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MORGAN STANLEY INTERNATIONAL LIMITED

Report and financial statements

31 December 2010

MORGAN STANLEY INTERNATIONAL LIMITED

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MORGAN STANLEY INTERNATIONAL LIMITED

DIRECTORS' REPORT

The Directors present their report and the consolidated financial statements of Morgan Stanley International Limited (the "Company"), and its subsidiary and associated undertakings (together the "Group"), together with the Company's balance sheet and related notes for the year ended 31 December 2010.

RESULTS AND DIVIDENDS

The Group's profit for the year, after tax and minority interest, was \$1,041 million (2009: \$613 million).

During the year, the Company paid an interim dividend of \$1,000 million to the holders of its ordinary shares (2009: \$nil). No final dividend is proposed (2009: \$nil).

PRINCIPAL ACTIVITY

The principal activity of the Group is the provision of financial services to corporations, governments and financial institutions. There have not been any significant changes in the Group's principal activities in the year under review and no significant change in the Group's principal business is expected. Certain of the Group's subsidiaries are authorised and regulated by the Financial Services Authority ("FSA") or by other financial services regulatory authorities.

The Group operates in the Europe, Middle East and Africa ("EMEA"), Americas and Asia markets. The Group operates branches in the Dubai International Financial Centre, France, Germany, Greece, Italy, Korea, Luxembourg, Netherlands, New Zealand, Poland (opened on 1 October 2010), the Qatar International Financial Centre, and Switzerland (opened on 8 February 2010).

The Group's ultimate parent undertaking and controlling entity is Morgan Stanley, which, together with the Group and Morgan Stanley's other subsidiary undertakings, form the "Morgan Stanley Group".

BUSINESS REVIEW

Global market and economic conditions continued to improve, and global capital markets continued to recover during 2010 and 2009, as compared with the severe economic and financial downturn that occurred in 2008. Although the modest economic recovery initiated in 2009 continued to be evident in the wider economy during 2010, as further noted below, the Group continues to be impacted by challenging market conditions. These conditions present uncertainty for the business outlook, and may adversely impact the financial performance of the Group in the future.

The consolidated profit and loss account for the year is set out on page 11. The Group's profit after tax and minority interest for the year has increased by \$428 million to \$1,041 million, compared to the year ended 31 December 2009. The Group's revenues are best reviewed across the aggregate of 'Net gains on financial instruments classified as held for trading', 'Net gains on financial instruments designated at fair value through profit or loss', 'Net gains on fixed asset investments', 'Interest income', 'Interest expense' and 'Other income'. Using this measure, aggregate revenues have improved in 2010 in line with the improvement in economic conditions and are driven by the institutional securities businesses. Improved results were reported within fixed income sales and trading, partially offset by a decrease in equity sales and trading revenue. The Group's net interest expense has decreased by 22% to \$440 million, with interest income and interest expense decreasing by 8% and 10% respectively, driven by reductions in interest rates. The Group's non-interest expenses have reduced by 6%, driven by reductions in direct staff costs and impairment losses on loans and receivables compared to the prior period. The Group's effective income tax rate was 26% for the year ended 31 December 2010 compared to 50% for the year ended 31 December 2009 driven by the release of certain tax reserves.

The consolidated balance sheet presented on pages 13-14 of the financial statements shows increases in the Group's total assets (fixed assets and current assets) of 14% and total liabilities of 15% when compared to 31 December 2009. These increases have been driven by increases of \$30,998 million and \$36,783 million in debtors and financial liabilities at amortised cost respectively as a result of increased secured financing activity. Other increases were in financial assets classified as held for trading and financial liabilities classified as held for trading of \$29,727 million and \$18,386 million respectively, primarily due to increases in the Group's derivative instrument assets and liabilities driven by market volatility in the year. Net derivative positions have not moved significantly year on year.

MORGAN STANLEY INTERNATIONAL LIMITED

DIRECTORS' REPORT (CONTINUED)

During 2010, the Group has continued to review and actively manage its capital position. As part of this capital management, the Group received a capital contribution of \$3,000 million from its parent undertaking, Morgan Stanley International Holdings Inc, and paid dividends of \$1,000 million.

Morgan Stanley has also continued to actively manage its capital and liquidity position to ensure adequate resources are available to support the activities of the Morgan Stanley Group, to enable the Morgan Stanley Group to withstand market stresses, and to meet regulatory stress testing requirements proposed by regulators globally. In line with this, in August 2010, the Morgan Stanley Group strengthened its capital position by converting \$5.6 billion of subordinated debentures issued to China Investment Corporation Limited into \$5.6 billion of equity shares. Throughout the year, the Morgan Stanley Group has been focussed on the composition of its funding liabilities, reducing reliance on short term funding in favour of more diverse and durable funding sources. This remains an ongoing objective of the Morgan Stanley Group.

During June 2011, Morgan Stanley strengthened its capital position by converting the outstanding Series B Non-Cumulative Non-Voting Perpetual Convertible Preferred Stock with a face value of \$7.8 billion and a 10% dividend issued to Mitsubishi UFJ Financial Group Inc ("MUFG"), for 385,464,097 shares in Morgan Stanley's common stock.

During 2011, global market and economic conditions were negatively impacted by concerns about a sovereign debt crisis in Europe. In connection with certain of its Institutional Securities business segment activities, the Group has exposure to European peripheral countries, which are defined as exposures in Greece, Ireland, Italy, Portugal and Spain. The exposures primarily arise in the Group's principal trading subsidiary, Morgan Stanley & Co. International plc ("MSIP"). As at 30 June 2011, MSIP's gross funded exposure before the benefit of hedges was approximately \$4,200 million and net funded exposure after hedges was approximately \$2,900 million. The majority of this gross funded exposure and net funded exposure is concentrated in Spain and Italy. Gross funded exposure includes obligations from sovereign governments, corporations, and financial institutions and the net funded exposure includes the impact of hedges held by MSIP, including credit default swap contracts. Net funded exposure excludes hedges held by members of the Morgan Stanley Group outside MSIP. Gross and net funded exposures arise on financial instruments classified as held for trading which are recognised at fair value in the Group's consolidated balance sheet, with changes in fair value recognised in the consolidated profit and loss account. In addition to the gross funded exposure, at 30 June 2011, MSIP had European peripheral country exposure for overnight deposits with banks of approximately \$1,700 million which are recognised at amortised cost in the Group's consolidated balance sheet. Substantially all of these deposits are held with Spanish banks. MSIP also has unfunded loans to Italian and Spanish corporations of approximately \$300 million.

On 5 August 2011, Standard & Poor's lowered its long term sovereign credit rating on the United States of America from AAA to AA+. While U.S. lawmakers reached agreement to raise the federal debt ceiling on 2 August 2011, the downgrade reflected Standard & Poor's view that the fiscal consolidation plan within that agreement fell short of what would be necessary to stabilize the U.S. government's medium term debt dynamics. Subsequently, Fitch and Moody's reaffirmed the AAA rating, although Moody's has cut its outlook to negative. The Standard & Poor's downgrade could have material adverse impacts on financial markets and economic conditions in the United States and throughout the world. Because of the unprecedented nature of negative credit rating actions with respect to U.S. government obligations, the ultimate impacts on global markets and our business, financial condition and liquidity are unpredictable and may not be immediately apparent.

To date the above events have not had a material impact on the Group's financial performance and position.

As set out in the risk management section below, the Group operates within the global liquidity management framework of the Morgan Stanley Group. Note 28 to the consolidated financial statements provides qualitative and quantitative disclosures about the Group's management and exposure to risks, including liquidity risk. The global liquidity management framework is expected to continue to provide sufficient liquidity to the Morgan Stanley Group and to the Group, and the Group's capital and liquidity position is satisfactory.

The performance of the Group is included in the results of the Morgan Stanley Group which are disclosed in the Morgan Stanley Group's Annual Report on Form 10-K to the United States Securities and Exchange Commission. The Morgan Stanley Group manages its key performance indicators on a global basis but in consideration of individual legal entities. For this reason, the Company's Directors believe that providing performance indicators for the Group itself would not enhance an understanding of the development, performance or position of the business of the Group.

MORGAN STANLEY INTERNATIONAL LIMITED

DIRECTORS' REPORT (CONTINUED)

Special purpose entities and securitisation exposures

The Group is involved with various entities in the normal course of business that may be deemed special purpose entities ("SPEs"). The Group's interests in SPEs include debt and equity interests and derivative instruments, and these interests primarily arise from trading activity and structured transactions. Consolidation of SPEs is determined in accordance with the Group's accounting policies. As at 31 December 2010 the total assets of SPEs in which the Group has an interest, but which are not consolidated by the Group are \$135 million (2009: \$3,669 million) and the Group's maximum exposure to loss relating to such SPEs is \$59 million (2009: \$43 million). The decrease in non-consolidated SPE assets is due to the unwind of a trade where the Group's retained interest, and therefore related maximum exposure to loss was small relative to the total assets of the SPE. The Group's consolidated balance sheet includes \$4,252 million of assets arising from consolidated SPEs (2009: \$3,477 million). The Group's maximum exposure to loss relating to these assets is \$2,036 million (2009: \$1,800 million).

The Group has exposure to mortgage-related risk. As at 31 December 2010 the amount recognised on the Group balance sheet in relation to residential mortgage backed securities ("RMBS") was \$1,311 million (2009: \$1,220 million). The increase in RMBS is mainly due to the purchase of retained interests in securitisations from other Morgan Stanley Group undertakings. The Group continues to have exposure to commercial mortgage-backed securities ("CMBS") arising from its trading activities. As at 31 December 2010 the amount recognised on the balance sheet in relation to CMBS is \$823 million (2009: \$672 million). The increase in CMBS is mainly due to increased trading positions and the positive impact of improving market conditions

Bank payroll tax

On 8 April 2010, the UK government enacted legislation as part of the 2010 Finance Act imposing a bank payroll tax. The tax applies to discretionary bonuses over a certain amount awarded to certain employees within scope ("Banking Employees") in the period from 9 December 2009 to 5 April 2010. The liability for the tax is for the entity that benefits from the services of the Banking Employees, rather than the employing entity. The charge incurred by the Group for the bank payroll tax and recognised in the consolidated profit and loss account for the year ended 31 December 2010 was \$271 million (2009: \$nil).

Risk management

Risk is an inherent part of both Morgan Stanley's and the Group's business activity and is managed by the Group within the context of the broader Morgan Stanley Group. The Morgan Stanley Group seeks to identify, assess, monitor and manage each of the various types of risk involved in its activities on a global basis, in accordance with defined policies and procedures and in consideration of the individual legal entities. The Group's own risk management policies and procedures are consistent with those of the Morgan Stanley Group.

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), correlations or other market factors, such as liquidity, will result in losses for a position or portfolio.

The Group is managed within the Morgan Stanley Group's global framework. The market risk management policies and procedures of the Group are consistent with those of Morgan Stanley Group, including reporting of material risks identified to appropriate key management personnel of the Group. Sound market risk management is an integral part of the Group's culture. The various business units and trading desks are responsible for ensuring that market risk exposures are well managed and prudent. The market risk department is responsible for ensuring transparency of material market risks, monitoring compliance with established limits, and escalating risk concentrations to appropriate senior management. To execute these responsibilities, the Morgan Stanley Group monitors its market risk against limits on aggregate risk exposures, performs a variety of risk analyses and maintains the Value at Risk ("VaR") system. A variety of limits are designed to control price and liquidity risk. Market risk is monitored through various measures: statistically (using VaR and related analytical measures); by measures of position sensitivity; and through routine stress testing and scenario analyses. The material risks identified by these processes are summarised and reported to senior management.

MORGAN STANLEY INTERNATIONAL LIMITED

DIRECTORS' REPORT (CONTINUED)

Risk management (continued)

Market risk (continued)

During 2010, the Group continued to enhance its market risk management framework to address the severe stresses observed in global markets during the recent economic downturn. The Group expanded and improved its risk measurement processes, including stress tests and scenario analysis, and further refined its market and credit risk limit framework. Stress Value-at-Risk ("S-VaR"), a proprietary methodology which comprehensively measures the Group's market and credit risks, was further refined and is now an important metric used in establishing the Group's risk appetite and its capital allocation framework. S-VaR simulates many stress scenarios based on more than 25 years of historical data and attempts to capture the different liquidities of various types of general and specific risks. Additionally, S-VaR captures event and default risks, which are particularly relevant for credit portfolios.

Credit risk

Credit risk refers to the risk of loss arising from borrower or counterparty default when a borrower, counterparty or obligor does not meet its obligations.

The Morgan Stanley Group manages credit risk exposure on a global basis as well as giving consideration to each individual legal entity. It does this by ensuring transparency of material credit risks, ensuring compliance with established limits, approving material extensions of credit, escalating risk concentrations to appropriate senior management and mitigating credit risk through the use of collateral and other arrangements.

Liquidity risk

Liquidity and funding risk refers to the risk that the Group will be unable to meet its funding obligations in a timely manner. Liquidity risk stems from the potential risk that the Group will be unable to obtain necessary funding through borrowing money at favourable interest rates or maturity terms, or selling assets in a timely manner and at a reasonable price.

The Morgan Stanley Group's senior management establishes the overall liquidity and funding policies of the Morgan Stanley Group and the liquidity risk management policies and procedures conducted within the Group are consistent with those of the Morgan Stanley Group. The Morgan Stanley Group's liquidity and funding risk management policies are designed to mitigate the potential risk that entities within the Morgan Stanley Group and the Group may be unable to access adequate financing to service their financial liabilities when they become payable without material, adverse franchise or business impact. The key objective of the liquidity and funding risk management framework is to support the successful execution of both the Group's and the Morgan Stanley Group's business strategies while ensuring ongoing and sufficient liquidity through the business cycle and during periods of stressed market conditions.

In managing both the Group's and the Morgan Stanley Group's liquidity and funding risk the composition and size of the entire balance sheet, not just financial liabilities, is monitored and evaluated. A substantial portion of the Group and Morgan Stanley Group's total assets consist of liquid marketable securities and short-term receivables arising from its sales and trading activities. The liquid nature of these assets provides the Group and the Morgan Stanley Group with flexibility in financing and managing its business.

This liquidity and funding risk management framework continues to provide sufficient liquidity to the Morgan Stanley Group and to the Group, and as a result, the Group's capital and liquidity position is satisfactory.

MORGAN STANLEY INTERNATIONAL LIMITED

DIRECTORS' REPORT (CONTINUED)

Risk management (continued)

Operational risk

Operational risk refers to the risk of financial or other loss, or damage to the Group's or the Morgan Stanley Group's reputation, resulting from inadequate or failed internal processes, people, resources, systems or from other internal or external events (e.g. internal or external fraud, legal and compliance risks, damage to physical assets, etc.). Legal and compliance risk is included in the scope of operational risk and is discussed below under "Legal and regulatory risk".

The Group's business is highly dependent on the ability to process, on a daily basis, a large number of transactions across numerous and diverse markets in many currencies. In general, the transactions processed are increasingly complex. The Group relies on the ability of its employees, its internal systems, and systems at technology centres operated by third parties to process a high volume of transactions.

The Group also faces the risk of operational failure or termination of any of the clearing agents, exchanges, clearing houses or other financial intermediaries it uses to facilitate securities transactions. In the event of a breakdown or improper operation of the Group's or a third party's systems or improper action by third parties or employees, the Group could suffer financial loss, an impairment to its liquidity, a disruption of its businesses, regulatory sanctions or damage to its reputation.

The Group's operations rely on the secure processing, storage and transmission of confidential and other information in its computer systems and may be vulnerable to unauthorized access, mishandling or misuse, computer viruses and other events that could have a security impact on such systems. If one or more of such events occur, this potentially could jeopardize the Group's or the Group's clients' or counterparties' personal, confidential, proprietary or other information processed and stored in, and transmitted through, the Group's computer systems. Furthermore, such events could cause interruptions or malfunctions in the Group's, the Group's clients', the Group's counterparties' or third parties' operations, which could result in reputational damage, litigation or regulatory fines or penalties not covered by insurance maintained by the Group, or adversely affect the business, financial condition or results of operations.

The Morgan Stanley Group has established an operational risk management process which operates on a global and regional basis to identify, measure, monitor and control risk. Effective operational risk management is essential to reducing the impact of operational risk incidents and mitigating legal, regulatory, and reputational risks.

Despite the business contingency plans the Group has in place, the Group's ability to conduct its business may also be adversely affected by a disruption in the infrastructure that supports its business and the communities in which it is located. This may include a disruption involving physical site access, terrorist activities, disease pandemics, catastrophic events, electrical, environmental, communications or other services used by the Group, its employees or third parties with whom the Group conducts business.

The business continuity management function is responsible for identifying key risks and threats to the Morgan Stanley Group's resiliency and planning to ensure a recovery strategy and required resources are in place for the resumption of critical business functions following a disaster or other business interruption. Disaster recovery plans are in place for critical facilities and resources on a global basis. The key components of the disaster recovery plans include: crisis management; business recovery plans; applications / data recovery; work area recovery; and other elements addressing management, analysis, training and testing.

MORGAN STANLEY INTERNATIONAL LIMITED

DIRECTORS' REPORT (CONTINUED)

Risk management (continued)

Legal and regulatory risk

Legal and regulatory risk includes the risk of exposure to fines, penalties, judgements, damages and / or settlements in conjunction with regulatory or legal actions as a result of non-compliance with applicable legal or regulatory requirements or litigation. Legal risk also includes contractual risk such as the risk that a counterparty's performance obligations will be unenforceable. In the current environment of rapid and possibly transformational regulatory change, the Morgan Stanley Group also views regulatory change as a component of legal risk.

The Morgan Stanley Group has established procedures based on legal and regulatory requirements on a worldwide basis that are designed to foster compliance with applicable statutory and regulatory requirements. The Morgan Stanley Group, principally through the Legal and Compliance Division, also has established procedures that are designed to require that the Morgan Stanley Group's policies relating to conduct, ethics and business practices be followed globally. In connection with its businesses, the Morgan Stanley Group has and continuously develops procedures addressing issues such as regulatory capital requirements, sales and trading practices, new products, potential conflicts of interest, structured transactions, use and safekeeping of customer funds and securities, credit granting, money laundering, privacy and recordkeeping. In addition, the Morgan Stanley Group has established procedures to mitigate the risk that a counterparty's performance obligations will be unenforceable, including consideration of counterparty legal authority and capacity, adequacy of legal documentation, the permissibility of a transaction under applicable law and whether applicable bankruptcy or insolvency laws limit or alter contractual remedies.

The legal and regulatory focus on the financial services industry presents a continuing business challenge for the Morgan Stanley Group. Significant changes in the way that major financial services institutions are regulated are occurring in the UK, the rest of Europe, the US and worldwide. The reforms being discussed and, in some cases, already implemented, include several that contemplate comprehensive restructuring of the regulation of the financial services industry. Such measures will likely lead to stricter regulation of financial institutions generally, and heightened prudential requirements for systemically important firms in particular. Such measures could include taxation of financial transactions, liabilities and employee compensation as well as reforms of the over-the-counter ("OTC") derivatives markets, such as mandated exchange trading and clearing, position limits, margin, capital and registration requirements. Many of these reforms, if enacted, may materially affect the Group's and the Morgan Stanley Group's business, financial condition, results of operations and cash flows in the future.

Basel II Pillar 3 disclosures

The disclosures made in order to comply with the Financial Services Authority's rules, which implement in the UK the EU Directives underlying the revised capital adequacy framework, for the Group are incorporated in the Pillar 3 disclosures of Morgan Stanley International Limited which are available on the Morgan Stanley website.

MORGAN STANLEY INTERNATIONAL LIMITED

DIRECTORS' REPORT (CONTINUED)

DIRECTORS

In 2010, the Group conducted a review of its corporate governance arrangements. As a result, the composition of the board of Directors has changed.

The following Directors held office throughout the year and to the date of approval of this report (except where otherwise shown):

P Bailas	(appointed 8 March 2011)
M C Bowe	(appointed 1 September 2010, resigned 27 July 2011)
C D S Bryce	
W A Chammah	(resigned 3 March 2011)
K Clark	(appointed 1 September 2010, resigned 30 September 2010)
A Classen	(resigned 11 August 2010)
L G P M Francois	(appointed 16 July 2010)
L Isasi Fernández de Bobadilla	(resigned 22 June 2010)
T C Kelleher (Chairman)	(appointed 26 April 2011)
G G Lynch	(resigned 21 March 2011)
A J Mack	(resigned 30 June 2010)
D Moore	(resigned 21 July 2010)
N S Nandra	(appointed 7 April 2011)
D R Nicol	(resigned 17 June 2010)
F R Petrigas	
L R Raettig	(resigned 18 June 2010)
S C T Robey	(resigned 9 August 2010)
R P Rooney	(appointed 26 July 2010)
D Russell	(appointed 23 May 2011)
R R Simonyan	(resigned 8 July 2010)
D Siniscalco	(resigned 21 June 2010)
C E Woodman	

DIRECTORS' LIABILITY INSURANCE

Directors' and Officers' Liability Insurance is taken out by Morgan Stanley, the Company's ultimate parent undertaking, for the benefit of the Directors of the Company.

QUALIFYING THIRD PARTY INDEMNITY PROVISIONS

Qualifying third party indemnity provisions (as defined in section 234 of the Companies Act 2006) were in force during the year and at the date of the Directors' report for the benefit of all the Directors of the Company.

EMPLOYEES

Both the Group and the Morgan Stanley Group place considerable value on the investment in their employees and have continued their practice of keeping employees informed on matters affecting them. Employees are encouraged to present their suggestions and views on Morgan Stanley Group's performance to management and employees participate directly in the success of the business through Morgan Stanley Group's various compensation incentive plans.

Every effort is also made to ensure that disabled applicants, or those existing employees that are disabled or may have become disabled, are treated as fairly as possible on terms comparable with those of other employees.

Appropriate training is arranged for disabled persons, including retraining for alternative work for employees who become disabled, to promote their career development within the organisation.

CHARITABLE CONTRIBUTIONS

During the year subsidiaries of the Company made donations to various charities totalling \$4.2 million (2009: \$3.4 million) of which \$1.3 million was donated to Morgan Stanley International Foundation (2009: \$1.3 million).

MORGAN STANLEY INTERNATIONAL LIMITED

DIRECTORS' REPORT (CONTINUED)

POST BALANCE SHEET EVENTS

Bank levy

In July 2011, the UK Government enacted legislation imposing a bank levy on relevant liabilities and equities on the consolidated balance sheets of "UK Banking Groups," as defined under the bank levy legislation at 31 December 2011. The Group continues to evaluate the impact of this legislation, and estimates the UK Banking Group will incur a full year charge of \$125 million, of which the Group will incur \$120 million. Due to the bank levy being determined on relevant liabilities and equities at 31 December 2011, the final charge may differ from this estimate. The levy is not deductible for UK Corporation Tax purposes.

Dividends

On 9 August 2011, the Company paid an interim dividend of \$2,000 million to the holders of its ordinary shares. This dividend has not been accrued in the financial statements. This dividend has been paid out of the capital contribution reserve.

POLICY AND PRACTICE ON PAYMENT OF CREDITORS

The Group's and the Company's trade creditors balances are comprised primarily of unsettled securities transactions with exchanges, clearing houses, market counterparties, individual investors and other Morgan Stanley Group undertakings. It is the Company's policy that these transactions are settled in accordance with the standard terms of the relevant exchange or market and disclosure of creditor days is not considered a relevant measure.

AUDIT COMMITTEE

The Company has an Audit Committee to assist the Board of the Company itself and the Boards of other MSI regulated subsidiaries in meeting their responsibilities in ensuring an effective system of internal control and compliance, and in meeting their external financial reporting obligations. The Audit Committee meets regularly and reports to the Board of the Company on a quarterly basis.

AUDITORS

Deloitte LLP have expressed their willingness to continue in office as auditors of the Company and, under sections 485 to 488 of the Companies Act 2006, will be deemed to be reappointed.

Statement as to disclosure of information to auditors

Each of the persons who are Directors of the Company at the date when this report is approved confirms that:

- so far as each of the Directors is aware, there is no relevant audit information (being information needed by the Group's auditors in connection with preparing their report) of which the Group's auditors are unaware; and
- each of the Directors has taken all the steps that he / she ought to have taken as a Director to make himself / herself aware of any relevant audit information and to establish that the Group's auditors are aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of section 418 of the Companies Act 2006.

MORGAN STANLEY INTERNATIONAL LIMITED

DIRECTORS' REPORT (CONTINUED)

STATEMENT OF DIRECTORS' RESPONSIBILITIES

The Directors are responsible for preparing the annual report and the financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare financial statements for each financial year. Under that law the Directors have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law). Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that year. In preparing these financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgments and accounting estimates that are reasonable and prudent;
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Approved by the Board and signed on its behalf by L GPM FRANCOIS

Director

27 September 2011



INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF MORGAN STANLEY INTERNATIONAL LIMITED

We have audited the Group and Company financial statements (the "financial statements") of Morgan Stanley International Limited for the year ended 31 December 2010 which comprise the consolidated profit and loss account, the consolidated statement of total recognised gains and losses, the consolidated and Company balance sheets and the related notes 1 to 35 for the Group financial statements and the related notes 1 to 12 for the Company financial statements. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of Directors and auditors

As explained more fully in the Directors' responsibilities statement, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Directors; and the overall presentation of the financial statements.

Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view of the state of the Group's and the Company's affairs as at 31 December 2010 and of the Group's profit for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matters prescribed by the Companies Act 2006

In our opinion the information given in the Directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of Directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.



Oliver Grundy FCA (Senior Statutory Auditor)
for and on behalf of Deloitte LLP
Chartered Accountants and Statutory Auditor
London
27 September 2011

MORGAN STANLEY INTERNATIONAL LIMITED

CONSOLIDATED PROFIT AND LOSS ACCOUNT

Year ended 31 December 2010

	Note	2010 \$millions	2009 \$millions
Net gains on financial instruments classified as held for trading		4,628	4,939
Net gains on financial instruments designated at fair value through profit or loss		318	57
Net gains on fixed asset investments:			
- Available-for-sale financial assets	2	61	16
Interest income	3	4,137	4,513
Interest expense	4	(4,577)	(5,075)
Other income	5	1,073	1,235
Other expense	6	(4,225)	(4,471)
PROFIT BEFORE TAXATION		1,415	1,214
Tax on profit on ordinary activities	9	(367)	(601)
PROFIT FOR THE FINANCIAL YEAR		1,048	613
Minority interest	26	(7)	-
PROFIT ATTRIBUTABLE TO SHAREHOLDERS OF THE COMPANY FOR THE FINANCIAL YEAR		1,041	613

All operations were continuing in the current and prior year.

A reconciliation of the movement in shareholders' funds is disclosed in note 26 to the accounts.

The notes on pages 15 to 81 form an integral part of the financial statements.

MORGAN STANLEY INTERNATIONAL LIMITED

CONSOLIDATED STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES
Year Ended 31 December 2010

	Note	2010 \$millions	2009 \$millions
PROFIT FOR THE FINANCIAL YEAR		1,048	613
Foreign currency revaluation reserve:			
- Currency translation differences on foreign currency net investments	26	(100)	257
Fair value reserve:			
- Net change in fair value of available-for-sale financial assets recognised directly in equity	12	13	(3)
- Net amount transferred to profit and loss account		(3)	-
Pension reserve:			
- Actuarial loss recognised on post-retirement benefit plans	23	(9)	(10)
Net current and deferred tax:			
- on items taken directly to equity		2	-
TOTAL RECOGNISED GAINS AND LOSSES RELATING TO THE YEAR		<u>951</u>	<u>857</u>

The notes on pages 15 to 81 form an integral part of the financial statements.

MORGAN STANLEY INTERNATIONAL LIMITED

Registration No. 3584019

CONSOLIDATED BALANCE SHEET

As at 31 December 2010

	Note	2010 \$millions	2009 \$millions
FIXED ASSETS			
Intangible assets	10	10	24
Tangible assets	11	790	870
Investments:			
- Available-for-sale financial assets	12	151	163
- Joint venture	12	7	7
		<u>958</u>	<u>1,064</u>
CURRENT ASSETS			
Financial assets classified as held for trading (of which \$55,504 million (2009: \$57,877 million) were pledged to various parties)	13	285,378	255,651
Financial assets designated at fair value through profit or loss	14	9,363	1,908
Loans and receivables			
- Cash at bank	15	11,255	14,480
- Debtors	16	202,275	171,277
Other assets	17	<u>579</u>	<u>1,124</u>
		<u>508,850</u>	<u>444,440</u>
CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR			
Financial liabilities held for trading	13	(227,888)	(209,502)
Financial liabilities designated at fair value through profit or loss	14	(12,456)	(7,879)
Financial liabilities at amortised cost	19	(233,621)	(202,180)
Other creditors	20	<u>(1,543)</u>	<u>(2,338)</u>
		<u>(475,508)</u>	<u>(421,899)</u>
NET CURRENT ASSETS		<u>33,342</u>	<u>22,541</u>
TOTAL ASSETS LESS CURRENT LIABILITIES		<u>34,300</u>	<u>23,605</u>
CREDITORS: AMOUNTS FALLING DUE AFTER MORE THAN ONE YEAR			
Financial liabilities designated at fair value through profit or loss	14	(4,135)	-
Financial liabilities at amortised cost	19	(15,984)	(10,642)
PROVISIONS FOR LIABILITIES AND CHARGES	21	(97)	(119)
NET ASSETS EXCLUDING PENSION LIABILITIES		<u>14,084</u>	<u>12,844</u>
Pension liabilities	23	(7)	(8)
NET ASSETS INCLUDING PENSION LIABILITIES		<u>14,077</u>	<u>12,836</u>

MORGAN STANLEY INTERNATIONAL LIMITED
Registration No. 3584019

CONSOLIDATED BALANCE SHEET (CONTINUED)
As at 31 December 2010

	Note	2010 \$millions	2009 \$millions
CAPITAL AND RESERVES			
Called up share capital	25	1,614	1,614
Capital redemption reserve	26	1,400	1,400
Foreign currency revaluation reserve	26	(541)	(387)
Capital contribution reserve	26	3,141	141
Fair value reserve	26	(22)	(32)
Pension reserve	26	(107)	(98)
Profit and loss account	26	8,476	8,119
EQUITY SHAREHOLDERS' FUNDS		<hr/> 13,961	<hr/> 10,757
MINORITY INTEREST	26	116	2,079
TOTAL EQUITY		<hr/> 14,077	<hr/> 12,836

These financial statements were approved by the Board and authorised for issue on 27 September 2011.

Signed on behalf of the Board

Director


LÉONARD FRANÇOIS
The notes on pages 15 to 81 form an integral part of the financial statements.

MORGAN STANLEY INTERNATIONAL LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Year ended 31 December 2010

1. ACCOUNTING POLICIES

The Group's principal accounting policies are summarised below and have been applied consistently throughout the year and preceding year.

a. Basis of preparation

The Group financial statements are prepared under the historical cost convention, modified by the inclusion of financial instruments at fair value as described in note 1(e) below, and in accordance with applicable United Kingdom company law and accounting standards. Certain limited format changes have been made to prior year amounts to conform to the current year presentation.

The consolidated financial statements of the Group comprise the financial statements of the Company and its subsidiaries made up to 31 December 2010. The financial statements for consolidated subsidiaries are prepared for the same reporting period as the Group, using consistent accounting policies. The financial statements of subsidiaries which are presented in currencies other than US dollars are translated into US dollars as described in note 1(d). Subsidiaries are consolidated from the date that the Group gains control until the date that control ceases. All subsidiaries have been included in the consolidation.

Intra-group balances, transactions, income and expenses and profits and losses resulting from intra-group transactions are eliminated in preparing the consolidated financial statements.

Minority interests represent the portion of profit or loss and net assets not owned, directly or indirectly, by the Group and are presented separately in the consolidated profit and loss account and within equity in the consolidated balance sheet, separately from parent shareholders' equity. Acquisitions of minority interests are accounted for using the parent entity extension method, whereby the difference between the consideration paid and the fair value of the share of the net assets acquired is recognised in consolidated equity.

b. The going concern assumption

The Group's business activities, together with the factors likely to affect its future development, performance and position, are set out in the Business Review sections of the Director's report on pages 1 to 9. In addition, the notes to the financial statements include the Group's objectives, policies and processes for managing its capital; its financial risk management objectives; details of its financial instruments; and its exposures to credit risk and liquidity risk.

As set out in the Directors' report, the Group operates within the global liquidity management framework of the Morgan Stanley Group. Throughout the difficult market conditions, this framework has continued to provide sufficient liquidity to the Morgan Stanley Group and to the Company, and the Company's capital and liquidity position is satisfactory.

Taking all of these factors into consideration, the Directors believe it is reasonable to assume that the Group will have access to adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the annual report and financial statements.

c. Functional currency

Items included in the financial statements are measured and presented in US dollars, the currency of the primary economic environment in which the Company operates. All currency amounts in the Directors' report and the financial statements are rounded to the nearest million US dollars, except when otherwise indicated.

MORGAN STANLEY INTERNATIONAL LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS Year ended 31 December 2010

1. ACCOUNTING POLICIES (CONTINUED)

d. Foreign currencies

All monetary assets and liabilities denominated in currencies other than US dollars are translated into US dollars at the rates ruling at the balance sheet date. Assets and liabilities of the overseas branches and subsidiaries are translated into US dollars using the closing rate method. Transactions in currencies other than US dollars are recorded at the rates prevailing at the dates of the transactions. Translation differences arising from the net investments in the overseas branches and subsidiaries are taken to the foreign currency revaluation reserve and all other translation differences are taken through the consolidated profit and loss account, with the exception of non-monetary financial investments classified as available-for-sale, where foreign exchange differences and the related tax amounts are recorded in the fair value reserve in equity until the investment is sold. Exchange differences recognised in the consolidated profit and loss account are presented in 'Other income' or 'Other expense', except where noted in 1(e) below.

On the disposal of a foreign operation, all foreign exchange differences accumulated in the 'Currency translation reserve' attributable to the equity holders of the Company are reclassified to retained earnings.

e. Financial instruments

The Group classifies its financial assets into the following categories on initial recognition: financial assets classified as held for trading; financial assets designated at fair value through profit or loss; available-for-sale fixed asset investments; investments in joint ventures and loans and receivables.

The Group classifies its financial liabilities into the following categories on initial recognition: financial liabilities classified as held for trading, financial liabilities designated at fair value through profit or loss and financial liabilities at amortised cost.

More information regarding these classifications is included below:

i) *Financial instruments classified as held for trading*

With the exception of loans, financial instruments classified as held for trading, including all derivatives, are initially recorded on trade date at fair value (see note 1(f) below). All subsequent changes in fair value, foreign exchange differences, interest and dividends, are reflected in the consolidated profit and loss account in 'Net gains/ (losses) on financial instruments classified as held for trading'.

For loans classified as held for trading, from the date a loan is entered into (trade date), until settlement date, the Group recognises any unrealised fair value changes in the loan as financial instruments classified as held for trading. On settlement date, the fair value of consideration given or received is recognised as a financial instrument classified as held for trading. All subsequent changes in fair value, foreign exchange differences and interest are reflected in the consolidated profit and loss account in 'Net gains / (losses) from financial instruments classified as held for trading'.

For all financial instruments classified as held for trading, transaction costs are excluded from the initial fair value measurement of the financial instrument. These costs are recognised in the consolidated profit and loss account in 'Other expense'.

ii) *Financial instruments designated at fair value through profit or loss*

The Group has designated certain financial assets and financial liabilities at fair value through profit or loss when either:

- the financial assets or financial liabilities are managed, evaluated and reported internally on a fair value basis;
- the designation at fair value eliminates or significantly reduces an accounting mismatch which would otherwise arise; or
- the financial asset or financial liability contains an embedded derivative that significantly modifies the cash flows that would otherwise be required under the contract.

MORGAN STANLEY INTERNATIONAL LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS Year ended 31 December 2010

1. ACCOUNTING POLICIES (CONTINUED)

e. Financial instruments (continued)

ii) Financial instruments designated at fair value through profit or loss (continued)

From the date the transaction in a financial instrument designated at fair value is entered into (trade date) until settlement date, the Group recognises any unrealised fair value changes in the contract as financial instruments designated at fair value through profit or loss. On settlement date, the fair value of consideration given or received is recognised as a financial instrument designated at fair value through profit or loss (see note 1(f) below). All subsequent changes in fair value, foreign exchange differences, interest and dividends, are reflected in the consolidated profit and loss account in 'Net gains / (losses) on financial instruments designated at fair value through profit or loss'. Transaction costs are excluded from the initial fair value measurement of the financial instrument. These costs are recognised in the consolidated profit and loss account in 'Other expense'.

iii) Available-for-sale fixed assets investments

Fixed asset investments classified as available-for-sale are non-derivative financial assets that are either designated in this category or not classified in any of the other categories of financial instruments. Fixed asset investments classified as available-for-sale are recorded on trade date and are initially recognised and subsequently measured at fair value (see note 1(f) below).

For debt instruments, interest calculated using the effective interest method (see note 1(e) (v) below), impairment losses and reversals of impairment losses and exchange differences on the amortised cost of the asset are recorded in the consolidated profit and loss account in 'Net gains / (losses) on fixed asset investments in available-for-sale financial assets'. For equity instruments, dividend income and impairment losses are recorded in the consolidated profit and loss account in 'Net gains / (losses) on fixed asset investments in available-for-sale financial assets'. All other gains and losses on debt and equity instruments classified as available-for-sale are recognised in the 'Fair value reserve' within equity.

Transaction costs that are directly attributable to the acquisition of the available-for-sale fixed asset investment are added to the fair value on initial recognition.

On disposal or impairment of an available-for-sale fixed asset investment, the cumulative gain or loss in the 'Fair value reserve' is transferred to and recognised in the consolidated profit and loss account and reported in 'Net gains / (losses) on fixed asset investments in available-for-sale financial assets'.

iv) Investment in joint venture

The Group's investment in its joint venture is accounted for using the equity method of accounting.

Under the equity method, the investment in the joint venture is carried on the consolidated balance sheet at cost, including attributable goodwill, and is adjusted for post-acquisition changes in the Group's share of total assets less total liabilities of the joint venture. The Group's share of its joint venture's post-acquisition profits or losses is recognised in the consolidated profit and loss account; its share of post-acquisition movements in equity is recognised in equity. Profits and losses resulting from transactions between the Group and the joint venture are eliminated to the extent of the interest in the joint venture. Distributions received from the joint venture reduce the carrying amount of the investment.

MORGAN STANLEY INTERNATIONAL LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Year ended 31 December 2010

1. ACCOUNTING POLICIES (CONTINUED)

e. Financial instruments (continued)

v) *Loans and receivables and financial liabilities at amortised cost*

Financial assets categorised as loans and receivables are initially recognised on settlement date at fair value (see note 1(f) below) and subsequently measured at amortised cost less allowance for impairment. Interest is recognised in the consolidated profit and loss account in 'Interest income', using the effective interest method. Transaction costs that are directly attributable to the acquisition or issue of the financial asset are added to or deducted from the fair value on initial recognition.

Financial liabilities held at amortised cost are initially recognised on settlement date at fair value (see note 1(f) below) and subsequently measured at amortised cost. Interest is recognised in the consolidated profit and loss account in 'Interest expense' using the effective interest method as described below. Foreign exchange differences on financial liabilities held at amortised cost are recognised in the consolidated profit and loss account in 'Other income' or 'Other expense' as appropriate. Transaction costs that are directly attributable to the issue of the financial liability are added to or deducted from the fair value on initial recognition.

The effective interest method is a method of calculating the amortised cost of a financial asset or financial liability (or group of financial assets or financial liabilities) and of allocating the interest income or interest expense over the expected life of the financial asset or financial liability. The effective interest rate is the rate that exactly discounts the estimated future cash payments and receipts through the expected life of the financial asset or financial liability (or, where appropriate a shorter period) to the carrying amount of the financial asset or financial liability. The effective interest rate is established on initial recognition of the financial asset and liability. The calculation of the effective interest rate includes all fees and commissions paid or received, transaction costs, and discounts or premiums that are an integral part of the effective interest rate. Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial asset or liability.

Impairment losses, reversals of impairment losses and foreign exchange differences on financial assets classified as loans and receivables are recognised in the consolidated profit and loss account in either 'Other expense' or 'Other income' as appropriate.

In the course of financing its business and as part of its trading activities, the Group enters into arrangements which involve the sale of securities with agreements to repurchase, the purchase of securities with resale agreements, the lending of securities with collateral received and the borrowing of securities with collateral given. Cash collateral balances repayable and accrued interest arising under repurchase agreements and securities lending arrangements are classified as 'Financial liabilities at amortised cost' and the related securities, where owned by the Group, are included in 'Financial assets classified as held for trading'. Cash collateral balances receivable and accrued interest arising under resale agreements and securities borrowing arrangements are classified as debtors within 'Loans and receivables'. Securities received by the Group under resale arrangements and securities borrowing arrangements are generally not recognised on the consolidated balance sheet.

The redeemable preference shares issued by the Group are classified as financial liabilities at amortised cost in accordance with the substance of the contractual arrangement. Dividends on these redeemable preference shares are recognised in the consolidated profit and loss account in 'Interest expense' using the effective interest rate method.

MORGAN STANLEY INTERNATIONAL LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS Year ended 31 December 2010

1. ACCOUNTING POLICIES (CONTINUED)

f. Fair value of financial instruments

Fair value measurement

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.

In determining fair value, the Group uses various valuation approaches and establishes a hierarchy for inputs used in measuring fair value that maximises the use of relevant observable inputs and minimises 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 developed based on market data obtained from sources independent of the Group. Unobservable inputs are inputs that reflect the Group's assumptions about the assumptions other market participants would use in pricing the asset or liability, developed based on the best information available in the circumstances.

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 the markets and other characteristics particular to the transaction. 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 judgement.

The Group uses 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. In addition, a downturn in market conditions could lead to further declines in the valuation of many instruments.

Valuation techniques

Fair value for many cash and OTC contracts, is derived using pricing models. Pricing models take into account the contract terms (including the maturity), as well as multiple inputs including, where applicable, commodity prices, equity prices, interest rate yield curves, credit curves, correlation, creditworthiness of the counterparty, option volatility and currency rates. Where appropriate, valuation adjustments are made to account for various factors such as liquidity risk (bid-ask adjustments), credit quality and model uncertainty. Credit valuation adjustments are applied to both cash instruments and OTC derivatives. For cash instruments, the impact of changes in own credit spreads is considered when measuring the fair value of liabilities and the impact of changes in the counterparty's credit spreads is considered when measuring the fair value of assets. For OTC derivatives, the impact of changes in both the Group's and the counterparty's credit standing is considered when measuring fair value. In determining the expected exposure, the Group considers collateral held and legally enforceable master netting agreements that mitigate the Group's exposure to each counterparty. All valuation adjustments are subject to judgement, are applied on a consistent basis and are based upon observable inputs where available. The Group generally subjects all valuations and models to a review process initially and on a periodic basis thereafter.

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, the Group's own assumptions are set to reflect those that the Group believes market participants would use in pricing the asset or liability at the measurement date.

Gains and losses on inception

In the normal course of business, the fair value of a financial instrument on initial recognition is the transaction price (i.e. the fair value of the consideration given or received). In certain circumstances, however, the fair value will be based on other observable current market transactions in the same instrument, without modification or repackaging, or on a valuation technique whose variables include only data from observable markets. When such evidence exists, the Group recognises a gain or loss on inception of the transaction.

When unobservable market data has a significant impact on determining fair value at the inception of the transaction, the entire initial change in fair value indicated by the valuation technique as at the transaction date is not recognised immediately in the consolidated profit and loss account and is recognised instead when the market data becomes observable.

MORGAN STANLEY INTERNATIONAL LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS Year ended 31 December 2010

1. ACCOUNTING POLICIES (CONTINUED)

g. Impairment of financial assets

At each balance sheet date, an assessment is made as to whether there is any objective evidence of impairment in the value of financial assets classified as available-for-sale fixed asset investments, other fixed asset investments or loans and receivables. Impairment losses are recognised if an event has occurred which will have an adverse impact on the expected future cash flows of an asset and the expected impact can be reliably estimated.

Impairment losses on available-for-sale fixed asset investments are measured as the difference between cost (net of any principal repayment and amortisation) and the current fair value. When a decline in the fair value of an available-for-sale financial asset has been recognised through the statement of total recognised gains and losses and there is evidence that the asset is impaired, the cumulative loss that had been recognised through the statement of total recognised gains and losses is removed from reserves and recognised in the consolidated profit and loss account within 'Net gains / (losses) on fixed asset investments in available-for-sale financial assets'.

Impairment losses on loans and receivables carried at amortised cost are measured as the difference between the carrying amount of the financial asset and the present value of estimated cash flows discounted at the asset's original effective interest rate. Such impairment losses are recognised in the consolidated profit and loss account within 'Other expenses' and are reflected against the carrying amount of the impaired asset on the consolidated balance sheet. Interest on the impaired asset continues to be accrued on the reduced carrying amount based on the original effective interest rate of the asset.

Subsequent increases in fair value of previously impaired equity available-for-sale financial assets are reported as fair value gains in the statement of total recognised gains and losses and not separately identified as an impairment reversal. For all other financial assets, if in a subsequent year, the amount of the estimated impairment loss decreases because of an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed as detailed by financial asset in note 1(e) (iii, iv and v). Any reversal is limited to the extent that the value of the asset may not exceed the original amortised cost of the asset had no impairment occurred.

h. Fees and commissions

Fees and commissions classified within 'Other income' in the consolidated profit and loss account include account servicing fees, investment management fees, sales commissions, placement fees, advisory fees and syndication fees.

Fees and commissions classified within 'Other expense' include transaction and service fees. These amounts are recognised as the related services are performed or received respectively.

MORGAN STANLEY INTERNATIONAL LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS Year ended 31 December 2010

1. ACCOUNTING POLICIES (CONTINUED)

i. Tangible fixed assets

Tangible fixed assets are stated at cost net of depreciation and any provision for impairment in value, which is included within 'Other expense' in the consolidated profit and loss account. For assets in the course of construction, interest that is directly attributable to the construction of the qualifying asset is capitalised as a cost of the asset. The interest capitalisation rate is based on the Morgan Stanley Group's blended funding rates.

For premises held under operating leases, a reinstatement provision is recognised for the estimated cost to reinstate the premises at the end of the lease period. When the reinstatement provision is established and included within 'Provisions for liabilities' in the consolidated balance sheet, an equivalent asset is recognised and included in the cost of leasehold improvements at the initial present value of any reinstatement obligations. The discount effect included in the reinstatement provision is reversed over time using a constant effective yield method and included within 'Interest expense' in the consolidated profit and loss account. The reinstatement asset is depreciated over the useful economic life of the relevant leasehold improvement asset and this depreciation is included within 'Other expense'.

Depreciation is provided on tangible fixed assets at rates calculated to write off the cost of the assets on a straight-line basis over their expected useful lives as follows:

Freehold property	-	3 to 39 years
Leasehold improvements, including reinstatement assets	-	shorter of remaining lease term and 39 years
Fixtures, fittings and equipment	-	3 to 8 years

Freehold land is not depreciated. Assets in the course of construction are not depreciated until the construction is complete and the asset is ready for use. The asset is then transferred to leasehold improvements or fixtures, fittings and equipment, where it is depreciated at the relevant rate.

j. Operating leases

Rentals payable under operating leases are charged to 'Other expense' in the consolidated profit and loss account on a straight-line basis over the lease term. Lease incentives are recognised as a reduction of rentals payable and are allocated on a straight line basis over the shorter of the lease term and a period ending on a date from which it is expected the market rent will be payable.

Rentals receivable under operating leases are credited to 'Other income' in the consolidated profit and loss account on a straight-line basis over the lease term. Lease incentives are recognised as a reduction of rentals receivable and are allocated on a straight-line basis over the shorter of the lease term and a period ending on a date from which it is expected the market rent will be receivable.

k. Taxation

UK corporation tax is provided at amounts expected to be paid / recovered using the tax rates and laws that have been enacted or substantively enacted at the balance sheet date.

Full provision has been made for deferred tax assets and liabilities arising from timing differences. Deferred tax is measured using the average tax rates that are expected to apply in the periods in which the timing differences are expected to reverse, based on tax rates and laws that have been enacted or substantively enacted by the balance sheet date. Deferred tax assets are recognised to the extent that it is regarded as more likely than not that they will be recovered. Deferred tax assets and liabilities are not discounted.

Current tax assets are offset against current tax liabilities when there is a legally enforceable right to offset current tax assets against current tax liabilities and when they relate to taxes levied by the same taxation authority and the Group intends to settle its current tax assets and current tax liabilities on a net basis. Deferred tax assets are offset against deferred tax liabilities to the extent that they relate to taxes levied by the same tax authority and arise in the same taxable entity.

MORGAN STANLEY INTERNATIONAL LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Year ended 31 December 2010

1. ACCOUNTING POLICIES (CONTINUED)

l. Intangible fixed assets

Purchased goodwill, being the difference between the purchase consideration and the fair value of net assets acquired, is amortised over a period of between five to twenty years in respect of subsidiary undertakings, being the periods for which the Directors expect the values of the underlying businesses acquired to exceed the value of the underlying net assets. Goodwill is assessed for impairment if events or changes in circumstances indicate that its carrying value may not be recoverable in full.

m. Retirement benefits

The Group operates both defined benefit and defined contribution plans.

Contributions due under defined contribution plans are recognised in 'Other expense' in the consolidated profit and loss account when payable.

For the defined benefit plans, plan obligations are measured on an actuarial basis in accordance with the advice of an independent qualified actuary using the projected unit credit method and discounted at a rate that reflects the current rate of return on a high quality corporate bond of equivalent term and currency to the plan liabilities. Plan assets are measured at their fair value at the reporting date. A surplus or deficit of plan assets over liabilities is recognised in the consolidated balance sheet as an asset or a liability respectively. The value of any asset recognised is restricted to the sum of any unrecognised actuarial losses and past service costs plus the present value of available refunds and reductions in future contributions to the plan. The current service cost and any past service costs are charged to 'Other expense'. The expected return on plan assets and the unwinding of the discount on the plan liabilities are presented net and recognised within either 'Interest income' or 'Interest expense'. Actuarial gains and losses are recognised in full in the period in which they occur in the statement of recognised gains and losses.

Details of the plans are given in note 23 of the consolidated financial statements.

n. Employee compensation plans

(i) Equity-settled share based compensation plans

Morgan Stanley operates equity based compensation plans on behalf of the Group and, in relation to which, the Group pays Morgan Stanley in consideration of the procurement of the transfer of shares or cash payment to employees. The cost of equity settled transactions with employees is measured based on the fair value of the equity instruments at grant date. Fair value of stock unit awards is based on the market price of Morgan Stanley shares and fair value of stock option awards is estimated using the Black-Scholes option pricing model, which takes into account the option's exercise price, its expected term, the risk free interest rate and the expected volatility of the market price of Morgan Stanley shares. Non-market vesting conditions are not taken into account when measuring fair value, but are reflected by adjusting over time the number of equity instruments included in the measurement of the transaction such that the amount ultimately recognised reflects the number that actually vest. The expense for Financial Reporting Standard 20 *Share-based payment* ("FRS 20") purposes is taken directly to 'Other expense' in the consolidated profit and loss account; the corresponding credit to reserves is reduced to the extent that payments are due to Morgan Stanley in respect of these awards.

(ii) Other deferred compensation plans

Morgan Stanley also maintains deferred compensation plans for the benefit of certain employees that provide a return to the participating employees based upon the performance of various referenced investments. Liabilities for these awards, which are included within 'Other creditors' in the consolidated balance sheet, are measured at fair value and recognised over time in accordance with the awards' vesting conditions. The related expense is recorded within 'Staff costs' in 'Other expense'. The Group economically hedges the exposure created by these deferred compensation plans by entering into derivative transactions with other Morgan Stanley undertakings. The derivatives are recognised within financial instruments classified as held for trading and the related gains and losses are recorded within 'Net gains / loss on financial instruments classified as held for trading'.

MORGAN STANLEY INTERNATIONAL LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS Year ended 31 December 2010

1. ACCOUNTING POLICIES (CONTINUED)

o. Cash flow statement

The Group's ultimate parent undertaking, Morgan Stanley, produces consolidated financial statements in which the Group is included and which are publicly available. Accordingly, the Group, which is wholly owned by Morgan Stanley, has elected to avail itself of the exemption provided in Financial Reporting Standard 1 (Revised 1996), *Cash Flow Statements*, and has not presented a cash flow statement.

p. Subsidiaries and significant holdings

Details of the Group's and the Company's investments in subsidiaries and other significant holdings, including the name, country of incorporation, and proportion of ownership is given in note 3 to the Company's separate financial statements.

2. NET GAINS ON INVESTMENTS IN AVAILABLE-FOR- SALE FINANCIAL ASSETS

	2010 \$millions	2009 \$millions
Net fair value gains transferred from equity on disposal of asset	3	-
Dividends receivable	58	16
	<u>61</u>	<u>16</u>

3. INTEREST INCOME

	2010 \$millions	2009 \$millions
Interest income from loans to other Morgan Stanley Group undertakings	1,909	2,083
Net pension plan finance income	-	6
Other interest income	<u>2,228</u>	<u>2,424</u>
	<u>4,137</u>	<u>4,513</u>

Other interest income includes \$8 million (2009: \$14 million) of interest income accrued on impaired loans and receivables.

4. INTEREST EXPENSE

	2010 \$millions	2009 \$millions
Interest expense on bank loans	4	19
Interest expense on loans from other Morgan Stanley Group undertakings	3,239	3,833
Net pension plan finance cost	2	9
Other interest expense	<u>1,332</u>	<u>1,214</u>
	<u>4,577</u>	<u>5,075</u>

MORGAN STANLEY INTERNATIONAL LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS Year ended 31 December 2010

5. OTHER INCOME

	2010 \$millions	2009 \$millions
Fees and commission income	945	993
Operating lease rentals received	54	60
Other	74	182
	<u>1,073</u>	<u>1,235</u>

6. OTHER EXPENSE

	2010 \$millions	2009 \$millions
Staff costs (note 7)	1,215	1,481
Management recharges relating to staff costs borne by other Morgan Stanley Group undertakings	906	987
Management recharges from other Morgan Stanley Group undertakings relating to other services	76	69
Bank payroll tax	271	-
Impairment loss on loans and receivables (note 28)	22	134
Reversal of impairment loss on loans and receivables (Note 28)	(48)	(11)
Realised losses on loans and receivables	1	28
Operating lease rentals	68	63
Depreciation on property, plant and equipment (note 11)	137	176
Amortisation of goodwill (note 10)	14	14
Auditors remuneration:		
- Fees payable to the Company's auditors for the audit of the subsidiaries' accounts	5	4
Foreign exchange losses	3	56
Brokerage fees and commission expense	562	502
Business development and corporate services	394	485
Other operating expense	599	483
	<u>4,225</u>	<u>4,471</u>

Included within both staff costs and management recharges relating to staff costs borne by other Morgan Stanley Group undertakings is an amount of \$264 million (2009: \$281 million) in relation to equity-settled share-based payment transactions. These costs reflect the amortisation of equity-based awards granted to employees over the last three years and are therefore not directly aligned with other staff costs in the current year.

Fees payable to the Company's auditors for the audit of the Company's annual accounts are \$125,000 (2009: \$97,000). Fees payable to the Company's auditors for non-audit services are \$308,000 (2009: \$317,000).

On 8 April 2010 the UK government enacted legislation as part of the 2010 Finance Act imposing a bank payroll tax. The tax applies to discretionary bonuses over a certain amount awarded to certain employees within scope ("Banking Employees") in the period from 9 December 2009 to 5 April 2010. The charge incurred by the Group for the bank payroll tax and recognised in the consolidated profit and loss account for the year ended 31 December 2010 was \$271 million (2009: \$nil).

MORGAN STANLEY INTERNATIONAL LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS Year ended 31 December 2010

7. STAFF COSTS

The average number of employees of the Group including the Directors is analysed below:

	2010	2009
Company and institutional securities infrastructure	2,925	2,968
Business units and other	1,308	1,378
	<u>4,233</u>	<u>4,346</u>

The costs of the staff including Directors, are analysed below:

	2010 \$millions	2009 \$millions
Wages and salaries	1,048	1,316
Social security costs	120	127
Pension costs	47	38
	<u>1,215</u>	<u>1,481</u>

8. DIRECTORS' BENEFITS

	2010 \$millions	2009 \$millions
Total emoluments of all Directors:		
Aggregate emoluments excluding pension contributions	16	30
Long term incentive schemes	6	1
Group contributions to pension plans	1	-
	<u>23</u>	<u>31</u>
Disclosures in respect of the highest paid Director:		
Aggregate emoluments	5	4
Long term incentive plans	3	-
Aggregate emoluments paid to Directors for loss of office	3	-

Directors' emoluments have been calculated as the sum of cash, bonuses, and benefits in kind.

All Directors who are employees of the Group are eligible for shares and share options of the parent company, Morgan Stanley, awarded under the Group's equity based long term incentive schemes. In accordance with Schedule 5 paragraph 1(3)(a) of The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008, the above disclosures include neither the value of shares or share options awarded, nor the gains made on exercise of share options. During the year no Directors exercised share options awarded under these incentive schemes, including the highest paid Director (2009: none).

The value of assets (other than shares or share options) awarded under other long term incentive schemes has been included in the above disclosures when the awards vest, which is generally within three years from the date of the award.

There are eight Directors to whom retirement benefits were accruing under a money purchase scheme (2009: thirteen). Four Directors have retirement benefits accruing under defined benefits plans (2009: two). In addition, no Director has benefits accruing under the Alternative Retirement Plan, a defined benefit plan, operated by Morgan Stanley UK Limited (2009: one).

MORGAN STANLEY INTERNATIONAL LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
Year ended 31 December 2010

9. TAX ON PROFIT ON ORDINARY ACTIVITIES

Analysis of charge in the year

	2010 \$millions	2009 \$millions
UK corporation tax at 28% (2009: 28%)		
- Current year charge	379	175
- Adjustment in respect of prior years	<u>(123)</u>	<u>162</u>
	256	337
Double taxation relief		
- Current year credit	(76)	(63)
- Adjustment in respect of prior years	<u>(13)</u>	<u>49</u>
Foreign Tax		
- Current year charge	199	226
- Adjustment in respect of prior years	<u>4</u>	<u>(6)</u>
Total current tax	370	543
Deferred taxation		
- Current year charge	(7)	2
- Adjustment in respect of prior years	-	56
- Impact of change in the UK corporation tax rate	4	-
Total deferred tax	(3)	58
Tax on profit on ordinary activities	367	601

MORGAN STANLEY INTERNATIONAL LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS Year ended 31 December 2010

9. TAX ON PROFIT ON ORDINARY ACTIVITIES (CONTINUED)

Factors affecting the tax charge for the year

The current year UK taxation charge is lower (2009: higher) than that resulting from applying the standard UK corporation tax rate of 28% (2009: 28%). The main differences are explained below:

	2010 \$millions	2009 \$millions
Profit on ordinary activities before tax	<u>1,415</u>	<u>1,214</u>
Profit on ordinary activities multiplied by the standard rate of corporation tax in the UK of 28% (2009: 28%)	396	340
Effects of:		
Expenses not deductible for tax purposes	12	20
Non deductible interest expense	2	2
Depreciation for the year (lower than) / in excess of capital allowances	(1)	3
Utilisation of tax losses	(6)	(172)
Net Group relief (received) / surrendered for nil consideration from / to associated UK companies	(10)	25
Higher rate taxes on overseas earnings	7	30
Adjustments to the tax charge in respect of prior periods	(29)	80
Reversal of timing differences relating to compensation	30	29
Other income not subject to UK taxes	-	(8)
Withholding tax rebate	(4)	(9)
Tax reserves movement relating to prior periods	(102)	125
Currency translation on tax	-	5
Non deductible bank payroll tax	74	-
Non deductible gain on disposal of fixed asset investments	5	-
Other timing difference	(10)	81
Other	6	(8)
Current tax charge for the year	<u>370</u>	<u>543</u>

MORGAN STANLEY INTERNATIONAL LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS Year ended 31 December 2010

9. TAX ON PROFIT ON ORDINARY ACTIVITIES (CONTINUED)

Withholding tax credits are generated by the Group from its equity trading activities as an integral component of net revenues, but are offset against the current year tax charge in accordance with Financial Reporting Standard 16 *Current tax*.

The Finance (No 2) Act 2010 enacted a 1% reduction in the UK corporation tax rate to 27% with effect from April 2011. In the Budget announcement on 23 March 2011, a further 1% reduction in the rate of UK corporation tax to 26% was announced and subsequently substantively enacted on 29 March 2011. The combined 2% reduction in the tax rate will impact the current tax charge in 2011. Finance Act 2011 received Royal Assent on 19 July 2011 and also enacted an additional 1% reduction to the UK corporation tax rate to 25% with effect from April 2012. This further 1% reduction in the tax rate will impact the current tax charge in 2012.

10. INTANGIBLE FIXED ASSETS

	Purchased goodwill \$millions
Cost	
At 31 December 2009 and 31 December 2010	151
Amortisation	
At 31 December 2009	(127)
Charge for the year	(14)
At 31 December 2010	<u>(141)</u>
Net book value	
At 31 December 2010	<u>10</u>
At 31 December 2009	<u>24</u>

MORGAN STANLEY INTERNATIONAL LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
Year ended 31 December 2010

11. TANGIBLE FIXED ASSETS

	Freehold land and property \$millions	Leasehold improve- ments \$millions	Assets in the course of construction \$millions	Fixtures, fittings and equipment \$millions	Total \$millions
Cost					
At 1 January 2010	3	855	22	760	1,640
Additions	-	20	24	33	77
Disposals	-	(34)	(1)	(31)	(66)
Transfers	-	29	(29)	-	-
Foreign exchange revaluation on assets held in overseas subsidiaries	-	-	-	(1)	(1)
At 31 December 2010	<u>3</u>	<u>870</u>	<u>16</u>	<u>761</u>	<u>1,650</u>
Depreciation					
At 1 January 2010	-	217	-	553	770
Charge for the year	-	61	-	76	137
Disposals	-	(32)	-	(14)	(46)
Foreign exchange revaluation on assets held in overseas subsidiaries	-	-	-	(1)	(1)
At 31 December 2010	<u>-</u>	<u>246</u>	<u>-</u>	<u>614</u>	<u>860</u>
Net book value					
At 31 December 2009	<u>3</u>	<u>638</u>	<u>22</u>	<u>207</u>	<u>870</u>
At 31 December 2010	<u>3</u>	<u>624</u>	<u>16</u>	<u>147</u>	<u>790</u>

Interest capitalised on assets in the course of construction included within additions during the year amounted to \$nil million (2009: \$2 million). The cumulative amount of interest capitalised in the total cost of tangible fixed assets amounts to \$22 million (2009: \$23 million). The interest capitalisation rate is based on the internal Group funding rates.

MORGAN STANLEY INTERNATIONAL LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS Year ended 31 December 2010

12. FIXED ASSETS INVESTMENTS

Fixed asset investments classified as available-for-sale:

Fixed asset investments that are categorised as available-for-sale are summarised in the table below:

	2010 \$millions	2009 \$millions
Corporate equities	151	163
	<u>151</u>	<u>163</u>

Movements in fixed asset investments categorised as available-for-sale during the year are as follows:

	2010 \$millions	2009 \$millions
Fair value		
At 1 January 2010	163	193
Additions	7	-
Disposals and other settlements	(24)	(38)
Changes in fair value recognised in the 'Fair value reserve'	13	(3)
Foreign exchange revaluation recognised in 'Foreign currency revaluation reserve'	(8)	11
At 31 December 2010	<u>151</u>	<u>163</u>

Included in 'Available-for-sale financial assets' are listed investments of \$75 million (2009: \$2 million).

Foreign exchange revaluation arises from assets held in entities with a non US dollar functional currency being translated into US dollars on consolidation by the Group.

All available-for-sale financial assets are expected to be held for a period of more than twelve months.

Fixed assets investment in a joint venture

The Group holds an investment in a joint venture where it does not consolidate its 50% holding as it has significant influence rather than control.

There has been no change in the value of the Group's investment in the joint venture in the current or prior year.

MORGAN STANLEY INTERNATIONAL LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS Year ended 31 December 2010

13. FINANCIAL ASSETS AND FINANCIAL LIABILITIES HELD FOR TRADING

Financial assets and financial liabilities classified as held for trading are summarised in the table below:

	2010		2009	
	Assets \$millions	Liabilities \$millions	Assets \$millions	Liabilities \$millions
Fair value				
Derivative financial instruments (listed and OTC):				
- Interest rate and currency swaps and options, credit derivatives and other fixed income securities contracts	110,951	108,841	93,150	90,630
- Foreign exchange forward contracts and options	16,327	16,546	11,571	11,774
- Equity securities contracts (including equity swaps, warrants and options)	42,383	46,063	44,552	52,033
- Commodity forwards, options and swaps	21,025	20,487	18,685	18,131
	<u>190,686</u>	<u>191,937</u>	<u>167,958</u>	<u>172,568</u>
Government debt securities	17,983	15,105	15,091	11,859
Corporate equities	52,633	16,119	48,321	17,563
Corporate and other debt	24,076	4,727	24,281	7,512
Total financial instruments classified as held for trading	<u>285,378</u>	<u>227,888</u>	<u>255,651</u>	<u>209,502</u>

There are no terms and conditions of any financial asset or liability classified as held for trading that may individually significantly affect the amount, timing and certainty of future cash flows for the Group.

MORGAN STANLEY INTERNATIONAL LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS Year ended 31 December 2010

14. FINANCIAL ASSETS AND FINANCIAL LIABILITIES DESIGNATED AT FAIR VALUE THROUGH PROFIT OR LOSS

Financial instruments designated at fair value through profit or loss consist primarily of the following financial assets and financial liabilities:

Prepaid OTC contracts: The risk on these financial instruments, both financial assets and financial liabilities, is primarily hedged using financial instruments categorised as held for trading including equity securities and interest rate swaps. These prepaid OTC contracts are designated at fair value as such contracts, as well as the financial instruments with which they are hedged, are risk managed on a fair value basis as part of the Group's trading portfolio, and the risk is reported to key management personnel on this basis.

Issued structured notes: These relate to financial liabilities which arise from selling structured products generally in the form of notes or certificates. These structured notes are designated at fair value as the risks to which the Group is a contractual party are risk managed on a fair value basis as part of the Group's trading portfolio, and the risk is reported to key management personnel on this basis.

Other financial assets and liabilities: These include financial assets and liabilities such as those that arise upon the consolidation of certain special purpose entities and those that arise as a result of continuing recognition of certain financial assets and the simultaneous recognition of an associated financial liability. These financial assets and liabilities are designated at fair value as the risks to which the Group is a contractual party are risk managed on a fair value basis as part of the Group's trading portfolio, and the risk is reported to key management personnel on this basis.

Financial assets and financial liabilities designated at fair value through profit or loss are summarised in the table below:

	2010		2009	
	Assets \$millions	Liabilities \$millions	Assets \$millions	Liabilities \$millions
Fair value				
Prepaid OTC contracts	4,909	3,708	1,784	2,213
Issued structured notes	-	492	-	670
Other financial assets and liabilities	4,454	12,391	124	4,996
Total financial instruments designated at fair value through profit or loss	9,363	16,591	1,908	7,879

Included within financial liabilities designated at fair value is an amount of \$4,135 million (2009: \$1,924 million) that is expected to be settled after more than twelve months.

The carrying amount of financial liabilities designated at fair value through profit or loss is \$8 million lower than the contractual amount due at maturity (2009: \$190 million higher). The change in fair value recognised through the consolidated profit and loss account attributable to own credit risk is a loss of \$1 million (2009: \$203 million loss) and cumulatively is \$121 million gain (2009: \$122 million gain). This change is determined as the amount of change in fair value that is not attributable to changes in market conditions that give rise to market risk.

There are no terms and conditions of any financial asset or liability designated at fair value through profit or loss that may individually significantly affect the amount, timing and certainty of future cash flows for the Group.

MORGAN STANLEY INTERNATIONAL LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS Year ended 31 December 2010

15. CASH AT BANK

Included within cash at bank is an amount of \$7,241 million (2009: \$7,977 million) which represents segregated client money, held in accordance with the FSA's Client Money Rules, and an amount of \$40 million (2009: \$235 million) which represents other client money.

16. DEBTORS

	2010 \$millions	2009 \$millions
Debtors classified within loans and receivables at amortised cost		
Trade debtors:		
- External counterparties	47,103	40,304
- Morgan Stanley Group undertakings	10,672	13,122
Securities purchased under agreements to resell and cash collateral on stocks borrowed:		
- External counterparties	93,176	73,992
- Morgan Stanley Group undertakings	43,116	34,691
Corporate loans	4,443	2,723
Other amounts due from Morgan Stanley Group undertakings	1,109	4,674
Other debtors classified within loans and receivables	2,656	1,771
	202,275	171,277

Amounts falling due after more than one year included above are as follows:

	2010 \$millions	2009 \$millions
Corporate loans:		
- between one and five years	4,320	2,555
- over five years	123	168
	4,443	2,723

17. OTHER ASSETS

	2010 \$millions	2009 \$millions
Deferred taxation (see note 18)		
Corporation tax recoverable	132	130
Other tax recoverable	191	443
Prepayments and accrued income	146	254
	110	297
	579	1,124

MORGAN STANLEY INTERNATIONAL LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS Year ended 31 December 2010

18. DEFERRED TAX

Deferred tax has been fully recognised and is analysed as follows:

	2010 \$millions	2009 \$millions
Accelerated capital allowances	(22)	(19)
Tax losses carried forward	-	-
Deferred compensation	146	121
Hedges of forecast currency transactions	(6)	(8)
Amounts not recognised due to unobservable market data	14	16
Other timing differences	4	31
Unrealised losses	(4)	(11)
	<u>132</u>	<u>130</u>

The movement in the deferred tax asset during the year is analysed as follows:

	\$millions
At 1 January 2010	130
Amounts recognised in the consolidated profit and loss account:	
- Current year timing differences	7
Amounts recognised in equity through the statement of recognised gains and losses	
- Current year timing differences	(2)
Foreign exchange revaluation	1
Impact of change in UK corporation tax rate	(4)
At 31 December 2010	<u>132</u>

As at 31 December 2010, a total deferred tax asset of \$62 million (2009: \$78 million) in respect of losses carried forward at nil value has not been recognised due to uncertainty of the recoverability of the asset.

The Finance (No 2) Act 2010 enacted a 1% reduction in the UK corporation tax rate to 27% with effect from April 2011. This rate reduction has had an impact on the Group's deferred tax balance as indicated above. As part of the Budget announcements on 23 March 2011, a further 1% cut in the rate of UK Corporation tax to 26% was announced and substantively enacted on 29 March 2011. Finance Act 2011 received Royal Assent on 19 July 2011 and also enacted an additional 1% reduction to the UK corporation tax rate to 25% with effect from April 2012. The effect of this further reduction has not been applied to the valuation of the Group's deferred tax assets and liabilities.

MORGAN STANLEY INTERNATIONAL LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS Year ended 31 December 2010

19. FINANCIAL LIABILITIES AT AMORTISED COST

	2010 \$millions	2009 \$millions
Financial liabilities at amortised cost falling due within one year		
Bank loans and overdrafts	580	427
Trade creditors:		
- External counterparties	55,027	54,545
- Morgan Stanley Group undertakings	13,150	10,766
Securities sold under agreements to repurchase and cash collateral on stocks loaned:		
- External counterparties	72,983	46,786
- Morgan Stanley Group undertakings	68,990	67,927
Corporate deposits	6,883	3,122
Other amounts owing to Morgan Stanley Group undertakings	12,753	14,782
Other financial liabilities	3,255	3,825
	<u>233,621</u>	<u>202,180</u>
 Financial liabilities at amortised cost falling due after more than one year		
Financial instruments issued:		
- Subordinated loans	10,571	10,591
Other long term creditors	-	51
Securities sold under agreements to repurchase and cash collateral on stocks loaned:		
- External counterparties	2,200	-
Other amounts owing to Morgan Stanley Group undertakings	3,213	-
	<u>15,984</u>	<u>10,642</u>
 Total financial liabilities at amortised cost	 <u>249,605</u>	 <u>212,822</u>

Total financial liabilities at amortised cost of \$11,647 million (2009: \$10,591 million), included in the above, fall due for payment after five years from the balance sheet date. Of this, \$nil (2009: \$nil) is payable by instalments.

Included in other amounts owing to Morgan Stanley Group undertakings are amounts of \$6,763 million (2009: \$3,309 million) representing cash collateral received as security for open trading positions held with other Morgan Stanley Group undertakings.

MORGAN STANLEY INTERNATIONAL LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS Year ended 31 December 2010

19. FINANCIAL LIABILITIES AT AMORTISED COST (CONTINUED)

Subordinated loan agreements

The amounts subject to subordinated loan agreements are wholly repayable as shown below:

Counterparty	Repayment Date	Interest rate	2010 \$millions	2009 \$millions
Morgan Stanley International Holdings Inc.	31 July 2019	3 month LIBOR plus 1.25%	389	404
Morgan Stanley International Finance S.A.	30 October 2020	3 month LIBOR plus 1.25%	820	820
Morgan Stanley International Holdings Inc.	31 October 2021	6 month LIBOR plus 1.25%	1,300	1,300
Morgan Stanley International Holdings Inc.	15 December 2021	3 month LIBOR plus 1.25%	156	161
Morgan Stanley International Finance S.A.	31 October 2025	3 month LIBOR plus 1.25%	7,906	7,906
			<u>10,571</u>	<u>10,591</u>

The movement in subordinated loan agreements during the year relate to the translation of non US dollar loans into US dollars.

All amounts outstanding under subordinated loan agreements are repayable at any time at the Group's option, subject to prior consent from the Financial Services Authority ("FSA"), which has the right under the agreement to refuse consent to repayment.

The Group has not had any defaults of principal, interest or other breaches with respect to its subordinated loans during the year.

20. OTHER CREDITORS

Amounts falling due within one year	2010 \$millions	2009 \$millions
Corporation tax	283	512
Other taxes and social security costs	321	365
Accruals and deferred income	939	1,461
	<u>1,543</u>	<u>2,338</u>

21. PROVISIONS FOR LIABILITIES AND CHARGES

	Property \$millions	Litigation \$millions	Total \$millions
At 1 January 2010	98	21	119
Additional provisions	2	25	27
Provisions utilised	(28)	(18)	(46)
Effect of unwind discount rate	3	-	3
Change in accounting estimates	(4)	-	(4)
Foreign exchange movements	(2)	-	(2)
At 31 December 2010	<u>69</u>	<u>28</u>	<u>97</u>

MORGAN STANLEY INTERNATIONAL LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS Year ended 31 December 2010

21. PROVISIONS FOR LIABILITIES AND CHARGES (CONTINUED)

Property

Property provisions represent the net present value of expected future costs of excess office space and the net present value of expected future costs of reinstating leasehold improvements at the end of the lease term that are released when the reinstatement obligations have been fulfilled. The related asset for lease reinstatement provisions is included in 'Leasehold improvements' within 'Tangible fixed assets' (note 11).

Litigation Matters

During the year the Group has been involved in various continuing litigation matters and provisions have been recognised and disclosed in accordance with FRS 12.

On 25 August 2008, the Morgan Stanley Group, a subsidiary of the Group 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 United States District Court for the Southern District of New York ("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 2 September 2009, the court dismissed all of the claims against the Morgan Stanley Group and the Group except for plaintiffs' claims for common law fraud. On 15 June 2010, the court denied plaintiffs' motion for class certification. On 20 July 2010, the court granted plaintiffs leave to replead their aiding and abetting common law fraud claims against the Morgan Stanley Group and the Group, and those claims were added in an amended complaint filed on 5 August 2010. Since the filing of the initial complaint, various additional plaintiffs have been added to the case. The deadline for new plaintiffs to join the case expired on 11 March 2011. There are currently 15 plaintiffs asserting individual claims related to approximately \$983 million of securities issued by the Cheyne SIV. Plaintiffs have not provided information quantifying the amount of compensatory damages they are seeking and are also seeking unspecified punitive damages. Based on currently available information, the Morgan Stanley Group and the Group believe that the defendants could incur a loss up to the amount of plaintiffs' claimed compensatory damages, once specified, related to their alleged purchase of approximately \$983 million of securities issued by the Cheyne SIV plus pre- and post-judgment interest, fees and costs.

On 25 September 2009, a subsidiary of the Group was named as a defendant in a lawsuit styled *Citibank, N.A. v. Morgan Stanley & Co. International, PLC*, which is pending in the United States District Court for the SDNY. The lawsuit relates to a credit default swap entered into by the Group 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 Group's prior written consent before it exercised a right 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 12 May 2010, the court granted Citi N.A.'s motion for judgment on the pleadings on its claim for breach of contract. On 8 October 2010, the court issued an order denying Citi N.A.'s motion for judgment on the pleadings as to the Group's counterclaim for reformation and granting Citi N.A.'s motion for judgment on the pleadings as to the Group's counterclaim for estoppel. On 25 May 2011, the court denied the Group's motion for summary judgment and granted Citi N.A.'s cross motion for summary judgment. On 27 June 2011, the court entered a judgment in favor of Citi N.A. for \$269 million plus post-judgment interest and the Group filed a notice of appeal to the United States Court of Appeals for the Second Circuit. Based on currently available information, the Morgan Stanley Group believes it could incur a loss of up to approximately \$269 million plus post-judgment interest. In compliance with the intra-group policies, revenues and costs related to the Capmark deal referenced above, including any potential litigation costs, are transferred to other Morgan Stanley Group undertakings outside the Group.

MORGAN STANLEY INTERNATIONAL LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS Year ended 31 December 2010

21. PROVISIONS FOR LIABILITIES AND CHARGES (CONTINUED)

Litigation Matters (continued)

On 15 July 2010, China Development Industrial Bank (“CDIB”) filed a complaint against the Morgan Stanley Group, 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 Morgan Stanley Group misrepresented the risks of the STACK 2006-1 CDO to CDIB, and that the Morgan Stanley Group 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 28 February 2011, the court presiding over this action denied the Morgan Stanley Group motion to dismiss the complaint. On 21 March 2011, the Morgan Stanley Group appealed the order denying its motion to dismiss the complaint. On 7 July 2011, the appellate court affirmed the lower court’s decision denying the Morgan Stanley Group motion to dismiss. Based on currently available information, the Morgan Stanley Group believes it could incur a loss of up to \$240 million.

The Directors are of the opinion that it would be seriously prejudicial to the position of the Group to disclose further details of these or any other individual continuing litigation matters and the amounts, if any, provided in respect of them.

22. COMMITMENTS AND CONTINGENCIES

At 31 December 2010 and 31 December 2009, the Group had the following outstanding commitments and contingent liabilities arising from off-balance sheet financial instruments:

Contingent liabilities	2010 \$millions	2009 \$millions
Financial guarantees	17	-
Contingent commitments	1,246	23
	<hr/>	<hr/>
	1,263	23
Commitments	2010 \$millions	2009 \$millions
Lease commitments	93	106
Loan commitments	2,344	985
Underwriting commitments	128	-
Unsettled reverse repurchase agreements	29,784	18,458
	<hr/>	<hr/>
	32,349	19,549

During the next year, the Group is committed to pay \$93 million (2009: \$106 million) in respect of operating leases as follows:

Maturity of lease:	Land and buildings 2010 \$millions	Land and buildings 2009 \$millions
- Within one year	1	11
- In two to five years	30	24
- Over five years	62	71
	<hr/>	<hr/>
	93	106

MORGAN STANLEY INTERNATIONAL LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS Year ended 31 December 2010

23. RETIREMENT BENEFITS

The Group operates both defined benefit and defined contribution plans for its employees. Details of the plans are below.

Defined contribution plans

The Group operates or contributes to the following defined contribution plans:

- the Morgan Stanley UK Group Pension Plan (the "Plan") and the Morgan Stanley UK Group Top-Up Pension Plan (the "Top-Up Plan"), which require contributions to be made to funds held in trust, separate from the assets of the Company, under the control of a trustee company.
- the Morgan Stanley Investment Management (Athens Branch) Group Insurance Policy
- the Morgan Stanley Investment Management Luxembourg Branch Supplementary Pension Plan
- Morgan Stanley Flexible Company Pension Plan (Amsterdam)
- Morgan Stanley & Co International Plc (Greece Branch) Group Insurance Policy
- MSII Offshore Retirement Benefit Plan IV, Dubai Section
- Morgan Stanley Asia Limited Retirement Benefit Plan
- Paschi Previdenza (a Milan multi employer defined contribution plan)

The Group pays fixed contributions to the funds, with no legal or constructive obligation to pay further contributions.

The defined contribution pension charge for the year was \$37 million (2009: \$59 million) of which \$nil was accrued at 31 December 2010 (2009: \$nil).

Defined benefit plans

Morgan Stanley UK Group Defined Benefit Pension Plan

The Morgan Stanley UK Group Pension Plan (the 'Plan') has both a defined benefit and defined contribution section. The defined benefit section of the Plan has been closed to new members since 1996. Under the Morgan Stanley UK Group's defined benefit plan, the amount of pension benefit that a member is entitled to receive on retirement is dependent on years of service and salary. The Plan was previously open to permanent employees employed in the UK and, with the consent of the Trustees, other Morgan Stanley employees employed outside the UK who at some point had been members of the Plan.

The plan assets relating to the defined benefits section of the Plan are held in a separate Trustee-administered fund to meet long-term pension liabilities. The Trustee of the Plan is required to act in the best interest of the Plan's beneficiaries. The appointment of Trustee Directors to the Plan is determined by the plan's trust documentation. The Company has a policy that one third of Trustee Directors should be nominated by members of the fund.

The most recent full formal actuarial valuation of the defined benefit section of the Plan was carried out at 31 December 2009 and updated by a qualified actuary at 31 December 2010. Annual updates of this formal valuation are made for changes in the market conditions and actuarial assumptions. The liabilities of the Plan are measured by discounting the best estimate of future cash flows to be paid out by the plan using the projected unit method. The projected unit method is an accrued benefits valuation method in which the plan liabilities make allowance for projected earnings. The accumulated benefit obligation is an actuarial measure of the present value of benefits for service already rendered but differs from the projected unit method in that it includes no assumption for future salary increases, given that the plan is closed to future accrual with no salary linkage. At the balance sheet date the accumulated benefit obligation was \$145 million (2009: \$148 million).

MORGAN STANLEY INTERNATIONAL LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS Year ended 31 December 2010

23. RETIREMENT BENEFITS (CONTINUED)

Defined benefit plans (continued)

Defined benefit plan expense

The amounts recognised in profit or loss in respect of these defined benefit plans are as follows:

	2010 \$millions	2009 \$millions
Expected return on plan assets	(6)	(6)
Interest on obligation	8	8
Total defined benefit plan expense	2	2

Of the charge for the year, \$2 million (2009: \$2 million) has been included in 'Interest expense'. Actuarial losses after the impact of the surplus cap of \$8 million (2009: \$8 million) have been recognised in the 'Statement of total recognised gains and losses'. The amount comprises any gains or losses on the plan assets and obligations, as well as the impact of foreign exchange rate changes during the period, and movement in the plan surplus

The cumulative amount of actuarial losses recognised in the 'Statement of total recognised gains and losses' is \$105 million (2009: \$97 million). The surplus cap restricts the surplus recognised on the balance sheet to the amount recoverable by the Group.

Retirement benefit asset

The following table provides a reconciliation of the present value of plan liabilities and fair value of plan assets included in the consolidated balance sheet, as well as a summary of the funded status of the plans:

	2010 \$millions	2009 \$millions
Present value of funded defined benefit obligation	(145)	(148)
Fair value of plan assets	167	151
	22	3
Adjustment for ceiling	(22)	(3)
Retirement benefit asset recognised in the balance sheet	-	-

Contributions for the year to the closed defined benefit section of the Plan totalled \$9 million (2009: \$9 million), of which \$nil was accrued at 31 December 2010 (2009: \$nil). The Group expects to contribute \$10 million (2009: \$10 million) in the next financial year, based upon the current funded status and the expected return assumptions for the next financial year.

Following the actuarial valuation of the defined benefit plan as at 31 December 2010, the Group's monthly contributions rate increased, with effect from 1 April 2011, from £500,000 to £541,667. The Group will monitor funding levels on an annual basis. The Group considers that the contribution rates agreed with Trustees are sufficient to eliminate the deficit over the agreed period and that regular contributions, which are based on service costs, will not increase significantly.

MORGAN STANLEY INTERNATIONAL LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS Year ended 31 December 2010

23. RETIREMENT BENEFITS (CONTINUED)

Defined benefit plans (continued)

Changes in the present value of the defined benefit plan obligations were as follows:

	2010 \$millions	2009 \$millions
Reconciliation of defined benefit obligations		
Defined benefit obligation at 1 January	148	132
Interest cost	8	8
Actuarial gain	(2)	(4)
Benefits paid	(3)	(3)
Foreign exchange rate changes	(6)	15
Defined benefit obligation at 31 December	<u>145</u>	<u>148</u>

Changes in the fair value of plan assets were as follows:

	2010 \$millions	2009 \$millions
Reconciliation of fair value of plan assets		
Fair value of plan assets at 1 January	151	149
Expected return on plan assets	6	6
Actuarial gain / (loss)	9	(27)
Employer contributions	9	9
Benefits paid	(3)	(3)
Foreign exchange rate changes	(5)	17
Fair value of plan assets at 31 December	<u>167</u>	<u>151</u>
Actual return on fund assets	<u>15</u>	<u>(21)</u>

The major categories of plan assets as a percentage of total plan assets and the expected rates of return are as follows:

	Expected return		Fair value of assets	
	2010	2009	2010	2009
	%	%	\$millions	\$millions
Equity securities	7.0	7.0	3	2
Fixed income securities	4.3	4.4	<u>164</u>	<u>149</u>
			<u>167</u>	<u>151</u>

In conjunction with the trustees, the Group has recently conducted an asset-liability review for the Plan. The review is used to assist the Trustees and the Group to determine the optimal long-term asset allocation with regard to the structure of liabilities within the Plan. The results of the review are used to determine the pension plans investment strategy by managing the risk of significant increases in the deficit and the volatility of the investment performance.

The expected long-term rate of return on assets represents the Group's best estimate of the long-term return on plan assets and generally was estimated by computing a weighted average return of the underlying long-term expected returns on the different asset classes, based on the target asset allocations. The expected long-term return on assets is a long-term assumption that generally is expected to remain the same from one year to the next unless there is a significant change in the target asset allocation, the fees and expenses paid by the Plan or market conditions.

MORGAN STANLEY INTERNATIONAL LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS Year ended 31 December 2010

23. RETIREMENT BENEFITS (CONTINUED)

Defined benefit plans (continued)

The Group, in consultation with its independent investment consultants and actuaries, determined the asset allocation targets based on its assessment of business and financial conditions, demographic and actuarial data, funding characteristics and related risk factors. Other relevant factors, including industry practices, long-term historical and prospective capital market returns, were also considered.

The Plan return objectives provide long-term measures for monitoring the investment performance against growth in the pension obligations. The overall allocation is expected to help protect the Plan's funded status while generating sufficiently stable real returns (net of inflation) to help cover current and future benefit payments.

Both the equity and fixed income portions of the asset allocation use a combination of active and passive investment strategies and different investment styles. The fixed income asset allocation consists of longer duration fixed income securities in order to help reduce plan exposure to interest rate variation and to better correlate assets with obligations. The longer duration fixed income allocation is expected to help stabilize plan contributions over the long run.

The following table presents the principal actuarial assumptions at the balance sheet date:

	2010	2009
Pre retirement discount rate	5.6%	5.7%
Post retirement discount rate	4.3%	4.5%
Rate of increase in pensions in deferment	3.6%	3.8%
Inflation assumption	3.6%	3.8%
Expected long-term rate of return on plan assets:		
Bonds	4.3%	4.4%
Equities	7.0%	7.0%

The mortality assumptions used give the following life expectations at 65:

	Life expectancy at age 65 for a male member currently:		Life expectancy at age 65 for a female member currently:	
	Aged 65	Aged 45	Aged 65	Aged 45
	31 December 2010		31 December 2009	
UK	89.2	92.1	91.7	94.7
UK	88.1	91.7	88.1	91.7

The sensitivities regarding the principal assumptions used to measure the plan liabilities are as follows:

Assumption	Change in assumption	Impact on plan liabilities
Discount rate	Increase by 0.5%	Decrease by 15.0%
Inflation assumption	Increase / decrease by 0.5%	Increase / decrease by 4.0%
Rate of mortality	Increase by 1 year	Increase by 2.0%

MORGAN STANLEY INTERNATIONAL LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS Year ended 31 December 2010

23. RETIREMENT BENEFITS (CONTINUED)

Defined benefit plans (continued)

The five-year history of experience adjustments is as follows:

	2010 \$millions	2009 \$millions	2008 \$millions	2007 \$millions	2006 \$millions
Present value of defined benefit obligation	(145)	(148)	(132)	(170)	(151)
Fair value of plan assets	167	151	149	195	161
Surplus	22	3	17	25	10
Experience adjustments on plan liabilities:					
- Amount (\$ millions)	(10)	-	-	(6)	-
- Percentage of plan liabilities (%)	(7)%	-	-	3%	-
Experience adjustments on plan assets					
- Amount (\$ millions)	(9)	27	-	3	(6)
- Percentage of plan assets (%)	(5)%	18%	-	(2)%	4%

Other defined benefits plans in the Group

In addition to the Morgan Stanley UK Group Pension Plan, the Group also operates several other defined benefits plans, which provide post employment benefits dependent on factors such as years of service and salary. The Group's policy is to fund at least the amounts sufficient to meet minimum funding requirements under applicable employee benefit and tax regulations.

The defined benefits plans are as follows:

- Morgan Stanley Bank International Ltd German Branch DC Plan
- Morgan Stanley Bank International Ltd German Branch General Plan
- Morgan Stanley Bank International Ltd Milan Branch Termination Indemnity Plan
- Morgan Stanley Bank International Ltd Milan Branch Leaving Indemnity Plan
- Personalvorsorgestiftung der Bank Morgan Stanley AG Plan
- Morgan Stanley & Co. International plc Paris Branch IFC (Indemnites de Fin de Carriere)
- Morgan Stanley France (SAS) Leaving Indemnity Plan (Indemnites de Fin de Carriere)
- Morgan Stanley & Co. International plc Athens Branch Retirement Indemnity
- Morgan Stanley Investment Management Ltd Athens Branch Retirement Indemnity
- Morgan Stanley Asia (Taiwan) Limited Retirement Plan
- Morgan Stanley Asia (Taiwan) Limited Book Reserve Plan
- Morgan Stanley & Co International plc Dubai Branch End of Service Gratuity Plan

Disclosures in respect of the above plans have been made on an aggregated basis.

The Group also operated the Morgan Stanley Bank International Limited Korean Branch Severance Pay Plan and the Morgan Stanley & Co International Plc Seoul Branch Severance Pay Plan until 1 October 2010 when the plans closed and liabilities were either settled in cash or transferred to defined contribution plans.

MORGAN STANLEY INTERNATIONAL LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS Year ended 31 December 2010

23. RETIREMENT BENEFITS (CONTINUED)

Other defined benefits plans in the Group (continued)

During the year, Bank Morgan Stanley AG transferred its institutional securities business to the Morgan Stanley Bank International Limited, Zurich Branch but its employees remained in the same Personalvorsorgestiftung der bank Morgan Stanley AG Plan, together with all remaining Bank Morgan Stanley AG employees. The plan was considered transferred into the Zurich Branch with the difference between assets and liabilities recognised as part of the consideration for the transfer of the Zurich Branch to the Group.

Defined benefit plan expense

The amounts recognised in profit or loss in respect of these defined benefit plans are as follows:

	2010 \$millions	2009 \$millions
Current service cost	3	2
Expected return on plan assets	(1)	-
Interest on obligation	1	1
Foreign exchange rate changes	1	-
Total defined benefit plan expense	4	3

Of the charge for the year, the amounts as disclosed above have been included in 'Interest expense'. Actuarial losses of \$1 million (2009: \$2 million loss) have been recognised in the 'Statement of total recognised gains and losses'. The cumulative amount of actuarial gains and losses recognised in the 'Statement of total recognised gains and losses' is \$1 million loss (2009: \$nil).

Retirement benefit liability

The following table provides a reconciliation of the present value of plan liabilities and fair value of plan assets included in the balance sheet, as well as a summary of the funded status of the plans in the Group, excluding the MSUK Group Pension Plan:

	2010 \$millions	2009 \$millions
Present value of funded defined benefit obligation	(16)	(7)
Fair value of plan assets	13	4
	(3)	(3)
Present value of unfunded defined benefit obligation	(5)	(6)
Deficit	(8)	(9)
Related deferred tax asset	1	1
Retirement benefit liability recognised in the balance sheet	(7)	(8)

Total contributions for the year to the Group's defined benefits plans totalled \$9 million (2009: \$2 million), of which \$nil was accrued at 31 December 2010 (2009: \$nil). The Group expects to contribute \$1 million (2009: \$1 million) in the next financial year, based upon the current funded status, and the expected return assumptions for the next financial year.

MORGAN STANLEY INTERNATIONAL LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS Year ended 31 December 2010

23. RETIREMENT BENEFITS (CONTINUED)

Other defined benefits plans in the Group (continued)

Changes in the present value of the defined benefit plan obligations were as follows:

	2010 \$millions	2009 \$millions
Reconciliation of defined benefit obligations		
Defined benefit obligation at 1 January	13	10
Current service cost	3	2
Interest cost	1	1
Actuarial loss	1	2
Net transfer in	12	-
Benefits paid	-	(1)
Liabilities extinguished on settlements	(10)	(2)
Foreign exchange rate changes	1	1
Defined benefit obligation at 31 December	<u>21</u>	<u>13</u>

Changes in the fair value of plan assets were as follows:

	2010 \$millions	2009 \$millions
Reconciliation of fair value of plan assets		
Fair value of plan assets at 1 January	4	4
Expected return on plan assets	1	-
Net transfer in	9	-
Employer contributions	9	2
Benefits paid	-	(1)
Assets distributed on settlements	(10)	(2)
Foreign exchange rate changes	-	1
Fair value of plan assets at 31 December	<u>13</u>	<u>4</u>
Actual return on fund assets		
	<u>-</u>	<u>-</u>

The major categories of plan assets as a percentage of total plan assets and the expected rates of return are as follows:

	Expected return		Fair value of assets	
	2010 %	2009 %	2010 \$millions	2009 \$millions
Equity securities	5.4 - 8.4	-	4	-
Fixed income securities	1.5 - 1.9	-	5	-
Insurance deposit	-	3.5	-	2
Other – primarily cash	2.0 - 2.1	2.5	<u>4</u>	<u>2</u>
			<u>13</u>	<u>4</u>

MORGAN STANLEY INTERNATIONAL LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS Year ended 31 December 2010

23. RETIREMENT BENEFITS (CONTINUED)

Other defined benefits plans in the Group (continued)

The following table presents the principle actuarial assumptions at the balance sheet date:

	2010	2009
Discount rate	2.75 - 6.25%	2.25 - 7.05%
Rate of increase in salaries	3.50 - 6.00%	2.50 - 5.50%
Inflation assumption	1.50 - 2.00%	2.00 - 5.00%
Expected long-term rate of return on plan assets	4.10 - 5.50%	0 - 5.50%

The mortality assumptions used give the following life expectations at age 65:

	2010	2009
Germany	Dr. Klaus Huebeck RT 2005 G	N/a
Switzerland	Unadjusted BVG 2005 Mortality Table	N/a
Taiwan	2002 Taiwan Standard Ordinary Mortality Table	2002 Taiwan Standard Ordinary Mortality Table
Korea	N/a	Korean Life Table 2006

The five-year history of experience adjustments is as follows:

	2010 \$millions	2009 \$millions	2008 \$millions	2007 \$millions	2006 \$millions
Present value of defined benefit obligation	(21)	(13)	(10)	(14)	(76)
Fair value of plan assets	13	4	4	4	67
Deficit	<u>(8)</u>	<u>(9)</u>	<u>(6)</u>	<u>(10)</u>	<u>(9)</u>
Experience adjustments on plan liabilities:					
- Amount (\$millions)	1	(1)	(2)	-	-
- Percentage of plan liabilities (%)	<u>(174)% - 33.75%</u>	<u>0% - 25%</u>	<u>(135)% - 45%</u>	<u>(18)% - 10%</u>	<u>(47)% - 63%</u>
Experience adjustments on plan assets					
- Amount (\$millions)	-	-	-	-	2
- Percentage of plan assets (%)	<u>(1)% - 0%</u>	<u>(8)% - 6%</u>	<u>(7)% - 1%</u>	<u>(2)% - 4%</u>	<u>(5)% - 4%</u>

MORGAN STANLEY INTERNATIONAL LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS Year ended 31 December 2010

24. EMPLOYEE COMPENSATION PLANS

Deferred stock awards

Morgan Stanley has made deferred stock awards pursuant to equity-based compensation plans. The plans provide for the deferral of a portion of certain key employees' discretionary compensation with awards made in the form of a right to receive unrestricted shares of common stock in the future ("restricted stock units"). Awards under these plans are generally subject to vesting over time contingent upon continued employment and to restrictions on sale, transfer or assignment until the end of a specified period, generally two to three years from date of grant. All or a portion of an award may be cancelled if employment is terminated before the end of the relevant restriction period. All or a portion of a vested award also may be cancelled in certain limited situations, including termination for cause during the relevant restriction period. Recipients of deferred stock awards generally have voting rights and receive dividend equivalents.

Equity-settled share-based awards

During the year Morgan Stanley granted 4,967,719 units of restricted common stock to employees of the Group with a weighted average fair value per unit of \$29.13 (2009: 687,555 units, weighted average fair value \$27.91), based on the market value of Morgan Stanley shares at grant date. Certain units granted in 2010 were subsequently modified to a cash-settled share-based awards as discussed below. Units granted in respect of employees' 2009 discretionary compensation were granted in January 2010, therefore the 2009 number of units do not include a full year's awards.

Cash-settled share-based awards

During the year, certain equity-settled awards in respect of 498,860 (2009: nil) restricted stock units were modified such that the Group will pay the cash value of the awards to the employees at settlement date. No difference was attributed between the grant date fair value of the original equity-settled award and the modified award hence no profit or loss was recognised on modification date.

As a result of becoming cash-settled, the modified awards are held at the fair value of the equivalent stock unit award determined at each reporting date based on the market price of Morgan Stanley shares. At 31 December 2010, the total carrying amount of liabilities arising from cash-settled share-based awards was \$14 million (2009: \$nil) of which \$1 million (2009: \$nil) had vested. The Group recognised total expenses of \$5 million (2009: \$nil) arising from these cash settled share-based payment transactions during the year.

Stock option awards

Morgan Stanley has also made stock option awards in the form of stock options on Morgan Stanley's common stock. The stock options generally have an exercise price of not less than the fair value of Morgan Stanley's common stock on the date of grant and generally become exercisable over a three year period, expiring ten years from the date of grant, subject to accelerated expiration upon termination of employment. Stock option awards have vesting, restriction and cancellation provisions that are similar to those in deferred stock awards.

The fair value of options granted has been determined using the Black Scholes Merton pricing model.

The expected option life has been determined based upon historical experience and the expected stock price volatility has been implied from options traded on Morgan Stanley stock.

There were no options granted during the year (2009: none). The following table shows activity relating to the Group's stock option awards:

	2010 Number of options millions	2010 Weighted average exercise price \$	2009 Number of options millions	2009 Weighted average exercise price \$
Options outstanding at 1 January	6	52.01	8	50.43
Forfeited during the year	-	66.73	-	66.73
Expired during the year	(1)	57.48	(2)	45.19
Options outstanding at 31 December	<u>5</u>	<u>50.41</u>	<u>6</u>	<u>52.01</u>
Options exercisable at end of year	<u>5</u>	<u>50.41</u>	<u>6</u>	<u>50.78</u>

MORGAN STANLEY INTERNATIONAL LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS Year ended 31 December 2010

24. EMPLOYEE COMPENSATION PLANS (CONTINUED)

Stock option awards (continued)

There were no stock options exercised during the year (2009: nil).

The following table presents information relating to the stock options outstanding:

Range of Exercise Prices	2010			2009		
	Number of options millions	Weighted average exercise price \$	Weighted average remaining life in years	Number of options millions	Weighted average exercise price \$	Weighted average remaining life in years
\$30.00 - \$39.99	1	36.18	1.91	1	36.18	2.91
\$40.00 - \$49.99	3	47.47	2.13	3	47.41	3.23
\$50.00 - \$59.99	-	55.91	1.26	1	55.09	0.90
\$60.00 - \$69.99	1	66.54	5.65	1	66.52	5.32
Total	5			6		

Other deferred compensation plans

The Group has granted deferred compensation awards to certain of its key employees. The plans provide for the deferral of a portion of the employees' discretionary compensation with awards that provide a return based upon the performance of various referenced investments. Awards under these plans are generally subject to a sole vesting condition of service over time, which is normally two to three years from the date of grant. All or a portion of an award may be cancelled if employment is terminated before the end of the relevant vesting period. The awards are settled in cash at the end of the relevant vesting period.

During the year, the Group granted awards with a value of \$129 million (2009: \$69 million) to employees, and has recognised an expense of \$103 million (2009: \$60 million) within 'Staff costs' in 'Other expense' in the consolidated profit and loss account in relation to outstanding awards. The liability to employees at the end of the year, reported within 'Other creditors' in the consolidated balance sheet, is \$219 million (2009: \$114 million).

The Group economically hedges the exposure created by these deferred compensation plans by entering into derivative transactions with other Morgan Stanley Group undertakings. The derivative balance at the end of the year, recognised within 'Financial assets classified as held for trading' in relation to these deferred compensation plans is \$11 million (2009: \$3 million) and the related profit and loss recorded within 'Net gains / losses on financial instruments classified as held for trading' for the year is \$10 million gain (2009: \$38 million gain).

25. CALLED UP SHARE CAPITAL

	2010 \$millions	2009 \$millions
Allotted and fully paid:		
Equity shares		
2 ordinary shares of £1 each	-	-
1,614,167,000 ordinary shares of \$1 each	1,614	1,614
	<u>1,614</u>	<u>1,614</u>

All ordinary shares are recorded at the rate of exchange ruling at the date the shares were paid up.

MORGAN STANLEY INTERNATIONAL LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS Year ended 31 December 2010

26. RECONCILIATION OF SHAREHOLDERS' FUNDS AND MOVEMENTS ON RESERVES

Group	Called up share capital	Adjustable Redeemable Capital Securities	Capital redemption reserve	Foreign currency revaluation reserve	Capital contribution reserve	Fair value reserve	Pension reserve	Profit and loss account	Minority Interest	Total
	\$millions	\$millions	\$millions	\$millions	\$millions	\$millions	\$millions	\$millions	\$millions	\$millions
At 1 January 2009	1,614	114	150	(641)	141	(29)	(88)	8,860	2,345	12,466
Total recognised gains and losses	-	-	-	254	-	(3)	-	613	3	867
Preference share repurchase	-	-	1,250	-	-	-	-	(1,250)	-	-
Restatement of equity component of ARCs	-	(16)	-	-	-	-	-	16	-	-
ARCS Redemption	-	(98)	-	-	-	-	-	-	-	(98)
Actuarial loss	-	-	-	-	-	-	(10)	-	-	(10)
Capital infusion from entities under common control	-	-	-	-	-	-	-	50	-	50
Redemption of equity preference shares held by minority interest	-	-	-	-	-	-	-	-	(1,080)	(1,080)
Capital infusion by minority interest into preference shares	-	-	-	-	-	-	-	-	811	811
Dividends on preference shares held by minority interest	-	-	-	-	-	-	-	(170)	-	(170)
At 1 January 2010	1,614	-	1,400	(387)	141	(32)	(98)	8,119	2,079	12,836
Reclassification adjustment net of income tax	-	-	-	(45)	-	-	-	45	-	-
Recognised gains and losses for the year	-	-	-	(100)	-	10	-	1,041	7	958
Reclassification adjustment on disposal of foreign operation	-	-	-	(11)	-	-	-	11	-	-
Actuarial losses on defined benefit pension plans	-	-	-	-	-	-	(9)	-	-	(9)
Share based payments	-	-	-	-	-	-	-	2	-	2
Income tax arising on transitional accounting adjustments	-	-	-	2	-	-	-	-	-	2
Capital contribution by parent company	-	-	-	-	3,000	-	-	-	-	3,000
Dividends to equity holders of the Company	-	-	-	-	-	-	-	(1,000)	-	(1,000)
Capital infusion by minority interest into preference shares	-	-	-	-	-	-	-	-	20	20
Repayment of capital to minority interest	-	-	-	-	-	-	-	258	(1,990)	(1,732)
At 31 December 2010	1,614	-	1,400	(541)	3,141	(22)	(107)	8,476	116	14,077

MORGAN STANLEY INTERNATIONAL LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS Year ended 31 December 2010

26. RECONCILIATION OF SHAREHOLDERS' FUNDS AND MOVEMENTS ON RESERVES (CONTINUED)

Capital redemption reserve

The opening capital redemption reserve arose on a transfer from the profit and loss account of the par value of certain sterling preference shares, translated into US dollars at the rate prevailing at their redemption dates.

Foreign currency revaluation reserve

Foreign currency revaluation reserve comprises all foreign exchange differences arising from the translation of the net assets of foreign operations denominated in currencies other than US dollars.

The Group hedges foreign exchange exposure arising from its investments in foreign branch operations by utilising forward foreign currency exchange contracts ("synthetic hedges") effected through intercompany accounts with the ultimate parent company, Morgan Stanley. Prior to the adoption of FRS 26 *Financial instruments: recognition and measurement* on 1 December 2006, the Group reported foreign exchange gains or losses arising on the synthetic hedges directly in reserves, in accordance with United Kingdom Generally Accepted Accounting Practice. A gain of \$63 million in respect of foreign exchange movement on the synthetic hedges for the period from 1 December 2006 to 31 December 2009 was transferred from the foreign currency revaluation reserve to the consolidated profit and loss account as a reclassification adjustment to opening reserves at 1 January 2010. The reclassification adjustment properly presents the cumulative foreign exchange gain arising on the synthetic hedges in accordance with FRS 26. A related current tax charge of \$18 million was reclassified from the foreign currency revaluation reserve to the consolidated profit and loss account.

During the year, the Group liquidated certain of its wholly owned foreign subsidiaries. Consequently, accumulated foreign exchange gains amounting to \$11 million in respect of the translation of the net assets of the foreign subsidiaries attributable to the Group, were reclassified from the foreign currency revaluation reserve to the consolidated profit and loss account.

Capital contribution reserve

The opening capital contribution reserve is non-distributable and was received from the Group's former immediate parent undertaking, to finance various Group acquisitions.

On 30 November 2010, the Company's immediate parent undertaking Morgan Stanley International Holdings Inc, made a cash capital contribution of \$3,000 million to capitalise Group operations, and this is classified as a distributable reserve.

Fair value reserve

The fair value reserve includes the cumulative net change in the fair value of available-for-sale financial assets held at the balance sheet date, prior to the investment being sold or impaired.

MORGAN STANLEY INTERNATIONAL LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS Year ended 31 December 2010

26. RECONCILIATION OF SHAREHOLDERS' FUNDS AND MOVEMENTS ON RESERVES (CONTINUED)

Minority interest

Significant movements in minority interest during the year were as follows:

- During April 2010, a subsidiary entity of the Group, Morgan Stanley Gala Limited, repurchased its voting non-participating shares and ordinary non-voting shares issued to minority interest shareholders. The Group paid \$133 million cash consideration for the repurchase of shares that had a carrying value of \$140 million, thereby realising a gain of \$7 million. The Group bought out the remaining minority interest in the subsidiary during December 2010, and recognised a gain of \$112 million, being the difference between \$258 million cash consideration paid and the carrying value of the minority interest at the date of disposal of \$370 million.
- During September 2010, a subsidiary entity of the Group, Morgan Stanley Finance (C.I) Limited, repurchased its shares issued to minority interest shareholders for a cash consideration of \$592 million. The Group recognised a gain of \$73 million, being the difference between \$592 million cash consideration paid (including dividends paid prior to repurchase) and the carrying value of minority interest at the date of disposal of \$665 million.
- During November 2010, Morgan Stanley UK Capital Limited subscribed for and was allotted \$20 million preference shares in a subsidiary entity of the Group, Morgan Stanley Group (Europe).
- During December 2010, a subsidiary entity of the Group, Morgan Stanley Finance Limited, repurchased the entire amount of its redeemable preference shares issued to minority interest shareholders. The Group realised a gain of \$66 million, being the difference between \$746 million cash consideration paid and the carrying value of the minority interest at the date of disposal of \$812 million.

MORGAN STANLEY INTERNATIONAL LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS Year ended 31 December 2010

27. SEGMENTAL REPORTING

Segment information is presented in respect of the Group's business and geographical segments. Both the primary format, business segments, and geographical segments are based on the Group's management and internal reporting structure.

Business segment

Morgan Stanley structures its business segments primarily based upon the nature of the financial products and services provided to customers and Morgan Stanley's internal management structure. The Group's own business segments are consistent with those of Morgan Stanley. The Group has one reportable business segment, Institutional Securities, which provides financial services to corporations, governments, financial institutions and individual investors including sales, trading, financing and market-making activities in equity and fixed income securities and related products, including foreign exchange. Morgan Stanley Global Wealth Management and Asset Management businesses are presented within 'Other' in the tables below.

Selected financial information to reconcile segment information to the Group's consolidated information is presented below.

2010	Institutional Securities \$millions	Other \$millions	Total \$millions
Consolidated profit and loss information			
Net gains on financial instruments held for trading	4,517	111	4,628
Net gains on financial instruments designated at fair value through profit or loss	316	2	318
Net gains on available-for-sale financial assets	61	-	61
Net interest expense	(435)	(5)	(440)
Other income	721	352	1,073
External revenues net of interest expense	5,180	460	5,640
Other expense	(3,889)	(336)	(4,225)
Profit on ordinary activities before taxation	1,291	124	1,415
Balance sheet information			
Net assets	13,885	192	14,077
2009	Institutional Securities \$millions	Other \$millions	Total \$millions
Consolidated profit and loss information			
Net gains on financial instruments held for trading	4,827	112	4,939
Net gains on financial instruments designated at fair value through profit or loss	57	-	57
Net gains on available-for-sale financial assets	16	-	16
Net interest (expense) / income	(602)	40	(562)
Other income	909	326	1,235
External revenues net of interest expense	5,207	478	5,685
Other expense	(4,135)	(336)	(4,471)
Profit on ordinary activities before taxation	1,072	142	1,214
Balance sheet information			
Net assets	11,960	876	12,836

MORGAN STANLEY INTERNATIONAL LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS Year ended 31 December 2010

27. SEGMENTAL REPORTING (CONTINUED)

Geographical segment

The group operates in three geographic regions as listed below:

- Europe, Middle East and Africa ("EMEA")
- Americas
- Asia

The following table presents selected profit and loss account and balance sheet information by geographic area. The revenues net of interest expense balance presented is based on the origin of the income, which is not materially different to revenues net of interest expense based on the destination of income. The basis for attributing profit or loss on ordinary activities before tax and net assets disclosed reflect the geographic view of the Group's operations on a managed basis, determined by a combination of client and trading desk location.

	EMEA \$millions	Americas \$millions	Asia \$millions	Total \$millions
Consolidated profit and loss information				
Net gains on financial instruments held for trading	4,597	29	2	4,628
Net gains on financial instruments designated at fair value through profit or loss	314	4	-	318
Net gains on available-for-sale financial assets	61	-	-	61
Net interest (expense) / income	(441)	1	-	(440)
Other income	634	401	38	1,073
External revenues net of interest	5,165	435	40	5,640
Other expense	(3,813)	(400)	(12)	(4,225)
Profit on ordinary activities before taxation	1,352	35	28	1,415
Balance sheet information				
Net assets	11,246	1,701	1,130	14,077
<hr/>				
	EMEA \$millions	Americas \$millions	Asia \$millions	Total \$millions
Consolidated profit and loss information				
Net gains / (losses) on financial instruments held for trading	5,078	(90)	(49)	4,939
Net gains on financial instruments designated at fair value through profit or loss	57	-	-	57
Net gains on available-for-sale financial assets	16	-	-	16
Net interest (expense) / income	(859)	99	198	(562)
Other income	779	408	48	1,235
External revenues net of interest	5,071	417	197	5,685
Other expense	(3,898)	(390)	(183)	(4,471)
Profit on ordinary activities before taxation	1,173	27	14	1,214
Balance sheet information				
Net assets	10,205	1,262	1,369	12,836

MORGAN STANLEY INTERNATIONAL LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS Year ended 31 December 2010

28. FINANCIAL RISK MANAGEMENT

Risk management procedures

Risk is an inherent part of both Morgan Stanley's and the Group's business activity and is managed by the Group within the context of the broader Morgan Stanley Group. The Morgan Stanley Group seeks to identify, assess, monitor and manage each of the various types of risk involved in its business activities in accordance with defined policies and procedures. The Group's own risk management policies and procedures are consistent with those of the Morgan Stanley Group.

As disclosed in the Directors' report, the Group has exposure to European peripheral countries, which are defined as Portugal, Ireland, Italy, Greece and Spain. The Group's exposure is included within either the credit risk or the market risk disclosures below consistent with how the financial instrument is managed.

Significant risks faced by the Group resulting from its trading, financing and investment activities are set out below.

Credit risk

Credit risk refers to the risk of loss arising from a borrower or counterparty default.

The Morgan Stanley Group manages credit risk exposure on a global basis, but in consideration of each individual legal entity, including those of the Group. The credit risk management policies and procedures of the Morgan Stanley Group include ensuring transparency of material credit risks, ensuring compliance with established limits, approving material extensions of credit and escalating risk concentrations to appropriate senior management. Credit risk management policies and procedures for the Group are consistent with those of the Morgan Stanley Group and include escalation to appropriate key management personnel of the Group.

The Group is exposed primarily to significant single-name credit risk, requiring credit analysis of specific counterparties, both initially and on an ongoing basis. Credit risk management takes place at the transaction, counterparty and portfolio levels. In order to help protect the Group from losses resulting from its business activities, the Group analyses all material lending and derivative transactions and ensures that the creditworthiness of the Group's counterparties and borrowers is reviewed regularly and that credit exposure is actively monitored and managed. The Group assigns obligor credit ratings to its counterparties and borrowers which are intended to assess a counterparty's probability of default and are derived using methodologies generally consistent with those used by external rating agencies. For lending transactions, the Group evaluates the relative position of its particular exposure in the borrower's capital structure and relative recovery prospects. Where applicable, the Group also considers collateral arrangements and other structural elements of the particular transaction. The Group has credit guidelines that limit potential credit exposure to any one borrower or counterparty and to aggregates of borrowers or counterparties; these limits are monitored and credit exposures relative to these limits are reported to key management personnel.

As well as assessing and monitoring its credit exposure and risk at the individual counterparty level, the Group also reviews its credit exposure and risk to geographic regions. As at 31 December 2010, credit exposure was concentrated in North America and Western European countries. In addition, the Group pays particular attention to smaller exposures in emerging markets given their higher risk profile. Country ceiling ratings are derived using methodologies generally consistent with those employed by external rating agencies.

The Group also reviews its credit exposure and risk to types of customers. At 31 December 2010, the Group's material credit exposure was to corporate entities (including financial institutions) and sovereign-related entities.

MORGAN STANLEY INTERNATIONAL LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS Year ended 31 December 2010

28. FINANCIAL RISK MANAGEMENT (CONTINUED)

Credit risk (continued)

Collateral and other credit enhancements

The amount and type of collateral required by the Group depends on an assessment of the credit risk of the counterparty. Collateral held is managed in accordance with the Group's guidelines and the relevant underlying agreements. The market value of securities received as collateral is monitored on a daily basis and securities provided as collateral generally are not recognised in the consolidated balance sheet.

Reverse Repurchase Agreements and Securities Borrowed

The Group manages credit exposure arising from reverse repurchase agreements and securities borrowed transactions by, in appropriate circumstances, entering into master netting agreements and collateral arrangements with counterparties that provide the Group, in the event of a counterparty default, the right to liquidate collateral and the right to offset a counterparty's rights and obligations. Under these reverse repurchase agreements and securities borrowed transactions, the Group receives collateral, including U.S. government and agency securities, other sovereign government obligations, corporate and other debt, and corporate equities. The Group also monitors the fair value of the underlying securities compared to the related receivable or payable, including accrued interest, and, as necessary, requests additional collateral to ensure such transactions are adequately collateralised.

Derivatives

The Group may seek to mitigate credit risk from its derivatives transactions in multiple ways. At the transaction level, the Group seeks to mitigate risk through management of key risk elements such as size and maturity. The Group actively hedges its credit exposure arising from derivatives through various financial instruments which may include single name, portfolio and structured credit derivatives. Additionally, the Group may enter into master netting agreements and collateral arrangements with counterparties. These master netting agreements and collateral arrangements may provide the Group with the ability to offset a counterparty's rights and obligations, to request additional collateral when necessary and to liquidate the collateral in the event of counterparty default. The Group monitors the creditworthiness of counterparties to these transactions on an ongoing basis and requests additional collateral in accordance with collateral arrangements when deemed necessary.

Exposure to credit risk

The maximum exposure to credit risk of the Group as at 31 December 2010 is disclosed below, based on the carrying amount of the financial assets the Group believes is subject to credit risk, without taking account of any collateral held or any other credit enhancement. Exposure arising from financial instruments not recognised on the consolidated balance sheet is measured as the maximum amount that the Group could have to pay, which may be significantly greater than the amount that would be recognised as a liability. This table does not include receivables arising from pending securities transactions with market counterparties. The "unrated" balance represents the pool of counterparties that individually generate no material credit exposure. This pool is highly diversified, monitored and subject to limits.

Financial assets classified as held for trading, excluding derivatives, are subject to traded credit risk through exposure to the issuer of the financial asset; the Group manages this issuer credit risk through its market risk management infrastructure and this traded credit risk is incorporated within the VaR-based risk measures included in the market risk disclosure.

MORGAN STANLEY INTERNATIONAL LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS Year ended 31 December 2010

28. FINANCIAL RISK MANAGEMENT (CONTINUED)

Credit risk (continued)

Exposure to credit risk by class

Class	Gross credit exposure 2010 \$millions	Gross credit exposure 2009 \$millions
Loans and receivables:		
Cash at bank	11,255	14,480
Trade debtors:		
- External counterparties	26,717	22,140
- Morgan Stanley Group undertakings	5,449	15,127
Securities purchased under agreements to resell and cash collateral on stocks borrowed:		
- External counterparties	93,176	73,992
- Morgan Stanley Group undertakings	43,116	34,691
Other amounts due from Morgan Stanley Group undertakings	3,793	4,674
Other debtors	2,656	1,771
Financial assets classified as held for trading;		
- OTC Derivatives	175,380	153,018
Financial assets designated at fair value through profit or loss	9,363	1,908
	<hr/>	<hr/>
	370,905	321,801
Unrecognised financial instruments		
Contingent commitments	1,246	23
Financial guarantees	17	-
Loan commitments	2,344	985
Underwriting commitments	128	-
Unsettled reverse repurchase agreements	29,784	18,458
	<hr/>	<hr/>
	404,424	341,267

Maximum exposure to credit risk by credit rating⁽¹⁾

Credit rating	Gross credit exposure 2010 \$millions	Gross credit exposure 2009 \$millions
AAA	10,557	12,414
AA	118,926	88,705
A	230,280	178,827
BBB	22,996	14,222
BB	7,402	3,551
B	5,959	25,243
CCC	7,984	5,336
D	-	1
Unrated	320	12,968
Total	<hr/>	<hr/>
	404,424	341,267

(1) Internal credit rating derived using methodologies generally consistent with those used by external rating agencies.

At 31 December 2010, there were no loans and receivables past due but not impaired (2009: None). The carrying amount of renegotiated loans that would otherwise be past due or impaired totalled \$nil (2009: \$1 million).

MORGAN STANLEY INTERNATIONAL LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS Year ended 31 December 2010

28. FINANCIAL RISK MANAGEMENT (CONTINUED)

Credit risk (continued)

Loans and receivables individually impaired

The breakdown of the carrying amount of individually impaired loans and receivables by class are as follows:

2010

	Loans and advances to banks \$millions	Loans and advances to customers \$millions	Total \$millions
Carrying value before deducting impairment	30	255	285
Impairment loss	(8)	(98)	(106)
Carrying value after deducting impairment loss	<u>22</u>	<u>157</u>	<u>179</u>

2009

	Loans and advances to banks \$millions	Loans and advances to customers \$millions	Total \$millions
Carrying value before deducting impairment	-	247	247
Impairment loss	-	(146)	(146)
Carrying value after deducting impairment loss	<u>-</u>	<u>101</u>	<u>101</u>

The main considerations for the impairment assessment include whether there are any known difficulties in the cash flows of counterparties, credit rating downgrades, or infringement of the original terms of the contract. The Group determines the allowance appropriate for each individually significant loan and receivable on an individual basis. Items considered when determining the allowance amount include the sustainability of the counterparty's business plan, the counterparty's ability to improve performance once a financial difficulty has arisen, the realisable value of collateral, and the timing of expected cash flows. The impairment losses are evaluated at least at each reporting date.

Movement in impairment losses on loans and receivables

Allowances for impairment	2010			2009		
	Loans and advances to banks \$millions	Loans and advances to customers \$millions	Total \$millions	Loans and advances to bank \$millions	Loans and advances to customers \$millions	Total \$millions
Balance at 1 January	-	146	146	37	25	62
Charge for the year	9	13	22	-	134	134
Reversal of impairment losses	-	(48)	(48)	-	(11)	(11)
Amounts written off	-	(8)	(8)	(37)	(3)	(40)
Foreign exchange revaluation	(1)	(5)	(6)	-	1	1
Balance at 31 December	<u>8</u>	<u>98</u>	<u>106</u>	<u>-</u>	<u>146</u>	<u>146</u>

The fair value of collateral held by the Group in respect of 'loans and receivables individually impaired' at 31 December 2010 was \$91 million (2009: \$72 million), and does not exceed the post impairment carrying value of the loans and receivables.

MORGAN STANLEY INTERNATIONAL LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS Year ended 31 December 2010

28. FINANCIAL RISK MANAGEMENT (CONTINUED)

Liquidity risk

Liquidity risk is the risk that the entity may encounter difficulty in meeting obligations associated with financial liabilities that are settled by delivering cash or another financial asset.

The Morgan Stanley Group's senior management establishes the overall liquidity and funding policies of the Morgan Stanley Group and the liquidity risk management policies and procedures conducted within the Group are consistent with those of the Morgan Stanley Group. The Morgan Stanley Group's liquidity and funding risk management policies are designed to mitigate the potential risk that entities within the Morgan Stanley Group, including those of the Group, may be unable to access adequate financing to service their financial liabilities when they become payable without material, adverse franchise or business impact. The key objective of the liquidity and funding risk management framework is to support the successful execution of both the Group's and the Morgan Stanley Group's business strategies while ensuring ongoing and sufficient liquidity through the business cycle and during periods of stressed market conditions.

Liquidity management policies

The principal elements of the Morgan Stanley Group's and the Group's liquidity management framework, are the Contingency Funding Plan ("CFP") and liquidity reserves. Comprehensive financing guidelines (secured funding, long-term funding strategy, surplus capacity, diversification and staggered maturities) support the Morgan Stanley Group, as well as the Group's, target liquidity profile.

Contingency Funding Plan. CFP is the Morgan Stanley Group's primary liquidity and funding risk management tool. The CFP models multiple scenarios related to idiosyncratic, systemic or a combination of both types of events, across various time horizons. The CFP and liquidity risk exposures are evaluated on an on-going basis and reported to the Firm Risk Committee, Asset / Liability Management Committee, and other appropriate risk committees including the European Financial Risk Committee.

CFP is produced on a Morgan Stanley Group as well as major group and subsidiary level, including the Group, to capture specific cash requirements and cash availability at various legal entities. The CFP assumes that Morgan Stanley does not have access to cash that may be held at certain subsidiaries due to regulatory, legal or tax constraints but that the Group does have access to the cash or liquidity reserve held by Morgan Stanley along with all other Morgan Stanley subsidiaries.

The Morgan Stanley Group's and the Group's CFP model incorporates scenarios with a wide range of potential cash outflows during a liquidity stress event, including, but not limited to, the following: (i) repayment of all unsecured debt maturing within one year and no incremental unsecured debt issuance; (ii) maturity roll-off of outstanding letters of credit with no further issuance and replacement of cash collateral; (iii) return of unsecured securities borrowed and any cash raised against these securities; (iv) additional collateral that would be required by counterparties in the event of a three-notch long-term credit ratings downgrade; (v) higher haircuts on or lower availability of secured funding; (vi) client cash withdrawals; (vii) drawdowns on unfunded commitments provided to third parties; and (viii) discretionary unsecured debt buybacks.

Global Liquidity Reserves. The Morgan Stanley Group seeks to maintain a target liquidity reserve ("the global liquidity reserve") that is sized to cover daily funding needs and meet strategic liquidity targets as outlined in the CFP. The global liquidity reserve is held within Morgan Stanley and the Morgan Stanley Group's major operating subsidiaries and consists of cash and cash equivalents, central bank eligible unencumbered securities (predominantly consisting of U.S. and European government bonds and U.S. agency and agency mortgage-backed securities). In addition to the global liquidity reserve, the Group maintains a locally managed liquidity reserve which consists of cash and cash equivalents, central bank eligible unencumbered securities that are owned outright or have been reversed or borrowed (predominantly consisting of European and UK government bonds). In addition to the liquidity reserve held by the Group, the Group has access to the global liquidity reserve. The Morgan Stanley Group's and the Group's funding requirements and target liquidity reserves may vary based on changes to the level and composition of its balance sheet, timing of specific transactions, client financing activity, market conditions and seasonal factors.

MORGAN STANLEY INTERNATIONAL LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS Year ended 31 December 2010

28. FINANCIAL RISK MANAGEMENT (CONTINUED)

Liquidity risk (continued)

Funding management policies

The Morgan Stanley Group's funding management policies are designed to provide for financings that are executed in a manner that reduces the risk of disruption to the Morgan Stanley Group's and the Group's operations. The Morgan Stanley Group pursues a strategy of diversification of secured and unsecured funding sources (by product, by investor and by region) and attempts to ensure that the tenor of the Morgan Stanley Group's, and the Group's, liabilities equals or exceeds the expected holding period of the assets being financed. Maturities of financings are designed to manage exposure to refinancing risk in any one period.

The Morgan Stanley Group funds its balance sheet on a global basis through diverse sources. These sources may include the Morgan Stanley Group's equity capital, long-term debt, repurchase agreements, securities lending, deposits, commercial paper, letters of credit and lines of credit. The Morgan Stanley Group has active financing programs for both standard and structured products in the U.S., European and Asian markets, targeting global investors and currencies such as U.S. dollar, Euro, British pound, Australian dollar and Japanese Yen.

In managing both the Group's and the Morgan Stanley Group's funding risk the composition and size of the entire balance sheet, not just financial liabilities, is monitored and evaluated. A substantial portion of the Morgan Stanley Group's total assets consist of highly liquid marketable securities and short-term receivables arising from its Institutional Securities sales and trading activities. The liquid nature of these assets provides the Group and the Morgan Stanley Group with flexibility in financing and managing its business.

Maturity analysis

In the following maturity analysis of financial liabilities, derivative contracts and other financial instruments held as part of the Group's trading activities are disclosed on demand and presented at fair value, consistent with how these financial liabilities are managed. Financial liabilities designated at fair value are disclosed according to their earliest contractual maturity; all such amounts are presented at their fair value, consistent with how these financial liabilities are managed. All other amounts represent undiscounted cash flows payable by the Group arising from its financial liabilities to earliest contractual maturities as at 31 December 2010. Repayments of financial liabilities that are subject to immediate notice are treated as if notice were given immediately and are classified as on demand. This presentation is considered by the Group to appropriately reflect the liquidity risk arising from those financial liabilities, presented in a way that is consistent with how the liquidity risk on these financial liabilities is managed by the Group.

MORGAN STANLEY INTERNATIONAL LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS Year ended 31 December 2010

28. FINANCIAL RISK MANAGEMENT (CONTINUED)

Liquidity risk (continued)

	On demand	Less than one month	More than 1 month but less than 3 months	More than 3 months but less than 1 year	More than 1 year but less than 5 years	More than 5 years	Total
31 December 2010	\$millions	\$millions	\$millions	\$millions	\$millions	\$millions	\$millions
Financial liabilities							
Financial liabilities at amortised cost:							
Bank loans and overdrafts	580	-	-	-	-	-	580
Trade Creditors:							
- External counterparties	55,027	-	-	-	-	-	55,027
- Group undertakings	13,150	-	-	-	-	-	13,150
Securities sold under agreements to repurchase and cash collateral on stocks loaned:							
- External counterparties	12,696	34,228	16,219	9,892	2,202	-	75,237
- Group undertakings	68,990	-	-	-	-	-	68,990
Other amounts owing to Morgan Stanley Group undertakings	822	-	-	11,931	2,137	1,076	15,966
Corporate deposits	6,883	-	-	-	-	-	6,883
Other financial liabilities	3,255	-	-	-	-	-	3,255
Subordinated debt	-	14	27	123	658	12,161	12,983
Financial liabilities classified as held for trading:							
Derivatives	191,937	-	-	-	-	-	191,937
Other	35,951	-	-	-	-	-	35,951
Financial liabilities designated at fair value through profit or loss	10,890	627	208	732	3,131	1,003	16,591
Total financial liabilities	400,181	34,869	16,454	22,678	8,128	14,240	496,550
Unrecognised financial instruments							
Contingent commitments	1,246	-	-	-	-	-	1,246
Financial guarantees	17	-	-	-	-	-	17
Lease commitments	-	-	-	1	30	62	93
Loan commitments	2,344	-	-	-	-	-	2,344
Underwriting commitments	-	-	128	-	-	-	128
Unsettled reverse repurchase agreements	29,784	-	-	-	-	-	29,784
Total unrecognised financial instruments	33,391	-	128	1	30	62	33,612

The Group does not expect that all of the cash flows associated with financial guarantees, letters of credits and loan commitments will be required.

MORGAN STANLEY INTERNATIONAL LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS Year ended 31 December 2010

28. FINANCIAL RISK MANAGEMENT (CONTINUED)

Liquidity risk (continued)

	On demand	Less than one month	More than 1 month but less than 3 months	More than 3 months but less than 1 year	More than 1 year but less than 5 years	More than 5 years	Total
31 December 2009	\$millions	\$millions	\$millions	\$millions	\$millions	\$millions	\$millions
Financial liabilities							
Financial liabilities at amortised cost:							
Bank loans and overdrafts	427	-	-	-	-	-	427
Trade Creditors:							
- External counterparties	54,545	-	-	-	-	-	54,545
- Group undertakings	10,766	-	-	-	-	-	10,766
Securities sold under agreements to repurchase and cash collateral on stocks loaned:							
- External counterparties	2,221	37,195	5,938	957	500	-	46,811
- Group undertakings	67,927	-	-	-	-	-	67,927
Other amounts owing to Morgan Stanley Group undertakings	12,410	-	2,373	-	-	-	14,783
Corporate deposits	3,122	-	-	-	-	-	3,122
Other financial liabilities	3,825	-	-	-	-	-	3,825
Subordinated debt	-	13	26	119	636	12,178	12,972
Financial liabilities classified as held for trading:							
Derivatives	172,568	-	-	-	-	-	172,568
Other	36,934	-	-	-	-	-	36,934
Financial liabilities designated at fair value through profit or loss	4,745	104	91	521	1,293	1,125	7,879
Total financial liabilities	369,490	37,312	8,428	1,597	2,429	13,303	432,559
Unrecognised financial instruments							
Contingent commitments	23	-	-	-	-	-	23
Financial guarantees	-	-	-	-	-	-	-
Lease commitments	-	1	2	8	24	71	106
Loan commitments	985	-	-	-	-	-	985
Underwriting commitments	-	-	-	-	-	-	-
Unsettled reverse repurchase agreements	18,458	-	-	-	-	-	18,458
Total unrecognised financial instruments	19,466	1	2	8	24	71	19,572

The Group does not expect that all of the cash flows associated with financial guarantees, letters of credits and loan commitments will be required.

MORGAN STANLEY INTERNATIONAL LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS Year ended 31 December 2010

28. FINANCIAL RISK MANAGEMENT (CONTINUED)

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), correlations or other market factors, such as liquidity, will result in losses for a position or portfolio.

Sound market risk management is an integral part of the Group's and the Morgan Stanley Group's culture. The Group is responsible for ensuring that market risk exposures are well-managed and prudent and more broadly for ensuring transparency of material market risks, monitoring compliance with established limits, and escalating risk concentrations to appropriate senior management.

To execute these responsibilities, the Morgan Stanley Group monitors the market risk of the firm against limits on aggregate risk exposures, performs a variety of risk analyses, routinely reports risk summaries and maintains the Value at Risk ("VaR") system. These limits are designed to control price and market liquidity risk. Market risk is monitored through various measures: statistically (using VaR and related analytical measures); by measures of position sensitivity; and through routine stress testing, which measures the impact of the value of existing portfolios of specified changes in market factors, and scenario analyses conducted by the market risk department in collaboration with the business units. The material risks identified by these processes are summarised and reported to senior management, the Risk Committee and the Group's Board.

The Group is managed within the Morgan Stanley Group's global framework. The market risk management policies and procedures of the Group are consistent with those of the Morgan Stanley Group, including reporting of material risks identified to appropriate key management personnel of the Group.

Risk and capital management initiative

During 2010, both the Morgan Stanley Group and the Group continued to enhance the market risk management framework to address the severe stresses observed in global markets during the recent economic downturn. The Morgan Stanley Group and the Group expanded and improved their risk measurement processes, including stress tests and scenario analysis, and refined their market risk limit framework. Included within the Morgan Stanley Group's risk management framework is a proprietary methodology called Stress VaR ("S-VaR") that measures the Morgan Stanley Group's market and credit risks. S-VaR simulates many stress scenarios based on more than 25 years of historical data and attempts to capture the different liquidities of various types of general and specific risks, as well as event and default risks particularly relevant for credit portfolios. S-VaR, while still evolving, is becoming an important metric for the Morgan Stanley Group's risk appetite assessment and its capital allocation framework. As a result of its importance to the overall Morgan Stanley Group's risk framework, S-VaR has been implemented at the Group level during the year.

Primary market risk exposures and market risk management

During the year ended 31 December 2010, the Group had exposures to a wide range of interest rates, equity prices, foreign exchange rates and commodity prices and the associated implied volatilities and spreads, related to the global markets in which it conducts its trading activities.

The Group is exposed to interest rate and credit spread risk as a result of its market-making activities and other trading in interest rate sensitive financial instruments (e.g. risk arising from changes in the level or implied volatility of interest rates, the shape of the yield curve and credit spreads). The activities from which those exposures arise and the markets in which the Group is active include, but are not limited to, the following: government debt, investment grade and non-investment grade corporate debt, interest rate derivatives, emerging market corporate and government debt, and asset-backed debt (including mortgage-related securities).

The Group is exposed to equity price and implied volatility risk as a result of making markets in equity securities and derivatives as well as maintaining proprietary positions. The Group is exposed to foreign exchange rate and implied volatility risk as a result of making markets in foreign currencies and foreign currency derivatives and from holding non U.S. dollar-denominated financial instruments. The Group is exposed to commodity price and implied volatility risk as a result of market-making activities and maintaining positions in physical commodities (such as base metals) and related derivatives. Commodity exposures are subject to periods of high price volatility as a result of changes in supply and demand. These changes can be caused by physical production, transportation and storage issues; or geopolitical and other events that affect the available supply and level of demand for these commodities.

MORGAN STANLEY INTERNATIONAL LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS Year ended 31 December 2010

28. FINANCIAL RISK MANAGEMENT (CONTINUED)

Market risk (continued)

The Group, as part of the Morgan Stanley Group's global market risk management framework 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). Hedging activities may not always provide effective mitigation against trading losses due to differences in the terms, specific characteristics or other basis risks that may exist between the hedge instrument and the risk exposure that is being hedged. The Group manages the market risk associated with its trading activities on a Group basis, on a entity-wide basis, on a worldwide trading division level and on an individual product strategy level. The Group manages and monitors its market risk exposures in such a way as to maintain a portfolio that the Group believes is well-diversified in the aggregate with respect to market risk factors and that reflects the aggregate risk tolerance of key entities within the Group as established by the Group's senior management.

Aggregate market risk limits have been approved for the key entities within the Group and major trading divisions globally (equity and fixed income, which includes interest rate products, credit products, foreign exchange and commodities) as well as for the Morgan Stanley Group. Additional market risk limits are assigned to trading desks and, as appropriate, products and regions. Trading division risk managers, desk risk managers, traders and the market risk department monitor market risk measures against limits in accordance with policies set by senior management.

The market risk department independently reviews the Group's trading portfolios on a regular basis from a market risk perspective utilising VaR and other quantitative and qualitative risk measures and analyses. The Group's trading businesses and the market risk department also use, as appropriate, measures such as sensitivity to changes in interest rates, prices, implied volatilities and time decay to monitor and report market risk exposures. Net exposure, defined as the potential loss to the Group over a period of time in the event of default of a referenced asset, assuming zero recovery, is one key measure the Group employs to standardise the aggregation of market risk exposures across cash and derivative products. Stress testing, which measures the impact on the value of existing portfolios of specified changes in market factors for certain products, is performed periodically and is reviewed by trading division risk managers, desk risk managers and the market risk department.

VaR

The Group uses the statistical technique known as VaR as one of the tools used to measure, monitor and review the market risk exposures of its trading portfolios. The market risk department calculates and distributes daily VaR-based risk measures to various levels of management.

VaR methodology, assumptions and limitations

The Group estimates VaR using a model based on historical simulation for major market risk factors and Monte Carlo simulation for name-specific risk in certain equity and fixed income exposures. Historical simulation involves constructing a distribution of hypothetical daily changes in the value of trading portfolios based on two sets of inputs: historical observation of daily changes in key market indices or other market factors ("market risk factors"); and information on the current sensitivity of the portfolio values to these market risk factor changes. The Group's VaR model uses approximately four years of historical data to characterise potential changes in market risk factors. The Group's 95% / one-day VaR corresponds to the unrealised loss in portfolio value that, based on historically observed market risk factor movements, would have been exceeded with a frequency of 5%, or five times in every 100 trading days, if the portfolio were held constant for one day.

The Group's VaR model generally takes into account linear and non-linear exposures to equity and commodity price risk, interest rate risk, credit spread risk, foreign exchange rates, as well as linear exposures to implied volatility risks. The VaR model also captures certain implied correlation risks associated with portfolio credit derivatives, as well as certain basis risks (e.g. corporate debt and related credit derivatives).

MORGAN STANLEY INTERNATIONAL LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS Year ended 31 December 2010

28. FINANCIAL RISK MANAGEMENT (CONTINUED)

Market risk (continued)

The Group's VaR models evolve over time in response to changes in the composition of trading portfolios and to improvements in modelling techniques and systems capabilities. The Group is committed to continuous review and enhancement of VaR methodologies and assumptions in order to capture evolving risks associated with changes in market structure and dynamics. As part of regular process improvement, additional systematic and name-specific risk factors may be added to improve the VaR model's ability to more accurately estimate risks to specific asset classes or industry sectors. Additionally, the Group continues to evaluate enhancements to the VaR model to make it more responsive to more recent market conditions, while maintaining a longer-term perspective.

Among their benefits, VaR models permit estimation of a portfolio's aggregate market risk exposure, incorporating a range of varied market risks; reflect risk reduction due to portfolio diversification or hedging activities; and can cover a wide range of portfolio assets. However, VaR risk measures should be interpreted carefully in light of the methodology's limitations, which include the following: past changes in market risk factors may not always yield accurate predictions of the distributions and correlations of future market movements; changes in portfolio value in response to market movements (especially for complex derivative portfolios) may differ from the responses calculated by a VaR model; VaR using a one-day time horizon may not fully capture the market risk of positions that cannot be liquidated or hedged within one day; the historical market risk factor data used for VaR estimation may provide only limited insight into losses that could be incurred under market conditions that are unusual relative to the historical period used in estimating the VaR; and published VaR results reflect past trading positions while future risk depends on future positions. The Group is aware of these and other limitations and, therefore, uses VaR as only one component in its risk management oversight process. As explained above, this process also incorporates stress testing and scenario analyses and extensive risk monitoring, analysis, and control at the trading desk, division, entity, group and global levels.

VaR for the year ended 31 December 2010

The table below presents the Group's Trading, Non-trading and Aggregate VaR for each of the Group's primary market risk exposures at 31 December 2010 and 31 December 2009, incorporating substantially all financial instruments generating market risk that are managed by the Group's trading businesses. This measure of VaR incorporates most of the Group's trading-related market risks. However, a small proportion of trading positions generating market risk is not included in VaR, and the modelling of the risk characteristics of some positions relies upon approximations that, under certain circumstances, could produce different VaR results from those produced using more precise measures.

The counterparty portfolio, which reflects adjustments, net of hedges, relating to counterparty credit risk and other market risks, was reclassified from Non-Trading VaR into Trading VaR as of 1 January 2010. This reclassification reflects regulatory considerations surrounding the Morgan Stanley Group's conversion to a financial holding company, and the trading book nature of the Group's counterparty risk-hedging activities that the Group follows. Aggregate VaR was not affected by this change; however, this reclassification increased Trading VaR and decreased Non-Trading VaR for the year ended 31 December 2010.

Since the VaR statistics reported below are estimates based on historical position and market data, VaR should not be viewed as predictive of the Group's future revenues or financial performance or of its ability to monitor and manage risk. There can be no assurance that the Group's actual losses on a particular day will not exceed the VaR amounts indicated below or that such losses will not occur more than five times in 100 trading days. VaR does not predict the magnitude of losses which, should they occur, may be significantly greater than the VaR amount.

MORGAN STANLEY INTERNATIONAL LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS Year ended 31 December 2010

28. FINANCIAL RISK MANAGEMENT (CONTINUED)

Market risk (continued)

The table below presents 95% one-day VaR for each of the Group's primary market risk categories and on an aggregate basis.

95% Total VaR primary market risk category	95% one-day VaR At 31 December 2010				95% one-day VaR At 31 December 2009				
	Period	End \$'m	Average \$'m	High \$'m	Low \$'m	Period	End \$'m	Average \$'m	High \$'m
Interest rate and credit spread	61	69	86	54	48	51	72	39	
Equity price	26	22	53	13	14	14	22	11	
Foreign exchange rate	10	9	17	3	8	9	19	4	
Commodity price	2	3	9	2	3	2	4	1	
Subtotal	99	103	165	72	73	76	117	55	
Less diversification benefit ⁽¹⁾	(26)	(29)	(59)	(18)	(18)	(23)	(30)	(19)	
Total trading VaR	73	74	106	54	55	53	87	36	
Total non-trading VaR	13	12	20	7	22	25	31	15	
Aggregate VaR	79	76	106	56	73	61	100	39	

(1) Diversification benefit equals the difference between total VaR and the sum of the VaRs for the four risk categories. This benefit arises because the simulated one-day losses for each of the four primary market risk categories occur on different days; similar diversification benefits also are taken into account within each category.

The Group's average Trading VaR for the year ended 31 December 2010 was \$74 million compared with \$53 million for the year ended 31 December 2009. Excluding the counterparty portfolio, which has been reclassified from Non-Trading VaR to Trading VaR for the year ended 31 December 2010, the Group's Average Trading VaR for 2010 would have been \$65 million. The increase, excluding the counterparty portfolio reclassification, has been driven primarily by an increase in interest rate and credit spread risk combined with an increased equity price risk.

Interest rate risk

The Group's VaR excludes certain funding liabilities and money market transactions. As at 31 December 2010, the net notional amount of such funding liabilities and money market activities was a liability of approximately \$9.4 billion compared to a liability of \$7.4 billion as at 31 December 2009. The application of a parallel shift in interest rates of 50 basis points increase or decrease to these positions would result in a net gain or loss to the Group of approximately \$1.9 million compared to a gain or loss of \$9.2 million gain as at 31 December 2009.

Aggregate VaR currently incorporates certain non-trading risks, such as the interest rate risk generated by funding liabilities related to institutional trading positions and public company equity positions recorded as fixed asset investments by the Group. Investments made by the Group that are not publicly traded are not reflected in the Aggregate VaR results.

MORGAN STANLEY INTERNATIONAL LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS Year ended 31 December 2010

28. FINANCIAL RISK MANAGEMENT (CONTINUED)

Market risk (continued)

Currency risk

The Group has foreign currency exposure arising from its investments in branches and subsidiaries where those investments operate in currencies other than US dollars. For the foreign currency exposure arising from the investments in subsidiaries and branches that operate in currencies other than US dollars, the majority of this foreign currency risk has been hedged by other members of the Morgan Stanley Group, primarily Morgan Stanley, by utilising both forward foreign currency exchange contracts and non-US dollar denominated debt.

The analysis below details this foreign currency exposure for the Group, by foreign currency, and calculates the impact on total recognised gains and losses of a reasonably possible parallel shift of the foreign currency against the US dollar, with all other variables held constant. This analysis does not take into account the effect of any foreign currency hedges held by the Group or by other members of the Morgan Stanley Group.

	2010			2009		
	Foreign currency exposure	Sensitivity to applied percentage change in currency (+/-)		Foreign currency exposure	Sensitivity to applied percentage change in currency (+/-)	
		Percentage change applied	Total recognised gain or loss		Percentage change applied	Total recognised gain or loss
	\$millions	%	\$millions	\$millions	%	\$millions
Australian Dollar	(6)	27%	2	(5)	27%	1
British Pound	2,025	29%	587	1,867	29%	541
Chinese Yuan	185	8%	15	160	8%	13
Euro	522	7%	37	437	5%	22
New Taiwan Dollar	60	8%	5	92	3%	3
New Zealand Dollar	2	24%	-	2	24%	-
Russian Rouble	273	24%	66	269	24%	65
Singapore Dollar	4	9%	-	3	2%	-
South Korean Won	425	42%	179	347	42%	146
Swedish Krona	15	23%	3	14	23%	3
Swiss Franc	5	10%	1	-	-	-
	3,510			3,186		

The reasonably possible percentage change in the currency rate against US dollars has been calculated based on the greatest annual percentage change over the period from 1 December 2007 to 31 December 2010. The percentage change applied may not be the same percentage change in the currency rate for the year.

MORGAN STANLEY INTERNATIONAL LIMITED

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29. TRANSFERS OF FINANCIAL ASSETS, INCLUDING PLEDGES OF COLLATERAL

In the ordinary course of business, the Group enters into various transactions that result in the transfer of financial assets to third parties, which for accounting purposes may not give rise to full derecognition of the financial assets.

The following table presents those financial assets which have been sold or otherwise transferred, but which for accounting purposes do not qualify for derecognition and continue to be recognised in the consolidated balance sheet.

	2010 \$millions	2009 \$millions
Government debt securities	14,238	9,655
Corporate equities	42,082	45,260
Corporate and other debt	12,760	10,950
	<hr/> <u>69,080</u>	<hr/> <u>65,865</u>

The majority of financial assets that do not qualify for derecognition arise from repurchase agreements and securities lending arrangements. Under these types of transactions, the Group generally retains substantially all risks and rewards of the transferred assets including credit risk, settlement risk, country risk and market risk.

Other financial assets transferred that continue to be recognised for accounting purposes include pledges of securities as collateral for open derivative transactions, as well as certain sales of securities with related transactions, such as derivatives, that result in the Group either retaining substantially all the risks and rewards of the financial assets transferred, or not retaining substantially all the risks and rewards but retaining control of those financial assets.

These transactions are mostly conducted under standard agreements used by financial market participants and are undertaken with counterparties subject to the Group's normal credit risk control processes. The resulting credit exposures are controlled by daily monitoring and collateralisation of the positions. The carrying amount of the associated liabilities related to financial assets transferred that continue to be recognised approximate the carrying amount of those transferred assets.

30. FINANCIAL ASSETS ACCEPTED AS COLLATERAL

The Group accepts financial assets as collateral which, dependent on the terms of the arrangement, the Group is allowed to sell or repledge. The majority of the financial assets accepted as collateral are received as part of reverse repurchase agreements or securities borrowing and are mostly conducted under standard documentation used by financial market participants.

The fair value of collateral accepted under such arrangements as at 31 December 2010 was \$199,601 million (2009: \$156,057 million). Of this amount \$168,166 million (2009: \$129,613 million) has been sold or repledged to third parties in connection with financing activities, or to comply with commitments under short sale transactions.

MORGAN STANLEY INTERNATIONAL LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS Year ended 31 December 2010

31. FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE

a. Fair value hierarchy

Financial instruments recognised at fair value are broken down for disclosure purposes into a three level fair value hierarchy based on the observability of inputs as follows:

- *Quoted prices (unadjusted) in an active market for identical assets or liabilities (Level 1)* - valuations based on quoted prices in active markets for identical assets or liabilities that the Morgan Stanley Group has the ability to access. 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, valuations of these products do not entail a significant degree of judgement.
- *Valuation techniques using observable inputs (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.
- *Valuation techniques with significant non-observable inputs (Level 3)* - valuations based on inputs that are unobservable and significant to the overall fair value measurement.

Fair value control processes

The Group employs control processes to validate the fair value of its financial instruments, 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 utilised is appropriate and consistently applied and that the assumptions are reasonable. These control processes include reviews of the pricing model's theoretical soundness and appropriateness by Morgan Stanley Group personnel with relevant expertise who are independent from the trading desks.

Additionally, groups independent from the trading divisions within the financial control, market risk and credit risk management departments participate in the review and validation of the fair values generated from pricing models, as appropriate. Where a pricing model is used to determine fair value, recently executed comparable transactions and other observable market data are considered for purposes of validating assumptions underlying the model.

MORGAN STANLEY INTERNATIONAL LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS Year ended 31 December 2010

31. FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE (CONTINUED)

a. Fair value hierarchy (continued)

Financial assets and liabilities recognised at fair value

The following table presents the carrying value of the Group's financial assets and liabilities, recognised at fair value, classified according to the fair value hierarchy described above:

2010	Valuation techniques			Total \$millions
	Quoted prices in active market (Level 1) \$millions	Valuation techniques using observable inputs (Level 2) \$millions	Valuation techniques with significant non- observable inputs (Level 3) \$millions	
Financial assets classified as held for trading:				
- Government debt securities	12,369	5,614	-	17,983
- Corporate equities	51,345	1,136	152	52,633
- Corporate and other debt	110	20,294	3,672	24,076
- Derivatives	972	187,281	2,433	190,686
Total financial assets classified as held for trading	64,796	214,325	6,257	285,378
Financial assets designated at fair value through profit or loss	-	8,834	529	9,363
Fixed asset investments : Available-for-sale financial assets	75	-	76	151
Total financial assets measured at fair value	64,871	223,159	6,862	294,892
Financial liabilities classified as held for trading:				
- Government debt securities	11,944	3,161	-	15,105
- Corporate equities	15,683	423	13	16,119
- Corporate and other debt	-	4,695	32	4,727
- Derivatives	928	187,097	3,912	191,937
Total financial liabilities classified as held for trading	28,555	195,376	3,957	227,888
Financial liabilities designated at fair value through profit or loss	-	15,736	855	16,591
Total financial liabilities measured at fair value	28,555	211,112	4,812	244,479

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS Year ended 31 December 2010

31. FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE (CONTINUED)

a. Fair value hierarchy (continued)

Financial assets and liabilities recognised at fair value (continued)

2009	Quoted prices in active market (Level 1) \$millions	Valuation techniques using observable inputs (Level 2) \$millions	Valuation techniques with significant non- observable inputs (Level 3) \$millions	Total \$millions
Financial assets classified as held for trading:				
- Government debt securities	11,920	3,169	2	15,091
- Corporate equities	47,352	857	112	48,321
- Corporate and other debt	10	20,677	3,594	24,281
- Derivatives	1,145	162,358	4,455	167,958
Total financial assets classified as held for trading	60,427	187,061	8,163	255,651
Financial assets designated at fair value through profit or loss				
	-	497	1,411	1,908
Fixed asset investments: Available-for-sale financial assets	-	-	163	163
Total financial assets measured at fair value	60,427	187,558	9,737	257,722
Financial liabilities classified as held for trading:				
- Government debt securities	10,585	1,274	-	11,859
- Corporate equities	16,125	1,434	4	17,563
- Corporate and other debt	69	7,405	38	7,512
- Derivatives	1,352	165,230	5,986	172,568
Total financial liabilities classified as held for trading	28,131	175,343	6,028	209,502
Financial liabilities designated at fair value through profit or loss				
	-	6,987	892	7,879
Total financial liabilities measured at fair value	28,131	182,330	6,920	217,381

MORGAN STANLEY INTERNATIONAL LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS Year ended 31 December 2010

31. FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE (CONTINUED)

a. Fair value hierarchy (continued)

Financial assets and financial liabilities classified as held for trading and available-for-sale financial assets

- *Government debt securities*

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

- *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 categorised in Level 1 of the fair value hierarchy; otherwise, they are categorised in Level 2.

Investments. The Group's investments include exchange-traded equity securities, direct private equity investments and investments in private equity funds, real estate funds and hedge funds. Initially, the transaction price is generally considered by the Group as the exit price and is the Group's best estimate of fair value.

After initial recognition, in determining the fair value of internally and externally managed funds, the Group considers the net asset value of the fund provided by the fund manager to be the best estimate of fair value. For direct private investments and privately held investments within internally managed funds, fair value after initial recognition is based on an assessment of each underlying investment, considering rounds of financing 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. If the investments are exchange-traded they will be categorised as Level 1, otherwise they will be categorised as Level 3.

- *Corporate and other debt*

Corporate Bonds. The fair value of corporate bonds is estimated using recently executed transactions, market price quotations (where observable), bond spreads or credit default swap spreads 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 does not reference the issuer, then data that reference a comparable issuer are used. When observable price quotations are not available, fair value is determined based on cash flow models with yield curves, bond or single name credit default swap spreads and recovery rates as significant inputs. Corporate bonds are generally categorised in Level 2 of the fair value hierarchy; in instances where prices, spreads or any other of the aforementioned key inputs are unobservable, they are categorised in Level 3 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 external price or spread data. When position-specific external price data are not observable, the valuation is based on prices of comparable bonds. Valuation levels of RMBS and CMBS indices are used as an additional data point for benchmarking purposes or to price outright index positions.

Fair value for retained interests in securitised financial assets (in the form of one or more tranches of the securitisation) is determined using observable prices or, in cases where observable prices are not available for certain retained interests, the fair value is estimated based on the present value of expected future cash flows using the best estimate of the key assumptions, including forecasted credit losses, prepayment rates, forward yield curves and discount rates commensurate with the risks involved.

RMBS, CMBS and other ABS, including retained interests in these securitised financial assets, are categorised in Level 3 if external prices or spread inputs are unobservable or if the comparability assessment involves significant subjectivity related to property type differences, cash flows, performance and other inputs; otherwise, they are categorised in Level 2 of the fair value hierarchy.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS Year ended 31 December 2010

31. FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE (CONTINUED)

a. Fair value hierarchy (continued)

Financial assets and financial liabilities classified as held for trading and available-for-sale financial assets (continued)

- *Corporate and other debt (continued)*

Collateralised Debt Obligations ("CDOs"). The Group holds CDOs where the collateral primarily is synthetic and references either a basket credit default swap or CDO-squared (a CDO-squared is a special purpose vehicle that issues interests, or tranches, that are backed by tranches issued by other CDOs). The correlation input between reference credits within the collateral is unobservable and is benchmarked to standardised proxy baskets for which correlation data are available. The other model inputs such as credit spreads, interest rates and recovery rates are observable. CDOs are categorised in Level 2 of the fair value hierarchy when the correlation input is insignificant. In instances where the correlation input is deemed to be significant, these instruments are categorised in Level 3 of the fair value hierarchy.

- *Derivatives*

Listed Derivative Contracts. Listed derivatives that are actively traded are valued based on quoted prices from the exchange and are categorised in Level 1 of the fair value hierarchy. Listed derivatives that are not actively traded are valued using the same approaches as those applied to OTC derivatives; they are generally categorised 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 modelled using a series of techniques, and model inputs from comparable benchmarks, including closed-form analytical 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 judgement, 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 are widely accepted by the financial services industry. A substantial majority of OTC derivative products valued using pricing models fall into this category and are categorised within Level 2 of the fair value hierarchy.

Other derivative products, including complex products that have become illiquid, require more judgement in the implementation of the valuation technique applied due to the complexity of the valuation assumptions and the reduced observability of inputs. This includes derivative interests in certain mortgage-related CDO securities, basket credit default swaps, CDO-squared positions and certain types of ABS credit default swaps where direct trading activity or quotes are unobservable. These instruments involve significant unobservable inputs and are categorised in Level 3 of the fair value hierarchy.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS Year ended 31 December 2010

31. FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE (CONTINUED)

a. Fair value hierarchy (continued)

Financial assets and financial liabilities classified as held for trading and available-for-sale financial assets (continued)

- *Derivatives (continued)*

OTC Derivative Contracts (continued)

Derivative interests in mortgage-related CDOs, and credit default swaps, for which observability of external price data is extremely limited, are valued based on an evaluation of the market and model input parameters sourced from similar positions as indicated by primary and secondary market activity. Each position is evaluated independently taking into consideration the underlying collateral performance and pricing, behaviour of the tranche under various cumulative loss and prepayment scenarios, deal structures (e.g., non-amortising reference obligations, call features) 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 judgement.

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

The Group trades various derivative structures with commodity underlyings. Depending on the type of structure, the model inputs generally include interest rate yield curves, commodity underlier curves, implied volatility of the underlying commodities and, in some cases, the implied correlation between these inputs. The fair value of these products is estimated 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 categorised in Level 2 of the fair value hierarchy; in instances where significant inputs are unobservable, they are categorised in Level 3 of the fair value hierarchy.

OIS Fair Value Measurement. In the fourth quarter of 2010, the Group began using the overnight indexed swap ("OIS") curve as an input to value substantially all of its collateralised interest rate derivative contracts. The Group believes using the OIS curve, which reflects the interest rate typically paid on cash collateral, more accurately reflects the fair value of collateralised interest rate derivative contracts. Previously, the Group discounted these collateralised interest rate derivative contracts based on London Interbank Offered Rate ("LIBOR").

- *Financial assets and financial liabilities designated at fair value through profit or loss*

Prepaid OTC contracts and issued structured notes designated as fair value through profit or loss

The Group issues structured notes and trades prepaid OTC derivatives that have coupons or repayment terms linked to the performance of debt or equity securities, indices, currencies or commodities. Fair value of structured notes and prepaid OTC derivatives is estimated using calculation models for the derivative and debt portions of the notes. These models incorporate observable inputs referencing identical or comparable securities, including prices that the notes are linked to, interest rate yield curves, option volatility and currency, commodity or equity rates. Independent, external and traded prices for the notes are also considered. The impact of own credit spreads is also based on observed secondary bond market spreads. Most structured notes and prepaid OTC derivatives are categorised in Level 2 of the fair value hierarchy.

This includes financial liabilities such as those arising from the consolidation of certain special purpose entities and those that arise as a result of continuing recognition of certain assets, where the Group retains substantially all the risks and rewards of the transferred assets, and the simultaneous recognition of an associated liability. The fair value of these financial liabilities, which are effectively secured financing liabilities, is estimated using the appropriate valuation methodology for the related assets that continue to be recognised, adjusted for any differences between the assets that continue to be recognised and the liability that is simultaneously recognised. Generally these financial liabilities are recognised in Level 2 of the fair value hierarchy.

MORGAN STANLEY INTERNATIONAL LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS Year ended 31 December 2010

31. FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE (CONTINUED)

b. Changes in Level 3 financial assets and liabilities measured at fair value

The following table presents the changes in the fair value of the Group's Level 3 financial assets and financial liabilities for the year ended 31 December 2010:

2010 \$millions	Balance at 1 January 2010	Total gains or (losses) in profit or loss	Total gains or (losses) recognised in other comprehensive income	Purchases	Sales	Issuances	Settlements	Net transfers in and / or out of Level 3	Balance at 31 December (1)	Unrealised gains or (losses) for level 3 assets / liabilities outstanding as at 31 December 2010 (2)
Financial assets classified as held for trading:										
- Government debt securities	2	-	-	-	-	-	-	(2)	-	-
- Corporate equities	112	42	-	126	(177)	-	-	49	152	27
- Corporate and other debt	3,594	92	-	1,508	(1,761)	-	(137)	376	3,672	27
Total financial assets classified as held for trading	3,708	134	-	1,634	(1,938)	-	(137)	423	3,824	54
Financial assets designated at fair value through profit or loss										
	1,411	-	-	527	-	-	-	(1,409)	529	-
Available-for-sale financial assets:										
- Corporate equities	163	-	1	7	(24)	-	-	(71)	76	-
Total financial assets measured at fair value	5,282	134	1	2,168	(1,962)	-	(137)	(1,057)	4,429	54
Financial liabilities held for trading:										
- Government debt securities	-	-	-	-	-	-	-	-	-	-
- Corporate equities	(4)	1	-	-	(48)	-	49	(11)	(13)	1
- Corporate and other debt	(38)	4	-	-	(86)	-	79	9	(32)	-
- Net derivative contracts (3)	(1,531)	(33)	-	-	-	-	72	13	(1,479)	(313)
Total financial liabilities classified as held for trading	(1,573)	(28)	-	-	(134)	-	200	11	(1,524)	(312)
Financial liabilities designated at fair value through profit or loss										
	(892)	(167)	-	-	121	(105)	39	149	(855)	(258)
Total financial liabilities measured at fair value	(2,465)	(195)	-	-	(13)	(105)	239	160	(2,379)	(570)

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

(2) Amounts represent unrealized gains or (losses) for the year related to financial assets and liabilities still outstanding as at the end of the year.

(3) Net derivative contracts represent Financial assets classified as held for trading (derivative contracts) net of Financial liabilities classified as held for trading (derivative contracts).

MORGAN STANLEY INTERNATIONAL LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS Year ended 31 December 2010

31. FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE (CONTINUED)

b. Changes in Level 3 financial assets and liabilities measured at fair value (continued)

2009 \$millions	Balance at 1 January 2009	Total gains or (losses) at 1 recognised in profit or loss	Total gains or (losses) recognised in other comprehensive income	Purchases	Sales	Issuances	Settlements	Net transfers in and / or out of Level 3	Balance at 31 December (1)	Unrealised gains or (losses) for level 3 assets / liabilities outstanding as at 31 December 2009 (2)
Financial assets classified as held for trading:										
- Government debt securities	2	-	-	-	-	-	-	-	2	-
- Corporate equities	456	(63)	-	130	(131)	-	-	(280)	112	(34)
- Corporate and other debt	4,574	188	-	1,019	(996)	-	(123)	(1,068)	3,594	207
Total financial assets classified as held for trading	5,032	125	-	1,149	(1,127)	-	(123)	(1,348)	3,708	173
Financial assets designated at fair value through profit or loss										
	1,136	643	-	3	-	-	(288)	(83)	1,411	643
Available-for-sale financial assets:										
- Corporate equities	189	11	(3)	-	(38)	-	-	4	163	-
Total financial assets measured at fair value	6,357	779	(3)	1,152	(1,165)	-	(411)	(1,427)	5,282	816
Financial liabilities classified as held for trading:										
- Government debt securities	-	-	-	-	-	-	-	-	-	-
- Corporate equities	(37)	-	-	-	(10)	-	33	10	(4)	-
- Corporate and other debt	(320)	6	-	-	(18)	-	275	19	(38)	(24)
- Net derivative contracts (3)	(3,232)	1,547	-	-	-	-	(3)	157	(1,531)	1,041
Total financial liabilities classified as held for trading	(3,589)	1,553	-	-	(28)	-	305	186	(1,573)	1,017
Financial liabilities designated at fair value through profit or loss										
	(865)	30	-	-	-	(380)	565	(242)	(892)	30
Total financial liabilities measured at fair value	(4,454)	1,583	-	-	(28)	(380)	870	(56)	(2,465)	1,047

(1) For financial assets and financial liabilities that were transferred into and out of Level 3 during the year, gains or (losses) are presented as if the assets or liabilities had been transferred into or out of Level 3 as at the beginning of the year.
 (2) Amounts represent unrealized gains or (losses) for the year related to financial assets and liabilities still outstanding as at the end of the year.
 (3) Net derivative contracts represent Financial assets classified as held for trading (derivative contracts) net of Financial liabilities classified as held for trading (derivative contracts).

MORGAN STANLEY INTERNATIONAL LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS Year ended 31 December 2010

31. FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE (CONTINUED)

b. Changes in Level 3 financial assets and liabilities measured at fair value (continued)

As disclosed in the Directors' report the Morgan Stanley Group operates a number of intra-group policies to ensure that, where possible, revenues and related costs are matched. Where the trading positions included in the above gains or losses are risk managed using financial instruments across a number of Morgan Stanley Group entities, these policies potentially result in the recognition of offsetting gains or losses in the Group.

During the year, the Group reclassified approximately \$1,409 million of certain financial assets designated at fair value through profit and loss from Level 3 to Level 2. The Group reclassified these hybrid contracts as external prices became observable and the remaining unobservable inputs were deemed insignificant to the overall measurement.

During the year ended 31 December 2009, the Group reclassified approximately \$772 million of derivative contracts and corporate and other debt from Level 3 to Level 2. The reclassifications primarily related to debt linked bonds and interests in hedge funds and were due to an increase in market price quotations for these or comparable instruments, such that observable inputs were utilised for the fair value measurement. In addition, the Group reclassified \$1,088 million of loans and advances to customers from Level 3 to Level 2. The reclassifications were mainly related to residential mortgages and were due to an increase in market price transparency of comparable instruments and portfolio specific refinancing activities which enables the significant observable inputs to be sourced from the market and specific transactional activities to be utilised for the fair value measurement.

c. Significant transfers between Level 1 and Level 2 of the fair value hierarchy

During the year, there were no significant reclassifications between Level 1 and Level 2.

d. Sensitivity of fair values to changing significant assumptions to reasonably possible alternatives

All financial instruments are valued in accordance with the techniques outlined in the fair value hierarchy disclosure above. Some of these techniques, including those used to value instruments categorised in Level 3 of the fair value hierarchy, are dependent on unobservable parameters and the fair value for these financial instruments has been determined using parameters appropriate for the valuation methodology based on prevailing market evidence. It is recognised that the unobservable parameters could have a range of reasonably possible alternative values.

In estimating the change in fair value, the unobservable parameters were varied to the extremes of the ranges of reasonably possible alternatives using statistical techniques, such as dispersion in comparable observable external inputs for similar asset classes, historic data or judgement if a statistical technique is not appropriate. Where a financial instrument has more than one unobservable parameter, the sensitivity analysis reflects the greatest increase or decrease to fair value by varying the assumptions individually. It is unlikely that all unobservable parameters would concurrently be at the extreme range of possible alternative assumptions and therefore the sensitivity shown below is likely to be greater than the actual uncertainty relating to the financial instruments.

MORGAN STANLEY INTERNATIONAL LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS Year ended 31 December 2010

31. FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE (CONTINUED)

d. Sensitivity of fair values to changing significant assumptions to reasonably possible alternatives (continued)

The following table presents the sensitivity of the fair value of Level 3 financial assets and financial liabilities as at 31 December 2010 to reasonably possible alternative assumptions.

2010	Fair value \$millions	Effect of reasonably possible alternative assumptions	
		Increase in fair value \$millions	Decrease in fair value \$millions
Financial assets classified as held for trading:			
- Government debt securities	-	-	-
- Corporate equities	152	3	(3)
- Corporate and other debt	3,672	223	(222)
Financial assets designated at fair value through profit or loss:			
- Prepaid OTC contracts	-	-	-
- Structured notes	-	-	-
- Other	529	11	(6)
Available-for-sale financial assets:			
- Corporate equities	76	11	(6)
Financial liabilities classified as held for trading:			
- Government debt securities	-	-	-
- Corporate equities	(13)	-	(1)
- Corporate and other debt	(32)	1	(1)
- Net derivatives contracts ⁽¹⁾	(1,479)	128	(148)
Financial liabilities designated at fair value through profit or loss:			
- Prepaid OTC contracts	(3)	-	-
- Structured notes	-	-	-
- Other	(852)	8	(8)

(1) Net derivative contracts represent Financial assets classified as held for trading (derivative contracts) net of Financial liabilities classified as held for trading (derivative contracts).

MORGAN STANLEY INTERNATIONAL LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
Year ended 31 December 2010

31. FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE (CONTINUED)

**d. Sensitivity of fair values to changing significant assumptions to reasonably possible alternatives
(continued)**

	2009	Effect of reasonably possible alternative assumptions		
		Fair value \$millions	Increase in fair value \$millions	Decrease in fair value \$millions
Financial assets classified as held for trading:				
- Government debt securities	2	-	-	-
- Corporate equities	112	3	(5)	
- Corporate and other debt	3,594	150	(137)	
Financial assets designated at fair value through profit or loss:				
- Prepaid OTC contracts	1,411	8	(8)	
Available-for-sale financial assets:				
- Corporate equities	163	-	-	
Financial liabilities classified as held for trading:				
- Government debt securities	-	-	-	-
- Corporate equities	(4)	-	-	
- Corporate and other debt	(38)	3	(6)	
- Net derivatives contracts ⁽¹⁾	(1,531)	217	(206)	
Financial liabilities designated at fair value through profit or loss:				
- Prepaid OTC contracts	(188)	1	(1)	
- Structured notes	(64)	1	(1)	
- Other	(640)	30	(30)	

(1) Net derivative contracts represent Financial assets classified as held for trading (derivative contracts) net of Financial liabilities classified as held for trading (derivative contracts).

MORGAN STANLEY INTERNATIONAL LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS Year ended 31 December 2010

31. FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE (CONTINUED)

e. Financial instruments valued using unobservable market data

The amounts not recognised in the consolidated profit and loss account relating to the difference between the fair value at initial recognition (the transaction price) and the amounts determined at initial recognition using valuation techniques are as follows:

	2010 \$millions	2009 \$millions
At 1 January	215	281
New transactions	94	42
Amounts recognised in the consolidated profit and loss account during the year	(49)	(108)
At 31 December	<u>260</u>	<u>215</u>

The balance above predominantly relates to derivatives.

The balance sheet categories 'Financial assets and financial liabilities classified as held for trading', 'Financial assets and financial liabilities designated at fair value', and 'Available-for-sale financial assets' include financial instruments whose fair value is based on valuation techniques using unobservable market data.

32. FINANCIAL INSTRUMENTS NOT MEASURED AT FAIR VALUE

For all financial assets and financial liabilities not recognised at fair value, the carrying amount is considered to be a reasonable approximation of fair value due to the short term nature of these financial assets and liabilities, except for the following:

	31 December 2010	Carrying value \$millions	Fair value \$millions	Unrecognised gain / (loss) \$millions
Financial assets				
Termed reverse repurchase agreements	71,990	72,016	26	
Corporate Loans	3,200	3,235	35	
Financial liabilities				
Subordinated loans	10,571	8,551	2,020	
Termed repurchase agreements	72,147	72,151	(4)	
	31 December 2009	Carrying value \$millions	Fair value \$millions	Unrecognised gain / (loss) \$millions
Financial assets				
Termed reverse repurchase agreements	75,352	75,354	2	
Financial liabilities				
Subordinated loans	10,591	8,476	2,115	
Termed repurchase agreements	59,262	59,267	(5)	

The fair value for subordinated loans has been determined based on the assumption that all subordinated loans are held to the latest repayment date, although the amounts outstanding are repayable at any time at the Group's option, subject to seven business days' notice to the FSA, which has the right to refuse consent to repayment.

MORGAN STANLEY INTERNATIONAL LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS Year ended 31 December 2010

33. CAPITAL MANAGEMENT

The Morgan Stanley Group manages its capital on a global basis with consideration for each individual legal entity. The capital managed by the Morgan Stanley Group broadly includes ordinary share capital, preference share capital, subordinated loans and reserves.

The Morgan Stanley Group also uses an economic capital framework. The economic capital framework estimates the amount of equity capital required to support the businesses over a wide range of market environments while simultaneously satisfying regulatory, rating agency and investor requirements. The framework will evolve over time in response to changes in the business and regulatory environment and to incorporate enhancements in modelling techniques. Economic capital is based on regulatory capital usage plus additional capital for stress losses.

The Morgan Stanley Group's objectives when managing global capital are:

- to comply with the capital requirements of the Board of Governors of the Federal Reserve System of the United States; and
- to minimise capital within a legal entity whilst safeguarding that entity's ability to continue as a going concern, so that it can continue to provide returns for the Morgan Stanley Group.

The Morgan Stanley Group sets the amount of capital for each entity in proportion to its risk and in line with regulatory requirements.

The Group actively manages its capital structure and makes adjustments to it in the light of changing economic conditions and the risk characteristics of the underlying assets and liabilities. In order to maintain or adjust the capital structure, the Group may adjust the amount of dividends paid, return capital to shareholders, issue new shares, issue or repay subordinated debt or sell assets to reduce debt.

The Group is regulated by the Financial Services Authority ("FSA") and as such is subject to minimum capital and liquidity requirements. The Group's capital and liquidity is monitored on an ongoing basis to ensure compliance with the rules within the FSA's General Prudential Sourcebook. At a minimum, the Group must ensure that Capital Resources (share capital, subordinated debt, audited profit and loss and eligible reserves) are greater than the Capital Resource Requirement covering credit, market and operational risk and that liquidity exceeds regulatory requirements. The Group's capital and liquidity exceeded all of its regulatory requirements during the period.

In December 2010, the Basel Committee on Banking Supervision published the final rules text on a comprehensive set of reform measures, developed to strengthen the regulation, supervision and risk management of the banking sector ("the Basel III Framework").

The Basel III Framework covers both microprudential and macroprudential elements. It sets out requirements for higher and better-quality capital, better risk coverage, the introduction of a leverage ratio as a backstop to the risk-based requirement, measures to promote the build up of capital that can be drawn down in periods of stress, and the introduction of two global liquidity standards. The Morgan Stanley Group is currently working to ensure compliance with these new regulatory standards as they are implemented from end-2011 onwards.

The Group considers the below to be its managed capital:

	2010 \$millions	2009 \$millions
Ordinary share capital	1,614	1,614
Subordinated loans	10,571	10,591
Reserves	12,403	9,143
	<u>24,588</u>	<u>21,348</u>

During 2010, the Group has continued to review and actively manage its capital position. As part of this capital management, the Group received a capital contribution of \$3,000 million, and paid ordinary dividends of \$1,000 million. The movement in subordinated loan agreements during the year relate to the translation of non US dollar loans into US Dollars.

MORGAN STANLEY INTERNATIONAL LIMITED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS **Year ended 31 December 2010**

34. RELATED PARTY TRANSACTIONS

The Group is exempt from the requirement to disclose transactions with fellow wholly owned Morgan Stanley Group undertakings under paragraph 3(c) of Financial Reporting Standard 8 *Related Party Disclosures*.

There were no other related party transactions requiring disclosure.

35. POST BALANCE SHEET EVENTS

Bank levy

In July 2011, the UK Government enacted legislation imposing a bank levy on relevant liabilities and equities on the consolidated balance sheets of “UK Banking Groups,” as defined under the bank levy legislation at 31 December 2011. The Group continues to evaluate the impact of this legislation, and estimates the UK Banking Group will incur a full year charge of \$125 million, of which the Group will incur \$120 million. Due to the bank levy being determined on relevant liabilities and equities at 31 December 2011, the final charge may differ from this estimate. The levy is not deductible for UK Corporation Tax purposes.

Dividends

On 9 August 2011, the Company paid an interim dividend of \$2,000 million to the holders of its ordinary shares. This dividend has not been accrued in the financial statements. The dividend has been paid out of the capital contribution reserve.

MORGAN STANLEY INTERNATIONAL LIMITED
Registration No. 3584019

COMPANY BALANCE SHEET
As at 31 December 2010

	Note	2010 \$millions	2009 \$millions
FIXED ASSETS			
Investments	3	4,113	4,113
CURRENT ASSETS			
Debtors	4	8,396	10,960
CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR	5	(5,247)	(11,073)
NET CURRENT ASSETS / (LIABILITIES)		<u>3,149</u>	<u>(113)</u>
TOTAL ASSETS LESS CURRENT LIABILITIES		<u>7,262</u>	<u>4,000</u>
CREDITORS: AMOUNTS FALLING DUE AFTER MORE THAN ONE YEAR	6	(1,322)	(1,900)
		<u>5,940</u>	<u>2,100</u>
CAPITAL AND RESERVES			
Called up share capital	7	1,614	1,614
Capital contribution reserve	8	3,138	138
Profit and loss account	8	1,188	348
EQUITY SHAREHOLDERS' FUNDS		<u>5,940</u>	<u>2,100</u>

These financial statements were approved by the Board and authorised for issue on 27 September 2011.

Signed on behalf of the Board

Director


L GPM Francois.

The notes on pages 83 to 88 form an integral part of the financial statements.

MORGAN STANLEY INTERNATIONAL LIMITED

NOTES TO THE COMPANY FINANCIAL STATEMENTS Year ended 31 December 2010

1. ACCOUNTING POLICIES

The Company's principal accounting policies are summarised below and have been applied consistently throughout the year and preceding year.

a) Basis of preparation

The financial statements are prepared under the historical cost convention and in accordance with applicable United Kingdom company law and accounting standards.

b) The going concern assumption

The Company's business activities, together with the factors likely to affect its future development, performance and position, are reflected in the Business Review section of the Directors' report on pages 1 to 9.

As set out in the Directors' report, the Company is parent to a group of companies with a significant level of capital and resources, and operates within the global liquidity management framework of the Morgan Stanley Group. Throughout the difficult market conditions, this framework has continued to provide sufficient liquidity to the Morgan Stanley Group and to the Company, and the Company's capital and liquidity position is satisfactory.

Taking all of these factors into consideration, the Directors believe it is reasonable to assume that the Company will have access to adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the annual report and financial statements.

c) Functional currency

Items included in the financial statements are measured and presented in US dollars, the currency of the primary economic environment in which the Company operates.

All currency amounts in the Company accounts and the notes to the Company accounts are rounded to the nearest million US dollars.

d) Foreign currencies

All monetary assets and liabilities denominated in currencies other than US dollars are translated into US dollars at the rates ruling at the balance sheet date. Transactions in currencies other than US dollars are recorded at the rates prevailing at the dates of the transactions. Foreign exchange differences on monetary fixed asset investments are taken through the profit and loss account and are presented in 'Net gains/ losses from fixed asset investments'. All other translation differences are taken through the profit and loss account and are presented in 'Other income' or 'Other expense'.

e) Recognition of income and expense

i) Interest income and expense

Interest income and interest expense are recognised on an accruals basis within 'Interest income' and 'Interest expense' in the profit and loss account.

ii) Dividend income

Dividend income from fixed asset investments is recognised when the Company's right to receive payment is established.

f) Fixed asset investments

Fixed asset investments are stated at cost, less provision for any impairment.

MORGAN STANLEY INTERNATIONAL LIMITED

NOTES TO THE COMPANY FINANCIAL STATEMENTS **Year ended 31 December 2010**

1. ACCOUNTING POLICIES (CONTINUED)

g) Taxation

UK corporation tax is provided at amounts expected to be paid / recovered using the tax rates and laws that have been enacted or substantively enacted at the balance sheet date.

Full provision has been made for deferred tax assets and liabilities arising from timing differences. Deferred tax is measured using the average tax rates that are expected to apply in the periods in which the timing differences are expected to reverse, based on tax rates and laws that have been enacted or substantively enacted by the balance sheet date. Deferred tax assets are recognised to the extent that it is regarded as more likely than not that they will be recovered. Deferred tax assets and liabilities are not discounted.

Current tax assets are offset against current tax liabilities when there is a legally enforceable right to offset current tax assets against current tax liabilities and when they relate to taxes levied by the same taxation authority and the Company intends to settle its current tax assets and current tax liabilities on a net basis. Deferred tax assets are offset against deferred tax liabilities to the extent that they relate to taxes levied by the same tax authority and arise in the same taxable entity.

h) Cash flow statement

The Company's ultimate parent undertaking produces consolidated cash flow statements in which the Company is included and which are publicly available. Accordingly, the Company, which is a wholly-owned subsidiary, has elected to avail itself of the exemption provided in Financial Reporting Standard ("FRS") 1 (Revised 1996) *Cash flow statements* and not present a cash flow statement.

2. PROFIT FOR THE YEAR

The Company has taken advantage of the exemption, as permitted by section 408 of the Companies Act 2006, from presenting its own profit and loss account and related notes. The Company's profit after taxation for the year ended 31 December 2010 was \$1,840 million (2009: \$53 million loss). During the year an interim dividend of \$1,000 million was paid to the holders of the ordinary shares (2009: \$nil). A net profit after dividends of \$840 million has been carried to reserves (2009: \$53 million loss carried to reserves).

MORGAN STANLEY INTERNATIONAL LIMITED

NOTES TO THE COMPANY FINANCIAL STATEMENTS Year ended 31 December 2010

3. FIXED ASSET INVESTMENTS

The Company's investments in subsidiary undertakings are as follows:

Cost and net book value	\$millions
At 31 December 2010 and 2009	<u>4,113</u>

The principal subsidiary undertakings of the Company are as follows:

Name of company	Country of incorporation	Proportion of shares held	Type of shares held	Proportion of voting rights	Nature of business
Morgan Stanley & Co. International plc	England and Wales	100%	Ordinary shares*	100%	Financial services
Morgan Stanley & Co. Limited	England and Wales	100%	Ordinary shares*	100%	Financial services
Morgan Stanley Bank International Limited	England and Wales	100%	Ordinary shares*	100%	Financial services
Morgan Stanley Equity Finance (Malta) Limited	England and Wales	100%	Ordinary shares*	100%	Financial services
Morgan Stanley Group (Europe)	England and Wales	100%	Ordinary shares	100%	Intermediate holding company
Morgan Stanley Investment Management Limited	England and Wales	100%	Ordinary shares*	100%	Financial services
Morgan Stanley Securities Limited	England and Wales	100%	Ordinary shares*	100%	Financial services
Morgan Stanley Strategic Funding Limited	England and Wales	100%	Ordinary shares	100%	Funding company
Morgan Stanley UK Group	England and Wales	100%	Ordinary shares*	100%	Service company
Morgan Stanley UK Limited	England and Wales	100%	Ordinary shares*	100%	Service company
OOO Morgan Stanley Bank	Russian Federation	100%	Participation shares*	100%	Financial services

An * denotes shareholdings attributed to the Company which are held indirectly by the Company.

A full list of the Company's subsidiary and associate undertakings will be annexed to the Company's next Annual Return and filed with the Registrar of Companies.

MORGAN STANLEY INTERNATIONAL LIMITED

NOTES TO THE COMPANY FINANCIAL STATEMENTS Year ended 31 December 2010

4. DEBTORS

	2010 \$millions	2009 \$millions
Amounts due from Morgan Stanley Group undertakings	1,494	1,608
Amounts due from Group undertakings	6,902	9,352
	<u>8,396</u>	<u>10,960</u>

5. OTHER CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR

	2010 \$millions	2009 \$millions
Amounts owing to Morgan Stanley Group undertakings	567	4,714
Amounts owing to Group undertakings	4,680	6,359
	<u>5,247</u>	<u>11,073</u>

6. CREDITORS: AMOUNTS FALLING DUE AFTER MORE THAN ONE YEAR

	2010 \$millions	2009 \$millions
Subordinated loan agreements	1,300	1,300
Amounts due to Group undertakings		
- Long term loan	22	600
	<u>1,322</u>	<u>1,900</u>

The amounts subject to subordinated loan agreements are wholly repayable as shown below:

Counterparty	Repayment date	Interest rate	2010 \$millions	2009 \$millions
Morgan Stanley International Holdings Inc.	31 October 2021	6 month LIBOR plus 1.25%	1,300	1,300
			<u>1,300</u>	<u>1,300</u>
			<u>1,300</u>	<u>1,300</u>

All amounts outstanding under subordinated loan agreements are repayable at any time at the Company's option, subject to prior consent from the Financial Services Authority ("FSA"), which has the right under the agreement to refuse consent to repayment.

The Company has not had any defaults of principal, interest or other breaches with respect to its subordinated loans during the year.

MORGAN STANLEY INTERNATIONAL LIMITED

NOTES TO THE COMPANY FINANCIAL STATEMENTS Year ended 31 December 2010

6. CREDITORS: AMOUNTS FALLING DUE AFTER MORE THAN ONE YEAR (CONTINUED)

Details of the remaining balance of the long-term loan as at 31 December 2010 is as follows:

Counterparty	Repayment date	Interest rate	2010 \$millions	2009 \$millions
Morgan Stanley Finance (C.I.) Limited	Repayable on thirteen months notice by the counterparty	LIBOR-related managed rate	22	600
			<u>22</u>	<u>600</u>

On 15 November 2010, the Company repaid \$578 million of the long term loan to Morgan Stanley Finance (C.I.) Limited.

7. CALLED UP SHARE CAPITAL

	2010 \$millions	2009 \$millions
Allotted and fully paid:		
Equity shares		
2 ordinary shares of £1 each		
1,614,167,000 ordinary shares of \$1 each	<u>1,614</u>	<u>1,614</u>
	<u>1,614</u>	<u>1,614</u>

All ordinary shares are recorded at the rate of exchange ruling at the date the shares were paid up.

8. RECONCILIATION OF SHAREHOLDERS' FUNDS AND MOVEMENTS ON RESERVES

	Called up share capital \$millions	Capital contribution reserve \$millions	Profit and loss account \$millions	Total \$millions
At 1 January 2009	1,614	138	401	2,153
Loss for the year	-	-	(53)	(53)
At 31 December 2009	1,614	138	348	2,100
Profit for the year	-	-	1,840	1,840
Capital contribution from parent company	-	3,000	-	3,000
Dividends paid	-	-	(1,000)	(1,000)
At 31 December 2010	1,614	3,138	1,188	5,940

MORGAN STANLEY INTERNATIONAL LIMITED

NOTES TO THE COMPANY FINANCIAL STATEMENTS **Year ended 31 December 2010**

8. RECONCILIATION OF SHAREHOLDERS' FUNDS AND MOVEMENTS ON RESERVES (CONTINUED)

Capital contribution reserve

The opening capital contribution reserve balance is non-distributable and was received from the Group's former immediate parent undertaking, to finance various Group acquisitions. On 30 November 2010, the Company's immediate parent undertaking, Morgan Stanley International Holdings Inc, made a capital contribution of \$3,000 million to finance Group operations, and this is classified as a distributable reserve.

9. COMMITMENTS AND CONTINGENCIES

The Company has provided a letter of financial support to two Morgan Stanley Group undertakings. In addition these undertakings have letters of support from the Group's ultimate parent. This support has not been called upon. It is considered unlikely that the letters of support would be called upon as these undertakings are funded by short-term loans from other Morgan Stanley Group undertakings. The maximum amount of support potentially required by the Company is \$12,800 million, before taking into account the support provided to these entities by the Group's ultimate parent Morgan Stanley.

10. RELATED PARTY TRANSACTIONS

The Company is exempt from the requirement to disclose transactions with fellow wholly owned Morgan Stanley undertakings under paragraph 3(c) of FRS 8 *Related Party Disclosures*. There were no other related party transactions requiring disclosure.

11. PARENT UNDERTAKINGS

The Company's ultimate parent undertaking and controlling entity, and the largest group of which the Group is a member and for which group financial statements are prepared, is Morgan Stanley. The Company's immediate controlling party is Morgan Stanley International Holdings Inc. Both Morgan Stanley and Morgan Stanley International Holdings Inc are registered and incorporated in Delaware, the United States of America and copies of their financial statements can be obtained from 25 Cabot Square, Canary Wharf, London E14 4QA.

12. POST BALANCE SHEET EVENTS

Dividends

On 9 August 2011, the Company paid an interim dividend of \$2,000 million to the holders of its ordinary shares. This dividend has not been accrued in the financial statements. The dividend has been paid out of the capital contribution reserve.