swaps. A credit default swap protects the buyer against the loss of principal on a bond or loan in case of a default by the issuer. The protection buyer pays a periodic premium (generally quarterly) over the life of the contract and is protected for the period. The Company in turn will have to perform under a credit default swap if a credit event as defined under the contract occurs. Typical credit events include bankruptcy, dissolution or insolvency of the referenced entity, failure to pay and restructuring of the obligations of the referenced entity. In order to provide an indication of the current payment status or performance risk of the credit default swaps, the external credit ratings of the underlying reference entity of the credit default swaps are disclosed.

Index and Basket Credit Default Swaps. Index and basket credit default swaps are credit default swaps that reference multiple names through underlying baskets or portfolios of single name credit default swaps. Generally, in the event of a default on one of the underlying names, the Company will have to pay a pro rata portion of the total notional amount of the credit default index or basket contract. In order to provide an indication of the current payment status or performance risk of these credit default swaps, the weighted average external credit ratings of the underlying reference entities comprising the basket or index were calculated and disclosed.

The Company also enters into index and basket credit default swaps where the credit protection provided is based upon the application of tranching techniques. In tranched transactions, the credit risk of an index or basket is separated into various portions of the capital structure, with different levels of subordination. The most junior tranches cover initial defaults, and once losses exceed the notional of the tranche, they are passed on to the next most senior tranche in the capital structure.

When external credit ratings are not available, credit ratings were determined based upon an internal methodology.

Credit Protection Sold through CLNs and CDOs. The Company has invested in CLNs and CDOs, which are hybrid instruments containing embedded derivatives, in which credit protection has been sold to the issuer of the note. If there is a credit event of a reference entity underlying the instrument, the principal balance of the note may not be repaid in full to the Company.

Purchased Credit Protection with Identical Underlying Reference Obligations. For single name credit default swaps and non-tranched index and basket credit default swaps, the Company has purchased protection with a notional amount of approximately $1.7 trillion and $1.9 trillion at June 30, 2012 and December 31, 2011, compared with a notional amount of approximately $1.8 trillion and $2.1 trillion at June 30, 2012 and December 31, 2011, respectively, of credit protection sold with identical underlying reference obligations. In order to identify purchased protection with the same underlying reference obligations, the notional amount for individual reference obligations within non-tranched indices and baskets was determined on a pro rata basis and matched off against single name and non-tranched index and basket credit default swaps where credit protection was sold with identical underlying reference obligations.

The purchase of credit protection does not represent the sole manner in which the Company risk manages its exposure to credit derivatives. The Company manages its exposure to these derivative contracts through a variety of risk mitigation strategies, which include managing the credit and correlation risk across single name, non-tranched indices and baskets, tranched indices and baskets, and cash positions. Aggregate market risk limits have been established for credit derivatives, and market risk measures are routinely monitored against these limits. The Company may also recover amounts on the underlying reference obligation delivered to the Company under credit default swaps where credit protection was sold.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

11. Commitments, Guarantees and Contingencies.

Commitments.

The Company s commitments associated with outstanding letters of credit and other financial guarantees obtained to satisfy collateral requirements, investment activities, corporate lending and financing arrangements, mortgage lending and margin lending at June 30, 2012 are summarized below by period of expiration. Since commitments associated with these instruments may expire unused, the amounts shown do not necessarily reflect the actual future cash funding requirements:

	Years to Maturity				
	Less than 1	1-3	3-5	Over 5	Total at June 30, 2012
	(dollars in millions)				
Letters of credit and other financial guarantees obtained to satisfy collateral requirements	$ 797	$ 8	$ 6	$	$ 811
Investment activities	1,132	174	44	281	1,631
Primary lending commitments investment grade(1)(2)	11,352	12,303	33,824	946	58,425
Primary lending commitments non-investment grade(2)	1,801	2,450	9,434	1,755	15,440
Secondary lending commitments(3)	71	135	28	73	307
Commitments for secured lending transactions	891	41			932
Forward starting reverse repurchase agreements and securities borrowing agreements(4)(5)	57,864				57,864
Commercial and residential mortgage-related commitments	1,583	34	253	358	2,228
Other commitments	1,249	144	45	63	1,501
Total	$ 76,740	$ 15,289	$ 43,634	$ 3,476	$ 139,139

(1) This amount includes commitments to asset-backed commercial paper conduits of $275 million at June 30, 2012, of which $138 million have maturities of less than one year and $137 million of which have maturities of one to three years.

(2) This amount includes $24.1 billion of investment grade and $4.3 billion of non-investment grade unfunded commitments accounted for as held for investment and $4.7 billion of investment grade and $2.1 billion of non-investment grade unfunded commitments accounted for as held for sale at June 30, 2012. The remainder of these lending commitments are carried at fair value.

(3) These commitments are recorded at fair value within Financial instruments owned and Financial instruments sold, not yet purchased in the condensed consolidated statements of financial condition (see Note 3).

(4) The Company enters into forward starting reverse repurchase and securities borrowing agreements (agreements that have a trade date at or prior to June 30, 2012 and settle subsequent to period-end) that are primarily secured by collateral from U.S. government agency securities and other sovereign government obligations. These agreements primarily settle within three business days and of the amount at June 30, 2012, $52.7 billion settled within three business days.

(5) The Company also has a contingent obligation to provide financing to a clearinghouse through which it clears certain transactions. The financing is required only upon the default of a clearinghouse member. The financing takes the form of a reverse repurchase facility, with a maximum amount of approximately $3 billion.

The above table excludes the commitment related to the Company s exercise of its right to purchase an additional 14% in MSSB (see Note 21).

For further description of these commitments, refer to Note 13 to the consolidated financial statements for the year ended December 31, 2011 included in the Form 10-K.

The Company sponsors several non-consolidated investment funds for third-party investors where the Company typically acts as general partner of, and investment advisor to, these funds and typically commits to invest a minority of the capital of such funds, with subscribing third-party investors contributing the majority. The Company s employees, including its senior officers, as well as the Company s directors, may participate on the same terms and conditions as other investors in certain of these funds that the Company forms primarily for client investment, except that the Company may waive or lower applicable fees and charges for its employees. The Company has contractual capital commitments, guarantees, lending facilities and counterparty arrangements with respect to these investment funds.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Guarantees.

The table below summarizes certain information regarding the Company s obligations under guarantee arrangements at June 30, 2012:

	Maximum Potential Payout/Notional Years to Maturity					Carrying Amount	
Type of Guarantee	Less than 1	1-3	3-5	Over 5	Total	(Asset)/ Liability	Collateral/ Recourse
				(dollars in millions)			
Credit derivative contracts(1)	$ 521,915	$ 681,228	$ 737,154	$ 217,256	$ 2,157,553	$ 56,664	$
Other credit contracts	704	564	815	2,301	4,384	(1,744)	
Non-credit derivative contracts(1)	1,196,592	889,494	349,593	433,506	2,869,185	101,063	
Standby letters of credit and other financial guarantees issued(2)(3)	1,305	1,235	1,199	5,861	9,600	(127)	8,244
Market value guarantees		41	172	566	779	12	87
Liquidity facilities	4,322	186		65	4,573	(6)	6,181
Whole loan sales representations and warranties				24,754	24,754	79	
Securitization representations and warranties				73,492	73,492	34	
General partner guarantees	77	26	17	159	279	77	

(1) Carrying amounts of derivative contracts are shown on a gross basis prior to cash collateral or counterparty netting. For further information on derivative contracts, see Note 10.

(2) Approximately $2.2 billion of standby letters of credit are also reflected in the Commitments table in primary and secondary lending commitments. Standby letters of credit are recorded at fair value within Financial instruments owned or Financial instruments sold, not yet purchased in the condensed consolidated statements of financial condition.

(3) Amounts include guarantees issued by consolidated real estate funds sponsored by the Company of approximately $198 million. These guarantees relate to obligations of the fund s investee entities, including guarantees related to capital expenditures and principal and interest debt payments. Accrued losses under these guarantees of approximately $7 million are reflected as a reduction of the carrying value of the related fund investments, which are reflected in Financial instruments owned Investments on the condensed consolidated statement of financial condition.

For further description of these guarantees, refer to Note 13 to the consolidated financial statements for the year ended December 31, 2011 included in the Form 10-K.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Company has obligations under certain guarantee arrangements, including contracts and indemnification agreements that contingently require a guarantor to make payments to the guaranteed party based on changes in an underlying measure (such as an interest or foreign exchange rate, security or commodity price, an index or the occurrence or non-occurrence of a specified event) related to an asset, liability or equity security of a guaranteed party. Also included as guarantees are contracts that contingently require the guarantor to make payments to the guaranteed party based on another entity s failure to perform under an agreement, as well as indirect guarantees of the indebtedness of others. The Company s use of guarantees is described below by type of guarantee:

Other Guarantees and Indemnities.

In the normal course of business, the Company provides guarantees and indemnifications in a variety of commercial transactions. These provisions generally are standard contractual terms. Certain of these guarantees and indemnifications are described below.

Trust Preferred Securities. The Company has established Morgan Stanley Capital Trusts for the limited purpose of issuing trust preferred securities to third parties and lending the proceeds to the Company in exchange for junior subordinated debentures. The Company has directly guaranteed the repayment of the trust preferred securities to the holders thereof to the extent that the Company has made payments to a Morgan Stanley Capital Trust on the junior subordinated debentures. In the event that the Company does not make payments to a Morgan Stanley Capital Trust, holders of such series of trust preferred securities would not be able to rely upon the guarantee for payment of those amounts. The Company has not recorded any liability in the condensed consolidated financial statements for these guarantees and believes that the occurrence of any events (*i.e.*, non-performance on the part of the paying agent) that would trigger payments under these contracts is remote. See Note 15 to the consolidated financial statements for the year ended December 31, 2011 included in the Form 10-K for details on the Company s junior subordinated debentures.

Indemnities. The Company provides standard indemnities to counterparties for certain contingent exposures and taxes, including U.S. and foreign withholding taxes, on interest and other payments made on derivatives, securities and stock lending transactions, certain annuity products and other financial arrangements. These indemnity payments could be required based on a change in the tax laws or change in interpretation of applicable tax rulings or a change in factual circumstances. Certain contracts contain provisions that enable the Company to terminate the agreement upon the occurrence of such events. The maximum potential amount of future payments that the Company could be required to make under these indemnifications cannot be estimated.

Exchange/Clearinghouse Member Guarantees. The Company is a member of various U.S. and non-U.S. exchanges and clearinghouses that trade and clear securities and/or derivative contracts. Associated with its membership, the Company may be required to pay a proportionate share of the financial obligations of another member who may default on its obligations to the exchange or the clearinghouse. While the rules governing different exchange or clearinghouse memberships vary, in general the Company s guarantee obligations would arise only if the exchange or clearinghouse had previously exhausted its resources. The maximum potential payout under these membership agreements cannot be estimated. The Company has not recorded any contingent liability in the condensed consolidated financial statements for these agreements and believes that any potential requirement to make payments under these agreements is remote.

Merger and Acquisition Guarantees. The Company may, from time to time, in its role as investment banking advisor be required to provide guarantees in connection with certain European merger and acquisition transactions. If required by the regulating authorities, the Company provides a guarantee that the acquirer in the merger and acquisition transaction has or will have sufficient funds to complete the transaction and would then be required to make the acquisition payments in the event the acquirer s funds

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

are insufficient at the completion date of the transaction. These arrangements generally cover the time frame from the transaction offer date to its closing date and, therefore, are generally short term in nature. The maximum potential amount of future payments that the Company could be required to make cannot be estimated. The Company believes the likelihood of any payment by the Company under these arrangements is remote given the level of the Company s due diligence associated with its role as investment banking advisor.

Guarantees on Morgan Stanley Stable Value Program. On September 30, 2009, the Company entered into an agreement with the investment manager for the Stable Value Program (SVP), a fund within the Company s 401(k) plan, and certain other third parties. Under the agreement, the Company may have had a future obligation to make a payment of $40 million to the SVP, contingent upon performance of the SVP and other circumstances. The Company did not record a liability for this guarantee in the condensed consolidated financial statements. Effective July 31, 2012, the SVP and the agreement, including the Company s aforementioned contingent future obligation, were both terminated without any payment by the Company.

In the ordinary course of business, the Company guarantees the debt and/or certain trading obligations (including obligations associated with derivatives, foreign exchange contracts and the settlement of physical commodities) of certain subsidiaries. These guarantees generally are entity or product specific and are required by investors or trading counterparties. The activities of the subsidiaries covered by these guarantees (including any related debt or trading obligations) are included in the Company s condensed consolidated financial statements.

Contingencies.

Legal. In the normal course of business, the Company has been named, from time to time, as a defendant in various legal actions, including arbitrations, class actions and other litigation, arising in connection with its activities as a global diversified financial services institution. Certain of the actual or threatened legal actions include claims for substantial compensatory and/or punitive damages or claims for indeterminate amounts of damages. In some cases, the entities that would otherwise be the primary defendants in such cases are bankrupt or are in financial distress. These actions have included, but are not limited to, residential mortgage and credit crisis related matters. Over the last several years, the level of litigation and investigatory activity focused on residential mortgage and credit crisis related matters has increased materially in the financial services industry. As a result, the Company expects that it may become the subject of increased claims for damages and other relief regarding residential mortgages and related securities in the future and, while the Company has identified below any individual proceedings where the Company believes a material loss to be reasonably possible and reasonably estimable, there can be no assurance that material losses will not be incurred from claims that have not yet been notified to the Company or are not yet determined to be probable or possible and reasonably estimable losses.

The Company is also involved, from time to time, in other reviews, investigations and proceedings (both formal and informal) by governmental and self-regulatory agencies regarding the Company s business, including, among other matters, accounting and operational matters, certain of which may result in adverse judgments, settlements, fines, penalties, injunctions or other relief.

The Company contests liability and/or the amount of damages as appropriate in each pending matter. Where available information indicates that it is probable a liability had been incurred at the date of the condensed consolidated financial statements and the Company can reasonably estimate the amount of that loss, the Company accrues the estimated loss by a charge to income. In many proceedings, however, it is inherently difficult to determine whether any loss is probable or even possible or to estimate the amount of any loss. In addition, even where loss is possible or an exposure to loss exists in excess of the liability already accrued with respect to a previously recognized loss contingency, it is not always possible to reasonably estimate the size of the possible loss or range of loss.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

For certain legal proceedings, the Company cannot reasonably estimate such losses, particularly for proceedings that are in their early stages of development or where plaintiffs seek substantial or indeterminate damages. Numerous issues may need to be resolved, including through potentially lengthy discovery and determination of important factual matters, determination of issues related to class certification and the calculation of damages, and by addressing novel or unsettled legal questions relevant to the proceedings in question, before a loss or additional loss or range of loss or additional loss can be reasonably estimated for any proceeding.

For certain other legal proceedings, the Company can estimate reasonably possible losses, additional losses, ranges of loss or ranges of additional loss in excess of amounts accrued, but does not believe, based on current knowledge and after consultation with counsel, that such losses will have a material adverse effect on the Company s condensed consolidated financial statements as a whole, other than the matters referred to in the following paragraphs.

On September 25, 2009, the Company was named as a defendant in a lawsuit styled *Citibank, N.A. v. Morgan Stanley & Co. International, PLC*, which was pending in the United States District Court for the Southern District of New York (SDNY). The lawsuit relates to a credit default swap referencing the Capmark VI CDO (Capmark), which was structured by Citibank, N.A. (Citi N.A.). At issue is whether, as part of the swap agreement, Citi N.A. was obligated to obtain the Company s prior written consent before it exercised its rights to liquidate Capmark upon the occurrence of certain contractually-defined credit events. Citi N.A. is seeking approximately $245 million in compensatory damages plus interest and costs. On October 8, 2010, the court issued an order denying Citi N.A. s motion for judgment on the pleadings as to the Company s counterclaim for reformation and granting Citi N.A. s motion for judgment on the pleadings as to the Company s counterclaim for estoppel. On May 25, 2011, the court issued an order denying the Company s motion for summary judgment and granting Citi N.A. s cross motion for summary judgment. On June 27, 2011, the court entered a judgment in favor of Citi N.A. for $269 million plus post-judgment interest and costs, and the Company filed a notice of appeal with the United States Court of Appeals for the Second Circuit, which appeal is now pending. Based on currently available information, the Company believes it could incur a loss of up to approximately $269 million plus post-judgment interest.

On August 25, 2008, the Company and two ratings agencies were named as defendants in a purported class action related to securities issued by a structured investment vehicle called Cheyne Finance (the Cheyne SIV). The case is styled *Abu Dhabi Commercial Bank, et al. v. Morgan Stanley & Co. Inc., et al.* and is pending in the SDNY. The complaint alleges, among other things, that the ratings assigned to the securities issued by the Cheyne SIV were false and misleading because the ratings did not accurately reflect the risks associated with the subprime residential mortgage backed securities held by the Cheyne SIV. On September 2, 2009, the court dismissed all of the claims against the Company except for plaintiffs claims for common law fraud. On June 15, 2010, the court denied plaintiffs motion for class certification. On July 20, 2010, the court granted plaintiffs leave to replead their aiding and abetting common law fraud claims against the Company, and those claims were added in an amended complaint filed on August 5, 2010. On December 27, 2011, the court permitted plaintiffs to reinstate their causes of action for negligent misrepresentation and breach of fiduciary duty against the Company. The Company moved to dismiss these claims on January 10, 2012. On January 5, 2012, the court permitted plaintiffs to amend their Complaint and assert a negligence claim against the Company. The amended complaint was filed on January 9, 2012 and the Company moved to dismiss the negligence claim on January 17, 2012. On January 23, 2012, the Company moved for summary judgment with respect to the fraud and aiding and abetting fraud claims, which motion is now pending. On May 4, 2012, the court granted the Company s motion to dismiss claims against the Company for breach of fiduciary duty and negligence, and denied the Company s motion to dismiss claims against the Company for negligent misrepresentation. There are 15 plaintiffs in this action asserting claims related to approximately $983 million of securities issued by the Cheyne SIV. On July 2, 2012, the plaintiffs filed supplemental disclosures with the Court alleging that they are seeking approximately $811

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

million in compensatory damages. Plaintiffs are also seeking punitive damages. Based on currently available information, the Company believes that the defendants could incur a loss up to approximately $811 million, plus pre- and post-judgment interest, fees and costs.

On July 15, 2010, China Development Industrial Bank (CDIB) filed a complaint against the Company, which is styled *China Development Industrial Bank v. Morgan Stanley & Co. Incorporated et al*. and is pending in the Supreme Court of the State of New York, New York County. The complaint relates to a $275 million credit default swap referencing the super senior portion of the STACK 2006-1 CDO. The complaint asserts claims for common law fraud, fraudulent inducement and fraudulent concealment and alleges that the Company misrepresented the risks of the STACK 2006-1 CDO to CDIB, and that the Company knew that the assets backing the CDO were of poor quality when it entered into the credit default swap with CDIB. The complaint seeks compensatory damages related to the approximately $228 million that CDIB alleges it has already lost under the credit default swap, rescission of CDIB s obligation to pay an additional $12 million, punitive damages, equitable relief, fees and costs. On February 28, 2011, the court presiding over this action denied the Company s motion to dismiss the complaint. On March 21, 2011, the Company appealed the order denying its motion to dismiss the complaint. On July 7, 2011, the appellate court affirmed the lower court s decision denying the motion to dismiss. Based on currently available information, the Company believes it could incur a loss of up to approximately $240 million plus pre- and post-judgment interest, fees and costs.

On March 15, 2010, the Federal Home Loan Bank of San Francisco filed two complaints against the Company and other defendants in the Superior Court of the State of California. These actions are styled *Federal Home Loan Bank of San Francisco v. Credit Suisse Securities (USA) LLC, et al.*, and *Federal Home Loan Bank of San Francisco v. Deutsche Bank Securities Inc. et al.*, respectively. Amended complaints were filed on June 10, 2010. The complaints allege that defendants made untrue statements and material omissions in connection with the sale to plaintiff of mortgage pass through certificates backed by securitization trusts containing residential mortgage loans. The original amount of the certificates allegedly sold to plaintiff by the Company in these cases was approximately $980 million collectively. The complaints raise claims under both the federal securities laws and California law and seek, among other things, to rescind the plaintiff s purchase of such certificates. On July 29, 2011 and September 8, 2011, the court presiding over these cases dismissed the federal securities law claims against the Company, but denied the Company s motion to dismiss with respect to other claims. At June 30, 2012, the current unpaid balance of the mortgage pass through certificates at issue in these cases was approximately $386 million and the certificates had not yet incurred losses. Based on currently available information, the Company believes it could incur a loss up to the difference between the $386 million unpaid balance of these certificates and their fair market value at the time of a judgment against the Company, plus pre- and post-judgment interest, fees and costs. The Company may be entitled to be indemnified for some of these losses and would be entitled to an offset for interest received by the plaintiff prior to a judgment.

12. Regulatory Requirements.

Morgan Stanley. The Company is a financial holding company under the Bank Holding Company Act of 1956, as amended, and is subject to the regulation and oversight of the Board of Governors of the Federal Reserve System (the Federal Reserve). The Federal Reserve establishes capital requirements for the Company, including well-capitalized standards, and evaluates the Company s compliance with such capital requirements. The Office of the Comptroller of the Currency establishes similar capital requirements and standards for the Company s national bank subsidiaries.

The Company calculates its capital ratios and risk-weighted assets (RWA) in accordance with the capital adequacy standards for financial holding companies adopted by the Federal Reserve. These standards are based upon a framework described in the International Convergence of Capital Measurement and Capital Standards,

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

July 1988, as amended, also referred to as Basel I. In December 2007, the U.S. banking regulators published final regulation incorporating the Basel II Accord, which requires internationally active banking organizations, as well as certain of their U.S. bank subsidiaries, to implement Basel II standards over the next several years. In July 2010, the Company began reporting its capital adequacy standards on a parallel basis to its regulators under Basel I and Basel II as part of a phased implementation of Basel II.

In December 2009, the Basel Committee released proposals on risk-based capital, leverage and liquidity standards, known as Basel III . In June 2012, the U.S. Banking regulators proposed rules to implement many aspects of Basel III (the proposals). The proposals complement an earlier proposal for revisions to the market risk framework. The earlier proposal, also referred to as Basel 2.5 , increases capital requirements for securitizations and correlation trading within the Company s trading book. In June 2012, the U.S. banking regulators issued final rules that are intended to implement certain aspects of the Basel 2.5 market risk framework proposals. Those rules will become effective on January 1, 2013.

The proposals contain new capital standards that raise the quality of capital and strengthen counterparty credit risk capital requirements and introduce a leverage ratio as a supplemental measure to the risk-based ratio. The proposals include a new capital conservation buffer, which imposes a common equity requirement above the new minimum that can be depleted under stress, and could result in restrictions on capital distributions and discretionary bonuses under certain circumstances. The proposals also provide for a potential countercyclical buffer which regulators can activate during periods of excessive credit growth in their jurisdiction. The U.S. banking regulators did not address the new additional loss absorbency capital requirement for global systemically important banks (GSIB), such as the Company, that is included in the original Basel III standards; however, the U.S. banking regulators indicated that guidance on GSIB capital requirement would be forthcoming. The proposals also propose amendments to the advanced approaches risk-based capital rule that will amend certain aspects of the treatment of counterparty credit risk under the Basel II framework and replace the use of externally developed credit ratings with proposed alternatives such as internally developed credit ratings. Under the proposals, the new capital requirements would be phased in over several years, beginning in 2013.

In June 2011, the U.S. banking regulators published final regulations implementing a certain provision of the Dodd-Frank Act requiring that certain institutions supervised by the Federal Reserve, including the Company, be subject to minimum capital requirements that are not less than the generally applicable risk-based capital requirements. The proposals would establish a standardized approach that, among other things, modifies risk weights for certain types of asset classes and would serve as the minimum capital floor for certain financial institutions, including the Company. The proposals also include proposed changes to the determination of risk weights for certain types of asset classes for financial institutions employing advanced approaches.

At June 30, 2012, the Company was in compliance with Basel I capital requirements with ratios of Tier 1 capital to RWAs of 17.2% and total capital to RWAs of 18.4% (6% and 10% being well-capitalized for regulatory purposes, respectively). Also, the ratio of Tier 1 common capital to RWAs was 13.6% (5% being the minimum under the Federal Reserve s new capital plan framework). In addition, financial holding companies are subject to a Tier 1 leverage ratio as defined by the Federal Reserve. The Company calculated its Tier 1 leverage ratio as Tier 1 capital divided by adjusted average total assets (which reflects adjustments for disallowed goodwill, certain intangible assets, deferred tax assets and financial and non-financial equity investments). The adjusted average total assets are derived using weekly balances for the year. At June 30, 2012, the Company was in compliance with this leverage restriction, with a Tier 1 leverage ratio of 7.1% (5% being well-capitalized for regulatory purposes).

At June 30, 2012, the Company calculated its RWAs in accordance with the regulatory capital requirements of the Federal Reserve, which is consistent with guidelines described under Basel I. RWAs reflect both on and

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off-balance sheet risk of the Company. The risk capital calculations will evolve over time as the Company enhances its risk management methodology and incorporates improvements in modeling techniques while maintaining compliance with the regulatory requirements and interpretations.

The following table summarizes the capital measures for the Company:

	June 30, 2012		December 31, 2011	
	Balance	Ratio	Balance	Ratio
	(dollars in millions)			
Tier 1 common capital(1)(2)	$ 42,765	13.6%	$ 39,785	12.6%
Tier 1 capital(1)	54,245	17.2%	51,114	16.2%
Total capital(1)	57,954	18.4%	54,956	17.5%
RWAs(1)	314,800		314,827	
Adjusted average assets(1)	760,831		769,578	
Tier 1 leverage(1)		7.1%		6.6%

(1) The December 31, 2011 deferred tax asset disallowance was adjusted by approximately $1.2 billion, resulting in a reduction to the Company s Tier 1 common capital, Tier 1 capital, Total capital, RWAs and adjusted average assets by such amount, Tier 1 common capital ratio, Tier 1 capital ratio and Total capital ratio by approximately 30 basis points and Tier 1 leverage ratio by approximately 20 basis points.

(2) Tier 1 common capital ratio equals Tier 1 common capital divided by RWAs. On December 30, 2011, the Federal Reserve formalized regulatory definitions for Tier 1 common capital and Tier 1 common capital ratio. The Federal Reserve defined Tier 1 common capital as Tier 1 capital less non-common elements in Tier 1 capital, including perpetual preferred stock and related surplus, minority interest in subsidiaries, trust preferred securities and mandatory convertible preferred securities. Previously, the Company s definition of Tier 1 common capital included all of the items noted in the Federal Reserve s definition, but it also included an adjustment for the portion of goodwill and non-servicing intangible assets associated with MSSB s noncontrolling interests (i.e., Citigroup, Inc. s (Citi) share of MSSB s goodwill and intangibles). The Company s conformance to the Federal Reserve s definition under the final rule reduced its Tier 1 common capital and Tier 1 common ratio by approximately $4.2 billion and 132 basis points, respectively at December 31, 2011.

The Company s U.S. Bank Operating Subsidiaries. The Company s domestic bank operating subsidiaries are subject to various regulatory capital requirements as administered by U.S. federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory, and possibly additional, discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company s U.S. bank operating subsidiaries financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company s U.S. bank operating subsidiaries must meet specific capital guidelines that involve quantitative measures of the Company s U.S. bank operating subsidiaries assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices.

At June 30, 2012, the Company s U.S. bank operating subsidiaries met all capital adequacy requirements to which they are subject and exceeded all regulatory mandated and targeted minimum regulatory capital requirements to be well-capitalized. There are no conditions or events that management believes have changed the Company s U.S. bank operating subsidiaries category.

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The table below sets forth the capital information for the Company s U.S. bank operating subsidiaries, which are U.S. depository institutions, calculated in a manner consistent with the guidelines described under Basel I:

	June 30, 2012		December 31, 2011	
	Amount	Ratio	Amount	Ratio
	(dollars in millions)			
Total capital (to RWAs):				
Morgan Stanley Bank, N.A.	$ 10,769	16.9%	$ 10,222	17.8%
Morgan Stanley Private Bank, National Association	$ 1,320	30.0%	$ 1,278	31.9%
Tier I capital (to RWAs):				
Morgan Stanley Bank, N.A.	$ 9,236	14.5%	$ 8,703	15.1%
Morgan Stanley Private Bank, National Association	$ 1,315	29.9%	$ 1,275	31.8%
Leverage ratio:				
Morgan Stanley Bank, N.A.	$ 9,236	13.6%	$ 8,703	13.2%
Morgan Stanley Private Bank, National Association	$ 1,315	11.0%	$ 1,275	10.2%

Under regulatory capital requirements adopted by the U.S. federal banking agencies, U.S. depository institutions, in order to be considered well-capitalized, must maintain a ratio of total capital to RWAs of 10%, a capital ratio of Tier 1 capital to RWAs of 6%, and a ratio of Tier 1 capital to average book assets (leverage ratio) of 5%. Each U.S. depository institution subsidiary of the Company must be well-capitalized in order for the Company to continue to qualify as a financial holding company and to continue to engage in the broadest range of financial activities permitted for financial holding companies. At June 30, 2012 and December 31, 2011, the Company s U.S. depository institutions maintained capital at levels in excess of the universally mandated well-capitalized levels. These subsidiary depository institutions maintain capital at levels sufficiently in excess of the well-capitalized requirements to address any additional capital needs and requirements identified by the federal banking regulators.

MS&Co. and Other Broker-Dealers. MS&Co. is a registered broker-dealer and registered futures commission merchant and, accordingly, is subject to the minimum net capital requirements of the U.S. Securities and Exchange Commission (SEC), the Financial Industry Regulatory Authority, Inc. and the U.S. Commodity Futures Trading Commission. MS&Co. has consistently operated with capital in excess of its regulatory capital requirements. MS&Co. s net capital totaled $6,943 million and $8,249 million at June 30, 2012 and December 31, 2011, respectively, which exceeded the amount required by $5,682 million and $7,215 million, respectively. MS&Co. s net capital and excess net capital decreased from December 31, 2011 due to regulatory capital deductions required for debt securities issued by the Company pursuant to Rule 144A under the Securities Act of 1933, as amended, held by MS&Co. at June 30, 2012. MS&Co. is required to hold tentative net capital in excess of $1 billion and net capital in excess of $500 million in accordance with the market and credit risk standards of Appendix E of SEC Rule 15c3-1. MS&Co. is also required to notify the SEC in the event that its tentative net capital is less than $5 billion. At June 30, 2012, MS&Co. had tentative net capital in excess of the minimum and the notification requirements.

Morgan Stanley Smith Barney LLC is a registered broker-dealer and registered futures commission merchant and, accordingly, is subject to the minimum net capital requirements of the SEC, the Financial Industry Regulatory Authority, Inc. and the U.S. Commodity Futures Trading Commission. Morgan Stanley Smith Barney LLC has consistently operated with capital in excess of its regulatory capital requirements. Morgan Stanley Smith Barney LLC clears certain customer activity directly and introduces other business to MS&Co. and Citi. Subsequent to July 6, 2012, MSSB clears customer activity that was previously introduced to Citigroup, Inc. MSIP, a London-based broker-dealer subsidiary, is subject to the capital requirements of the Financial Services

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Authority, and MSMS, a Tokyo-based broker-dealer subsidiary, is subject to the capital requirements of the Financial Services Agency. MSIP and MSMS have consistently operated in excess of their respective regulatory capital requirements.

Other Regulated Subsidiaries. Certain other U.S. and non-U.S. subsidiaries are subject to various securities, commodities and banking regulations, and capital adequacy requirements promulgated by the regulatory and exchange authorities of the countries in which they operate. These subsidiaries have consistently operated in excess of their local capital adequacy requirements.

Morgan Stanley Derivative Products Inc. (MSDP), a derivative products subsidiary rated A2 by Moody s and AAA by S&P, maintains certain operating restrictions that have been reviewed by Moody s and S&P. MSDP is operated such that creditors of the Company should not expect to have any claims on the assets of MSDP, unless and until the obligations to its own creditors are satisfied in full. Creditors of MSDP should not expect to have any claims on the assets of the Company or any of its affiliates, other than the respective assets of MSDP.

13. Total Equity.

Morgan Stanley Shareholders Equity.

Common Equity Offerings.

During the quarters and six months ended June 30, 2012 and 2011, the Company did not purchase any of its common stock as part of its share repurchase program. At June 30, 2012, the Company had approximately $1.6 billion remaining under its current share repurchase authorization. Share repurchases by the Company are subject to regulatory approval.

MUFG Stock Conversion.

On June 30, 2011, the Company s outstanding Series B Preferred Stock owned by MUFG with a face value of $7.8 billion (carrying value $8.1 billion) and a 10% dividend was converted into 385,464,097 shares of the Company s common stock, including approximately 75 million shares resulting from the adjustment to the conversion ratio pursuant to the transaction agreement. As a result of the adjustment to the conversion ratio, the Company incurred a one-time, non-cash negative adjustment of approximately $1.7 billion in its calculation of basic and diluted earnings per share during the quarter and six months ended June 30, 2011.

Noncontrolling Interests.

Changes in noncontrolling interests in the six months ended June 30, 2012 primarily resulted from $622 million in net assets received from Citi related to the Smith Barney delayed contribution businesses, partially offset by distributions related to MSMS of $151 million. Changes in noncontrolling interests in the six months ended June 30, 2011 primarily resulted from distributions related to MSMS of $139 million.

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14. Earnings per Common Share.

Basic earnings per common share (EPS) is computed by dividing earnings (loss) applicable to Morgan Stanley common shareholders by the weighted average number of common shares outstanding for the period. Common shares outstanding include common stock and vested restricted stock units (RSUs) where recipients have satisfied either the explicit vesting terms or retirement eligibility requirements. Diluted EPS reflects the assumed conversion of all dilutive securities. The Company calculates EPS using the two-class method and determines whether instruments granted in share-based payment transactions are participating securities (see Note 2 to the consolidated financial statements for the year ended December 31, 2011 in the Form 10-K). The following table presents the calculation of basic and diluted EPS (in millions, except for per share data):

	Three Months Ended June 30, 2012	Three Months Ended June 30, 2011	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011
Basic EPS:				
Income from continuing operations	$ 714	$ 1,432	$ 863	$ 2,577
Net gain (loss) from discontinued operations	36	(26)	21	(41)
Net income	750	1,406	884	2,536
Net income applicable to noncontrolling interests	159	213	387	375
Net income applicable to Morgan Stanley	591	1,193	497	2,161
Less: Preferred dividends (Series A Preferred Stock)	(11)	(11)	(22)	(22)
Less: Preferred dividends (Series B Preferred Stock)				(196)
Less: MUFG stock conversion		(1,726)		(1,726)
Less: Preferred dividends (Series C Preferred Stock)	(13)	(13)	(26)	(26)
Less: Allocation of earnings to participating RSUs(1):				
From continuing operations	(3)	(1)	(3)	(3)
Earnings (loss) applicable to Morgan Stanley common shareholders	$ 564	$ (558)	$ 446	$ 188
Weighted average common shares outstanding	1,885	1,464	1,881	1,460
Earnings (loss) per basic common share:				
Income (loss) from continuing operations	$ 0.28	$ (0.36)	$ 0.23	$ 0.16
Net gain (loss) from discontinued operations	0.02	(0.02)	0.01	(0.03)
Earnings (loss) per basic common share	$ 0.30	$ (0.38)	$ 0.24	$ 0.13
Diluted EPS:				
Earnings (loss) applicable to Morgan Stanley common shareholders	$ 564	$ (558)	$ 446	$ 188
Weighted average common shares outstanding	1,885	1,464	1,881	1,460
Effect of dilutive securities:				
Stock options and RSUs(1)	27		26	17
Weighted average common shares outstanding and common stock equivalents	1,912	1,464	1,907	1,477
Earnings (loss) per diluted common share:				
Income (loss) from continuing operations	$ 0.28	$ (0.36)	$ 0.23	$ 0.16

Net income (loss) from discontinued operations	0.01	(0.02)		(0.03)
Earnings (loss) per diluted common share	$ 0.29	$ (0.38)	$ 0.23	$ 0.13

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

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

Number of Antidilutive Securities Outstanding at End of Period:	Three Months Ended June 30, 2012	Three Months Ended June 30, 2011	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011
	(shares in millions)			
RSUs and Performance-based stock units	32	36	13	25
Stock options	45	59	45	59
Total	77	95	58	84

15. Interest Income and Interest Expense.

Details of Interest income and Interest expense were as follows:

	Three Months Ended June 30, 2012	Three Months Ended June 30, 2011	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011
	(dollars in millions)			
Interest income(1):				
Financial instruments owned(2)	$ 662	$ 926	$ 1,453	$ 1,845
Securities available for sale	76	96	162	191
Loans	139	83	257	159
Interest bearing deposits with banks	24	43	51	77
Federal funds sold and securities purchased under agreements to resell and Securities borrowed	46	330	159	605
Other	376	483	783	943
Total Interest income	$ 1,323	$ 1,961	$ 2,865	$ 3,820
Interest expense(1):				
Deposits	$ 45	$ 60	$ 90	$ 126
Commercial paper and other short-term borrowings	11	11	24	18
Long-term debt	1,087	1,292	2,341	2,604
Securities sold under agreements to repurchase and Securities loaned	529	682	992	1,155
Other	(188)	(16)	(362)	(21)
Total Interest expense	$ 1,484	$ 2,029	$ 3,085	$ 3,882
Net interest	$ (161)	$ (68)	$ (220)	$ (62)

(1)

Interest income and expense are recorded within the condensed consolidated statements of income depending on the nature of the instrument and related market conventions. When interest is included as a component of the instrument s fair value, interest is included within Principal transactions Trading revenues or Principal transactions Investments revenues. Otherwise, it is included within Interest income or Interest expense.

(2) Interest expense on Financial instruments sold, not yet purchased is reported as a reduction to Interest income on Financial instruments owned.

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16. Employee Benefit Plans.

The Company sponsors various pension plans for the majority of its U.S. and non-U.S. employees. The Company provides certain other postretirement benefits, primarily health care and life insurance, to eligible U.S. employees. The Company also provides certain postemployment benefits to certain former employees or inactive employees prior to retirement.

Effective January 1, 2011, the Morgan Stanley Employees Retirement Plan (the Pension Plan) for U.S. participants ceased accruals of benefits under the Pension Plan.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
	(dollars in millions)			
Service cost, benefits earned during the period	$ 7	$ 8	$ 15	$ 16
Interest cost on projected benefit obligation	41	41	82	83
Expected return on plan assets	(27)	(33)	(55)	(66)
Net amortization of prior service costs	(4)	(4)	(7)	(8)
Net amortization of actuarial loss	7	5	14	10
Net periodic benefit expense	$ 24	$ 17	$ 49	$ 35

17. Income Taxes.

The Company is under continuous examination by the Internal Revenue Service (the IRS) and other tax authorities in certain countries, such as Japan and the U.K., and states in which the Company has significant business operations, such as New York. The Company is currently under review by the IRS Appeals Office for the remaining issues covering tax years 1999 2005. Also, the Company is currently at various levels of field examination with respect to audits with the IRS, as well as New York State and New York City, for tax years 2006 2008 and 2007 2009, respectively. During 2012, the Company expects to reach a conclusion with U.K. tax authorities on substantially all issues through tax year 2009. Also during 2012, the Company expects to reach a conclusion with the Japanese tax authorities on substantially all issues covering tax years 2007 2008 and commence an audit covering tax years 2009 2010.

The Company believes that the resolution of tax matters will not have a material effect on the condensed consolidated statements of financial condition of the Company, although a resolution could have a material impact on the Company s condensed consolidated statements of income for a particular future period and on the Company s effective income tax rate for any period in which such resolution occurs. The Company has established a liability for unrecognized tax benefits that the Company believes is adequate in relation to the potential for additional assessments. Once established, the Company adjusts unrecognized tax benefits only when more information is available or when an event occurs necessitating a change.

It is reasonably possible that significant changes in the gross balance of unrecognized tax benefits may occur within the next 12 months. At this time, however, it is not possible to reasonably estimate the expected change to the total amount of unrecognized tax benefits and impact on the effective tax rate over the next 12 months.

The Company s effective tax rate from continuing operations for the six months ended June 30, 2011, included a $447 million net tax benefit from the remeasurement of a deferred tax asset and the reversal of a related valuation

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allowance. The deferred tax asset and valuation allowance were recognized in income from discontinued operations in 2010 in connection with the recognition of a $1.2 billion loss due to writedowns and related costs following the Company s commitment to a plan to dispose of Revel Entertainment Group, LLC (Revel). The Company recorded the valuation allowance because the Company did not believe it was more likely than not that it would have sufficient future net capital gain to realize the benefit of the expected capital loss to be recognized upon the disposal of Revel. During the quarter ended March 31, 2011, the disposal of Revel was restructured as a tax-free like kind exchange and the disposal was completed. The restructured transaction changed the character of the future taxable loss to ordinary. The Company reversed the valuation allowance because the Company believes it is more likely than not that it will have sufficient future ordinary taxable income to recognize the recorded deferred tax asset. In accordance with the applicable accounting literature, this reversal of a previously established valuation allowance due to a change in circumstances was recognized in income from continuing operations.

18. Segment and Geographic Information.
Segment Information.

The Company structures its segments primarily based upon the nature of the financial products and services provided to customers and the Company s management organization. The Company provides a wide range of financial products and services to its customers in each of its business segments: Institutional Securities, Global Wealth Management Group and Asset Management. For further discussion of the Company s business segments, see Note 1.

Revenues and expenses directly associated with each respective segment are included in determining its operating results. Other revenues and expenses that are not directly attributable to a particular segment are allocated based upon the Company s allocation methodologies, generally based on each segment s respective net revenues, non-interest expenses or other relevant measures.

As a result of treating certain intersegment transactions as transactions with external parties, the Company includes an Intersegment Eliminations category to reconcile the business segment results to the Company s consolidated results. Intersegment eliminations also reflect the effect of fees paid by the Institutional Securities business segment to the Global Wealth Management Group business segment related to the bank deposit program.

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

Three Months Ended June 30, 2012	Institutional Securities	Global Wealth Management Group	Asset Management (dollars in millions)	Intersegment Eliminations	Total
Total non-interest revenues	$ 3,777	$ 2,914	$ 465	$ (42)	$ 7,114
Net interest	(543)	391	(9)		(161)
Net revenues(1)	$ 3,234	$ 3,305	$ 456	$ (42)	$ 6,953