

MORGAN STANLEY SMITH BARNEY LLC

**CONSOLIDATED STATEMENT OF FINANCIAL CONDITION
AS OF DECEMBER 31, 2017
AND
REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors of Morgan Stanley Smith Barney LLC

Opinion on the Financial Statement

We have audited the accompanying consolidated statement of financial condition of Morgan Stanley Smith Barney LLC and subsidiaries (the "Company") as of December 31, 2017, and the related notes (collectively referred to as the "financial statement"). In our opinion, the financial statement presents fairly, in all material respects, the financial position of the Company as of December 31, 2017, in conformity with accounting principles generally accepted in the United States of America.

Basis for Opinion

The financial statement is the responsibility of the Company's management. Our responsibility is to express an opinion on this financial statement based on our audit. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statement is free of material misstatement, whether due to error or fraud.

Our audit included performing procedures to assess the risks of material misstatement of the financial statement, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statement. Our audit also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statement. We believe that our audit of the financial statement provides a reasonable basis for our opinion.

/S/Deloitte & Touche LLP

New York, New York
February 28, 2018

We have served as the Company's auditor since 2009.

MORGAN STANLEY SMITH BARNEY LLC
CONSOLIDATED STATEMENT OF FINANCIAL CONDITION
December 31, 2017
(In millions of dollars)

ASSETS		
Cash	\$	982
Cash deposited with clearing organizations or segregated under federal and other regulations or requirements		1,128
Financial instruments owned, at fair value		431
Securities purchased under agreements to resell		6,928
Securities borrowed		234
Receivables:		
Customers (net of \$3 allowance for doubtful accounts)		13,445
Brokers, dealers and clearing organizations		98
Fees, interest and other		516
Affiliates		54
Goodwill		4,609
Intangible assets (net of accumulated amortization of \$2,120)		1,830
Other assets		211
Total assets	\$	30,466
LIABILITIES AND MEMBER'S EQUITY		
Financial instruments sold, not yet purchased, at fair value	\$	38
Securities sold under agreements to repurchase		2,500
Securities loaned		1,447
Payables:		
Customers		8,166
Brokers, dealers and clearing organizations		657
Interest and dividends		21
Affiliates		1,175
Other liabilities and accrued expenses		5,173
Long-term borrowings		922
Total liabilities		20,099
Subordinated liabilities		100
Member's equity		10,267
Total liabilities and member's equity	\$	30,466

See Notes to Consolidated Statement of Financial Condition.

MORGAN STANLEY SMITH BARNEY LLC
NOTES TO CONSOLIDATED STATEMENT OF FINANCIAL CONDITION
As of December 31, 2017
(In millions of dollars, except where noted)

1. Introduction and Basis of Presentation

The Company

MSSB together with its wholly owned subsidiaries (the “Company”) provides a wide variety of financial products and services to a large and diversified group of clients, financial institutions and individuals. Its businesses include financial advisory services, sales, and trading in fixed income products, equity products, and other instruments including foreign exchange and new issue distribution of fixed income and equity products. The Company provides clients with a comprehensive array of financial solutions, including MSSB products and services, and products and services from third party providers, such as insurance companies and mutual fund families. The Company offers brokerage and investment advisory services covering various investment alternatives; financial and wealth planning services; annuity and insurance products; cash management; and retirement plan services through a network of approximately sixteen thousand financial advisors in the U.S. See the “Glossary of Common Acronyms” for definitions of certain acronyms used throughout the notes to the statement of financial condition.

MSSB is registered with the SEC as a broker-dealer and as an investment adviser. The Company is also registered as an introducing broker with the CFTC and clears futures transactions through an affiliate, MS&Co.

MSSB is a wholly owned subsidiary of MSDHI. MSDHI is a wholly owned subsidiary of MSCM, which is a wholly owned subsidiary of Morgan Stanley (the “Ultimate Parent”).

Basis of Financial Information

The consolidated statement of financial condition is prepared in accordance with U.S. GAAP, 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 legal and tax matters, and other matters that affect its consolidated statement of financial condition and related disclosures. The Company believes that the estimates utilized in the preparation of its consolidated statement of financial condition are prudent and reasonable. Actual results could differ materially from these estimates.

Consolidation

The consolidated statement of financial condition includes the accounts of MSSB and its wholly owned licensed insurance subsidiaries in which MSSB has a controlling financial interest.

At December 31, 2017, the Company’s consolidated subsidiaries reported \$6 of assets, \$3 of liabilities and \$3 of equity on a stand-alone basis.

All material intercompany balances and transactions with its subsidiaries have been eliminated in consolidation.

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. 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. At December 31, 2017, there are no consolidated VIEs.

2. Significant Accounting Policies

Fair Value of Financial Instruments

Instruments within Financial instruments owned and Financial instruments sold, not yet purchased, are measured at fair value in accordance with accounting guidance. These financial instruments primarily represent the Company’s trading positions to facilitate customer transactions and include both cash and derivative products.

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

Fair Value Measurement – Definition and Hierarchy

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (i.e., the “exit price”) in an orderly transaction between market participants at the measurement date.

Fair value is a market-based measure considered from the perspective of a market participant rather than an entity-specific measure. Therefore, even when market assumptions are not readily available, assumptions are set to reflect those that the Company believes market participants would use in pricing the asset or liability at the measurement date. Where the Company manages a group of financial assets and financial liabilities on the basis of its net exposure to either market risk or credit risk, the Company measures the fair value of that group of financial instruments consistently with how market participants would price the net risk exposure at the measurement date.

In determining fair value, the Company uses various valuation approaches and establishes a hierarchy for inputs used in measuring fair value that maximizes the use of relevant

observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available.

Observable inputs are inputs that market participants would use in pricing the asset or liability that were developed based on market data obtained from sources independent of the Company. Unobservable inputs are inputs that reflect assumptions the Company believes other market participants would use in pricing the asset or liability that are developed based on the best information available in the circumstances. The hierarchy is broken down into three levels based on the observability of inputs as follows, with Level 1 being the highest and Level 3 being the lowest.

- Level 1 -- Valuations based on quoted prices in active markets that the Company has the ability to access for identical assets or liabilities. Valuation adjustments and block discounts are not applied to Level 1 instruments. Since valuations are based on quoted prices that are readily and regularly available in an active market, valuation of these products does not entail a significant degree of judgment.
- Level 2 -- Valuations based on one or more quoted prices in markets that are not active or for which all significant inputs are observable, either directly or indirectly.
- Level 3 -- Valuations based on inputs that are unobservable and significant to the overall fair value measurement.

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

The Company considers prices and inputs that are current as of the measurement date, including during periods of market dislocation. In periods of market dislocation, the observability of prices and inputs may be reduced for many instruments. This condition could cause an instrument to be reclassified from Level 1 to Level 2 or from Level 2 to Level 3 of the fair value hierarchy (see Note 4).

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

For assets and liabilities that are transferred between levels in the fair value hierarchy during the period, fair values are ascribed as if the assets or liabilities had been transferred as of the beginning of the period.

Valuation Techniques

Many cash instruments and OTC derivative contracts have bid and ask prices that can be observed in the marketplace. Bid prices reflect the highest price that a party is willing to pay for an asset. Ask prices represent the lowest price that a party is willing to accept for an asset. The Company carries positions at the point within the bid-ask range that meets its best estimate of fair value. For offsetting positions in the same financial instrument, the same price within the bid-ask spread is used to measure both the long and short positions.

Fair value for many cash instruments and OTC derivative contracts is derived using pricing models. Pricing models take into account the contract terms as well as multiple inputs including, where applicable, commodity prices, equity prices, interest rate yield curves, credit curves, correlation, creditworthiness of the counterparty, creditworthiness of the Company, option volatility and currency rates.

See Note 4 for a description of valuation techniques applied to the major categories of financial instruments measured at fair value.

Valuation Process

The VRG within the FCG of the Ultimate Parent and its consolidated subsidiaries is responsible for the Ultimate Parent and its consolidated subsidiaries' fair value valuation policies, processes and procedures. VRG is independent of the business units and reports to the CFO, who has final authority over the valuation of the Company's financial instruments. VRG implements valuation control processes designed to validate the fair value of the Company's financial instruments measured at fair value, including those derived from pricing models.

Model Review. VRG, in conjunction with the MRM which reports to the CRO, independently reviews valuation models' 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 determine that 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 models. The Company generally subjects valuations and models to a review process initially and on a periodic basis thereafter.

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 by testing compliance with the documented valuation methodologies approved in the model review process described above.

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, the CFO and the CRO on a regular basis.

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 value 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 are evaluated using a number of approaches; for example, by corroborating the external sources' prices to executed trades, by 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 designed to ensure that the highest-ranked market data source is used to validate the business unit's fair value of financial instruments.

VRG reviews the models and valuation methodology used to price new material Level 2 and Level 3 transactions and both FCG and MRM must approve the fair value of the trade that is initially recognized.

Level 3 Transactions. VRG reviews the business unit's valuation techniques to assess whether these are consistent with market participant assumptions.

Offsetting of Derivative Instruments

In connection with its derivative activities, the Company generally enters into master netting agreements and collateral agreements with its counterparties. These agreements provide the Company with the right, in the event of a default by the counterparty, to net a counterparty's rights and obligations under the agreement and to liquidate and set off collateral against any net amount owed by the counterparty.

For information related to offsetting of derivatives and certain collateralized transactions, see Notes 5 and 6, respectively.

Income Taxes

The Company accounts for income taxes using the asset and liability method. Under this method, deferred tax assets and

liabilities are recorded based upon the temporary differences between the financial statement and income tax bases of assets and liabilities using currently enacted tax rates in effect for the year in which the differences are expected to reverse.

The Company recognizes net deferred tax assets to the extent that it believes these assets are more likely than not to be realized. In making such a determination, the Company considers all available positive and negative evidence, including future reversals of existing taxable temporary differences, projected future taxable income, tax planning strategies and results of recent operations. When performing the assessment the Company considers all types of deferred tax assets in combination with each other, regardless of the origin of the underlying temporary difference. If a deferred tax asset is determined to be unrealizable, a valuation allowance is established. If the Company subsequently determines that it would be able to realize deferred tax assets in excess of their net recorded amount, it would make an adjustment to the deferred tax asset valuation allowance, which would reduce the provision for income taxes.

In accordance with the terms of the Tax Sharing Agreement with the Ultimate Parent, substantially all current and deferred taxes (federal, combined and unitary state) are settled periodically with the Ultimate Parent.

Uncertain tax positions are recorded on the basis of a two-step process, whereby (1) the Company determines whether it is more likely than not that the tax positions will be sustained on the basis of the technical merits of the position and (2) for those tax positions that meet the more-likely-than-not recognition threshold, the Company recognizes the largest amount of tax benefit that is more than 50% likely to be realized upon ultimate settlement with the related tax authority.

Cash

Cash represents funds deposited with financial institutions.

Cash Deposited with Clearing Organizations or Segregated Under Federal and Other Regulations or Requirements

Cash deposited with clearing organizations or segregated under federal and other regulations or requirements include cash segregated in compliance with federal and other regulations and funds deposited by customers.

Collateralized Financing

Securities borrowed, securities purchased under agreements to resell ("reverse repurchase agreements"), Securities loaned and securities sold under agreements to repurchase ("repurchase agreements") are treated as collateralized financings. Reverse repurchase agreements and repurchase agreements are carried on the consolidated statement of financial condition at the amounts of cash paid or received, plus accrued interest. Where appropriate, repurchase agreements and reverse repurchase agreements with the same counterparty are reported on a net basis. Securities borrowed and Securities loaned are recorded at the amount of cash collateral advanced or received.

Receivables and Payables – Customers

Receivables from customers (net of allowance for doubtful accounts) and payables to customers include amounts due on cash, margin and other customer securities-based lending transactions. Securities owned by customers, including those that collateralize margin or similar transactions, are not reflected on the consolidated statement of financial condition.

Receivables and Payables – Brokers, Dealers and Clearing Organizations

Receivables from brokers, dealers and clearing organizations include amounts receivable for securities failed to deliver by the Company to a purchaser by the settlement date, margin deposits, commissions, and net receivables/payables arising from unsettled trades. Payables to brokers, dealers and clearing organizations include amounts payable for securities failed to receive by the Company from a seller by the settlement date and payables to clearing organizations. Receivables and payables arising from unsettled trades are reported on a net basis.

Goodwill and 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. For both the annual and interim tests, the Company has the option to either (a) perform a *quantitative* impairment test or (b) first perform a *qualitative* assessment to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount, in which case the quantitative test would be performed.

When performing a *quantitative* impairment test, the Company compares the fair value of a reporting unit with its carrying amount, including goodwill. If the fair value of the reporting unit is less than its carrying amount, the goodwill impairment loss is equal to the lesser of the excess of the carrying value over the fair value or the carrying amount of goodwill allocated to that reporting unit.

The estimated fair value of the reporting unit is derived based on valuation techniques the Company believes market participants would use for the reporting unit. The estimated fair values are generally determined by utilizing a discounted cash flow methodology.

Goodwill is not amortized, but, as noted above, is reviewed annually (or more frequently when certain events or circumstances exist) for impairment. Finite lived intangible assets are amortized over their estimated useful lives and reviewed for impairment.

3. Related Party Transactions

The Company enters into transactions with the Ultimate Parent and its consolidated affiliates, including collateralized financings and OTC derivatives.

The Company also obtains long-term funding from affiliates and subordinated liabilities from the Ultimate Parent as described in Notes 8 and 9, respectively.

On May 15, 2017, the Company paid a dividend of \$2,200 to the Parent.

The Company has various agreements with an affiliate, MS&Co., to provide sales and distribution services for MS&Co.'s equities and fixed income trading activities.

The Company is a party to deposit sweep agreements with MSBNA and MSPBNA, both affiliates of the Ultimate Parent.

The Company participates in various deferred compensation plans maintained by the Ultimate Parent for the benefit of certain employees that provide a return to the participating employees based upon the performance of various referenced investments. The Company has entered into equity derivative swap contracts with an affiliate to economically hedge its obligations under these plans. See Note 5 for additional disclosures on fair value and notional amounts related to the derivatives associated with these deferred compensation plans, included within equity contracts.

Receivables from and payables to affiliates consist of affiliate transactions that occur in the normal course of business. Payables to affiliates are unsecured, bear interest at rates established by the treasury function of the Ultimate Parent and are intended to approximate the market rate of interest that the Ultimate Parent incurs in funding its business as it is periodically reassessed and are payable on demand.

A significant portion of collateralized transactions that occur in the normal course of business are with affiliates of the Company.

On March 1, 2017 the Company expanded upon a service level agreement that it signed with an affiliated service entity, MSSG, to receive additional support services as part of the final phase to reorganize support services for recovery and resolution planning purposes. The service level agreement includes support services associated with multiple divisions including Operations, Finance, Legal and Compliance, Risk Management, Human Resources, Internal Audit and Administration. A subset of regulatory services which exclusively support the Company and are essential in maintaining compliance with applicable regulatory rules will continue to be performed by employees of the Company. In connection with this agreement, the Company effected a series of steps to transfer related assets and liabilities to MSSG, as well as support service personnel. MSSB recognized an offsetting affiliate payable to the Parent, and therefore, the transfer did not impact member's equity in the Company. MSSG also provides healthcare and life insurance benefits for the employees of the Company, as well as information processing and communications services.

An affiliated service entity, MSSBF, also provides other services for the Company, primarily information processing, communications, and occupancy and equipment.

Assets and receivables from affiliated companies at December 31, 2017 are comprised of:

Cash deposited with clearing organizations or segregated under federal and other regulations or requirements	\$ 16
Financial instruments owned, at fair value	184
Securities purchased under agreements to resell	6,928
Securities borrowed	234
Receivables - Customers	49
Receivables - Affiliates	54

Liabilities and payables to affiliated companies at December 31, 2017 are comprised of:

Securities sold under agreements to repurchase	\$ 2,500
Securities loaned	1,447
Payables - Brokers, dealers and clearing organizations	10
Payables - Affiliates	1,175
Other liabilities and accrued expenses	320
Long-term borrowings	922
Subordinated liabilities	100

4. Fair Values

Fair Value Measurements

Asset and Liability / Valuation Technique	Valuation Hierarchy Classification
Trading Assets and Trading Liabilities	
<p><i>U.S. Agency Securities</i></p> <ul style="list-style-type: none"> Non-callable agency-issued debt securities are generally valued using quoted market prices, and callable agency-issued debt securities are valued by benchmarking model-derived prices to quoted market prices and trade data for comparable instruments. The fair value of agency mortgage pass-through pool securities is model-driven based on spreads of comparable to-be-announced securities. 	<ul style="list-style-type: none"> Level 1 - non-callable agency-issued debt securities Generally Level 2 - callable agency-issued debt securities, agency mortgage pass-through pool securities Level 3 - in instances where the inputs are unobservable
<p><i>Corporate Bonds</i></p> <ul style="list-style-type: none"> Fair value is determined using recently executed transactions, market price quotations, bond spreads, CDS spreads, or at the money volatility and/or volatility skew 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 comparable instruments or cash flow models with yield curves, bond or single name CDS spreads and recovery rates as significant inputs. 	<ul style="list-style-type: none"> Generally Level 2 —if value based on observable market data for comparable instruments Level 3 - in instances where prices significant spread inputs are unobservable
<p><i>Corporate Equities</i></p> <ul style="list-style-type: none"> Fair value is determined based on quoted prices from the exchange. To the extent these securities are actively traded, valuation adjustments are not applied. 	<ul style="list-style-type: none"> Generally Level 1 — if actively traded Level 2 or 3—if the securities are not actively traded, or are undergoing a recent mergers and acquisitions event or corporate actions
<p><i>Listed Derivative Contracts</i></p> <ul style="list-style-type: none"> Listed derivatives that are actively traded are valued based on quoted prices from the exchange. Listed derivatives that are not actively traded are valued using the same approaches as those applied to OTC derivatives. 	<ul style="list-style-type: none"> Level 1—if actively traded Level 2—if not actively traded
<p><i>OTC Derivative Contracts</i></p> <ul style="list-style-type: none"> OTC derivative contracts include forward, swap and option contracts related to interest rates, currencies, equity prices or commodity prices Depending on the product and the terms of the transaction, the fair value of OTC derivative products can be modeled using a series of techniques, including closed-form analytic formulas, such as the Black-Scholes option-pricing model, simulation models or a combination thereof. Many pricing models do not entail material subjectivity as the methodologies employed do not necessitate significant judgment, since model inputs may be observed from actively quoted markets, as is the case for generic interest rate swaps, many equity, commodity and foreign currency option contracts, and certain CDS. In the case of more established derivative products, the pricing models used by the Firm are widely accepted by the financial services industry. For further information on the valuation techniques for OTC derivative products, see Note 2. For further information on derivative instruments and hedging activities, see Note 5. 	<ul style="list-style-type: none"> Generally Level 2—OTC derivative products valued using observable inputs, or where the unobservable input is not deemed significant. Level 3—OTC derivative products for which the unobservable inputs are deemed significant

Assets and Liabilities Measured at Fair Value on a Recurring Basis

	Level 1	Level 2	Level 3	Collateral Netting	At December 31, 2017
Assets					
Financial instruments owned:					
U.S. government and agency securities					
U.S. agency securities	\$ 1	\$ 124	\$ -	\$ -	\$ 125
Other sovereign government obligations	2	-	-	-	2
Corporate and other debt					
MABS	-	5	-	-	5
Corporate bonds	-	69	-	-	69
Total corporate and other debt	-	74	-	-	74
Corporate equities ⁽¹⁾	1	-	-	-	1
Derivative contracts:					
Foreign exchange contracts	-	40	-	-	40
Equity contracts ⁽²⁾	-	183	-	-	183
Commodity contracts	-	3	-	-	3
Netting	-	(12)	-	-	(12)
Total derivative contracts	-	214	-	-	214
Physical commodities	-	15	-	-	15
Total financial instruments owned	\$ 4	\$ 427	\$ -	\$ -	\$ 431
Liabilities					
Financial instruments sold, not yet purchased:					
U.S. government and agency securities					
U.S. Treasury securities	\$ 5	\$ -	\$ -	\$ -	\$ 5
Corporate and other debt	-	2	-	-	2
Corporate equities ⁽¹⁾	2	7	-	-	9
Derivative contracts:					
Foreign exchange contracts	-	38	-	-	38
Commodity contracts	-	11	-	-	11
Netting	-	(12)	-	(15)	(27)
Total derivative contracts	-	37	-	(15)	22
Total financial instruments sold, not yet purchased ⁽³⁾	\$ 7	\$ 46	\$ -	\$ (15)	\$ 38

⁽¹⁾ For trading purposes, the Company holds or sells short equity securities issued by entities in diverse industries and of varying sizes.

⁽²⁾ Represents fair value of derivative assets associated with deferred compensation plans as mentioned in Note 3.

⁽³⁾ Amounts exclude the unsettled fair value of short futures contracts of \$10 included in Receivables - Brokers, dealers and clearing organizations in the consolidated statement of financial condition. These contracts are primarily classified as Level 1 in the fair value hierarchy, actively traded, and valued based on quoted prices from the exchange.

Transfers During 2017

For assets and liabilities that were transferred between levels during the period, fair values are ascribed as if the assets or liabilities had been transferred as of January 1, 2017.

During 2017, there were no material transfers between levels.

Valuation Techniques for Assets and Liabilities Not Measured at Fair Value

<p><i>Repurchase agreements, reverse repurchase agreements, Securities borrowed, and Securities loaned</i></p> <ul style="list-style-type: none"> The inputs to the valuation include contractual cash flows and collateral funding spreads, which are estimated using various benchmarks and interest rate yield curves.
<p><i>Long term borrowings and Subordinated liabilities</i></p> <ul style="list-style-type: none"> The fair value 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.
<p>The carrying values of the remaining assets and liabilities not measured at fair value in the following tables approximate fair value due to their short-term nature.</p>

Financial Instruments Not Measured at Fair Value

	At December 31, 2017		Fair Value by Level:		
	Carrying Value	Fair Value	Level 1	Level 2	Level 3
Financial Assets					
Cash	\$ 982	\$ 982	\$ 982	\$ -	\$ -
Cash deposited with clearing organizations or segregated under federal and other regulations or requirements	1,128	1,128	1,128	-	-
Reverse repurchase agreements	6,928	6,928	-	6,928	-
Securities borrowed	234	234	-	234	-
Receivables: ⁽¹⁾					
Customers	13,445	13,445	-	13,445	-
Brokers, dealers and clearing organizations	98	98	-	98	-
Fees, interest and other	500	500	-	500	-
Affiliates	54	54	-	54	-
Other assets ⁽²⁾	63	63	-	63	-
Financial Liabilities					
Repurchase agreements	\$ 2,500	\$ 2,500	\$ -	\$ 2,500	\$ -
Securities loaned	1,447	1,447	-	1,447	-
Payables: ⁽¹⁾					
Customers	8,166	8,166	-	8,166	-
Brokers, dealers and clearing organizations	657	657	-	657	-
Affiliates	1,175	1,175	-	1,175	-
Other liabilities and accrued expenses ⁽²⁾	2,926	2,926	-	2,926	-
Long-term borrowings	922	938	-	938	-
Subordinated liabilities	100	107	-	107	-

⁽¹⁾ Accrued interest, fees and dividend receivables and payables, where carrying value approximates fair value, have been excluded.

⁽²⁾ Other assets and Other liabilities and accrued expenses exclude certain non-financial instruments.

5. Derivative Instruments

The Company may trade listed futures, forwards, options and other derivatives referencing, among other things, interest rates, equities, currencies, and bonds. The Company uses these instruments to hedge their client facilitation activity. The Company does not apply hedge accounting.

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 and on an individual product basis.

Derivative Assets and Liabilities

Derivative Assets at December 31, 2017

	Fair Value			Notional		
	Bilateral OTC	Exchange Traded	Total	Bilateral OTC	Exchange Traded	Total
Derivative contracts						
Interest rate contracts	\$ -	\$ -	\$ -	\$ 90	\$ 20	\$ 110
Foreign exchange contracts	40	-	40	1,520	-	1,520
Equity contracts ⁽¹⁾	183	-	183	1,690	-	1,690
Commodity contracts	3	-	3	3	-	3
Total gross derivative contracts	226	-	226	\$ 3,303	\$ 20	\$ 3,323
Counterparty netting	(12)	-	(12)			
Total derivative assets	\$ 214	\$ -	\$ 214			

Derivative Liabilities at December 31, 2017

	Fair Value			Notional		
	Bilateral OTC	Exchange Traded	Total	Bilateral OTC	Exchange Traded	Total
Derivative contracts						
Interest rate contracts	\$ -	\$ -	\$ -	\$ 30	\$ 10	\$ 40
Foreign exchange contracts	38	-	38	1,437	-	1,437
Commodity contracts	11	-	11	11	-	11
Total gross derivative contracts	49	-	49	\$ 1,478	\$ 10	\$ 1,488
Cash collateral netting	(15)	-	(15)			
Counterparty netting	(12)	-	(12)			
Total derivative liabilities	\$ 22	\$ -	\$ 22			

⁽¹⁾ Bilateral OTC Equity contracts includes derivative assets associated with deferred compensation plans with a fair value of \$183 and a notional amount of \$1,690, as mentioned in Note 3.

6. 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 its inventory positions.

The Company manages credit exposure arising from such transactions by, in appropriate circumstances, entering into master netting agreements and collateral agreements with counterparties that provide the Company, in the event of a counterparty default (such as bankruptcy or a counterparty's failure to pay or perform), with the right to net a counterparty's rights and obligations under such agreement and liquidate and set-off collateral held by the Company against the net amount owed by the counterparty.

The Company's policy is generally to take possession of securities purchased or borrowed in connection with reverse repurchase agreements and securities borrowed transactions, respectively, and to receive cash and securities delivered under repurchase agreements or securities loaned transactions (with rights of rehypothecation). In certain cases, the Company may be permitted to post collateral to a third-party custodian under a tri-party arrangement that enables the Company to take control of such collateral in the event of a counterparty default.

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, as provided under the applicable agreement to ensure such transactions are adequately collateralized, or the return of excess collateral.

The risk related to a decline in the market value of collateral (pledged or received) is managed by setting appropriate market-based haircuts. Increases in collateral margin calls on secured financing due to market value declines may be mitigated by increases in collateral margin calls on reverse repurchase agreements and securities borrowed transactions with similar quality collateral. Additionally, the Company may request lower quality collateral pledged be replaced with higher quality collateral through collateral substitution rights in the underlying agreements.

The Company actively manages its secured financing in a manner that reduces the potential refinancing risk of secured financing for less liquid assets. The Company considers the quality of collateral when negotiating collateral eligibility with counterparties, as defined by its fundability criteria. The Company utilizes shorter-term secured financing for highly liquid assets and has established longer tenor limits for less liquid assets, for which funding may be at risk in the event of a market disruption.

Offsetting of Certain Collateralized Transactions

At December 31, 2017					
	Gross Amounts	Amounts Offset	Net Amounts Presented	Amounts not Offset ⁽¹⁾	Net Amounts
Assets					
Reverse repurchase agreements	\$ 6,928	\$ -	\$ 6,928	\$ (6,877)	\$ 51
Securities borrowed	234	-	234	(228)	6
Liabilities					
Repurchase agreements	\$ 2,500	\$ -	\$ 2,500	\$ (2,500)	\$ -
Securities loaned	1,447	-	1,447	(1,409)	38

⁽¹⁾ Amounts relate to master netting agreements that have been determined by the Company to be legally enforceable in the event of default but where certain other criteria are not met in accordance with applicable offsetting accounting guidance.

For information related to offsetting of derivatives, see Note 5.

Maturities and Collateral Pledged

Gross Secured Financing Balances by Remaining Contractual Maturity

At December 31, 2017					
	Overnight and Open	Less than 30 Days	30-90 Days	Over 90 Days	Total
Repurchase agreements	\$ 2,500	\$ -	\$ -	\$ -	\$ 2,500
Securities loaned	1,447	-	-	-	1,447
Gross amount of secured financing included in the above offsetting disclosure	\$ 3,947	\$ -	\$ -	\$ -	\$ 3,947

Gross Secured Financing Balances by Class of Collateral Pledged

	At December 31, 2017	
Repurchase agreements		
U.S. government and agency securities	\$	10
Corporate equities		965
Corporate and other debt		1,525
Total repurchase agreements	\$	2,500
Securities loaned		
Other sovereign government obligations	\$	4
Corporate and other debt		50
Corporate equities		1,393
Total securities loaned		1,447
Gross amount of secured financing included in the above offsetting disclosure	\$	3,947

Financial Instruments Pledged

The Company pledges its financial instruments owned to collateralize repurchase agreements, securities loaned and other secured financings. Counterparties may or may not have the right to sell or repledge the collateral. 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 Company's consolidated statement of financial condition. At December 31, 2017, the Company had not pledged any financial instruments owned that could be sold or repledged. At December 31, 2017, the carrying value of Financial instruments owned that have been loaned or pledged to counterparties where those counterparties do not have the right to sell or repledge the collateral was \$145.

Collateral Received

The Company receives collateral in the form of securities in connection with reverse repurchase agreements, securities borrowed, derivative transactions, and customer margin loans. In many cases, the Company is permitted to sell or repledge these securities held as collateral and use the securities to secure repurchase agreements, to enter into securities lending and derivative transactions or for delivery to counterparties to cover short positions. At December 31, 2017, the total fair value of financial instruments received as collateral where the Company is permitted to sell or repledge the securities was \$22,145 and the fair value of the portion that had been sold or repledged was \$7,103.

Customer Margin Lending

The Company also engages in margin and other customer securities-based lending ("margin") to clients that allows the client to borrow against the value of qualifying securities. Margin loans are included within Customer receivables in the Company's consolidated statement of financial condition. Under these agreements and transactions, the Company receives 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 activities are collateralized by customer-owned securities held by the Company. The Company monitors required margin levels and established credit terms 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.

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 its credit exposure in the event of a 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 December 31, 2017, the balances related to net customer receivables representing margin loans were \$12,087.

7. Goodwill and Intangibles

The Company completed its annual goodwill impairment testing as of July 1, 2017. The Company's impairment testing did not indicate any goodwill impairment. Adverse market or economic events could result in impairment charges in future periods.

At December 31, 2017 intangible assets were \$1,830 and represented customer relationships.

8. Long-Term Borrowings

The total carrying value of all long term borrowings at December 31, 2017 was \$922. The weighted average coupon at period-end for all long-term borrowings was 2.55%. The weighted average coupon was calculated utilizing U.S. and non-U.S. dollar interest rates.

Long-term borrowings consist exclusively of unsecured borrowings from affiliates. These unsecured borrowings from affiliates are callable with maturities of 13 months or more from when it is called. The interest rates for these unsecured borrowings from affiliates are variable in nature and are established by the treasury function of the Ultimate Parent and are intended to approximate the market rate of interest that the Ultimate Parent incurs in funding its business as it is periodically reassessed.

9. Subordinated Liabilities

Subordinated liabilities consist of a \$250 subordinated revolving credit agreement with the Ultimate Parent at December 31, 2017. The maturity dates, interest rates and book value of the outstanding balance on the line of credit at December 31, 2017 are as follows:

Subordinated Notes	Maturity Date	Interest Rate	Book Value
Subordinated Revolver ⁽¹⁾	July 31, 2022	4.19%	\$ 100

⁽¹⁾ The interest rate on the drawn balance of the subordinated revolving credit agreement is three month LIBOR plus 250 basis points.

10. Commitments, Guarantees and Contingencies

Letters of Credit

The Company has the ability to issue letters of credit to satisfy various collateral requirements; however, none were outstanding at December 31, 2017.

Premises and Equipment

At December 31, 2017, future minimum lease commitments, principally on computer equipment, furniture, fixtures and other equipment, were as follows:

Fiscal Year	Lease Commitments
2018	\$ 17
2019	13
2020	8
2021	2
2022	-
Thereafter	-
Total	\$ 40

Securities Activities

Financial instruments sold, not yet purchased represent obligations of the Company to deliver specified financial instruments at contracted prices, thereby creating commitments to purchase the financial instruments in the market at prevailing prices. Consequently, the Company's ultimate obligation to satisfy the sale of financial instruments sold, not yet purchased may exceed the amounts recognized in the consolidated statement of financial condition.

Guarantees

The Company has obligations under certain guarantee arrangements, including contracts and indemnification agreements that contingently require the Company 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 Company

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.

Derivative Contracts

Certain derivative contracts meet the accounting definition of a guarantee, including certain written options and contingent forward contracts. The Company has disclosed information regarding all derivative contracts that could meet the accounting definition of a guarantee and has used the notional amount as the maximum potential payout for certain derivative contracts, such as written foreign currency options.

In certain situations, collateral may be held by the Company for those contracts that meet the definition of a guarantee. Generally, the Company sets collateral requirements by counterparty so that the collateral covers various transactions and products and is not allocated specifically to individual contracts. Also, the Company may recover amounts related to the underlying asset delivered to the Company under the derivative contract.

The Company records derivative contracts at fair value. Aggregate market risk limits have been established and market risk measures are routinely monitored against these limits. The Company also manages its exposure to these derivative contracts through a variety of risk mitigation strategies including, but not limited to, entering into offsetting economic hedge positions. The Company believes that the notional amounts of the derivative contracts generally overstate its exposure.

Legal

In addition to the matter described below, 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 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 in financial distress.

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, and involving, among other matters, sales and trading activities, financial products or offerings sold by the Company, and 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 consolidated statement of financial

condition 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 and investigations, however, it is inherently difficult to determine whether any loss is probable or even possible, or to estimate the amount of any loss. The Company cannot predict with certainty if, how or when such proceedings or investigations will be resolved or what the eventual settlement, fine, penalty or other relief, if any, may be, particularly for proceedings and investigations where the factual record is being developed or contested or where plaintiffs or government entities seek substantial or indeterminate damages, restitution, disgorgement or penalties. 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 or other relief, and by addressing novel or unsettled legal questions relevant to the proceedings or investigations in question, before a loss or additional loss or range of loss or additional loss can be reasonably estimated for a proceeding or investigation. Subject to the foregoing, the Company believes, based on current knowledge and after consultation with counsel, that the outcome of such proceedings and investigations will not have a material adverse effect on the consolidated financial condition of the Company.

Over the last several years, the level of litigation and investigatory activity (both formal and informal) by government and self-regulatory agencies has increased materially in the financial services industry. While the Company has identified below a proceeding that the Company believes to be material, individually or collectively, there can be no assurance that additional material losses will not be incurred from claims that have not yet been asserted or are not yet determined to be material.

On May 27, 2014, the Firm was named as a defendant in a civil case styled *Tracy Chen, as an aggrieved employee, v. Morgan Stanley Smith Barney LLC, et al.*, which is pending in Orange County Superior Court in California. Plaintiff seeks civil penalties on behalf of the State of California and all current and former California employees allegedly aggrieved by certain of the Company's policies, pursuant to the California Private Attorney General Act, Cal. Labor Code section 2699 et seq. Plaintiff asserts that the Company's expense reimbursement and final pay policies, and specifically, the Firm's Alternative Flexible Grid program, violate the California Labor Code under various factual and legal theories, including by passing the Company's costs of doing business onto Financial Advisors, and by paying some terminated Financial Advisors outside the statutorily prescribed time period for final wages. On August 31, 2017, the court denied both Plaintiff and the Company's motions for summary judgment regarding the legality of the Alternative Flexible Grid program. Plaintiff seeks per pay period remedies based on the number of impacted employees, attorneys' fees, and enhanced penalties for a "willful" violation, which can potentially include 25% of the amount found to have been unlawfully withheld. The total penalties sought are currently unspecified.

11. Variable Interest Entities and Securitization Activities

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

The Company's variable interests in VIEs include debt and equity interests. The Company's involvement with VIEs arises primarily from interests purchased in connection with secondary market-making activities.

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 Company generally has no power in these structures.

Securitization transactions generally involve VIEs. Primarily as a result of its client facilitation activities, the Company owned securities issued by securitization SPEs for which the maximum exposure to loss is less than specific thresholds. These securities totaled \$64 at December 31, 2017. The Company's primary risk exposure is to the securities issued by the SPE, owned by the Company, with the highest risk on the most subordinate class of beneficial interests. These securities are included in Financial instruments owned 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 equals the fair value of the securities owned.

12. Risk Management

The Company's trading portfolios are managed with a view toward the risk and profitability of the portfolios. The following is a discussion of the Company's policies and procedures covering its market, credit, operational, and liquidity risks.

The Company's risk management policies and related procedures are aligned with those of the Ultimate Parent and its other consolidated subsidiaries. These policies and related procedures are administered on a coordinated global and legal entity basis with consideration given to each subsidiary's, including the Company's, specific capital and regulatory requirements. For the Risk Management discussion which follows, the term "Company" includes the Ultimate Parent and its subsidiaries.

Risk is an inherent part of the Company's business activities. Management believes effective risk management is vital to the success of the Company's business activities. Accordingly, the Company has policies and procedures in place to identify,

measure, monitor, advise, challenge and control the principal risks involved in the activities of its business and support functions. The Company's ability to properly and effectively identify, measure, monitor, advise, challenge and control each of the various types of risk involved in its activities is critical to its soundness and profitability.

The cornerstone of the Company's risk management philosophy is the execution of risk-adjusted returns through prudent risk-taking that protects the Company's capital base and franchise. Five key principles underlie this philosophy: integrity, comprehensiveness, independence, accountability, and transparency. To help ensure the efficacy of risk management, which is an essential component of the Company's reputation, senior management requires thorough and frequent communication and the appropriate escalation of risk matters. The fast-paced, complex, and constantly-evolving nature of global financial markets requires that the Company maintain a risk management culture that is incisive, knowledgeable about specialized products and markets, and subject to ongoing review and enhancement.

Market Risk

Market risk refers to the risk that a change in the level of one or more market prices, rates, indices, implied volatilities (the price volatility of the underlying instrument imputed from option prices) or other market factors, such as market liquidity, will result in losses for a position or portfolio owned by the Company. Generally, the Company incurs market risk as a result of trading, investing, and client facilitation activities.

Sound market risk management is an integral part of the Company's culture. The various business units and trading desks are responsible for ensuring that market risk exposures are well-managed and prudent. Market risk is monitored through various measures: using statistics; by measures of position sensitivity; and through routine stress testing, which measures the impact on the value of existing portfolios of specified changes in market factors, and through scenario analyses conducted in collaboration with business units.

Credit Risk

Credit risk refers to the risk of loss arising when a borrower, counterparty or issuer does not meet its financial obligations owned by the Company. The Company primarily incurs credit risk exposure to institutions and individuals. This risk may arise from a variety of business activities, including, but not limited to, entering into derivative contracts under which counterparties have obligations to make payments to the Company; extending credit to clients; providing funding that is secured by physical or financial collateral whose value may at times be insufficient to cover the loan repayment amount; and posting margin and/or collateral to counterparties. This type of risk requires credit analysis of specific counterparties, both initially and on an ongoing basis. The Company also incurs credit risk through margin and other customer securities-based lending transactions, which are collateralized by securities.

The Company has structured its credit risk management framework to reflect that each of its businesses generates unique credit risks, and establishes practices to evaluate, monitor and control credit risk exposure both within and across its business activities. The Company is responsible for ensuring transparency of material credit risks, ensuring compliance with established limits, approving material extensions of credit, and escalating risk concentrations to appropriate senior management. The Company's credit risk exposure is managed by credit professionals and risk committees of the Company that monitor risk exposures, including margin loans and credit sensitive, higher risk transactions.

Operational Risk

Operational risk refers to the risk of loss, or of damage to the Company's reputation, resulting from inadequate or failed processes or systems, human factors or from external events (e.g., fraud, theft, legal and compliance risks, cyber attacks or damage to physical assets). The Company may incur operational risk across the full scope of its business activities, including revenue-generating activities (e.g., sales and trading) and support and control groups (e.g., information technology and trade processing). As such, the Company may incur operational risk in each of its divisions.

The goal of the operational risk management framework is to establish Company-wide operational risk standards related to risk measurement, monitoring and management. Operational risk policies are designed to reduce the likelihood and/or impact of operational incidents as well as to mitigate legal, regulatory, and reputational risks.

Liquidity Risk

Liquidity risk refers to the risk that the Company will be unable to finance its operations due to a loss of access to the capital markets or difficulty in liquidating its assets. Liquidity and funding risk also encompasses the Company's ability to meet its financial obligations in a timely manner without experiencing significant business disruption or reputational damage that may threaten its viability as a going concern.

The primary goal of the Company's Liquidity Risk Management Framework is to ensure that the Company has access to adequate funding across a wide range of market conditions. The framework is designed to enable the Company to fulfill its financial obligations and support the execution of its business strategies. The Company's Required Liquidity Framework reflects the amount of liquidity the Company must hold in both normal and stressed environments to ensure that its financial condition or overall soundness is not adversely affected by an inability (or perceived inability) to meet its financial obligations in a timely manner. The Required Liquidity Framework considers the most constraining liquidity requirement to satisfy all regulatory and internal limits. The Company uses Liquidity Stress Tests to model liquidity inflows and outflows across multiple scenarios over a range of time horizons. These scenarios contain various combinations of idiosyncratic and systemic stress events of different severity and duration. The

methodology, implementation, production and analysis of the Company's Liquidity Stress Tests are important components of the Required Liquidity Framework.

Concentration Risk

Substantially all of the collateral held by the Company for reverse repurchase agreements or bonds borrowed, which together represented approximately 24% of the Company's total assets at December 31, 2017, consist of securities issued by the U.S. government, federal agencies or other sovereign governments.

13. Employee Stock-Based Compensation Plans

Eligible employees of the Company participate in several of the Ultimate Parent's stock-based compensation plans. The Ultimate Parent determines the fair value of stock-based awards based on the grant-date fair value of its common stock.

Restricted Stock Units

RSUs are generally subject to vesting over time, generally three years from the date of award, contingent upon continued employment and subject to restrictions on sale, transfer or assignment until conversion to common stock. All or a portion of an award may be cancelled if employment is terminated before the end of the relevant vesting period and after the relevant vesting period in certain situations. Recipients of RSUs may have voting rights, at the Ultimate Parent's discretion, and generally receive dividend equivalents if the awards vest. The Ultimate Parent determines the fair value of RSUs based on the grant-date fair value of its common stock, measured as the volume-weighted average price on the date of grant. Certain awards provide the Ultimate Parent discretion to cancel all or a portion of the award under specified circumstances.

Performance-Based Stock Units

PSUs will vest and convert to shares of common stock only if the Ultimate Parent satisfies predetermined performance and market-based conditions over a three-year performance period. The number of PSUs that will actually vest will be based on the extent to which the Ultimate Parent achieves the specified performance goals. PSUs have vesting, restriction and cancellation provisions that are generally similar to those of RSUs. The Ultimate Parent determines the fair value of PSUs with non-market performance conditions based on the grant-date fair value of its common stock, measured as the volume-weighted average price on the date of grant. PSUs with market-based conditions are valued using a Monte Carlo valuation model.

14. Employee Benefit Plans

Certain employees of the Company participate in employee benefit plans sponsored by the Ultimate Parent or affiliates.

Pension and Other Postretirement Plans

The pension and postretirement plans have generally ceased future benefit accruals. The pension plans generally provide pension benefits that are based on each employee's years of credited service and on compensation levels specified in the plans.

Certain employees are covered by a postretirement benefit plan that provides medical and life insurance for eligible retirees and medical insurance for their dependents.

Morgan Stanley 401(k) Plan

Eligible employees receive discretionary 401(k) matching cash contributions that are allocated according to participants' investment direction. In 2017, the Company made a dollar for dollar Company match up to 4% of eligible pay, up to the IRS limit. Eligible employees with eligible pay less than or equal to one hundred thousand dollars received a fixed contribution of 2% of eligible pay. Certain employees received a transition contribution based on prior plan membership.

15. Income Taxes

The Company is a single-member limited liability company that is treated as a disregarded entity for federal income tax purposes. The Company is included in the consolidated federal income tax return filed by the Ultimate Parent. Federal income taxes have generally been provided on a modified separate entity basis in accordance with the Tax Sharing Agreement with the Ultimate Parent. The Company is included in the combined state and local income tax returns with the Ultimate Parent and certain other subsidiaries of the Ultimate Parent. State and local income taxes have been provided on separate entity income at the effective tax rate of the Company's combined filing group.

In accordance with the terms of the Tax Sharing Agreement with the Ultimate Parent, substantially all current and deferred taxes (federal, combined and unitary state) are settled periodically with the Ultimate Parent.

On December 22, 2017, the Tax Cuts and Jobs Act ("Tax Act") significantly revised the U.S. corporate income tax law by, among other things, reducing the corporate income tax rate to 21%, and broadens the tax base by partially or wholly eliminating a tax deduction for certain historically deductible expenses (e.g., executive compensation).

Notwithstanding the above, it may be appropriate to record future adjustments in the reporting period the adjustments are determined, depending on the nature of the estimate and reason for the adjustment.

Deferred Tax Assets and Liabilities

Deferred income taxes reflect the net tax effects of temporary differences between the financial reporting and tax bases of assets and liabilities and are measured using the applicable enacted tax rates and laws that will be in effect when such differences are expected to reverse. In absence of the Tax

Sharing Agreement with the Ultimate Parent, the Company's net deferred tax asset at December 31, 2017 would be \$566 after the impact of the Tax Act, which is primarily attributable to employee compensation, goodwill and intangibles.

Unrecognized Tax Benefits

The Company is subject to the income and indirect tax laws of the U.S., its states and municipalities in which the Company has significant business operations. These tax laws are complex and subject to different interpretations by the taxpayer and the relevant governmental taxing authorities. The Company must make judgments and interpretations about the application of these inherently complex tax laws when determining the provision for income taxes and the expense for indirect taxes and must also make estimates about when certain items affect taxable income in the various tax jurisdictions. Disputes over interpretations of the tax laws may be settled with the taxing authority upon examination or audit. The Company periodically evaluates the likelihood of assessments in each taxing jurisdiction resulting from current and subsequent years' examinations, and unrecognized tax benefits related to potential losses that may arise from tax audits are established in accordance with the guidance on accounting for unrecognized tax benefits and incorporated into the amounts settled periodically with the Ultimate Parent under the Tax Sharing Agreement. Once established, unrecognized tax benefits are adjusted when there is more information available or when an event occurs requiring a change.

Tax Authority Examinations

The Company, through its inclusion in the partnership return of the Ultimate Parent prior to October 31, 2014 is currently under audit by the IRS as well as New York City for tax years 2009 – 2013 and 2010 – 2012 respectively. The Company, through its inclusion in the return of the Ultimate Parent, is under continuous examination by the IRS and other tax authorities in certain states in which the Company has significant business operations, such as New York. The Company believes its unrecognized tax benefits, and associated interest, if applicable ("tax liabilities"), is adequate in relation to the potential for additional assessments. The Company will adjust such unrecognized tax benefits only when new information is available or when an event occurs necessitating a change.

The Company believes that the resolution of the above tax matters will not have a material effect on the consolidated statement of financial condition.

It is reasonably possible that significant changes in the balance of unrecognized tax benefits 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 the impact on the Company's effective tax rate over the next 12 months.

Earliest Tax Year Subject to Examination in Major Tax Jurisdictions

Jurisdiction	Tax Year
United States	2014
New York State and New York City	2014
New York City Unincorporated Business Tax	2010

16. Regulatory Capital and Other Requirements

Regulatory Capital

MSSB is a registered U.S. broker-dealer and, accordingly, is subject to the minimum net capital requirements of the SEC. Under SEA Rule 15c3-1, MSSB is required to maintain minimum Net Capital, as defined, of the greater of 2% of aggregate debit items arising from customer transactions, plus excess margin collateral on reverse repurchase agreements, or \$1. At December 31, 2017, MSSB's Net Capital was \$2,567, which exceeded the minimum requirement by \$2,400.

FINRA may require a member firm to reduce its business if net capital is less than 4% of such aggregate debit items and may prohibit a firm from expanding its business if net capital is less than 5% of such aggregate debit items.

Advances to the Ultimate Parent and its affiliates, repayment of subordinated liabilities, dividend payments and other equity withdrawals are subject to certain notification and other provisions of the SEC Net Capital rule.

Other

At December 31, 2017, cash of \$1,128 and securities at fair value of \$3,121 were deposited with clearing organizations or segregated under federal and other regulations or requirements. Securities deposited with clearing organizations or segregated under federal and other regulations or requirements are sourced from reverse repurchase agreements in the consolidated statement of financial condition.

17. Subsequent Events

The Company has evaluated subsequent events for adjustment to or disclosure in the consolidated statement of financial condition through the date of this report and the Company has not identified any recordable or disclosable events, not otherwise reported in these consolidated statement of financial condition or the notes thereto.

Glossary of Common Acronyms

ABS – Asset-backed securities	MSDHI – Morgan Stanley Distribution Holdings, Inc.
CDS – Credit default swap	MSPBNA – Morgan Stanley Private Bank, National Association
CFO – Chief Financial Officer of the Ultimate Parent and its consolidated subsidiaries	MSSB – Morgan Stanley Smith Barney LLC
CFTC – Commodity Futures Trading Commission	MSSBF – Morgan Stanley Smith Barney Financing LLC
CRO – Chief Risk Officer of the Ultimate Parent and its consolidated subsidiaries	MSSG – Morgan Stanley Services Group Inc.
FCG – Financial Control Group	OTC – Over-the-counter
FINRA – The Financial Industry Regulatory Authority	PSU – Performance-based stock units
IRS – Internal Revenue Service	RSU – Restricted stock unit
LIBOR– 3 month London Interbank Offered Rate	SEC – U.S. Securities and Exchange Commission
MABS – Mortgage- and Asset-backed securities	SPE – Special purpose entities
MRM – Model Risk Management Department	U.S. – United States of America
MS&Co. – Morgan Stanley & Co. LLC	U.S. GAAP – Accounting principles generally accepted in the United States of America
MSBNA – Morgan Stanley Bank, N.A.	VIE – Variable interest entity
MSCM – Morgan Stanley Capital Management, LLC	VRG – Valuation Review Group

A copy of our December 31, 2017, consolidated statement of financial condition filed pursuant to Rule 17a-5 of the Securities Exchange Act of 1934 is available for examination at the New York Office of the Securities and Exchange Commission or at our principal office at 2000 Westchester Avenue, Purchase, N.Y. 10577.

A copy of this Morgan Stanley Smith Barney LLC Consolidated Statement of Financial Condition can be viewed online at the Morgan Stanley website at:

http://www.morganstanley.com/about-us-ir/shareholder/morganstanley_smithbarney_llc.pdf