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MORGAN STANLEY & CO. INTERNATIONAL plc

Half-yearly financial report

30 June 2009

MORGAN STANLEY & CO. INTERNATIONAL plc

INTERIM MANAGEMENT REPORT

The Directors present their interim management report and the consolidated condensed financial statements of Morgan Stanley and Co. International plc (the “Company”) and all of its subsidiary and associated undertakings (together the “Group”), for the six months ended 30 June 2009. This interim report has been prepared for the Group as a whole and therefore gives greater emphasis to those matters which are significant to the Company and its subsidiary and associated undertakings when viewed as a whole.

The Company changed its accounting reference date from 30 November to 31 December on 18 December 2008, to align with the changed year end of its ultimate parent undertaking, Morgan Stanley. Accordingly, these condensed financial statements are for the six months to 30 June 2009. With the exception of the comparatives for the condensed consolidated statement of financial condition, which are as at 31 December 2008, the comparative figures reflected in the interim management report and condensed financial statements are for the six months to May 2008, which is considered comparable for the purposes of IAS 34 “*Interim Financial Reporting*”.

The interim management report contains certain forward-looking statements. These statements are made by the Directors in good faith based on the information available at the time of their approval of this report and such statements should be treated with caution due to the inherent uncertainties, including both economic and business risk factors, underlying any such forward-looking information.

RESULTS AND DIVIDENDS

The Group’s profit for the six months to 30 June 2009, after tax, is \$761 million (31 May 2008: \$1,237 million profit). During the six month period, no dividends were paid on the ordinary shares (31 May 2008: \$nil).

PRINCIPAL ACTIVITY AND BUSINESS REVIEW

The principal activity of the Group is the provision of financial services to corporations, governments, financial institutions and individual investors. As part of the previously announced transaction to combine Morgan Stanley’s Global Wealth Management Group (“GWM”) and the businesses of Citigroup Inc’s Smith Barney operations, the Group’s European GWM introducing broker activities were reorganised and transferred to a consolidated joint venture Morgan Stanley Smith Barney LLC (“MSSB”) (see note 9) from 1 June 2009. Other than disclosed above, there have not been any significant changes in the Group’s principal activities in the period under review and no significant change in the Group’s principal business is expected. The Company is authorised and regulated by the Financial Services Authority (“FSA”).

The Company operates branches in Korea, France, Greece, the Netherlands, the Dubai International Financial Centre, the Qatar Financial Centre and New Zealand. The Company’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 (the “Morgan Stanley Group”).

The Group’s operating performance for the six month period to 30 June 2009 is not as strong as the prior interim period to 31 May 2008 as the Group continues to be impacted by challenging market conditions. The condensed consolidated income statement for the period is set out on page 7. Comparing the six months to 30 June 2009 to the six months to 31 May 2008, the Group’s profit for the period decreased by \$476 million to \$761 million, a decrease of 38%. As noted in the 2008 report and financial statements, the Group’s revenues continue to be impacted by the difficult market conditions in all businesses during the period. Equity sales and trading revenues have declined significantly compared to the prior interim period, partially offset by gains in Fixed Income sales and trading. The Group’s revenues have also been negatively impacted by the narrowing of own credit spreads on certain of the Group’s issued financial instruments that are accounted for at fair value. The Group’s net interest expense has reduced by 45% to \$516 million. Interest income and interest expense have reduced by 79% and 76% respectively. This decrease is driven by significant reductions in the stock lending and repurchase and reverse repurchase agreements asset and liability positions, when compared to 31 May 2008, coupled with declining interest rates. The Group’s other expenses have reduced by 19%. Other expenses have reduced in all areas, with significant reductions in brokerage costs and staff costs compared to the prior interim period. The Morgan Stanley Group operates a number of intra-group policies to ensure that, where possible, revenues and related costs are matched. In the current interim period this has resulted in losses being incurred on other Morgan Stanley Group entities that would otherwise have been transferred to the Group, thereby reducing the impact of the current market conditions on the Group’s results. Further details on these policies are contained in note 7 of the condensed consolidated financial statements. These policies are currently under review. If changes are made to these policies, the results of the Group in the future may be less than otherwise would be the case.

INTERIM MANAGEMENT REPORT (CONTINUED)

The Group is involved with various entities in the normal course of business that may be deemed to be 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 30 June 2009 the total assets of SPEs in which the Group has an interest, but which are not consolidated by the Group, are \$4,098 million (31 December 2008: \$7,673 million) and the Group's maximum exposure to loss relating to such SPEs is \$61 million (31 December 2008: \$124 million). The Group's consolidated statement of financial position includes \$3,046 million (31 December 2008: \$3,639 million) of assets arising from consolidated SPEs. The Group's maximum exposure to loss relating to these assets is \$1,507 million (31 December 2008: \$2,073 million).

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 business 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.

The Group's trading VaR at 30 June 2009 was \$50 million compared with \$27 million at 31 December 2008. The increase in trading VaR is primarily due to increased interest rate risks combined with higher exposures to emerging market currencies. The overall change in VaR reflects the Group's strategy across its businesses to take advantage of the opportunities presented by market conditions.

Credit risk

Credit risk refers to the risk of loss arising from a borrower or counterparty default when a borrower, counterparty or obligor is unable to meet its financial obligations. The Morgan Stanley Group manages credit risk exposure in consideration of each individual legal entity, but on a global basis, 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.

MORGAN STANLEY & CO. INTERNATIONAL plc

RESPONSIBILITY STATEMENT

We, the directors listed below, confirm that to the best of our knowledge:

- (a) the condensed set of financial statements have been prepared in accordance with IAS 34 'Interim Financial Reporting' as adopted by the EU; and
- (b) in accordance with 4.2.7R of the Disclosure and Transparency Rules, the interim management report includes a fair review of the important events that have occurred during the period and their impact on the condensed financial statements and provides a description of the principal risks and uncertainties for the remaining six months of the financial year.

By order of the Board on 26 August 2009

Director

Board of Directors:

C D S Bryce
W A Chammah (Chairman and Chief Executive Officer)
A Classen
R Hoornweg
D R Nicol
F R Petitgas
D Siniscalco
C E Woodman

INDEPENDENT REVIEW REPORT TO MORGAN STANLEY & CO. INTERNATIONAL plc

We have been engaged by the Company to review the condensed set of financial statements in the half-yearly financial report for the six months ended 30 June 2009 which comprises the condensed consolidated income statement, the condensed consolidated statement of comprehensive income, the condensed consolidated statement of changes in equity, the condensed consolidated statement of financial position, the condensed consolidated statement of cash flows and related notes 1 to 9. We have read the other information contained in the half-yearly financial report and considered whether it contains any apparent misstatements or material inconsistencies with the information in the condensed set of financial statements.

This report is made solely to the Company in accordance with International Standard on Review Engagements (UK and Ireland) 2410 issued by the Auditing Practices Board. Our work has been undertaken so that we might state to the Company those matters we are required to state to them in an independent review 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, for our review work, for this report, or for the conclusions we have formed.

Directors' responsibilities

The half-yearly financial report is the responsibility of, and has been approved by, the Directors. The Directors are responsible for preparing the half-yearly financial report in accordance with the Disclosure and Transparency Rules of the United Kingdom's Financial Services Authority.

As disclosed in note 1, the annual financial statements of the Group are prepared in accordance with IFRSs as adopted by the European Union. The condensed set of financial statements included in this half-yearly financial report has been prepared in accordance with International Accounting Standard 34 "*Interim Financial Reporting*", as adopted by the European Union.

Our responsibility

Our responsibility is to express to the Company a conclusion on the condensed set of financial statements in the half-yearly financial report based on our review.

Scope of review

We conducted our review in accordance with International Standard on Review Engagements (UK and Ireland) 2410, "*Review of Interim Financial Information Performed by the Independent Auditor of the Entity*", issued by the Auditing Practices Board for use in the United Kingdom. A review of interim financial information consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical procedures and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing (UK and Ireland) and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the condensed set of financial statements in the half-yearly financial report for the six months ended 30 June 2009 is not prepared, in all material aspects, in accordance with International Accounting Standard 34 as adopted by the European Union and the Disclosure and Transparency Rules of the United Kingdom's Financial Services Authority.

Deloitte LLP

Deloitte LLP

Chartered Accountants and Statutory Auditors

London

26 August 2009

Notes:

- a. Neither an audit nor a review provides assurance on the maintenance of information presented on a website, including controls used to achieve this, and in particular whether any changes may have occurred to the financial statements since first published. These matters are the responsibility of the directors but no control procedures can provide absolute assurance in this area.
- b. Legislation in the United Kingdom governing the preparation and dissemination of financial information differs from legislation in other jurisdictions.

MORGAN STANLEY & CO. INTERNATIONAL plc

CONDENSED CONSOLIDATED INCOME STATEMENT

Six months ended 30 June 2009

	Note	Six months ended 30 June 2009 \$millions (unaudited)	Six months ended 31 May 2008 \$millions (unaudited)
Net gains on financial instruments held for trading		3,723	3,845
Net (losses) / gains on financial instruments designated at fair value through profit or loss		(517)	527
Net gains on available-for-sale financial assets		-	-
Interest income		2,288	10,719
Interest expense		(2,804)	(11,650)
Other operating income		95	162
Other operating expense		(1,647)	(2,036)
OPERATING PROFIT		1,138	1,567
Share of losses of associates		-	(23)
Net gain on disposal of subsidiaries		-	41
PROFIT BEFORE INCOME TAX		1,138	1,585
Income tax expense	2	(377)	(348)
PROFIT FOR THE PERIOD		761	1,237
Attributable to:			
Equity holders of the Company		759	1,237
Minority interest		2	-
PROFIT FOR THE PERIOD		761	1,237

All operations were continuing in the current and prior period.

The notes on pages 12 to 35 form an integral part of the condensed financial statements.

MORGAN STANLEY & CO. INTERNATIONAL plc

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY Six months ended 30 June 2009

	Share capital	Share premium	Currency translation reserve	Capital redemption reserve	Capital contribution reserve	Fair value reserve	Retained earnings	Equity attributable to equity holders	Minority interest	Total equity
	\$millions	\$millions	\$millions	\$millions	\$millions	\$millions	\$millions	\$millions	\$millions	\$millions
	(unaudited)	(unaudited)	(unaudited)	(unaudited)	(unaudited)	(unaudited)	(unaudited)	(unaudited)	(unaudited)	(unaudited)
Balance at 1 December 2007	4,328	513	(64)	149	3	3	3,068	8,000	63	8,063
Total comprehensive income	-	-	(24)	-	-	10	1,237	1,223	-	1,223
Capital infusion	-	-	-	-	-	-	-	-	13	13
Balance at 31 May 2008	4,328	513	(88)	149	3	13	4,305	9,223	76	9,299
<hr/>										
Balance at 1 January 2009	4,328	513	(22)	149	3	2	3,098	8,071	67	8,138
Total comprehensive income	-	-	41	-	-	(7)	759	793	2	795
Share-based payments	-	-	-	-	-	-	1	1	-	1
Net capital contribution	-	-	-	-	-	-	50	50	-	50
Balance at 30 June 2009	4,328	513	19	149	3	(5)	3,908	8,915	69	8,984

The notes on pages 12 to 35 form an integral part of the condensed financial statements.

MORGAN STANLEY & CO. INTERNATIONAL plc

CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS

As at 30 June 2009

	Note	Six months ended 30 June 2009 \$millions (unaudited)	Six months ended 31 May 2008 \$millions (unaudited)
NET CASH FLOWS (USED IN) / FROM OPERATING ACTIVITIES	3(b)	(7,302)	8,174
INVESTING ACTIVITIES			
Purchase of property, plant and equipment		(1)	(3)
Proceeds from sale of property, plant and equipment		2	-
Purchase of available-for-sale investments		(4)	(5,899)
Proceeds from disposal of associate		3	140
Proceeds from sale of available-for-sale investments		19	9
Acquisition of subsidiaries net of cash		(2)	(7)
Capital contribution arising from MSSB joint venture	9	50	-
NET CASH FLOWS FROM / (USED IN) INVESTING ACTIVITIES		<u>67</u>	<u>(5,760)</u>
FINANCING ACTIVITIES			
Interest paid on subordinated loans		(190)	-
Capital infusion by minority interest		-	13
NET CASH FLOWS (USED IN) / FROM FINANCING ACTIVITIES		<u>(190)</u>	<u>13</u>
NET (DECREASE) / INCREASE IN CASH AND CASH EQUIVALENTS		(7,425)	2,427
Currency translation differences on foreign currency cash balances		197	239
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE PERIOD		<u>19,537</u>	<u>20,346</u>
CASH AND CASH EQUIVALENTS AT THE END OF THE PERIOD	3(a)	<u>12,309</u>	<u>23,012</u>

The notes on pages 12 to 35 form an integral part of the condensed financial statements.

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE CONDENSED FINANCIAL STATEMENTS
Six months ended 30 June 2009

1. BASIS OF PREPARATION (CONTINUED)

ii Accounting policies (continued)

New standards and interpretations issued by the IASB and not endorsed by the EU

Amendments to IFRS 7 '*Financial Instruments: Disclosures*'; *Improving disclosures about financial instruments* was issued by the IASB in March 2009 for application in accounting periods beginning on or after 1 January 2009. The amendment will be applied by the Group once it has been endorsed by the EU. The Group has early adopted certain aspects of the amendments to IFRS 7 in order to improve the Group's financial reporting.

As part of the 2009 Annual Improvements to IFRS, the IASB made an amendment to IAS 39 '*Financial Instruments: Recognition and Measurement*' for application in accounting periods beginning on or after 1 January 2010. The amendment will be applied by the Group once it has been endorsed by the EU.

iii Use of estimates and sources of uncertainty

The preparation of financial information requires the Group to make estimates and assumptions regarding the valuation of certain financial instruments, the outcome of litigation, pension obligations and other matters that affect the financial statements and related disclosures. The Group believes that the estimates utilised in preparing the financial statements are prudent and reasonable. Actual results could differ materially from these estimates.

2. TAX EXPENSE

The Group's tax expense for the period has been accrued based on the expected tax rate of 33.1% for the period to 30 June 2009 (31 May 2008: 21.96%). This takes into account current expectations concerning allocation of group relief within the Morgan Stanley UK tax group and prevailing tax rates in the jurisdictions in which the Group operates.

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE CONDENSED FINANCIAL STATEMENTS
Six months ended 30 June 2009

4. SEGMENT 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's Global Wealth Management and Asset Management segments also provide some services through the Group. For the thirteen month period ended 31 December 2008, these segments were considered reportable segments for the Group for the first time, as their reported profit or loss exceeded 10% of the Group's profit or loss. Based on the Group's results for the six months ended 30 June 2009, these segments no longer meet the threshold to be considered reportable segments under IFRS 8 'Operating Segments'. Accordingly the results for these segments are presented within 'Other' in the tables below for both the current and comparative periods.

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

Consolidated income statement information Six months ended 30 June 2009	Institutional Securities \$millions	Other \$millions	Total \$millions
Net gains on financial instruments held for trading	3,723	-	3,723
Net gains on financial instruments designated at fair value through profit or loss	(517)	-	(517)
Net gains on available-for-sale financial assets	-	-	-
Net interest	(536)	20	(516)
Other income	62	33	95
External revenues net of interest expense	2,732	53	2,785
Other expense	(1,542)	(105)	(1,647)
Profit / (loss) on ordinary activities	1,190	(52)	1,138
Share of losses of associate and joint venture	-	-	-
Net gain on disposal of subsidiary	-	-	-
Profit / (loss) before tax	1,190	(52)	1,138
Income tax (expense) / credit	(392)	15	(377)
Profit / (loss) for the period	798	(37)	761

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE CONDENSED FINANCIAL STATEMENTS
Six months ended 30 June 2009

4. SEGMENT REPORTING (CONTINUED)

Consolidated statement of financial position information As at 31 December 2008	Institutional Securities \$millions	Other \$millions	Total \$millions
Segment assets	452,996	4,630	457,626
Associate and joint venture	11	-	11
Total assets	453,007	4,630	457,637
Segment liabilities	445,821	3,678	449,499
Total Liabilities	445,821	3,678	449,499
Other Segment Information			
Property, plant and equipment capital expenditure	6	-	6
Depreciation on property, plant and equipment	7	-	7

Geographical Segments

The Group operates in three geographic regions as listed below:

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

The following table presents selected consolidated income statement and statement of financial position information of the Group’s operations by geographic area. The external revenues (net of interest expense) and total assets disclosed in the following table reflect the regional view of the Group’s operations, on a managed basis. The basis for attributing external revenues (net of interest expense) and total assets is determined by a combination of client and trading desk location.

Geographical segments	EMEA		Americas		Asia		Total	
	30 June 2009 \$millions	31 May 2008 \$millions	30 June 2009 \$millions	31 May 2008 \$millions	30 June 2009 \$millions	31 May 2008 \$millions	30 June 2009 \$millions	31 May 2008 \$millions
External revenues net of interest	2,496	2,915	189	475	100	213	2,785	3,603
Profit /(loss) before income tax	1,218	1,080	(138)	469	58	36	1,138	1,585
	30 June 2009 \$millions	31 Dec 2008 \$millions	30 June 2009 \$millions	31 Dec 2008 \$millions	30 June 2009 \$millions	31 Dec 2008 \$millions	30 June 2009 \$millions	31 Dec 2008 \$millions
Total assets	374,152	385,208	999	9,086	67,278	63,343	442,429	457,637

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE CONDENSED FINANCIAL STATEMENTS
Six months ended 30 June 2009

5. FINANCIAL RISK MANAGEMENT (CONTINUED)

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 derivatives exposure 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 30 June 2009 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 statement of financial position 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 requiring a rating under the Group's and the Morgan Stanley Group's credit risk management policies. This pool is highly diversified, monitored and subject to limits.

Financial assets 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 & CO. INTERNATIONAL plc
NOTES TO THE CONDENSED FINANCIAL STATEMENTS
Six months ended 30 June 2009

5. FINANCIAL RISK MANAGEMENT (CONTINUED)

Liquidity risk

Liquidity risk is the risk that the entity may encounter difficulty in realising financial assets or otherwise raising funds to satisfy its financial liabilities.

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 financial difficulty.

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 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 highly liquid nature of these assets provides the Group and the Morgan Stanley Group with flexibility in financing and managing its business.

In the following contractual maturity analysis, derivative contracts held as part of the Group's trading activities are disclosed as on demand; financial liabilities designated at fair value are disclosed according to their earliest contractual maturity and all such amounts are presented at their fair value. All other amounts represent the undiscounted cash flows payable to contractual maturities by the Group arising from its financial liabilities as at 30 June 2009 and 31 December 2008. Repayments that are subject to 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 & CO. INTERNATIONAL plc
NOTES TO THE CONDENSED FINANCIAL STATEMENTS
Six months ended 30 June 2009

5. FINANCIAL RISK MANAGEMENT (CONTINUED)

Liquidity risk (continued)

	On demand	Less than 1 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
As at 31 December 2008	\$millions	\$millions	\$millions	\$millions	\$millions	\$millions	\$millions
Financial liabilities							
Financial liabilities at amortised cost:							
Bank loans and overdrafts	451	-	-	-	-	-	451
Securities loaned	42,286	-	1,500	2,000	-	-	45,786
Repurchase agreements	34,798	14,095	2,496	115	-	-	51,504
Trade payables	55,245	-	-	-	-	-	55,245
Other payables	35,190	-	-	-	-	-	35,190
Subordinated loans	-	29	58	262	1,395	17,217	18,961
Preference shares *	-	-	-	31	125	1,412	1,568
Financial liabilities held for trading							
Derivatives	221,794	-	-	-	-	-	221,794
Other	18,410	-	-	-	-	-	18,410
Financial liabilities designated at fair value through profit or loss	3,583	24	116	758	944	453	5,878
Total financial liabilities	411,757	14,148	4,170	3,166	2,464	19,082	454,787
Unrecognised financial instruments							
Letters of credit	-	33	15	94	-	-	142
Loan commitments	12,015	-	1	16	-	-	12,032
Total unrecognised financial instruments	12,015	33	16	110	-	-	12,174

* Preference shares are assumed to be redeemed in 20 years.

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

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE CONDENSED FINANCIAL STATEMENTS
Six months ended 30 June 2009

5. FINANCIAL RISK MANAGEMENT (CONTINUED)

Market risk (continued)

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. The market risk department also conducts scenario analysis, which estimates the revenue sensitivity of key entities within the Group, including the Company, to a set of specific, predefined market and geopolitical events.

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 price risk and interest rate risk, and linear exposures to implied volatility risks. Market risks that are incorporated in the VaR model include equity and commodity prices, interest rates, foreign exchange rates and associated implied volatilities. As a supplement to the use of historical simulation for major market risk factors, the Group's VaR model uses Monte Carlo simulation to capture name-specific risk in equities and credit products (i.e., corporate bonds, loans and credit derivatives).

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.

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE CONDENSED FINANCIAL STATEMENTS
Six months ended 30 June 2009

5. FINANCIAL RISK MANAGEMENT (CONTINUED)

Market Risk (continued)

The Group's trading VaR at 30 June 2009 was \$50 million compared with \$27 million at 31 December 2008. The increase in trading VaR is primarily due to increased interest rate risks combined with higher exposures to emerging market currencies. The overall change in VaR reflects the Group's strategy across its businesses to take advantage of the opportunities presented by market conditions.

The Group views average trading VaR over the fiscal year as more representative of trends in the business than VaR at any single point in time. The table below, which presents the high, low and average 95%/one-day trading VaR during the period to 30 June 2009, represents substantially all of the Group's trading activities. Certain market risks included in the aggregate VaR discussed above are excluded from these measures.

95% One-day high/low/average Trading VaR primary market risk category	Six months ended 30 June 2009			13 month period ended 31 December 2008		
	High \$millions	Low \$millions	Average \$millions	High \$millions	Low \$millions	Average \$millions
Interest rate and credit spread	44	27	31	37	18	26
Equity price	22	10	14	48	9	24
Foreign exchange rate	14	3	7	20	3	9
Commodity price	4	1	2	3	1	2
Trading VaR	50	26	32	58	26	38

Overall average trading VaR for the six months ended 30 June 2009 was \$32 million, lower than the average trading VaR for the 13 month period ended 31 December 2008. Although interest rate VaR has been increasing over the six month period to 30 June 2009, this increase has been offset by a reduction in equity VaR. The fall in equity price VaR reflects the fall in average equity risks during the six months ended 30 June 2009 compared to the 13 month period to 31 December 2008.

The Group's VaR excludes certain funding liabilities and money market transactions. As at 30 June 2009, the net notional amount of such funding liabilities and money market activities was approximately \$8.3 billion, compared to \$6.7 billion as at 31 December 2008. The application of a parallel increase or decrease in interest rates of 50 basis points to these positions would result in a net gain or loss to the Group of approximately \$7 million, compared to \$6.7 million as at 31 December 2008.

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE CONDENSED FINANCIAL STATEMENTS
Six months ended 30 June 2009

6. FINANCIAL INSTRUMENTS VALUED USING UNOBSERVABLE MARKET DATA

a Fair value hierarchy

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 in an active market (Level 1) – Valuations based on quoted prices in active markets that the Group has the ability to access for identical assets or liabilities. Valuation adjustments and block discounts are not applied to these financial instruments. Since valuations are based on quoted prices that are readily and regularly available in an active market, valuation of these products does not entail a significant amount of judgement.
- Valuation techniques using observable inputs (Level 2) – Valuations based on one or more quoted prices in markets that are 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.

The Group's valuation approach and fair value hierarchy categorisation for certain significant classes of financial instruments recognised at fair value is as follows:

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 Level 1 or 2 of the fair value hierarchy.

Corporate and other debt

The fair value of corporate bonds is estimated using recently executed transactions, market price quotations (where observable), bond spreads and / or credit default swap spreads. The spread data used are for the same maturity as the bond. If the spread data does not reference the issuer, then data that references a comparable issuer is 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 based on collateral values as key inputs. Corporate bonds 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 hierarchy.

The fair value of corporate loans is estimated using recently executed transactions, market price quotations (where observable) and market observable credit default swap spread levels, along with proprietary valuation models and default recovery analysis where such transactions and quotations are unobservable. The fair value of contingent corporate loan commitments is estimated by using executed transactions on comparable loans and the anticipated market price based on pricing indications from syndicate banks and customers. The valuation of these commitments also takes into account certain fee income. Corporate loans and loan commitments 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 hierarchy.

CMBS and RMBS may be valued based on external price or spread data. When position specific external price data is not observable, the valuation is based on prices of comparable bonds. Valuation levels of CMBS and RMBS indices are used as an additional data point for benchmarking purposes or to price outright index positions. CMBS and RMBS 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.

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE CONDENSED FINANCIAL STATEMENTS
Six months ended 30 June 2009

**6. FINANCIAL INSTRUMENTS VALUED USING UNOBSERVABLE MARKET DATA
(CONTINUED)**

a Fair value hierarchy (continued)

Derivatives (continued)

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 spread curves, volatility of the underlying commodities and, in some cases, the 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.

Structured notes and prepaid OTC derivatives designated at 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 these financial instruments is estimated using valuation models described above for the derivative and debt features of the financial instruments. These valuation models incorporate observable inputs referencing identical or comparable securities, including prices that the financial instruments are linked to, interest rate yield curves, option volatility and currency rates. The impact of own credit spreads is also included based on observed secondary bond market spreads. Structured notes and prepaid OTC derivatives are generally categorised in Level 2 or Level 3 of the fair value hierarchy.

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 Group personnel with relevant expertise who are independent from the trading divisions. Additionally, groups independent from the trading divisions within the financial control, market risk and credit risk 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 comparable transactions and other observable market data are considered for purposes of validating assumptions underlying the model.

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE CONDENSED FINANCIAL STATEMENTS
Six months ended 30 June 2009

**6. FINANCIAL INSTRUMENTS VALUED USING UNOBSERVABLE MARKET DATA
(CONTINUED)**

a Fair value hierarchy (continued)

	As at 31 December 2008			
	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 held for trading:				
- Government debt securities	8,716	2,835	2	11,553
- Corporate and other debt	34	12,887	2,302	15,223
- Corporate equities	36,749	6,220	460	43,429
- Derivatives	1,091	203,775	10,586	215,452
Total financial assets held for trading	46,590	225,717	13,350	285,657
Financial assets designated at fair value through profit or loss	190	74	1,131	1,395
Available-for-sale financial assets	-	-	87	87
Total financial assets held at fair value	46,780	225,791	14,568	287,139
Financial liabilities held for trading:				
- Government debt securities	3,355	2,051	-	5,406
- Corporate and other debt	17	909	88	1,014
- Corporate equities	10,508	1,458	24	11,990
- Derivatives	932	206,949	13,913	221,794
Total financial liabilities held for trading	14,812	211,367	14,025	240,204
Financial liabilities designated at fair value through profit or loss – structured notes and prepaid derivatives	1,424	3,939	515	5,878
Total financial liabilities at fair value	16,236	215,306	14,540	246,082

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE CONDENSED FINANCIAL STATEMENTS
Six months ended 30 June 2009

8. BUSINESS COMBINATION

On 12 May 2009, the Group purchased 60% of the ordinary share capital of Norwegian Energy Limited ("NEL") from a third party undertaking for \$2.5 million payable in cash, of which \$1.6 million was paid during the period. Goodwill of \$2.2 million arose on the acquisition. The goodwill reflects the significant emphasis the Group places on the value of NEL's work force in making the decision to acquire, however this is not a recognisable intangible asset in accordance with IFRS 3 "*Business Combinations*".

The acquisition has been accounted for using the purchase method of accounting. For each class of identifiable asset and liability of NEL, the carrying value immediately prior to acquisition equalled the fair value at acquisition, as follows:

	IFRS Book value / Fair value \$millions
ASSETS	
Cash at bank	0.4
Other receivables	0.4
TOTAL ASSETS	<u>0.8</u>
LIABILITIES	
Accruals and deferred income	(0.3)
TOTAL LIABILITIES	<u>(0.3)</u>
NET ASSETS	<u>0.5</u>
Due to minority interest (40%)	(0.2)
Goodwill	2.2
TOTAL PURCHASE CONSIDERATION	<u><u>2.5</u></u>

Since acquisition NEL has contributed \$nil to the Group's income.

9. MORGAN STANLEY SMITH BARNEY JOINT VENTURE

On 1 June 2009, Morgan Stanley and Citigroup Inc. ("Citi") consummated the previously announced transaction to combine its Global Wealth Management Group and the businesses of Citi's Smith Barney in the U.S., Quilter in the UK, and Smith Barney Australia ("Smith Barney"). The combined businesses operate as a consolidated joint venture, Morgan Stanley Smith Barney Holdings LLC ("MSSB").

As part of the transaction, on 1 June 2009, the Group's European GWM introducing broker activities were reorganised and transferred to MSSB. The transaction occurred between entities which were considered under common control for accounting purposes and gave rise to recognition within equity of a net capital contribution of \$50 million received from other Morgan Stanley Group companies. The Group will continue to provide certain ongoing services to support the European GWM business and will retain an interest in GWM in Asia. In the period to 1 June 2009, GWM contributed an \$11 million loss to the Group's results (six months to 31 May 08: \$44 million profit).