

MORGAN STANLEY
Form 10-Q
November 05, 2018
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2018

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 No

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Indicate by check mark whether the Registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). Yes No

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

Large Accelerated Filer

Accelerated Filer

Non-Accelerated Filer

Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the Registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

As of October 31, 2018, there were 1,720,154,771 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 September 30, 2018

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Available Information

We file annual, quarterly and current reports, proxy statements and other information with the SEC. The SEC maintains an internet site, www.sec.gov, that contains annual, quarterly and current reports, proxy and information statements and other information that issuers file electronically with the SEC. Our electronic SEC filings are available to the public at the SEC's internet site.

Our internet site is www.morganstanley.com. You can access our Investor Relations webpage at www.morganstanley.com/about-us-ir. We make available free of charge, on or through our Investor Relations webpage, our 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 (Exchange Act), as soon as reasonably practicable after such material is electronically filed with, or furnished to, the SEC. We also make available, through our Investor Relations webpage, via a link to the SEC's internet site, statements of beneficial ownership of our equity securities filed by our directors, officers, 10% or greater shareholders and others under Section 16 of the Exchange Act.

You can access information about our corporate governance at www.morganstanley.com/about-us-governance. Our Corporate Governance webpage includes:

- Amended and Restated Certificate of Incorporation;
- Amended and Restated Bylaws;
- Charters for our Audit Committee, Compensation, Management Development and Succession Committee, Nominating and Governance Committee, Operations and Technology Committee, and Risk Committee;
- Corporate Governance Policies;
- Policy Regarding Corporate Political Activities;
- Policy Regarding Shareholder Rights Plan;
- Equity Ownership Commitment;
- Code of Ethics and Business Conduct;
- Code of Conduct;
- Integrity Hotline Information; and
- Environmental and Social Policies.

Our Code of Ethics and Business Conduct applies to all directors, officers and employees, including our Chief Executive Officer, Chief Financial Officer and Deputy Chief Financial Officer. We 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 our 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 our internet site is not incorporated by reference into this report.

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Management's Discussion and Analysis of Financial Condition and Results of Operations

Introduction

Morgan Stanley is a global financial services firm that maintains significant market positions in each of its business segments Institutional Securities, Wealth Management and Investment Management. Morgan Stanley, through its subsidiaries and affiliates, provides a wide variety of products and services to a large and diversified group of clients and customers, including corporations, governments, financial institutions and individuals. Unless the context otherwise requires, the terms Morgan Stanley, Firm, us, we or our mean Morgan Stanley (the Parent Company) together with its consolidated subsidiaries. We define the following as part of our consolidated financial statements (financial statements): consolidated income statements (income statements), consolidated balance sheets (balance sheets), and consolidated cash flow statements (cash flow statements). See the Glossary of Common Acronyms for definitions of certain acronyms used throughout this Form 10-Q.

A description of the clients and principal products and services of each of our business segments is as follows:

Institutional Securities provides investment banking, sales and trading, lending and other services to corporations, governments, financial institutions, and high to ultra-high net worth clients. Investment banking services consist of capital raising and financial advisory services, including services relating to the underwriting of debt, equity and other securities, as well as advice on mergers and acquisitions, restructurings, real estate and project finance. Sales and trading services include sales, financing, prime brokerage and market-making activities in equity and fixed income products, including foreign exchange and commodities. Lending services include originating and/or purchasing corporate loans, commercial and residential mortgage lending, asset-backed lending and financing extended to equities and commodities customers and municipalities. Other activities include investments and research.

Wealth Management provides a comprehensive array of financial services and solutions to individual investors and small to medium-sized businesses and institutions covering brokerage and investment advisory services, financial and wealth planning services, annuity and insurance products, credit and other lending products, banking and retirement plan services.

Investment Management provides a broad range of investment strategies and products that span geographies, asset classes, and public and private markets to a diverse group of clients across institutional and intermediary channels. Strategies and products include equity, fixed income, liquidity and alternative/other products. Institutional clients include defined benefit/defined contribution plans, foundations, endowments, government entities, sovereign wealth funds, insurance companies, third-party fund sponsors and corporations. Individual clients are serviced through intermediaries, including affiliated and non-affiliated distributors.

The results of operations in the past have been, and in the future may continue to be, materially affected by competition; risk factors; and legislative, legal and regulatory developments; as well as other factors. These factors also may have an adverse impact on our ability to achieve our strategic objectives. Additionally, the discussion of our results of operations herein may contain forward-looking statements. These statements, which reflect management's beliefs and expectations, are subject to risks and uncertainties that may cause actual results to differ materially. For a discussion of the risks and uncertainties that may affect our future results, see Forward-Looking Statements,

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Business Competition, Business Supervision and Regulation and Risk Factors in the 2017 Form 10-K, and Liquidity and Capital Resources herein.

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Management's Discussion and Analysis

Executive Summary

Overview of Financial Results

Consolidated Results

Net Revenues

(\$ in millions)

Net Income Applicable to Morgan Stanley

(\$ in millions)

Earnings per Common Share¹

1. For the calculation of basic and diluted EPS, see Note 15 to the financial statements.

We reported net revenues of \$9,872 million in the quarter ended September 30, 2018 (current quarter, or 3Q 2018), compared with \$9,197 million in the quarter ended September 30, 2017 (prior year quarter, or 3Q 2017). For the current quarter, net income applicable to Morgan Stanley was \$2,112 million, or \$1.17 per diluted common share, compared with \$1,781 million, or \$0.93 per diluted common share, in the prior year quarter.

We reported net revenues of \$31,559 million in the nine months ended September 30, 2018 (current year period, or YTD 2018), compared with \$28,445 million in the nine months ended September 30, 2017 (prior year period, or YTD 2017). For the current year period, net income applicable to Morgan Stanley was \$7,217 million, or \$3.92 per

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diluted common share, compared with \$5,468 million, or \$2.79 per diluted common share, in the prior year period.

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Table of Contents**Management's Discussion and Analysis****Non-interest Expenses¹***(\$ in millions)*

1. The percentages on the bars in the charts represent the contribution of compensation and benefits expenses and non-compensation expenses to the total.

Compensation and benefits expenses of \$4,310 million in the current quarter and \$13,845 million in the current year period increased 3% and 7%, respectively, from \$4,169 million in the prior year quarter and \$12,887 million in the prior year period. These results primarily reflected increases in discretionary incentive compensation mainly driven by higher revenues as well as salaries across all business segments. These increases were partially offset by a decrease in the fair value of investments to which certain deferred compensation plans are referenced.

Non-compensation expenses were \$2,711 million in the current quarter and \$8,334 million in the current year period compared with \$2,546 million in the prior year quarter and \$7,626 million in the prior year period, representing a 6% and a 9% increase, respectively. These increases were primarily as a result of higher volume-related expenses, the gross presentation of certain expenses due to the adoption of the accounting update *Revenue from Contracts with Customers* (see Notes 2 and 19 to the financial statements for further information) and increased investment in technology. In the current quarter, these increases were partially offset by lower litigation expenses.

Income Taxes

The current year period includes intermittent net discrete tax benefits of \$92 million, primarily associated with new information pertaining to the resolution of multi-jurisdiction tax examinations and other matters. The prior year quarter and prior year period included intermittent net discrete tax benefits of \$83 million and \$65 million, respectively, primarily resulting from the remeasurement of certain deferred taxes. In addition, the effective tax rate is lower in the current quarter and current year period compared with the corresponding prior periods primarily as a result of the enactment of the U.S. Tax Cuts and Jobs Act (Tax Act). For further information, see Supplemental Financial Information and Disclosures Income Tax Matters herein.

Table of Contents**Management's Discussion and Analysis****Selected Financial Information and Other Statistical Data**

<i>\$ in millions</i>	Three Months		Nine Months	
	Ended September 30, 2018	2017	Ended September 30, 2018	2017
Income from continuing operations applicable to Morgan Stanley	\$ 2,113	\$ 1,775	\$ 7,222	\$ 5,489
Income (loss) from discontinued operations applicable to Morgan Stanley	(1)	6	(5)	(21)
Net income applicable to Morgan Stanley	2,112	1,781	7,217	5,468
Preferred stock dividends and other	93	93	356	353
Earnings applicable to Morgan Stanley common shareholders	\$ 2,019	\$ 1,688	\$ 6,861	\$ 5,115
Expense efficiency ratio ¹	71.1%	73.0%	70.3%	72.1%
ROE ²	11.5%	9.6%	13.1%	9.8%
ROTCE ²	13.2%	11.0%	15.1%	11.3%

<i>in millions, except per share and employee data</i>	At September 30, 2018	At December 31, 2017
	GLR ³	\$ 214,848
Loans ⁴	\$ 109,983	\$ 104,126
Total assets	\$ 865,517	\$ 851,733
Deposits	\$ 175,185	\$ 159,436
Borrowings	\$ 190,889	\$ 192,582
Common shares outstanding	1,726	1,788
Common shareholders' equity	\$ 70,183	\$ 68,871
Tangible common shareholders' equity	\$ 61,265	\$ 59,829
Book value per common share ⁵	\$ 40.67	\$ 38.52
Tangible book value per common share ^{2, 5}	\$ 35.50	\$ 33.46
Worldwide employees	59,835	57,633

Capital ratios⁶	At September 30, 2018	At December 31, 2017
	Common Equity Tier 1 capital ratio	16.7%
Tier 1 capital ratio	19.0%	18.9%
Total capital ratio	21.6%	21.7%
Tier 1 leverage ratio	8.2%	8.3%

SLR⁷

6.4%

6.5%

1. The expense efficiency ratio represents total non-interest expense as a percentage of net revenues.
2. Represents a non-GAAP measure. See Selected Non-GAAP Financial Informa