Registration No 2068222
Registered Office:
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Canary Wharf
London E14 4QA

MORGAN STANLEY & CO. INTERNATIONAL plc

Report and financial statements

31 December 2009

MORGAN STANLEY & CO. INTERNATIONAL plc

CONTENTS

MORGAN STANLEY & CO. INTERNATIONAL plc

DIRECTORS' REPORT

The Directors present their report and the consolidated financial statements of Morgan Stanley & Co. International plc (the "Company") and all of its subsidiary and associated undertakings (together the "Group"), together with the Company's balance sheet and related notes for the year ended 31 December 2009. The prior accounting period is a thirteen month period to 31 December 2008, due to a change in the accounting reference date in the prior period and therefore comparatives are not entirely comparable with amounts shown for the current period. The Group's consolidated financial statements have been prepared in accordance with applicable United Kingdom ("UK") law and International Financial Reporting Standards ("IFRS") as adopted by the European Union ("EU"). The Company's balance sheet and related notes have been prepared in accordance with applicable UK law and accounting standards.

RESULTS AND DIVIDENDS

The Group's profit for the year, after tax, is $125 million (2008: $29 million).

During the year the Company paid an interim dividend of $200 million on the ordinary shares (2008: $nil). No final dividend is proposed (2008: $nil). A dividend of $31 million was paid on the Class B preference shares during the period (2008: $42 million). A dividend of $1 million was paid on the Class C preference shares during the period (2008: $nil).

PRINCIPAL ACTIVITY

The principal activity of the Group is the provision of financial services to corporations, governments and financial institutions. 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, Middle East and Africa ("EMEA") GWM introducing broker activities were reorganised and transferred to a consolidated joint venture, Morgan Stanley Smith Barney LLC ("MSSB") (see note 34), from 1 June 2009. Other than this, 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. A further branch was opened in Switzerland 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 (the "Morgan Stanley Group").

BUSINESS REVIEW

The consolidated income statement for the year is set out on page 9. Comparing the year to 31 December 2009 to the 13 month period to 31 December 2008, the Group's profit for the period after tax has increased by $96 million to $125 million. The Group's revenues improved across all businesses during 2009, however the performance continues to be impacted by challenging market conditions. As a consequence of the Morgan Stanley Group's improved performance during 2009, revenues have 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 89% to $222 million. Interest income and interest expense have reduced by 77% and 79% respectively. This decrease is driven by significant reductions in secured financing activity, coupled with declining interest rates. Net gains on available-for-sale financial assets decreased by $1,199 million to $16 million; in 2008, the Group received significant dividend income from non-consolidated subsidiaries that are now being consolidated in 2009. The Group's other expenses have reduced by 15%. Other expenses have reduced in most areas, with significant reductions in brokerage costs and staff costs compared to the prior period.

The Morgan Stanley Group operates a number of intra-group policies to ensure that, where possible, revenues and related costs are matched. These policies can, amongst other things, result in losses being incurred on other Morgan Stanley Group entities, as a result of Group activities, that would otherwise have been transferred to the Group. In prior periods these policies have reduced the impact of difficult market conditions on the Group's performance. Following reviews throughout 2009, these policies have been refined and as a result the performance of the Group has been significantly impacted by accelerating the transfer of losses into the Group that were previously held on other Morgan Stanley entities. Further details of these policies are contained in note 35 to the consolidated financial statements.

The consolidated statement of financial position presented on page 13 of the financial statements shows reductions in the Group's total assets and total liabilities. Total assets and total liabilities have decreased by 5% and 4% respectively as at 31 December 2009 when compared to 31 December 2008. The reduction in total assets and total liabilities has been driven by reductions of $41,584 million and $36,649 million in financial assets classified as held for trading and financial liabilities classified as held for trading respectively. These movements are primarily due to reductions in the Group's derivative instruments, driven by market volatility in the period, although the change in net derivatives is minor. These reductions have been partially offset on the asset side by an increase of $26,096 million in reverse repurchase agreements and $6,030 million in other receivables. On the liabilities side the movement in financial liabilities classified as held for trading has been partially offset by increases of $14,303 million and $9,312 million in repurchase agreements and trade payables. Although repurchase and reverse repurchase agreements have increased compared to 31 December 2008, the current positions remain significantly lower than the average position during 2008. During 2009, the Group has continued to review and actively manage its capital position. As part of this capital management, the Group has repaid $4,400 million of subordinated loans and repurchased $1,250 million of issued class C preference share capital. This capital management activity has had a significant impact on the Group's cash flow during the year, as presented on page 12 of the financial statements.

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.

Current market conditions

During 2009, global market and economic conditions improved and global capital markets began to recover from the severe downturn that occurred at the end of 2008. Economic conditions however continue to be challenging. These conditions present difficulties and uncertainty for the business outlook which may adversely impact the financial performance of the Group in the future.

During the year ending 31 December 2008, the Morgan Stanley Group took certain steps to respond to the stresses experienced in global financial markets and to strengthen the Morgan Stanley Group's overall capital and liquidity position, including participation in the US Government's Troubled Asset Relief Program ("TARP"). In mid 2009, as a result of its strong capital position, Morgan Stanley received approval from the US Treasury to repay the $10 billion TARP investment received in 2008. Morgan Stanley continues to actively manage its capital and liquidity position to ensure adequate resources are available to support the activities of the Morgan Stanley Group, including its subsidiary entities. The risk management section below sets out the Group's and the Morgan Stanley Group's policies for the management of liquidity and cash flow risk and other significant business risks. Note 26 to the consolidated financial statements provides qualitative and quantitative disclosures about the Group's management and exposure to risks, including liquidity risk.

Taking all of these factors into consideration and as disclosed further in note 2 to the consolidated financial statements, the Directors have no reason to believe that the Group will not 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.

The Group has exposure to residential mortgage backed securities-related risk ("RMBS"). As at 31 December 2009 the amount recognised on the Group balance sheet in relation to RMBS is $468 million (2008: $105 million). The Group continues to have exposure to commercial mortgage-backed securities ("CMBS") arising from its trading activities. As at 31 December 2009 the amount recognised on the balance sheet in relation to CMBS is $610 million (2008: $669 million).

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 31 December 2009 the total assets of SPEs in which the Group has an interest, but which are not consolidated by the Group, are $3,669 million (2008: $7,673 million) and the Group's maximum exposure to loss relating to such SPEs is $43 million (2008: $124 million). The Group's consolidated balance sheet includes $3,474 million of assets arising from consolidated SPEs (2008: $3,639 million). The Group's maximum exposure to loss relating to these assets is $1,813 million (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 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 31 December 2009 is $44 million compared with $27 million at 31 December 2008. The increase in trading VaR is primarily due to increased interest rate and credit spread VaR. 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 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 and funding 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.

DIRECTORS' REPORT (CONTINUED)

The Morgan Stanley Group's senior management establishes the overall liquidity and capital policies of the Morgan Stanley Group. The Morgan Stanley Group's liquidity and funding risk management policies are designed to mitigate the potential risk that the Morgan Stanley Group and the Group may be unable to access adequate financing to service its financial obligations without material adverse franchise or business impact. The key objectives of the liquidity and funding risk management framework are to support the successful execution of the Morgan Stanley Group's and the Group's business strategies while ensuring sufficient liquidity through the business cycle and during periods of stressed market conditions. The Morgan Stanley Group has established regional committees to oversee the activities of its subsidiaries from a regional perspective.

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 the Group's capital and liquidity position is satisfactory.

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, are available on the Morgan Stanley website.

DIRECTORS

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

C D S Bryce	
W A Chammah	(Chairman)
K Clark	(resigned 30 June 2009)
A Classen	
R Hoornweg	(left on 17 December 2009)
G G Lynch	(appointed 08 October 2009)
D M McCarthy	(resigned 29 January 2009)
D R Nicol	
F R Petitgas	
D Siniscalco	
C E Woodman	(appointed 12 March 2009)

DIRECTORS' LIABILITY INSURANCE

Qualifying 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 under a Directors' and Officers' Liability Insurance policy taken out by Morgan Stanley, the Company's ultimate parent company and pursuant to the provisions of the Company's articles of association.

AUDIT COMMITTEE

Morgan Stanley International Limited ("MSI"), the Company's ultimate UK parent undertaking, has an Audit Committee which assists the Boards of MSI, the Company and other of MSI's subsidiary undertakings 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 on a quarterly basis.

DIRECTORS' REPORT (CONTINUED)

POST BALANCE SHEET EVENTS

On 9 December 2009 the UK government announced proposed legislation in its Pre-Budget Report imposing a Bank Payroll Tax. The legislation was enacted on 8 April 2010 as part of the Finance Act. 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 will be that of the entity that benefits from the services of the Banking Employees, rather than the employing entity. The Group is still evaluating the impact of this legislation and has recognised a charge of $256 million in 2010, when the legislation was enacted, based on the minimum amount currently estimated will be payable by the Group in August 2010. Due to the ongoing uncertainties regarding the application, scope and implementation of the legislation, the final payment amount may differ from this estimated financial effect.

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.

AUDITORS

Deloitte LLP have expressed their willingness to continue in office as auditors of the Company and a resolution to re-appoint them will be proposed at the forthcoming annual general meeting.

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 s418 of the Companies Act 2006.

Approved by the Board and signed on its behalf by DAVID NICOL

Director

22 April 2010

MORGAN STANLEY & CO. INTERNATIONAL plc

DIRECTORS' RESPONSIBILITY STATEMENT

The Directors are responsible for preparing their report and the consolidated financial statements in accordance with applicable law and regulations. Company law requires the Directors to prepare financial statements for each financial year. The Directors are required by the IAS Regulation to prepare the group financial statements under IFRSs as adopted by the European Union. The group financial statements are also required by law to be properly prepared in accordance with the Companies Act 2006 and Article 4 of the IAS Regulation.

International Accounting Standard 1 requires that IFRS financial statements present fairly for each financial year the Group's financial position, financial performance and cash flows. This requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the International Accounting Standards Board's 'Framework for the preparation and presentation of financial statements'. In virtually all circumstances, a fair presentation will be achieved by compliance with all applicable IFRSs. However, Directors are also required to:

(a) properly select and apply accounting policies;

(b) present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;

(c) provide additional disclosures when compliance with the specific requirements in IFRSs are insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance; and

(d) make an assessment of the Group's ability to continue as a going concern.

The Directors have elected to prepare the parent company financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law). The parent company financial statements are required by law to 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 period. In preparing these financial statements, the Directors are required to:

(a) select suitable accounting policies and then apply them consistently;

(b) make judgements and estimates that are reasonable and prudent;

(c) state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements; and

(d) 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 parent Company 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.

The Directors, the names of whom are set out on page 4 of the Directors' report, confirm to the best of their knowledge:

- in accordance with rule 4.1.12(3)(a) of the Financial Services Authority's Disclosure and Transparency Rules, the consolidated financial statements, which have been prepared in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board and as endorsed by the EU, have been prepared in accordance with the applicable set of accounting standards and give a true and fair view of the assets, liabilities, financial position and profit or loss of the Group and the undertakings included in the consolidation taken as a whole; and

- the management report represented by the Directors' report has been prepared in accordance with rule 4.1.12(3)(b) of the Disclosure and Transparency Rules, and includes a fair review of the development and performance of the business and the position of the Group and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that the Group faces.

Approved by the Board and signed on its behalf by DAVID NICOL

Director

22 April 2010

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF MORGAN STANLEY & CO. INTERNATIONAL plc

We have audited the Consolidated and Company financial statements (the "financial statements") of Morgan Stanley & Co. International plc for the year ended 31 December 2009, which comprise the Consolidated Income Statement, the Consolidated Statement of Comprehensive Income, the Consolidated Statement of Changes in Equity, the Consolidated Statement of Cash Flows and the Consolidated Statement of Financial Position and Company Balance Sheet and the related notes 1 to 36 for the Consolidated financial statements and the related notes 1 to 21 for the Company financial statements. The financial reporting framework that has been applied in the preparation of the group financial statements is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union. The financial reporting framework that has been applied in the preparation of the Company financial statements 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 Statement of Directors' Responsibilities, 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 (APB'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 Group's and 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 2009 and of the Group's profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union;
- the Company financial statements have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006; and, as regards the Group financial statements, Article 4 of the IAS Regulation.

Opinion on other matter 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.

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF MORGAN STANLEY & CO. INTERNATIONAL plc (CONTINUED)

Matters on which we are required to report by exception

We have nothing to report in respect of the following; under the Companies Act 2006, we are required to report to you if, in our opinion:

- adequate accounting records have not been kept by the Company, or returns adequate for our audit have not been received from branches not visited by us; or
- the Company 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
Senior Statutory Auditor

for and on behalf of Deloitte LLP
Chartered Accountants and Statutory Auditors
London, England

22 April, 2010

CONSOLIDATED INCOME STATEMENT
Year ended 31 December 2009

	Note	Year ended 31 December 2009 $millions	1 December 2007 to 31 December 2008 $millions
Net gains on financial instruments classified as held for trading		3,833	2,960
Net gains on financial instruments designated at fair value through profit or loss		57	1,319
Net gains on available-for-sale financial assets		16	1,215
Interest income	4	4,181	18,530
Interest expense	4	(4,403)	(20,572)
Other income	5	239	434
Other expense	6	(3,326)	(3,935)
PROFIT / (LOSS) ON ORDINARY ACTIVITIES		597	(49)
Share of losses of joint venture	14	-	(25)
Gain on disposal of subsidiary		-	41
PROFIT / (LOSS) BEFORE INCOME TAX		597	(33)
Income tax (expense) / credit	7	(472)	62
PROFIT FOR THE YEAR / PERIOD		125	29
Attributable to:			
Equity holders of the Company		120	26
Minority interest		5	3
PROFIT FOR THE YEAR / PERIOD		125	29

All operations were continuing in the current and prior period.
The notes on pages 14 to 82 form an integral part of the financial statements.

MORGAN STANLEY & CO. INTERNATIONAL plc

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
Year ended 31 December 2009

	Note	Year ended 31 December 2009 $millions	1 December 2007 to 31 December 2008 $millions
PROFIT FOR THE PERIOD		125	29
OTHER COMPREHENSIVE INCOME			
Foreign currency translation differences on foreign operations		(38)	42
Fair value reserve:			
Available-for-sale financial assets:			
Net change in fair value recognised directly in equity		(7)	(1)
Net amount transferred to consolidated income statement		-	-
Actuarial (losses) / gains on defined benefit pension plans	33	(2)	1
Net current and deferred tax on items taken directly to equity		2	-
OTHER COMPREHENSIVE INCOME AFTER INCOME TAX		(45)	42
TOTAL COMPREHENSIVE INCOME		80	71
Attributable to:			
Equity holders of the Company		73	68
Minority interest		7	3
TOTAL COMPREHENSIVE INCOME		80	71

The notes on pages 14 to 82 form an integral part of the financial statements.

MORGAN STANLEY & CO. INTERNATIONAL plc

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
Year ended 31 December 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
Balance at 1 December 2007	4,328	513	(64)	149	3	3	3,068	8,000	63	8,063
Profit for the period	-	-	-	-	-	-	26	26	3	29
Foreign currency translation differences on foreign operations	-	-	42	-	-	-	-	42	-	42
Net change in fair value recognised directly in equity	-	-	-	-	-	(1)	-	(1)	-	(1)
Actuarial gain	-	-	-	-	-	-	1	1	-	1
Share based payments	-	-	-	-	-	-	3	3	-	3
Capital infusion	-	-	-	-	-	-	-	-	1	1
Balance at 31 December 2008	4,328	513	(22)	149	3	2	3,098	8,071	67	8,138
Profit for the year	-	-	-	-	-	-	120	120	5	125
Foreign currency translation differences on foreign operations	-	-	(40)	-	-	-	-	(40)	2	(38)
Net change in fair value recognised directly in equity	-	-	-	-	-	(7)	-	(7)	-	(7)
Actuarial loss	-	-	-	-	-	-	(2)	(2)	-	(2)
Net deferred tax on items taken directly to equity	-	-	-	-	-	2	-	2	-	2
Preference share repurchase	(1,250)	-	-	1,250	-	-	(1,250)	(1,250)	-	(1,250)
Net capital contribution	-	-	-	-	-	-	50	50	-	50
Dividends	-	-	-	-	-	-	(201)	(201)	-	(201)
Balance at 31 December 2009	3,078	513	(62)	1,399	3	(3)	1,815	6,743	74	6,817

The notes on pages 14 to 82 form an integral part of the financial statements.

CONSOLIDATED STATEMENT OF CASH FLOWS
Year ended 31 December 2009

	Note	Year ended 31 December 2009 $millions	1 December 2007 to 31 December 2008 $millions
NET CASH FLOWS USED IN OPERATING ACTIVITIES	23(b)	(424)	(5,321)
INVESTING ACTIVITIES			
Purchase of property, plant and equipment		(1)	(6)
Proceeds from sale of property, plant and equipment		-	1
Purchase of available-for-sale financial assets		-	(5,944)
Dividends from available-for-sale financial assets		16	1,215
Proceeds from sale of available-for-sale financial assets		38	10,711
Acquisition of joint venture		-	(8)
Disposal of associate		4	178
Acquisition of subsidiaries, net of cash acquired		-	(526)
Proceeds from sale of subsidiary, net of cash disposed		-	143
Net capital contribution arising from MSSB joint venture	34	50	-
NET CASH FLOWS FROM INVESTING ACTIVITIES		107	5,764
FINANCING ACTIVITIES			
Repurchase of preference shares		(1,250)	-
Dividends paid to preference share holders of the Company		(31)	(42)
Repayments of subordinated loans		(4,400)	(150)
Interest paid on subordinated loans		(305)	(675)
Dividends paid to equity holders of the Company		(201)	-
Capital infusion by minority interest		-	1
NET CASH FLOWS USED IN FINANCING ACTIVITIES		(6,187)	(866)
NET DECREASE IN CASH AND CASH EQUIVALENTS		(6,504)	(423)
Currency translation differences on foreign currency cash balances		421	(386)
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE PERIOD		19,537	20,346
CASH AND CASH EQUIVALENTS AT THE END OF THE PERIOD	23(a)	13,454	19,537

The notes on pages 14 to 82 form an integral part of the accounts.

MORGAN STANLEY & CO. INTERNATIONAL plc
Registration No.2068222

CONSOLIDATED STATEMENT OF FINANCIAL POSITION
As at 31 December 2009

	Note	31 December 2009 $millions	31 December 2008 $millions
ASSETS			
Loans and receivables:			
Cash at bank	8	13,580	19,988
Securities borrowed		25,394	30,790
Reverse repurchase agreements		83,331	57,235
Trade receivables		51,642	51,532
Other receivables	9	16,184	10,154
		190,131	169,699
Financial assets classified as held for trading (of which approximately $54,185 million (2008: $46,682 million) were pledged to various parties)	10	244,073	285,657
Financial assets designated at fair value through profit or loss	11	1,907	1,395
Available-for-sale financial assets	12	43	87
Current tax		558	460
Deferred tax assets	19	47	173
Prepayments and accrued income		19	134
Property, plant and equipment	13	16	21
Associates and joint ventures	14	7	11
TOTAL ASSETS		436,801	457,637
LIABILITIES AND EQUITY			
Financial liabilities at amortised cost:			
Bank loans and overdrafts		126	451
Securities loaned		44,306	45,786
Repurchase agreements		65,766	51,463
Trade payables		64,557	55,245
Other payables	15	33,748	35,190
Subordinated loans	16	8,550	12,950
Preference shares	17	786	786
		217,839	201,871
Financial liabilities classified as held for trading	10	203,555	240,204
Financial liabilities designated at fair value through profit or loss	11	7,879	5,878
Provisions	18	22	29
Current tax		381	116
Deferred tax liabilities	19	7	9
Accruals and deferred income		297	1,390
Retirement benefit obligations	33	4	2
TOTAL LIABILITIES		429,984	449,499
EQUITY ATTRIBUTABLE TO SHAREHOLDERS			
Share capital	21	3,078	4,328
Share premium account		513	513
Other reserves		1,337	132
Retained earnings		1,815	3,098
		6,743	8,071
Minority interest		74	67
TOTAL EQUITY		6,817	8,138
TOTAL LIABILITIES AND EQUITY		436,801	457,637

These financial statements were approved by the Board and authorised for issue on 22 April 2010:
Signed on behalf of the Board

Director DAVID NICOL

The notes on pages 14 to 82 form an integral part of the financial statements.

1. CORPORATE INFORMATION

The principal activity of the Group is the provision of financial services to corporations, governments, financial institutions and individual investors. 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. The Company is a public limited company incorporated and domiciled in England and Wales, with its registered office at: 25 Cabot Square, Canary Wharf, London, E14 4QA. The Company is authorised and regulated by the Financial Services Authority ("FSA").

2. BASIS OF PREPARATION

i Statement of compliance

The Group has prepared its consolidated annual financial statements in accordance with IFRS adopted by the EU. The primary financial statements in this document are presented in accordance with International Accounting Standards ("IAS") 1 *'Presentation of Financial Statements'*.

During 2008, the Company changed its accounting reference date from 30 November to 31 December to align with the changed year end of its ultimate parent undertaking, Morgan Stanley. This change resulted in a reporting period of thirteen months to 31 December 2008. The comparative figures reflected in the financial statements are for a thirteen month period to 31 December 2008 and therefore are not entirely comparable with amounts shown for the current year.

ii New standards and interpretations adopted during the period

The following standards and interpretations relevant to the Group's operations were adopted during the year. Except where otherwise stated, the standards and interpretations did not have a material impact on the Group's financial statements.

IAS 1 *'Presentation of Financial Statements (revised)'* was issued by the International Accounting Standards Board ("IASB") in September 2007 for application in accounting periods beginning on or after 1 January 2009. The Group adopted the revised standard during the year resulting in the renaming and re-ordering of the primary statements and related minor changes to disclosure.

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.

An Amendment to IAS 23 *'Borrowing Costs'* was issued by the IASB in March 2007 for application in accounting periods beginning on or after 1 January 2009.

An Amendment to IFRS 2 *'Share-based Payment' – Vesting conditions and cancellations* was issued by the IASB in January 2008 for retrospective application in accounting periods beginning on or after 1 January 2009.

IFRS 8 *'Operating Segments'* was issued by the IASB in November 2006 for application in accounting periods beginning on or after 1 January 2009. The Group chose to early adopt IFRS 8 with effect from 1 December 2006, which resulted in minor changes to disclosure.

An Amendment to IFRS 1 *'First-time Adoption of International Financial Reporting Standards'* and IAS 27 *'Consolidated and separate financial statements' – Cost of an investment in a subsidiary, jointly controlled entity or associate* was issued by the IASB in May 2008 for application in accounting periods beginning on or after 1 January 2009.

As part of the May 2008 Annual Improvements to IFRS, the IASB made amendments to the following standards that are relevant to the Group's operations: IAS 1 *'Presentation of Financial Statements'*; IAS 16 *'Property, plant and equipment'*; IAS 19 *'Employee Benefits'*; IAS 20 *'Accounting for Government Grants and Disclosure of Government Assistance'*; IAS 23 *'Borrowing Costs'*; IAS 27 *'Consolidated and separate financial statements'*; IAS 28 *'Investments in Associates'*; IAS 36 *'Impairment of Assets'*, IAS 38 *'Intangible Assets'* and IAS 39 *'Financial Instruments: Recognition and Measurement'*. The amendments were made for application in accounting periods beginning on or after 1 January 2009.

2. BASIS OF PREPARATION (CONTINUED)

iii New standards and interpretations not yet adopted

At the date of authorisation of these financial statements, the following standards and interpretations relevant to the Group's operations were in issue by the IASB but not yet mandatory. The Group does not expect that the adoption of the following standards and interpretations will have a material impact on the Group's financial statements.

New standards and interpretations to be adopted when endorsed by the EU

Amendments to IFRIC 9 *'Reassessment of Embedded Derivatives'* and IAS 39 *'Financial Instruments: Recognition and Measurement' - Embedded derivatives'* were issued by the IASB in March 2009 for application in accounting periods ending on or after 30 June 2009. The amendment will be applied by the Group once it has been endorsed by the European Union ("EU").

New standards and interpretations that do not affect the current year

IFRS 3 *'Business Combinations'*. This was revised by the IASB in January 2008 for application in accounting periods beginning on or after 1 July 2009. The revised standard was endorsed by the EU in June 2009.

IFRS 9 Financial instruments was issued by the IASB in November 2009 for retrospective application in accounting periods beginning on or after 1 January 2013. Although there are expected to be changes to the presentation of financial instruments by the Company, there is not expected to be a significant impact on net assets.

IAS 27 'Consolidated and separate financial statements' was revised by the IASB in January 2008 for application in accounting periods beginning on or after 1 July 2009. The revised standard was endorsed by the EU in June 2009.

As part of the May 2008 Annual Improvements to IFRS, the IASB made amendments to IFRS 5 *'Non current assets held for sale and discontinued operations'*. The amendments were made in May 2008, for application in accounting periods beginning on or after 1 July 2009. These Annual Improvements to IFRSs were endorsed by the EU in January 2009.

As part of the April 2009 Annual Improvements to IFRS, the IASB made amendments to the following standards that are relevant to the Group's operations: IFRS 2 *'Share-based Payment'*, IFRS 5 *'Non-current Assets Held for Sale and Discontinued Operations'*, IFRS 8 *'Operating Segments'*, IAS 1 *'Presentation of Financial Statements'*, IAS 7 *'Statement of Cash Flows'*, IAS 17 *'Leases'*, IAS 18 *'Revenue'*, IAS 36 *'Impairment of Assets'*, IAS 38 *'Intangible Assets'*, IAS 39 *'Financial Instruments: Recognition and Measurement'*. The amendments are for application in accounting periods beginning from dates from 1 July 2009.

An amendment to IFRIC 14 *'Prepayments of a minimum funding requirement'* was issued by the IASB in November 2009 for application in annual periods beginning on or after 1 January 2011.

IFRIC 17 *'Distributions of non-cash assets to owners'* was issued by the IASB in November 2008 for application in accounting periods beginning on or after 1 July 2009.

iv Basis of measurement

The financial statements of the Group are prepared under the historical cost convention modified by the inclusion of certain financial instruments at fair value.

2. BASIS OF PREPARATION (CONTINUED)

v 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 5. 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 Group, and the Group'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.

vi 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, pension obligations, the outcome of litigation 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.

vii Basis of consolidation

The consolidated financial statements of the Group comprise the financial statements of the Company and its subsidiaries made up to 31 December 2009. The financial statements for the subsidiaries are prepared for the same reporting period as the Group, using consistent accounting policies. The financial statements of overseas subsidiaries are translated into US dollars as described in note 3(b). Subsidiaries are consolidated from the date that the Group gains control until the date that control ceases.

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 income statement and within equity in the consolidated statement of financial position, separately from parent shareholders' equity.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

a. 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 Group operates.

All currency amounts in the financial statements and Directors' report are rounded to the nearest million dollars.

b. 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 date of the consolidated statement of financial position. 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 currency translation reserve. All other translation differences are taken through the consolidated income statement, with the exception of non-monetary (i.e. equity) available-for-sale financial assets, 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 income statement are presented in 'Other income' or 'Other expense', except where noted in 3(c) below.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

c. Financial instruments

The Group classifies its financial assets in 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 financial assets, 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

Financial instruments classified as held for trading, including derivatives, are initially recorded on trade date at fair value. All subsequent related gains and losses, including foreign exchange differences, are reflected in the consolidated income statement in 'Net gains on financial instruments classified as held for trading'. Transaction costs are excluded from the initial and subsequent fair value measurement of the financial instrument. These costs are recognised in the consolidated income statement 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.

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. All related gains and losses, including foreign exchange differences, are reflected in the consolidated income statement in 'Net gains 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 income statement in 'Other expense'.

iii Available-for-sale financial assets

Equity instruments classified as available-for-sale are recorded on trade date and are initially recognised and subsequently measured at fair value. Dividend income and impairment losses are recorded in the consolidated income statement in 'Net gains on available-for-sale financial assets'. All other gains and losses are recognised in the 'Fair value reserve' in equity, including foreign exchange differences and reversals of impairments.

Transaction costs that are directly attributable to the acquisition of the financial asset are added to the fair value on initial recognition.

On disposal or impairment of an available-for-sale financial asset, the cumulative gain or loss in the 'Fair value reserve' is transferred to and recognised in the consolidated income statement and reported in 'Net gains on available-for-sale financial assets'.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

iv Loans and receivables and financial liabilities at amortised cost

Financial assets classified as loans and receivables are initially recognised on settlement date at fair value and subsequently measured at amortised cost less allowance for impairment. Interest is recognised in 'Interest income' in the consolidated income statement, using the effective interest rate method. Transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability are added to or deducted from the fair value on initial recognition.

The effective interest rate method is a method of calculating the amortised cost of a financial asset or a financial liability (or a 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 liability (or, where appropriate, a shorter period) to the carrying amount of the financial asset or 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 and reversals of impairment losses on financial assets classified as loans and receivables are recognised in the consolidated income statement in either 'Other expense' or 'Other income'.

Financial liabilities held at amortised cost are initially recognised on settlement date at fair value and subsequently measured at amortised cost. Interest is recognised in the consolidated income statement in 'Interest expense' using the effective interest rate method as described above.

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 instruments classified as held for trading'. Cash collateral balances receivable and accrued interest arising under resale agreements and securities borrowing arrangements are classified as 'Loans and receivables'. Securities received by the Group under resale arrangements and securities borrowing arrangements are generally not recognised on the consolidated statement of financial position.

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 income statement in 'Interest expense' using the effective interest rate method.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

d. Fair value of financial instruments

Fair value measurement

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties, in an arm's length transaction.

In determining fair value, the Group uses various valuation approaches. A hierarchy of inputs is used in measuring fair value that maximises the use of 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 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 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.

Valuation techniques

Fair value for many cash and Over the Counter ("OTC") contracts is derived using pricing models. Pricing models take into account the contract terms (including maturity), as well as multiple inputs including, where applicable, equity prices, interest rate yield curves, credit curves, correlation, creditworthiness of the counterparty, option volatility and currency rates. The impact of the Group's own credit spread is also considered when measuring the fair value of liabilities, including OTC derivative contracts. Where appropriate, valuation adjustments are made to account for various factors such as liquidity risk (bid-ask adjustments), credit quality, and model uncertainty. These 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 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 income statement and is recognised instead when the market data becomes observable.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

e. Impairment of financial assets

At each reporting date, an assessment is made as to whether there is any objective evidence of impairment in the value of a financial asset classified as either available-for-sale 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 financial assets 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 consolidated statement of comprehensive income and there is evidence that the asset is impaired, the cumulative loss that had been recognised through the consolidated statement of comprehensive income is removed from reserves and recognised in the consolidated income statement within 'Net gains and losses on 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 income statement within 'Other expenses' and are reflected against the carrying amount of the impaired asset on the consolidated statement of financial position. 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 comprehensive income 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 in note 3(c)(iii and iv).

f. Impairment of non-financial assets

Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and its value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash generating units). Non-financial assets that suffered an impairment are reviewed for possible reversal of the impairment at each reporting date.

g. Fees and commissions

Fees and commissions classified within 'Other income' in the consolidated income statement 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.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

h. Property, plant and equipment

Property, plant and equipment are stated at cost net of depreciation and any provision for impairment in value, which are included within 'Other expense' in the consolidated income statement. For assets in the course of construction (generally fit-out costs), interest that is directly attributable to the construction of the qualifying asset is capitalised as a cost of the asset.

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 (see note 3(n) below). When the reinstatement provision is established and included within 'Provisions' in the consolidated statement of financial position, 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 'Other expense' in the consolidated income statement. The reinstatement asset is depreciated over the useful economic life of the relevant leasehold improvement asset.

Depreciation is provided on property, plant and equipment at rates calculated to write off the cost of the assets on a straight line basis over their expected useful lives as follows:

Leasehold improvements	-	shorter of remaining lease term and 25 years
Fixtures, fittings and equipment	-	3 to 8 years

i. Investments in associates and joint ventures

The Group's investments in its associates and joint ventures are accounted for using the equity method of accounting.

Under the equity method, the investment in the associate or joint venture is carried on the statement of financial position 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 associate or joint venture. The Group's share of its associates' or joint ventures' post-acquisition profits or losses is recognised in the consolidated income statement; its share of post-acquisition movements in other comprehensive income is recognised in other comprehensive income within the consolidated statement of comprehensive income. Losses are only recognised in excess of the investment where the Group has incurred legal or constructive obligations or made payments on behalf of the associate or joint venture. Profits and losses resulting from transactions between the Group and the associate or joint venture are eliminated to the extent of the interest in the associate or joint venture. Distributions received from associates or joint ventures reduce the carrying amount of the investment.

j. Income tax

The tax expense represents the sum of the tax currently paid and payable, and deferred tax.

The tax currently payable is based on taxable profit for the year. Taxable profit may differ from net profit as reported in the consolidated income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Group's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the reporting date. Current tax is charged or credited in the consolidated income statement, except when it relates to items charged or credited directly to other comprehensive income or equity, in which case the current tax is also dealt with in other comprehensive income or equity respectively.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

l. Income tax (continued)

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised.

Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries and associates, except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

The carrying amount of deferred tax assets is reviewed at each reporting date and limited to the extent that it is probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised. Deferred tax is charged or credited in the consolidated income statement, except when it relates to items charged or credited directly to other comprehensive income or equity, in which case the deferred tax is dealt with in other comprehensive income or equity, respectively.

Current tax assets are offset against current tax liabilities and deferred tax assets are offset against deferred tax liabilities when there is a legally enforceable right to set off current tax assets against current tax liabilities and when they relate to income taxes levied by the same taxation authority and the Group intends to settle its current tax assets and liabilities on a net basis.

m. Operating leases

Rentals payable under operating leases are charged in the consolidated income statement on a straight line basis over the lease term. Lease incentives are allocated on a straight line basis over the lease term as a reduction to rental expense.

Rentals receivable under operating leases are credited in the consolidated income statement on a straight line basis over the lease term. Initial direct costs incurred in negotiating and arranging the lease are added to the carrying amount of the leased asset and recognised in the consolidated income statement on a straight line basis over the lease term. Lease incentives are allocated on a straight line basis over the lease term.

n. Provisions

Provisions are recognised when the Group has a present obligation as a result of a past event, when it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and when a reliable estimate can be made of the amount of the obligation.

o. Employee 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 to employees. The cost of equity based 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 IFRS 2 *'Share-based payments'* ("IFRS 2") purposes is taken directly to the consolidated income statement; the corresponding credit to reserves is reduced to the extent that payments are due to Morgan Stanley in respect of these awards.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

o. Employee compensation plans (continued)

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. Such awards are recognised over time, in accordance with the awards' vesting conditions, within 'Other payables' in the consolidated statement of financial position and are remeasured to fair value at the end of each reporting period. The related expense is recorded within 'Other expense' in the consolidated income statement. The Group economically hedges the exposure created by these deferred compensation schemes 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 profit and loss is recorded within 'Net gains on financial instruments classified as held for trading'.

p. Retirement benefits

The Group operates a defined contribution plan, the Morgan Stanley Defined Contribution Plan. The contributions due are recognised in the consolidated income statement when payable.

The Group also operates a defined benefit pension plan, the Morgan Stanley Defined Benefit Plan. For the defined benefit plan, the 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 statement of financial position 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 together with the expected return on plan assets less the unwinding of the discount on the plan liabilities is charged to 'Other expense' in the consolidated income statement. Actuarial gains and losses that arise in calculating the Group's obligation in respect of a plan are recognised in other comprehensive income, in the period in which they occur.

4. INTEREST INCOME AND INTEREST EXPENSE

'Interest income' and 'Interest expense' represent total interest income and total interest expense for financial assets and financial liabilities that are not at fair value through profit or loss.

No other gains or losses have been recognised in respect of loans and receivables other than as disclosed as 'Interest income' within the consolidated income statement.

No other gains or losses have been recognised in respect of financial liabilities measured at amortised cost other than as disclosed as 'Interest expense' within the consolidated income statement.

Interest expense includes a dividend of $31 million paid on the Class B preference shares during the period (2008: $42 million).

5. OTHER INCOME

	Year ended 31 December 2009 $millions	1 December 2007 to 31 December 2008 $millions
Fee and commission income		
Advisory fees	147	276
Trust and other fiduciary activities	92	123
Foreign exchange gains	-	35
	239	434

6. OTHER EXPENSE

	Year ended 31 December 2009 $millions	1 December 2007 to 31 December 2008 $millions
Fee and commission expense:		
Brokerage fees	410	732
Direct staff costs	189	226
Management recharges relating to staff costs borne by other Morgan Stanley Group undertakings	1,630	1,716
Management recharges from other Morgan Stanley Group undertakings relating to other services	307	168
Operating lease rentals	9	9
Depreciation on property, plant and equipment	7	7
Foreign exchange losses	25	-
Business development and corporate services	473	487
Auditors remuneration:		
Fees payable to the Company's auditors for the audit of the Company's accounts	3	3
Fees payable to the Company's auditors for the audit of the subsidiaries' accounts	1	1
Fees payable to the Company's auditors for other services:	1	1
Other operating expense	271	585
	3,326	3,935

Included within both direct staff costs and management recharges relating to staff costs borne by other Morgan Stanley Group undertakings is an amount of $230 million (2008: $470 million) in relation to equity-based compensation plans. 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 period. Also included within direct staff costs and management recharges relating to staff costs borne by other Morgan Stanley Group undertakings is an amount of $49 million (2008: $87 million) in relation to defined contribution pension plans.

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

	Number	
	Year ended 31 December 2009	1 December 2007 to 31 December 2008
Company and institutional securities infrastructure	159	164
Business units and other	192	238
	351	402

The costs of staff are analysed below:

	Year ended 31 December 2009 $millions	1 December 2007 to 31 December 2008 $millions
Wages and salaries, including termination costs	166	211
Social security costs	21	12
Pension costs	2	3
	189	226

The Group paid no remuneration to the Company's Directors during the current or prior period but incurred management recharges in respect of Directors' services provided to the Group. The amount of remuneration received by Directors in respect of their services to the Group is disclosed in note 35.

7. INCOME TAX EXPENSE / (CREDIT)

	Year ended 31 December 2009 $millions	1 December 2007 to 31 December 2008 $millions
Current tax expense		
United Kingdom corporation tax charge		
– current year / period	195	(304)
– adjustments in respect of prior years	(2)	(31)
Double taxation relief		
– current year / period	(39)	(64)
– adjustments in respect of prior years	49	5
Overseas tax		
– current year / period	151	461
– adjustment in respect of prior years	(7)	(2)
	347	65
Deferred tax credit		
Origination and reversal of temporary differences	97	(127)
Adjustment in respect of prior years	28	-
	472	(62)

The Company and its subsidiary undertakings in the United Kingdom ("UK") provide for UK corporation tax at 28%. Overseas subsidiary undertakings provide for taxation at the appropriate rates in the countries in which they operate.

	Year ended 31 December 2009 $millions	1 December 2007 to 31 December 2008 $millions
Reconciliation of effective tax rate		
Profit / (loss) before income tax	597	(33)
Income tax using the standard rate of corporation tax in the UK of 28%	167	(9)
Impact on tax of:		
Expenses not deductible for tax purposes	8	10
Interest not deductible	2	24
Group relief surrendered for nil consideration	176	147
Effect of tax rates in foreign jurisdictions	24	33
Carry forward tax losses	6	3
Under / (over) provided in prior years	68	(30)
Tax exempt income / (expense)	1	(213)
Non deductible preference share dividends shown as interest expense	9	12
Withholding tax expensed	(9)	-
Other	20	(39)
Total income tax expense / (credit) in the consolidated income statement	472	(62)

The Group has a policy of surrendering tax-deductible losses ('group relief') for nil consideration to other members of the Morgan Stanley UK tax group. Within the Group, a number of subsidiary undertakings generate tax-deductible losses which are surrendered to other Morgan Stanley subsidiary undertakings outside the Group. In addition to the amount charged to the consolidated income statement, the aggregate amount of current and deferred tax relating to items that are taken directly to equity, was $2 million (2008: $nil charge).

7. INCOME TAX EXPENSE / (CREDIT) (CONTINUED)

	2009			2008		
	Before tax $millions	Tax (expense)/ benefit $millions	Net of tax $millions	Before tax $millions	Tax (expense)/ benefit $millions	Net of tax $millions
Foreign currency translation differences on foreign operations	40	-	(40)	42	-	42
Fair value reserve:						
Net change in fair value of available-for-sale assets	(7)	2	(5)	(1)	-	(1)
Actuarial (losses) / gains on defined benefit pension plans	(2)	-	(2)	1	-	1
Other comprehensive income	(49)	2	(47)	42	-	42

8. CASH AT BANK

Included within cash at bank is an amount of $7,962 million (2008: $10,616 million) which represents segregated client money, held in accordance with the FSA's Client Money Rules, and an amount of $235 million (2008: $269 million) which represents other client money.

9. OTHER RECEIVABLES

	Year ended 31 December 2009 $millions	1 December 2007 to 31 December 2008 $millions
Amounts held at exchanges	169	125
Amounts due from other Morgan Stanley Group undertakings	14,136	8,451
Other	1,879	1,578
	16,184	10,154

10. FINANCIAL ASSETS AND FINANCIAL LIABILITIES CLASSIFIED AS HELD FOR TRADING

Financial assets and financial liabilities categorised as held for trading are summarised in the table below.

	2009 Assets $millions	2009 Liabilities $millions	2008 Assets $millions	2008 Liabilities $millions
Fair value				
Government debt securities	12,871	11,859	11,553	5,406
Corporate equities	44,703	15,667	43,429	11,990
Corporate and other debt	20,504	6,476	15,223	1,014
Derivatives	165,995	169,553	215,452	221,794
	244,073	203,555	285,657	240,204

11. 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 Over the Counter ("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.

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 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.

11. FINANCIAL ASSETS AND FINANCIAL LIABILITIES DESIGNATED AT FAIR VALUE THROUGH PROFIT OR LOSS (CONTINUED)

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

	2009 Assets $millions	2009 Liabilities $millions	2008 Assets $millions	2008 Liabilities $millions
Prepaid OTC contracts	1,784	2,213	1,205	1,197
Structured notes	-	670	-	1,273
Other financial assets and liabilities	123	4,996	190	3,408
	1,907	7,879	1,395	5,878

The difference between the carrying amount of financial liabilities designated at fair value through profit or loss and the contractual amount due at maturity is $190 million higher. The change in fair value recognised through the consolidated income statement attributable to own credit risk is a loss of $203 million (2008: $307 million gain) and cumulatively is $122 million gain (2008: $325 million gain). This change is determined as the amount of change in its fair value that is not attributable to changes in market conditions that give rise to market risk.

12. AVAILABLE-FOR-SALE FINANCIAL ASSETS

Financial assets that are categorised as available-for-sale consist of corporate equities.

Movement in available-for-sale financial assets	2009 $millions	2008 $millions
At the beginning of the year / period	87	6,226
Additions	-	6,664
Changes in fair value recognised in the fair value reserve	(7)	(1)
Disposals	(38)	(11,417)
Foreign exchange retranslation recognised in the currency translation reserve	1	(1,385)
At the end of the year / period	43	87
Of which:		
Other available-for-sale financial assets	43	87
	43	87

The disposals during the prior period mainly relate to investments made by the Group in unconsolidated companies as part of its structured products business. Foreign exchange translation arises on assets held in entities with a non US dollar functional currency being translated into US dollars on consolidation by the Group.

13. PROPERTY, PLANT AND EQUIPMENT

	Leasehold improvements $millions	Fixtures, fittings and equipment $millions	Total $millions
2009			
Cost			
At 1 January 2009	25	20	45
Additions	-	1	1
Foreign exchange revaluation on assets held in overseas branches and subsidiaries	1	1	2
Disposals	(2)	(1)	(3)
At 31 December 2009	24	21	45
Depreciation			
At 1 January 2009	11	13	24
Charge for the year	4	3	7
Foreign exchange revaluation on assets held in overseas branches and subsidiaries	-	1	1
Disposals	(2)	(1)	(3)
At 31 December 2009	13	16	29
Net book value			
At 31 December 2009	11	5	16
2008			
Cost			
At 1 December 2007	24	21	45
Additions	5	1	6
Foreign exchange revaluation on assets held in overseas branches and subsidiaries	(3)	(2)	(5)
Disposals	(1)	-	(1)
At 31 December 2008	25	20	45
Depreciation			
At 1 December 2007	8	11	19
Charge for the period	4	3	7
Foreign exchange revaluation on assets held in overseas branches and subsidiaries	(1)	(1)	(2)
At 31 December 2008	11	13	24
Net book value			
At 31 December 2008	14	7	21

14. ASSOCIATE AND JOINT VENTURE

The Group holds an interest in Tarvos Investments GmbH ("Tarvos"), a limited liability company incorporated in Germany. The Group has contributed 50% of the capital in the company. Tarvos is not consolidated as the Group's 50% holding results in the Group having significant influence rather than control.

During the year, the Group sold its interest in Brencourt Multi-Strategy Enhanced Dedicated Fund LP ("Brencourt"), a limited partnership incorporated in the Cayman Islands. The Company had contributed approximately 99.9% of the capital in the partnership. This limited partnership was not consolidated by the Group as the majority of the risks and rewards of the partnership are absorbed by entities outside the Group, resulting in the Group having significant influence rather than control. The sale of Brencourt resulted in no net gain or loss on disposal.

The following presents the movement in the Group's investments in Brencourt and Tarvos:

	2009 $millions	2008 $millions
At the beginning of the year / period	11	206
Addition	-	8
Disposal	(4)	(178)
Share of loss for the year / period	-	(25)
At the end of the year / period	7	11

15. OTHER PAYABLES

	2009 $millions	2008 $millions
Amounts owing to other Morgan Stanley Group undertakings	30,328	32,401
Other	3,420	2,789
	33,748	35,190

16. SUBORDINATED LOANS

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

Counterparty	Repayment Date	Interest Rate	2009 $millions	2008 $millions
Morgan Stanley Strategic Funding Limited	29 October 2026	LIBOR plus 2.00%	644	1,494
Morgan Stanley International Finance S.A.	31 October 2025	LIBOR plus 1.25%	7,906	7,906
Morgan Stanley International Holdings Inc	31 October 2026	LIBOR plus 1%	-	3,550
			8,550	12,950

All counterparties are part of the Morgan Stanley Group and all 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 under the agreement to refuse consent to repayment.

On 20 November 2009 the Group repaid $3,550 million and $850 million under its loan facilities with Morgan Stanley International Holdings Inc and Morgan Stanley Strategic Funding Limited respectively. These repayments were made as part of the Group's capital management activities.

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

17. PREFERENCE SHARES

	Class B preference shares of $1 each: $millions
Allotted and fully paid:	
At 31 December 2008 and 31 December 2009	786

At 31 December 2009 the Company's issued share capital included 785,772,500 Class B non-cumulative preference shares of $1 each, classified as liabilities. The holders of the Class B non-cumulative preference shares of $1 each are entitled to receive a LIBOR-based dividend as defined in the Company's Articles of association. The shares do not entitle holders to vote at any general meeting of the Company. On a return of capital, the holders of the Class B redeemable non-cumulative preference shares shall rank equally with the Company's Class C non-redeemable non-cumulative preference shares (see note 21) in priority to any other class of share.

18. PROVISIONS

	Property $millions	Litigation $millions	Total $millions
At 1 January 2009	3	26	29
Additional provisions	1	15	16
Provisions utilised	(1)	(23)	(24)
Foreign exchange adjustment	-	1	1
At 31 December 2009	3	19	22

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.

Litigation matters

During the year the Group has been involved in various continuing and other litigation matters. The Directors are of the opinion that it would be seriously prejudicial to the position of the Group to disclose details of individual continuing litigation matters and the amounts provided in respect of them.

19. DEFERRED TAX ASSETS AND LIABILITIES

Deferred taxes are calculated on all temporary differences under the liability method. The movement in the deferred tax account is as follows:

	2009		2008	
	Deferred tax asset $millons	Deferred tax liability $millions	Deferred tax asset $millions	Deferred tax liability $millions
At the beginning of the year / period	173	(9)	49	(11)
Amount recognised in the consolidated income statement	(127)	1	127	1
Amount recognised in equity: Available-for-sale financial assets	1	1	(3)	-
Foreign exchange adjustment	-	-	-	1
As at 31 December	47	(7)	173	(9)

19. DEFERRED TAX ASSETS AND LIABILITIES (CONTINUED)

The deferred tax included in the consolidated statement of financial position and changes recorded in the income tax expense are as follows:

	Deferred tax asset 2009 $millions	Deferred tax liability 2009 $millions	Consolidated Income statement 2009 $millions	Deferred tax asset 2008 $millions	Deferred tax liability 2008 $millions	Consolidated Income statement 2008 $millions
Depreciation - temporary differences	7	-	2	5	-	-
Deferred compensation	19	-	6	13	-	(7)
Tax losses carried forward		-	(135)	135		135
Available-for-sale financial assets	1	-	-	-	(1)	-
Forecast currency hedges	-	(5)	1	-	(6)	1
Amounts not recognised due to unobservable market data	17	-	-	19	-	-
Impact of tax rate changes	-	-	-	-	-	-
Other temporary differences	3	(2)	1	1	(2)	(2)
	47	(7)	(125)	173	(9)	127

The deferred tax assets recognised are based on management's assessment that it is probable that the Group will have taxable profits against which the temporary differences can be utilised.

Deferred tax assets have not been recognised in respect of the following temporary differences:

	2009 $millions	2008 $millions
Unused tax losses	153	7
	153	7

The aggregate amount of temporary differences associated with investments in subsidiaries, branches and associates, for which deferred tax liabilities have not been recognised is $nil (2008: $nil).

20. COMMITMENTS AND CONTINGENCIES

The Group has entered into commercial leases on premises and equipment. These leases have an average life of between two and five years.

	2009 $millions	2008 $millions
Minimum lease payments under non-cancellable operating leases recognised as an expense in the period	9	9

Future minimum lease payments under non-cancellable operating leases at 31 December 2009 and 31 December 2008 are due as follows:

	2009 $millions	2008 $millions
Within one year	8	9
In two to five years	22	27
Over five years	1	6
	31	42

At 31 December 2009 and 31 December 2008, the Group had the following outstanding commitments and contingent liabilities arising from off-balance sheet financial instruments:

	2009 $millions	2008 $millions
Letters of credit	1	142
Loan commitments	26	1,039
Forward starting reverse repurchase agreements	18,458	10,993

21. EQUITY

Share capital

	Class C, non-cumulative, preference shares of $1 each: $millions	Ordinary shares of $1 each: $millions	Ordinary shares of £1 each: $millions	Total shares: $millions
Issued and fully paid:				
At 1 January 2009	1,300	2,998	30	4,328
Repurchase in the year: 23 December 2009	(1,250)	-	-	(1,250)
At 31 December 2009	50	2,998	30	3,078

On 23 December 2009, the Company repurchased and cancelled 1,250,000,000 Class C non-redeemable non-cumulative preference shares of $1 each, at par value.

At 31 December 2009 the total issued share capital equated to $3,078 million (2008: $4,328 million) comprising 50,000,000 Class C non-redeemable non-cumulative preference shares of $1 each, 2,998,332,648 ordinary shares of $1 each and 17,615,107 ordinary shares of £1 each. All issued shares are fully paid.

The holders of the ordinary shares, irrespective of currency denomination, are entitled to receive dividends as declared from time to time and are entitled to one vote per share at meetings of the Company in accordance with the Company's articles of association.

The holders of the Class C non-redeemable non-cumulative preference shares of $1 each are entitled to receive a LIBOR based dividend in priority to any other class of share in accordance with the Company's articles of association. The holders of such shares in issue shall carry such number of votes in aggregate as represents 10% of the total voting rights of all the members of the Company having a right to attend and vote at general meetings. On a return of capital, the holders of the Class C non-redeemable non-cumulative preference shares shall rank equally with the Class B redeemable non-cumulative preference shares (see note 17), in priority to any other class of share.

21. EQUITY (CONTINUED)

Other shares classified as financial liabilities

The terms of other shares classified as financial liabilities are detailed in note 17, 'Preference shares'.

Currency translation reserve

The 'Currency translation reserve' comprises all foreign exchange differences arising from the translation of the total assets less total liabilities of foreign operations.

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. The tax effect of these movements is also included in the 'Fair value reserve'.

Capital contribution reserve

The 'Capital contribution reserve' includes contributions of capital from the Group's parent company to subsidiaries of the Group.

Capital redemption reserve

The 'Capital redemption reserve' represents transfers in prior years from retained earnings in accordance with relevant legislation.

22. DIVIDENDS

	2009		2008	
	Per Share $	**Total $millions**	**Per Share $**	**Total $millions**
Interim dividends on ordinary shares of £1 each	0.11	2	-	-
Interim dividends on ordinary shares of $1 each	0.07	198		
Dividend on class C preference shares	0.03	1	-	-
		201	-	-

The Directors have not recommended the payment of a final dividend out of the reserves available at 31 December 2009 (2008: $nil).

23. ADDITIONAL CASH FLOW INFORMATION

a. Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise the following balances which have less than three months maturity from the date of acquisition:

	2009 $millions	2008 $millions
Cash at bank	13,580	19,988
Bank loans and overdrafts	(126)	(451)
	13,454	19,537

Included within 'Cash at bank' is $8,197 million (2008: $10,885 million) of segregated client funds that are not available for use by the Group. The corresponding payable is recognised and included in 'financial liabilities at amortised cost'.

b. Reconciliation of cash flows from operating activities

	2009 $millions	2008 $millions
Profit for the period	125	29
Adjustments for:		
Depreciation on property, plant and equipment	7	7
Net gains on available-for-sale investments	(16)	(1,215)
Interest income	(4,181)	(18,530)
Interest expense	4,403	20,572
Income tax expense	472	(62)
Share of loss of joint venture	-	25
Other expenses	(2)	2
Profit before changes in operating assets and liabilities	808	828
Change in operating assets		
Net (increase) / decrease in loans and receivables	(26,698)	159,106
Net decrease in financial assets classified as held for trading	41,583	21,474
Net (increase) / decrease in financial assets designated at fair value through profit or loss	(512)	207
	14,373	180,787
Change in operating liabilities		
Net increase / (decrease) in financial liabilities at amortised cost	19,558	(205,813)
Net (decrease) / increase in financial liabilities classified as held for trading	(36,649)	27,827
Net increase / (decrease) in financial liabilities designated at fair value through profit or loss	2,001	(8,770)
Net (decrease) / increase in provisions	(7)	22
	(15,097)	(186,734)
Effect of foreign exchange movements	(460)	1,802
Cash used in operating activities	(376)	(3,317)
Interest received	4,156	19,209
Interest paid	(4,024)	(20,310)
Income tax paid	(180)	(903)
Net cash flows used in operating activities	(424)	(5,321)

24. EXPECTED MATURITY OF ASSETS AND LIABILITIES

The table below shows an analysis of assets and liabilities analysed according to when they are expected to be recovered or settled:

At 31 December 2009	Less than twelve months $millions	Equal to or more than twelve months $millions	Total $millions
ASSETS			
Loans and receivables:			
Cash at bank	13,580	-	13,580
Securities borrowed	25,394	-	25,394
Reverse repurchase agreements	83,331	-	83,331
Trade receivables	51,642	-	51,642
Other receivables	16,015	169	16,184
	189,962	169	190,131
Financial assets classified as held for trading	244,073	-	244,073
Financial assets designated at fair value through profit or loss	269	1,638	1,907
Available-for-sale financial assets	-	43	43
Current tax	558	-	558
Deferred tax assets	-	47	47
Prepayments and accrued income	19	-	19
Property, plant and equipment	-	16	16
Associates and joint ventures	-	7	7
TOTAL ASSETS	434,881	1,920	436,801
LIABILITIES			
Financial liabilities at amortised cost:			
Bank loans and overdrafts	126	-	126
Securities loaned	43,806	500	44,306
Repurchase agreements	65,766	-	65,766
Trade payables	64,557	-	64,557
Other payables	33,748	-	33,748
Subordinated loans	-	8,550	8,550
Preference shares	-	786	786
	208,003	9,836	217,839
Financial liabilities classified as held for trading	203,555	-	203,555
Financial liabilities designated at fair value through profit or loss	5,461	2,418	7,879
Provisions	19	3	22
Current tax	381	-	381
Deferred tax liabilities	-	7	7
Accruals and deferred income	297	-	297
Retirement benefit obligations	-	4	4
TOTAL LIABILITIES	417,716	12,268	429,984

24. EXPECTED MATURITY OF ASSETS AND LIABILITIES (CONTINUED)

At 31 December 2008	Less than twelve months $millions	Equal to or more than twelve months $millions	Total $millions
ASSETS			
Loans and receivables:			
Cash at bank	19,988	-	19,988
Securities borrowed	30,790	-	30,790
Reverse repurchase agreements	57,235	-	57,235
Trade receivables	51,532	-	51,532
Other receivables	10,029	125	10,154
	169,574	125	169,699
Financial assets classified as held for trading	285,657	-	285,657
Financial assets designated at fair value through profit or loss	232	1,163	1,395
Available-for-sale financial assets	-	87	87
Current tax	460	-	460
Deferred tax assets	-	173	173
Prepayments and accrued income	134	-	134
Property, plant and equipment	-	21	21
Associates and joint ventures	-	11	11
Intangible assets	-	-	-
TOTAL ASSETS	456,057	1,580	457,637
LIABILITIES			
Financial liabilities at amortised cost:			
Bank loans and overdrafts	451	-	451
Securities loaned	45,786	-	45,786
Repurchase agreements	51,463	-	51,463
Trade payables	55,245	-	55,245
Other payables	35,190	-	35,190
Subordinated loans	-	12,950	12,950
Preference shares	-	786	786
	188,135	13,736	201,871
Financial liabilities classified as held for trading	240,204	-	240,204
Financial liabilities designated at fair value through profit or loss	3,954	1,924	5,878
Provisions	26	3	29
Current tax	116	-	116
Deferred tax liabilities	-	9	9
Accruals and deferred income	1,390	-	1,390
Retirement benefit obligations	-	2	2
TOTAL LIABILITIES	433,825	15,674	449,499

25. 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 year ended 31 December 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 year and comparative period.

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

Consolidated income statement information Year ended 31 December 2009	**Institutional Securities $millions**	**Other $millions**	**Total $millions**
Net gains on financial instruments classified as held for trading	3,833	-	3,833
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	(261)	39	(222)
Other income	217	22	239
External revenues net of interest expense	3,862	61	3,923
Other expense	(3,247)	(79)	(3,326)
Profit / (loss) on ordinary activities	615	(18)	597
Share of losses of associate and joint venture	-	-	-
Profit / (loss) before tax	615	(18)	597
Income tax (expense) / credit	(477)	5	(472)
Profit / (loss) for the period	138	(13)	125

25. SEGMENT REPORTING (CONTINUED)

Consolidated statement of financial position information As at 31 December 2009	Institutional Securities $millions	Other $millions	Total $millions
Segment assets	432,087	4,707	436,794
Associate and joint venture	7	-	7
Total assets	432,094	4,707	436,801
Segment liabilities	426,216	3,768	429,984
Total Liabilities	426,216	3,768	429,984
Other segment information			
Property, plant and equipment capital expenditure	1	-	1
Depreciation on property, plant and equipment	7	-	7

Consolidated income statement information 13 months ended 31 December 2008	Institutional Securities $millions	Other $millions	Total $millions
Net gains on financial instruments classified as held for trading	2,960	-	2,960
Net gains on financial instruments designated at fair value through profit or loss	1,319	-	1,319
Net gains on available-for-sale financial assets	1,215	-	1,215
Net interest	(2,149)	107	(2,042)
Other income	273	161	434
External revenues net of interest expense	3,618	268	3,886
Other expense	(3,646)	(289)	(3,935)
Loss on ordinary activities	(28)	(21)	(49)
Share of losses of associate and joint venture	(25)	-	(25)
Net gain on disposal of subsidiary	41	-	41
Loss before tax	(12)	(21)	(33)
Income tax credit	56	6	62
Profit / (loss) for the period	44	(15)	29

25. 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 consolidated 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	
	2009 $millions	2008 $millions	2009 $millions	2008 $millions	2009 $millions	2008 $millions	2009 $millions	2008 $millions
External revenues net of interest	3,921	2,633	(8)	662	10	591	3,923	3,886
Profit / (loss) before income tax	787	(1,268)	(92)	836	(98)	399	597	(33)
Total assets	340,856	385,208	54,647	9,086	41,298	63,343	436,801	457,637

26. 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.

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 2009, 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 2009, the Group's material credit exposure was to corporate entities (including financial institutions) and sovereign-related entities.

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 on the consolidated statement of financial position.

26. 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 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 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. 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.

26. FINANCIAL RISK MANAGEMENT (CONTINUED)

Exposure to credit risk by class

Class	Gross credit exposure 2009 $millions	Gross credit exposure 2008 $millions
Loans and receivables:		
Cash at bank	13,580	19,988
Securities borrowed	25,394	30,790
Reverse repurchase agreements	83,331	57,235
Trade receivables	34,112	41,652
Other receivables	15,948	9,782
Financial assets classified as held for trading:		
Derivatives	151,578	193,072
Financial assets designated at fair value through profit or loss	1,907	1,395
	325,850	353,914
Unrecognised financial instruments		
Letters of credit	1	142
Lease commitments	31	42
Loan commitments	26	1,039
Unsettled reverse repurchase agreements	18,458	10,993
	344,366	366,130

Maximum exposure to credit risk by credit rating

Credit rating	Gross credit exposure 2009 $millions	Gross credit exposure 2008 $millions
AAA	11,351	9,466
AA	107,219	125,645
A	170,854	179,664
BBB	14,126	7,986
BB	3,551	6,324
B	24,876	14,507
CCC	5,336	602
D	1	45
Unrated	7,052	21,891
Total	344,366	366,130

At 31 December 2009 there were no financial assets past due but not impaired (2008: None). At 31 December 2009 there were no financial assets individually impaired (2008: None).

26. 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 risk management tool. The CFP models a potential, prolonged liquidity contraction over a one-year time period and sets forth a course of action to effectively manage a liquidity event. 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.

Liquidity Reserves. The Morgan Stanley Group and the Group seeks to maintain target liquidity reserves that are sized to cover daily funding needs and meet strategic liquidity targets as outlined in CFP. These liquidity reserves are held in the form of cash deposits and pools of central bank eligible unencumbered securities. The Group's liquidity reserve is managed locally and consists of overnight cash deposits and unencumbered U.S. and European government bonds, agencies and agency pass throughs. In addition to the liquidity reserve held by the Group, the Group has access to the liquidity reserve held by Morgan Stanley. The Morgan Stanley liquidity reserve is managed globally and consists of overnight cash deposits and unencumbered U.S. and European government bonds, agencies and agency pass throughs. The Morgan Stanley Group and the Group believes that diversifying the form in which its liquidity reserves are maintained (cash and securities) enhances its ability to quickly and efficiently source funding in a stressed environment. 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.

26. 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 statement of financial position, 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 liabilities 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 2009. 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 in managed by the Group.

26. 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
31 December 2009	**$millions**	**$millions**	**$millions**	**$millions**	**$millions**	**$millions**	**$millions**
Financial liabilities							
Financial liabilities at amortised cost:							
Bank loans and overdrafts	126	-	-	-	-	-	126
Securities loaned	37,800	1,335	1,968	2,703	500	-	44,306
Repurchase agreements	6,505	52,019	4,617	2,650	-	-	65,791
Trade payables	64,557	-	-	-	-	-	64,557
Other payables	33,748	-	-	-	-	-	33,748
Subordinated loans	-	11	22	100	533	10,008	10,674
Preference shares *	-	-	-	21	139	1,408	1,568
Financial liabilities classified as held for trading							
Derivatives	169,553	-	-	-	-	-	169,553
Other	34,002	-	-	-	-	-	34,002
Financial liabilities designated at fair value through profit or loss	4,750	104	86	521	1,293	1,125	7,879
Total financial liabilities	351,041	53,469	6,693	5,995	2,465	12,541	432,204
Unrecognised financial instruments							
Letters of credit	1	-	-	-	-	-	1
Lease commitments	8	-	-	-	-	23	31
Loan commitments	26	-	-	-	-	-	26
Unsettled reverse repurchase agreements	18,458	-	-	-	-	-	18,458
Total unrecognised financial instruments	18,493	-	-	-	-	23	18,516

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

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

26. FINANCIAL RISK MANAGEMENT (CONTINUED)

Liquidity risk (continued)

31 December 2008	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
	$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 classified as 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
Lease commitments	9	-	-	-	-	33	42
Loan commitments	1,022	-	1	16	-	-	1,039
Unsettled reverse repurchase agreements	10,993	-	-	-	-	-	10,993
Total unrecognised financial instruments	12,024	33	16	110	-	33	12,216

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

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

26. 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 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 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.

Primary market risk exposures and market risk management

During the year ended 31 December 2009, 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 distressed corporate debt.

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.

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). The Group manages the market risk associated with its trading activities on a Group basis, on a trading division level and on an individual product basis. 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 key management personnel.

26. 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 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 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.

26. FINANCIAL RISK MANAGEMENT (CONTINUED)

Market risk (continued)

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 and group levels.

VaR for the year ended 31 December 2009

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 2009 and 31 December 2008, 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. Also, the non-trading VaR excludes the Group's own credit risk generated through counterparty trades and through primary issuance.

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.

26. 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 as of December 31, 2009 and December 31, 2008.

95% Total VaR primary market risk category	95% one-day VaR 2009 Aggregate $millions	2009 Trading $millions	2009 Non-Trading $millions	2008 Aggregate $millions	2008 Trading $millions	2008 Non-Trading $millions
Interest rate and credit spread	47	38	18	28	28	17
Equity price	12	12	1	15	14	2
Foreign exchange rate	8	7	2	6	5	3
Commodity price	3	3	-	1	1	-
Subtotal	70	60	21	50	48	22
Less diversification benefit (1)	17	16	3	20	21	5
Total VaR	53	44	18	30	27	17

(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 Trading VaR at 31 December 2009 was $44 million compared with $27 million at 31 December 2008. The increase in trading VaR is primarily due to increased interest rate and credit spread VaR.

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 year to 31 December 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	2009 High $millions	2009 Low $millons	2009 Average $millions	2008 High $millions	2008 Low $millions	2008 Average $millions
Interest rate and credit spread	61	27	37	37	18	26
Equity price	22	10	14	48	9	24
Foreign exchange rate	19	3	9	20	3	9
Commodity price	4	1	2	3	1	2
Trading VaR	72	26	40	58	26	38

Average Trading VaR for 2009 was $40 million, $2 million higher than the average trading VaR for the 13 month period to 31 December 2008, driven by an increase in interest rate and credit spread VaR, partially offset by reduced average equity VaR.

26. FINANCIAL RISK MANAGEMENT (CONTINUED)

Market Risk (continued)

Interest rate risk

The Group's VaR excludes certain funding liabilities and money market transactions. As at 31 December 2009, the net notional amount of such funding liabilities and money market activities was approximately $1.2 billion, compared to $6.7 billion as at 31 December 2008. 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 of approximately $5.5 million, compared to $6.7 million as at 31 December 2008.

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. 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 comprehensive income 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 other members of the Morgan Stanley Group.

Foreign currency exposure	2009 $millions	Parallel shift %	Sensitivity $millions	2008 $millions	Parallel shift %	Sensitivity $millions
Australian Dollar	(5)	27%	1	(4)	27%	1
Euro	394	5%	20	(409)	5%	20
British Pound	120	29%	35	50	29%	15
New Taiwan Dollar	92	3%	3	100	3%	3
New Zealand Dollar	2	24%	-	1	24%	-
Singapore Dollar	3	2%	-	8	2%	-
South Korean Won	138	42%	58	211	42%	89
Swedish Krona	14	23%	3	13	23%	3
	758			(30)		

The parallel shift has been calculated based on the percentage change in the respective foreign currency rates against US dollars in the period from 1 December 2007 to 31 December 2008 or in the period from 1 January 2009 to 31 December 2009, using whichever produces the greater percentage change for each currency.

27. 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 2009 was $162,214 million (2008: $121,385 million). Of this amount $134,615 million (2008: $116,892 million) has been sold or repledged to third parties in connection with financing activities, or to comply with commitments under short sale transactions.

28. 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 asset.

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 statement of financial position.

	2009 $millions	2008 $millions
Government debt securities	9,958	10,706
Corporate equities	42,108	32,318
Corporate and other debt	10,107	8,414
	62,173	51,438

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.

29. FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE

Improving disclosures about Financial Instruments (Amendment to IFRS 7) was adopted during the year. The Group has taken advantage of the exemption in paragraph 44G of IFRS7, to not provide comparative disclosures for the changes implemented by these amendments.

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 does not entail a significant degree of judgment.
- 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.

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

29. FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE (CONTINUED)

a Fair value hierarchy (continued)

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 and other debt

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

- Residential Mortgage-Backed Securities ("RMBS"), Commercial Mortgage-Backed Securities ("CMBS"), and other Asset-Backed Securities ("ABS"). RMBS, CMBS and other ABS may be valued based on 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.

- 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 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 significant 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.

- 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. The correlation input between reference credits within the collateral is unobservable and is benchmarked to standardized 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.

29. FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE (CONTINUED)

a Fair value hierarchy (continued)

Corporate and other debt (continued)

- Corporate Loans and other lending commitments. The fair value of corporate loans is estimated using recently executed transactions, market prices quotations (where observable) and market observable loan credit default swap spread levels adjusted for any basis difference between cash and derivative instruments, along with proprietary valuation models and default recovery analysis where such transactions and quotations are unobservable. The fair value of contingent corporate 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.

Corporate equities and available-for-sale financial assets

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, to the extent not actively traded, these securities are categorised in Level 2 or 3 of the fair value hierarchy. Corporate equity securities are classified as either held for trading or available-for-sale financial assets in line with the Group's accounting policies described in Note 3.

Derivatives

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 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 financial instruments can be modelled using a series of techniques, including closed-form analytic formulae such as the Black-Scholes option pricing model, 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. In the case of more established derivative products, the pricing models used by the Group are widely accepted by the financial services industry. A substantial majority of OTC derivative products valued by the Group using pricing models are categorised within Level 2 of the fair value hierarchy.

Other derivative products, typically the newest and most complex products, or products that have become illiquid, require more judgment in the implementation of the valuation technique applied due to the complexity of the valuation assumptions and the reduced observability of inputs. This includes derivative interests in certain mortgage-related collateralised debt obligation ("CDO") securities, mortgage-related credit default swaps, basket credit default swaps and CDO-squared positions 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.

Derivative interests in mortgage-related CDOs, for which observability of external price data is extremely limited, are valued based on an evaluation of the market for similar positions as indicated by primary and secondary market activity in the cash CDO and synthetic CDO markets. 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 judgment and these interests are generally included in Level 3 of the fair value hierarchy.

29. FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE (CONTINUED)

a Fair value hierarchy (continued)

Derivatives (continued)

Mortgage-related credit default swaps are valued based on data from comparable credit instruments in the cash market and trades in comparable swaps as benchmarks, as prices and spreads for the specific credits subject to valuation tend to be of limited observability. These swaps are generally included in Level 3 of the fair value hierarchy.

For basket credit default swaps and CDO-squared positions, the correlation between reference credits is often a significant input into the pricing model, in addition to several other more observable inputs such as credit spread, interest and recovery rates. As the correlation input is unobservable for each specific swap, it is benchmarked to standardised proxy baskets for which external data are available.

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.

Investments (other than investments in other Morgan Stanley Group undertakings)

The Group's investments include 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.

Investments in private equity and real estate funds are generally categorised in Level 3 of the fair value hierarchy. Investments in hedge funds that are redeemable at the measurement date or in the near future, are categorised in Level 2 of the fair value hierarchy; otherwise they are categorised in Level 3.

Structured notes and prepaid OTC derivatives 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 valuation models described above for the derivative and debt features 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 rates. The impact of own credit spreads is also included based on observed secondary bond market spreads. Most structured notes and prepaid OTC derivatives are categorised in Level 2 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 desks.

29. FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE (CONTINUED)

a Fair value hierarchy (continued)

Fair Value Control Processes (continued)

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.

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:

	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	11,921	948	2	12,871
- Corporate equities	42,413	2,241	49	44,703
- Corporate and other debt	10	18,143	2,351	20,504
- Derivatives	1,175	160,586	4,234	165,995
Total financial assets classified as held for trading	55,519	181,918	6,636	244,073
Financial assets designated at fair value through profit or loss	107	389	1,411	1,907
Available-for-sale financial assets				
- Corporate equities	1	-	42	43
Total financial assets held at fair value	55,627	182,307	8,089	246,023
Financial liabilities classified as held for trading:				
- Government debt securities	10,585	1,274	-	11,859
- Corporate equities	14,143	1,521	3	15,667
- Corporate and other debt	69	6,403	4	6,476
- Derivatives	1,352	162,305	5,896	169,553
Total financial liabilities classified as held for trading	26,149	171,503	5,903	203,555
Financial liabilities designated at fair value through profit or loss	2,785	4,202	892	7,879
Total financial liabilities at fair value	28,934	175,705	6,795	211,434

29. FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE (CONTINUED)

a. Fair value hierarchy (continued)

Financial assets and liabilities recognised at fair value (continued)

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

29. FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE (CONTINUED)

b. Changes in Level 3 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 2009:

2009	Balance at 1 January 2009	Total gains or losses 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 (1)	Balance at 31 December 2009	Unrealised gains or (losses) for level 3 assets / liabilities outstanding as at 31 December 2009 (2)
	$millions	$millions	$millions	$millions	$millions	$millions	$millions	$millions	$millions	$millions
Financial assets held for trading:										
- Government debt securities	2	-	-	-	-	-	-	-	2	-
- Corporate equities	460	(63)	-	63	(131)	-	-	(280)	49	(34)
- Corporate and other debt	2,302	236	-	938	(704)	-	-	(421)	2,351	233
Financial assets designated at fair value through profit or loss:	1,131	643	-	3	-	-	(283)	(83)	1,411	643
Available-for-sale financial assets:										
- Corporate equities	87	-	(7)	-	(38)	-	-	-	42	-
Financial liabilities held for trading:										
- Government debt securities	-	-	-	-	-	-	-	-	-	-
- Corporate equities	(24)	-	-	-	(10)	-	21	10	(3)	-
- Corporate and other debt	(88)	6	-	-	(18)	-	77	19	(4)	(24)
- Net derivative contracts (3)	(3,327)	1,548	-	-	-	-	(30)	147	(1,662)	1,042
Financial liabilities designated at fair value through profit or loss:	(515)	30	-	-	-	(380)	215	(242)	(892)	30
	28	2,400	(7)	1,004	(901)	(380)	-	(850)	1,294	1,890

(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 ended 31 December 2009 related to assets and liabilities still outstanding at 31 December 2009.
(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.

For the year ended 31 December 2008, the total amount of the change in fair value of financial instruments held by the Group estimated using a valuation technique that includes unobservable market data was a net loss of $2,861 million.

29. FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE (CONTINUED)

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

As disclosed in note 35 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 $95 million of derivative contracts and structured notes from Level 2 to Level 3. The reclassifications primarily related to exotic equity linked notes and were due to certain significant inputs for the fair value measurement becoming unobservable.

During the year, the Group reclassified approximately $755 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.

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 judgment 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.

29. 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 2009 to reasonably possible alternative assumptions.

2009	Fair Value $millions	Effect of reasonably possible alternative assumptions: Increase in fair value $millions	Effect of reasonably possible alternative assumptions: Decrease in fair value $millions
Financial assets classified as held for trading:			
- Government debt securities	2	-	-
- Corporate equities	49	1	(4)
- Corporate and other debt	2,351	141	(123)
Financial assets designated at fair value through profit or loss:			
- Prepaid OTC contracts	1,411	8	(8)
Available-for-sale financial assets:			
- Corporate equities	42	-	-
Financial liabilities classified as held for trading:			
- Government debt securities	-	-	-
- Corporate equities	(3)	-	-
- Corporate and other debt	(4)	3	(6)
- Net derivatives contracts[(1)]	(1,662)	149	(154)
Financial liabilities designated at fair value through profit or loss:			
- Prepaid OTC contracts	(188)	1	(1)
- Note issuances	(61)	1	(1)
- Other	(643)	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.

For the year ended 31 December 2008, the potential impact of using reasonably possible alternative assumptions for the valuation techniques including unobservable market data was quantified as approximately $310 million, which could be either positive or negative.

29. FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE (CONTINUED)

e. Financial instruments valued using unobservable market data

The amounts not recognised in the consolidated income statement 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:

	2009 $millions	2008 $millions
At the beginning of the year / period	281	232
New transactions	42	68
Amounts recognised in the consolidated income statement during the period	(108)	(19)
At the end of the year / period	215	281

The balance above predominantly relates to derivatives.

The statement of financial position 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.

30. 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:

2009	Carrying value $millions	Fair value $millions	Unrecognised gain / (loss) $millions
Financial assets and liabilities			
Subordinated loans	8,550	6,874	1,676
Preference shares	786	677	109
Termed reverse repurchase agreements	75,352	75,354	2
Termed repurchase agreements	59,262	59,266	(4)

2008	Carrying value $millions	Fair value $millions	Unrecognised gain / (loss) $millions
Financial assets and liabilities			
Subordinated loans	12,950	6,793	6,157
Preference shares	786	399	387
Termed reverse repurchase agreements	37,864	37,869	5
Termed repurchase agreements	16,665	16,670	(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 prior consent from the FSA.

31. 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 requirements. The Group's capital 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. The Group's capital exceeded all of its regulatory capital requirements during the period.

The Group considers the below to be its managed capital:

	2009 $millions	2008 $millions
Ordinary share capital	3,028	3,028
Preference share capital	50	1,300
Subordinated loans	8,550	12,950
Preference shares classified as debt instruments	786	786
Reserves	3,665	3,743
	16,079	21,807

During 2009, the Group has continued to review and actively manage its capital position. As part of this capital management, the Group has repaid $4,400 million of intercompany subordinated debt and repurchased $1,250 million of the Group's issued class C non-redeemable non-cumulative preference share capital.

32. SHARE-BASED PAYMENT TRANSACTIONS

As described in note 35, the Group utilises staff employed by other Morgan Stanley Group undertakings and incurs management charges in respect of these employee services. These management charges include the costs of equity-based compensation provided to these employees.

Equity-based compensation plans provided to employees of the Group are detailed below.

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 restricted common stock or 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 a sole vesting condition of service over time 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 vesting 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.

During the year, Morgan Stanley granted 102,226 units of restricted common stock to employees of the Group with a weighted average fair value per unit of $20.87 (2008: 783,678 units, weighted average fair value $38.31 per unit) based on the market value of Morgan Stanley shares at grant date. The thirteen month reporting period in 2008 includes units of restricted stock granted for two fiscal year end awards. Units granted in respect of employees' 2009 discretionary compensation have been granted in January 2010.

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.

32. SHARE-BASED PAYMENT TRANSACTIONS (CONTINUED)

Stock option awards (continued)

The following table shows activity relating to the Morgan Stanley Group's stock option awards for employees of the Group:

	2009		2008	
	Number of options '000s	Weighted average exercise price $	Number of options '000s	Weighted average exercise price $
Options outstanding at 1 January 2009 and 1 December 2007	478	50.78	539	48.72
Granted during the year / period	-	-	-	-
Forfeited during the year / period	1	66.73	6	66.73
Exercised during the year / period	-	-	37	26.20
Expired during the year / period	152	44.95	18	44.65
Options outstanding at 31 December	325	53.47	478	50.81
Options exercisable at 31 December	276	51.10	338	44.80

No stock options were exercised during the year. The weighted average share price on exercise in 2008 was $49.85.

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

	2009			2008		
Range of exercise prices	Number of options '000s	Weighted average exercise price $	Average remaining life in years	Number of options '000s	Weighted average exercise price $	Average remaining life in years
$30.00 - $39.99	66	36.25	2.9	103	34.78	3.0
$40.00 - $49.99	108	47.43	3.3	184	46.69	4.6
$50.00 - $59.99	14	54.33	.7	53	55.42	2.2
$60.00 - $69.99	137	66.45	4.6	138	66.45	7.5
Total	325	53.47	3.6	478	50.78	4.8

33. RETIREMENT BENEFITS

Defined contribution plans

The Group operates several Morgan Stanley defined contribution plans which require contributions made to the plans to be held in trust, separate from the assets of the Group.

The defined contribution plans are as follows:

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

The defined contribution pension charge recognised within 'Staff costs' in 'Other expense' in the consolidated income statement was $911,453 for the year (2008: $980,338) of which $3,843 was accrued at 31 December 2009 (2008: $57,988). Contributions to the Morgan Stanley & Co International plc, (Greece Branch) Group Insurance Policy ceased during the year due to the winding down of activity in the branch.

Defined benefit plans

The Group also operates several Morgan Stanley defined benefit plans, which provide pension benefits that a member is entitled to receive based 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 & 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 Seoul Branch Severance Pay Plan

Morgan Stanley & Co International plc (Athens Branch) Retirement Indemnity

Morgan Stanley Asia (Taiwan) Limited Retirement Scheme

Morgan Stanley Dubai End of Service Gratuity

Expense recognised in the consolidated income statement

The amounts recognised in 'Staff costs', within 'Other expense', in the consolidated income statement in respect of these defined benefit plans are as follows:

	2009 $millions	2008 $millions
Current service cost	2	2
Total charge	2	2

Actuarial gains and losses have been reported in other comprehensive income.

The cumulative amount of actuarial gains and losses recognised in the statement of comprehensive income is $2 million loss (2008: $1 million gain).

33. RETIREMENT BENEFITS (CONTINUED)

Retirement benefit obligation

The following table provides a reconciliation of the present value of the defined benefit obligation and fair value of plan assets included in the consolidated statement of financial position, as well as a summary of the funded status of the plans.

	2009 $millions	2008 $millions
Retirement benefit liability:		
Present value of funded defined benefit obligation	(6)	(4)
Fair value of plan assets	3	3
	(3)	(1)
Present value of unfunded defined benefit obligation	(1)	(1)
Retirement benefit liability recognised in the consolidated statement of financial position	(4)	(2)

Contributions for the year to the defined benefit plan totalled $2 million (2008: $2 million), of which $nil was accrued at 31 December 2009 (2008: $nil). The Group expects to contribute $1 million (2008: $1 million) in the next financial year, based upon the current funded status, and the expected return assumptions for the next financial year.

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

	2009 $millions	2008 $millions
Reconciliation of defined benefit obligations:		
Benefit obligations at beginning of the period	5	7
Current service cost	2	2
Interest cost	-	-
Actuarial loss / (gain)	2	(1)
Benefits paid	(2)	(1)
Foreign exchange rate changes	-	(2)
Benefit obligations at end of the period	7	5

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

	2009 $millions	2008 $millions
Reconciliation of fair value of plan assets:		
Fair value of plan assets at beginning of the period	3	3
Employer contributions	2	2
Benefits paid	(2)	(1)
Foreign exchange rate changes	-	(1)
Fair value of plan assets at end of the period	3	3
Actual return on fund assets	-	-

33. RETIREMENT BENEFITS (CONTINUED)

The major categories of the total plan assets are as follows:

	Fair value of assets 2009 $millions	2008 $millions
Cash	3	3

	2009	2008
Expected long-term rate of return on plan assets:		
Rate at the beginning of the year used for income	0%-2.25%	3.00%-5.50%
Rate at the end of the year	2.50%-3.50%	0%-2.25%

The expected long-term rate of return on assets represents the Group's best estimate of the long-term return on the 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. For plans where there is no established target asset allocation, actual asset allocations were used. 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.

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.

The following table presents the principal actuarial assumptions at the statement of financial position date:

	2009	2008
Discount rate	2.25%- 7.05%	1.85%-7.75%
Rate of increase in salaries	2.50%-5.50%	2.25%-6.25%
Inflation assumption	2.00%	2.00%-5.00%

The inflation rate applied to the Paris and France schemes for the period is 2% (2008: 2%). The inflation rate for the Dubai scheme has been determined not to apply, for the current period (2008: 5%). The inflation assumption is not applicable to the remaining schemes included in the disclosure.

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

	Mortality table	Life expectancy at age 65 for a male member currently: Aged 65	Aged 45	Life expectancy at age 65 for a female member currently: Aged 65	Aged 45
31 December 2009					
Korea	Korean Life Table 2006	81.1	77.6	85.1	83.6
Taiwan	2002 Taiwan Standard Ordinary Mortality Table	N/A	N/A	N/A	N/A
31 December 2008					
Korea	Korean Life Table 2006	81.1	77.6	85.1	83.6
Taiwan	2002 Taiwan Standard Ordinary Mortality Table	N/A	N/A	N/A	N/A

33. RETIREMENT BENEFITS (CONTINUED)

The sensitivities regarding the principal assumptions used to measure the defined benefit obligation are as follows:

Assumption	**Change in assumption**	**Impact on scheme liabilities**
Taiwan		
Discount rate	Increase / decrease by 0.5%	Decrease 6.05% / increase by 6.66%
Rate of increase in salaries	Increase / decrease by 0.5%	Increase 6.61% / decrease by 6.06%
Korea		
Discount rate	Increase by 0.5%	Decrease 5.75
Rate of increase in salaries	Increase by 0.5%	Increase 6.34
Rate of mortality	Increase by 1 year	Increase by less than 0.02%

The Group has used the exemption in paragraph 160 of IAS 19 *'Employee benefits'* and disclosed amounts under paragraph 120A(p) of IAS 19 below for each annual reporting period prospectively from the date of transition to IFRS.

The four year history of experience adjustments is as follows:

	31 December 2009 $millions	**31 December 2008 $millions**	**30 November 2007 $millions**	**30 November 2007 $millions**
Present value of defined benefit obligation	(7)	(5)	(8)	(6)
Fair value of plan assets	3	3	4	3
(Deficit) / Surplus	(4)	(2)	(4)	3
Experience adjustments on plan liabilities:				
Amount	(1)	(1)	-	-
Percentage of plan liabilities (%)	(12.48%)	(15.85%)	0.31%	(4.26%)
Experience adjustments on plan assets:				
Amount	-	-	-	-
Percentage of plan liabilities (%)	2.22%	(3.79%)	(0.77%)	(0.31%)

Plans operated by fellow subsidiary undertakings

Along with a number of other Morgan Stanley Group companies, the Group incurs management charges from a fellow subsidiary undertaking, Morgan Stanley UK Limited ("MSUK"), in respect of MSUK's employees' services. These management recharges include pension costs related to the Morgan Stanley UK Group Pensions Plan (the "UK Plan"). The UK Plan is a defined contribution scheme with a closed defined benefit section. The management recharge incurred by the Group is affected by the financial position of the UK Plan, measured in accordance with United Kingdom accounting standards. The management recharge for the year in respect of the defined benefit plan recognised in the consolidated income statement was $9 million (2008: $5 million).

33. RETIREMENT BENEFITS (CONTINUED)

For the purposes of IAS19, disclosure for the defined benefit section of the UK Plan as a whole, measured in accordance with IAS 19, is presented below.

Defined benefit plan expense

The amounts recognised in 'Staff costs', within 'Other expense', in the consolidated income statement in respect of these defined benefit plans are as follows:

	2009 $millions	2008 $millions
Expected return on plan assets	(6)	(11)
Interest on obligation	8	9
Net debit / (credit) that would be recognised	2	(2)

The following table provides a reconciliation of the present value of the defined benefit obligation and fair value of plan assets included in the consolidated statement of financial position, as well as a summary of the funded status of the plans:

	2009 $millions	2008 $millions
Retirement benefit liability:		
Defined benefit obligation	(148)	(131)
Fair value of plan assets	151	149
Adjustment for ceiling	(3)	(18)
Retirement benefit liability recognised in the consolidated statement of financial position	-	-

Contributions for the year to the defined benefit plan totalled $9 million (2008: $6 million), of which $nil was accrued at 31 December 2009 (2008: $nil). The Group expects to contribute $9 million (2008: $8 million) in the next financial year, based upon the current funded status and the expected return assumptions for the next financial year.

Changes in the present value of the defined benefit obligation during the year were as follows:

	2009 $millions	2008 $millions
Reconciliation of defined benefit obligations:		
Defined benefit obligations at beginning of the year / period	131	170
Interest cost	8	9
Actuarial (gain) / loss	(3)	6
Benefits paid	(2)	(1)
Foreign exchange rate changes	14	(53)
Benefit obligations at end of year / period	148	131

33. RETIREMENT BENEFITS (CONTINUED)

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

	2009 $millions	2008 $millions
Reconciliation of fair value of plan assets:		
Fair value of plan assets at beginning of the year / period	149	195
Expected return on plan assets	6	11
Actuarial loss	(27)	(2)
Employer contributions	9	6
Benefits paid	(2)	(1)
Foreign exchange rate changes	16	(60)
Fair value of plan assets at end of the year / period	151	149
Actual return on fund assets	(21)	9

The major categories of the total plan assets are as follows:

	Fair value of assets	
	2009 $millions	2008 $millions
Equity securities	2	-
Fixed income securities	149	149
	151	149

The following table presents the principal actuarial assumptions at the date of the statement of financial position:

	2009	2008
Pre-retirement Discount rate	5.70%	5.80%
Post-retirement Discount rate	4.50%	3.90%
Rate of increase in defined benefit pensions in deferment	3.80%	2.90%
Inflation assumption	3.80%	2.90%
Expected rate of return on plan assets:		
- Equity securities	7.00%	-
- Fixed income securities	4.40%	3.80%

33. RETIREMENT BENEFITS (CONTINUED)

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 40**	**Aged 65**	**Aged 40**
31 December 2009				
UK	88.1	91.7	88.1	91.7
31 December 2008				
UK	87.9	91.6	87.9	91.7

The sensitivities regarding the principal assumptions used to measure the defined benefit obligation are as follows:

Assumption	Change in assumption	Impact on scheme liabilities
Discount rate	Increase by 0.5%	Decrease 15%
Inflation assumption	Increase by 0.5%	Increase 4%
Rate of increase in salaries	Not applicable	Not applicable
Rate of mortality	Increase by 1 year	Increase by 2%

The Group has used the exemption in paragraph 160 of IAS 19 *'Employee benefits'* and disclosed amounts under paragraph 120A(p) of IAS 19 below for each annual reporting period prospectively from the date of transition to IFRS.

The four year history of experience adjustments is as follows:

	2009 $millions	2008 $millions	2007 $millions	2006 $millions
Present value of defined benefit obligation	(148)	(131)	(170)	(151)
Fair value of plan assets	151	149	195	161
Surplus	3	18	25	10
Experience adjustments on plan liabilities:				
Amount ($millions)	-	-	(6)	-
Percentage of plan liabilities (%)	0%	0%	(3.51)%	0%
Experience adjustments on plan assets				
Amount ($millions)	27	1	5	(5)
Percentage of plan assets (%)	17.86%	0.68%	2.74%	(3.05%)

34. MORGAN STANLEY SMITH BARNEY

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 from 1 January 2009 to 1 June 2009, GWM contributed an $11 million loss to the Group's results (13 months to 31 December 2008: $21 million profit).

35. RELATED PARTY DISCLOSURES

Parent and ultimate controlling entity

The Group's immediate parent undertaking is Morgan Stanley UK Group, which is registered in England and Wales. Copies of its accounts can be obtained from the Registrar of Companies for England and Wales, Companies House, Crown Way, Maindy, Cardiff CF14 3UZ.

The ultimate parent undertaking and controlling entity and the largest group of which the Group is a member and for which group accounts are prepared is Morgan Stanley. Morgan Stanley is incorporated in Delaware, the United States of America and copies of its accounts can be obtained from 25 Cabot Square, Canary Wharf, London E14 4QA.

35. RELATED PARTY DISCLOSURES (CONTINUED)

Subsidiaries

The principal subsidiary undertakings of the Group are as follows:

Name of Company	Country of Incorporation	Holding (per share class)	Type of shares held	Proportion of voting rights	Nature of business
Morgan Stanley Taiwan Limited	Taiwan	100%	Ordinary Shares	100%	Financial Services
Morgan Stanley Mandarin Limited	United Kingdom	100%	Ordinary Shares	100%	Investment company
Morgan Stanley Turnberry Limited (formerly MSDW Turnberry Limited)	United Kingdom	100%	Ordinary Shares	100%	Investment company
Morgan Stanley Silvermere Limited	United Kingdom	100%	Ordinary Shares	100%	Investment company
Morgan Stanley Dover Investments Limited	United Kingdom	100%	Ordinary Shares	100%	Investment company
Morgan Stanley Rivelino Investments Limited	United Kingdom	100%	Ordinary Shares	100%	Investment company
Morgan Stanley Kochi Limited	United Kingdom	100%	Ordinary Shares	100%	Investment company
Morgan Stanley Longcross Limited	United Kingdom	100%	Ordinary Shares	100%	Investment company
Morgan Stanley Langton Limited	United Kingdom	100%	Ordinary Shares	100%	Investment company
Morgan Stanley Bowline Limited	United Kingdom	100%	Ordinary Shares	100%	Investment company
Morgan Stanley Derivative Products (Netherlands) BV	The Netherlands	100%	Ordinary Shares	100%	Investment company
Morgan Stanley Waterloo Limited	Cayman Islands	100%	Ordinary Shares	100%	Investment company
Morgan Stanley Piccadilly Limited	Cayman Islands	100%	Ordinary Shares	100%	Investment company

A full list of the Company's subsidiary and associated undertakings will be annexed to the Company's next annual return and filed with the Registrar of Companies. All subsidiaries are included in the Group's consolidated financial statements.

During the year there were no investments where the Group owned more than 50% of the voting rights which were not classified as subsidiaries, and none of the Group's subsidiaries have experienced significant restrictions on paying dividends or repaying loans and advances.

The Group consolidated various entities that were considered subsidiaries for accounting purposes where the Group owns less than 50% of the voting rights. These subsidiaries have no significant impact on the financial position and financial performance of the Group.

35. RELATED PARTY DISCLOSURES (CONTINUED)

Key management compensation

Key management personnel is defined as those persons having responsibility and authority for planning, directing and controlling the activities of the Group.

The Morgan Stanley Group's corporate governance framework gives consideration to legal, geographical and business lines through a combination of boards of directors, and regional and global management committees. Accordingly, in addition to the Directors of the Company, key management personnel of the Group is considered to include the boards of directors of certain parent companies, including that of Morgan Stanley, certain members of key Morgan Stanley Group management committees, and certain executive officers of Morgan Stanley.

The boards of the Group's parent companies, the management committees and the executive officers cover the full range of the Morgan Stanley Group's business activities. Only those members with responsibility for the Institutional Securities business, being the only reportable business segment of the Group, are considered to be key management personnel of the Group. The aggregate compensation below represents the proportion of compensation paid to these key management personnel, including the Directors of the Company, in respect of their services to the Group.

Compensation paid to key management personnel in respect of their services rendered to the Group is:

	2009 $millions	2008 $millions
Short-term employee benefits	38	31
Post-employment benefits	1	1
Share-based payment	47	41
Other long-term employee benefits	16	9
Termination benefits	-	3
	102	85

The share-based payment costs disclosed above reflect the amortisation of equity-based awards granted to key management personnel over the last three years and are therefore not directly aligned with other staff costs in the current period.

35. RELATED PARTY DISCLOSURES (CONTINUED)

	2009 $millions	2008 $millions
Total emoluments of all Directors:		
Aggregate emoluments	12	14
Disclosures in respect of the highest paid Director:		
Aggregate emoluments excluding pension contributions	4	4
The number of Directors who exercised share options	-	5

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 (2008: five).

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 six directors to whom retirement benefits are accruing under a money purchase scheme (2008: seven). The Morgan Stanley UK Group Pension Plan operated a defined benefit pension scheme, which closed in September 1996. One Director has deferred defined benefits under the scheme (2008: one). In addition, one Director has benefits accruing under the Alternative Retirement Plan, a defined benefit scheme, operated by Morgan Stanley UK Limited (2008: one). Three directors have benefits accruing under the Morgan Stanley non-UK defined benefits schemes (2008: four).

The Group has provided no loans or other credit advances to its Directors during the year.

35. RELATED PARTY DISCLOSURES (CONTINUED)

Transactions with related parties

The Morgan Stanley Group conducts business for clients globally through a combination of both functional and legal entity organisational structures. Accordingly, the Group is closely integrated with the operations of the Morgan Stanley Group and enters into transactions with other Morgan Stanley Group undertakings for the purposes of utilising financing, trading and risk management, and infrastructure services. The nature of these relationships along with information about the transactions and outstanding balances is given below. The Group has made no provision for bad and doubtful debts related to the amount of outstanding balances from related parties (2008: nil).

Financing

The Group receives financing from and provides financing to other Morgan Stanley Group undertakings in the following forms:

General funding

General funding is undated, unsecured, floating rate lending. Funding may be received or provided for specific transaction related financing requirements, or for general intra group financing purposes. The interest rates are established by the Morgan Stanley Group Treasury function for all entities within the Morgan Stanley Group and approximate the market rate of interest that the Morgan Stanley Group incurs in financing its business.

Details of the outstanding balances on these financing arrangements and the related interest income / expense recognised in the consolidated income statement during the year are shown in the table below:

	2009		2008	
	Interest $millions	**Balance $millions**	**Interest $millions**	**Balance $millions**
Amounts due from the Group's direct and indirect parent companies	29	7,635	194	1,050
Amounts due from other Morgan Stanley Group undertakings	433	6,419	1,355	7,400
	462	14,054	1,549	8,450
Amounts due to the Group's direct and indirect parent companies	759	14,174	2,885	15,059
Amounts due to other Morgan Stanley Group undertakings	411	16,039	1,432	17,385
	1,170	30,213	4,317	32,444

Subordinated loans

The Group receives subordinated loans from other Morgan Stanley Group undertakings. Details of the terms of such loans, including the contractual maturity and the interest rates are provided in note 17. The interest rates are established by the Morgan Stanley Group treasury function based on available market information at the time the loan is provided.

35. RELATED PARTY DISCLOSURES (CONTINUED)

Trading and risk management

In the course of financing its business, the Group enters into collateralised financing transactions with other Morgan Stanley Group undertakings. All such transactions are entered into on an arm's length basis. Details of the outstanding balances on such transactions and interest receivable / payable during the period are shown in the table below:

	2009		2008	
	Interest $millions	Balance $millions	Interest $millions	Balance $millions
Amounts due from other Morgan Stanley Group undertakings	2,694	41,130	7,173	39,958
	2,694	41,130	7,173	39,958
Amounts due to other Morgan Stanley Group undertakings	3,495	72,952	11,471	73,027
	3,495	72,952	11,471	73,027

The Group enters into purchases and sales of securities and derivative transactions with other Morgan Stanley Group undertakings to facilitate the provision of financial services to clients on a global basis and to manage the market risks associated with such business, and for proprietary trading purposes. All such transactions are entered into on an arm's length basis. The total amounts receivable and payable on such securities transactions not yet settled and the fair value of such derivatives contracts outstanding at the end of the period were as follows:

	2009 $millions	2008 $millions
Amounts due from the Group's direct and indirect parent companies on unsettled securities and derivatives transactions	1,195	1,508
Amounts due from other Morgan Stanley Group undertakings on unsettled securities and derivatives transactions	50,819	46,275
	52,014	47,783
Amounts due to the Group's direct and indirect parent companies on unsettled securities and derivatives transactions	1,164	1,332
Amounts due to other Morgan Stanley Group undertakings on unsettled securities and derivatives transactions	51,090	42,943
	52,254	44,275

35. RELATED PARTY DISCLOSURES (CONTINUED)

The Group has received collateral of $5,092 million (2008: $4,028 million) from other Morgan Stanley Group undertakings and has pledged collateral of $4,676 million (2008: $5,205 million) to other Morgan Stanley Group undertakings to mitigate credit risk on exposures arising under derivatives contracts between the Group and the other Morgan Stanley Group undertakings.

In addition, the management and execution of business strategies on a global basis results in many Morgan Stanley transactions impacting a number of Morgan Stanley Group entities. The Morgan Stanley Group operates a number of intra-group policies to ensure that, where possible, revenues and related costs are matched. For the year ended 31 December 2009, a net loss of $2,805 million was recognised in the consolidated income statement arising from such policies (2008: $1,896 million gain).

Until 1 August 2009, policies for certain of these business strategies transacted by the Group, where that business strategy booked positions on another Morgan Stanley Group entity, any losses on these positions were only transferred to the Group to the extent that the losses were offset by profits arising on the same business strategy after the loss was incurred. Since August 2009, these policies have been refined so that losses are now netted across all business strategies on each loss bearing entity and are transferred to the Group to the extent that the losses offset against available profits from the same population of strategies within the Group. This change in approach has accelerated the recognition of losses previously held on other Morgan Stanley Group entities and has negatively impacted the Group's performance during the year.

Infrastructure services

The Group incurs and receives management charges from other Morgan Stanley Group undertakings for infrastructure services, including the provision of staff and office facilities. Management recharges incurred or received during the period are as follows:

	2009		2008	
	Staff costs $millions	**Other services $millions**	**Staff costs $millions**	**Other services $millions**
Amounts recharged from the Group's direct and indirect parent companies	-	239	-	304
Amounts recharged from / (to) other Morgan Stanley Group undertakings	1,630	68	1,803	(136)
	1,630	307	1,803	168

Amounts outstanding at the balance sheet date are included within the general funding balances disclosed above.

Other related party transactions

The Group has received a guarantee from Morgan Stanley International Limited, to guarantee the obligations of the Company under derivative contracts to Morgan Stanley Capital Services Inc., Morgan Stanley Capital Group Inc., MSDW Equity Finance Services (Cayman) Limited, MSDW Equity Finance Services (Lux) S.A.R.L. and Morgan Stanley Asia Securities Products LLC. All entities are fellow Morgan Stanley Group undertakings. As at 31 December 2009, no call had been made by the Group under this arrangement.

36. POST BALANCE SHEET EVENTS

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 will be that of the entity that benefits from the services of the Banking Employees, rather than the employing entity. The Group is still evaluating the impact of this legislation and has recognised a charge of $256 million in 2010, when the legislation was enacted, based on the minimum amount currently estimated will be payable by the Group in August 2010. Due to the ongoing uncertainties regarding the application, scope and implementation of the legislation, the final payment amount may differ from this estimated financial effect.

MORGAN STANLEY & CO. INTERNATIONAL plc

Registration No.2068222

COMPANY BALANCE SHEET

31 December 2009

	Note	2009 $millions	2008 $millions
FIXED ASSETS			
Tangible assets	3	11	14
Investments			
- Available-for-sale financial assets	4	41	63
- Subsidiary and associated undertakings	4	127	128
		179	205
CURRENT ASSETS			
Financial assets classified as held for trading	5	226,393	272,605
Financial assets designated at fair value through profit or loss	6	1,907	1,395
Loans and receivables:			
- Cash at bank	7	13,378	19,787
- Debtors	8	212,821	182,908
Other assets	9	343	841
		454,842	477,536
CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR			
Financial liabilities classified as held for trading	5	198,394	235,826
Financial liabilities designated at fair value through profit and loss	6	5,907	4,046
Financial liabilities at amortised cost	11	234,529	213,914
Other creditors	12	267	1,579
		439,097	455,365
NET CURRENT ASSETS		15,745	22,171
TOTAL ASSETS LESS CURRENT LIABILITIES		15,924	22,376
CREDITORS: AMOUNTS FALLING DUE AFTER MORE THAN ONE YEAR			
Financial liabilities at amortised cost	11	9,336	13,736
PROVISIONS FOR LIABILITIES AND CHARGES	13	21	28
NET ASSETS EXCLUDING PENSION LIABILITY		6,567	8,612
Pension liability		4	2
		6,563	8,610
CAPITAL AND RESERVES			
Called up share capital	14	3,078	4,328
Share premium account	15	513	513
Capital redemption reserve	15	1,399	149
Foreign currency revaluation reserve	15	(18)	(14)
Fair value reserve	15	(4)	(1)
Capital contribution reserve	15	3	3
Pension reserve	15	(2)	(1)
Profit and loss account	15	1,594	3,633
SHAREHOLDERS' FUNDS		6,563	8,610

These financial statements were approved by the Board and authorised for issue on 22 April 2010
Signed on behalf of the Board

Director DAVID NICOL

The notes on pages 84 to 105 form an integral part of the financial statements.

1. ACCOUNTING POLICIES

a. Basis of preparation

The financial statements are prepared under the historical cost convention, modified by the inclusion of financial instruments at fair value as described in note 1(f) below, and in accordance with applicable United Kingdom company law and accounting standards.

The Company's ultimate UK parent undertaking, Morgan Stanley International Limited, presents information in accordance with FRS 29: *Financial Instruments: Disclosures.* Accordingly, the Company is exempt from the disclosure requirements of FRS 29.

b. The going concern assumption

The Company's business activities, together with the factors likely to affect its future development, performance and position are set out in the Business Review section of the consolidated Directors' report on pages 1 to 5.

As set out in the Directors' report, the Company 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 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 financial statements 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. Assets and liabilities of the overseas branches 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 are taken to the foreign currency revaluation reserve. Foreign exchange differences on financial investments classified as available-for-sale are recorded in the 'Fair value reserve' in equity, with the exception of translation differences on the amortised cost of the monetary available-for-sale assets, which are recognised through the profit and loss account. All other translation differences are taken through the profit and loss account. Exchange differences recognised in the profit and loss account are presented in 'Other income' or 'Other expense', except where noted in 1(e) below.

1. ACCOUNTING POLICIES (CONTINUED)

e. Financial instruments

The Company 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; other fixed asset investments and loans and receivables.

The Company 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

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 related gains and losses, including foreign exchange differences, interest and dividends, are reflected in the profit and loss account in 'Net gains on financial instruments classified as held for trading'. Transaction costs are excluded from the initial and subsequent fair value measurement of the financial instrument. These costs are recognised in the profit and loss account in 'Other expense'.

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

The Company 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; or
- 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.

From the date the transaction in a financial instrument designated at fair value is entered into (trade date) until settlement date, the Company 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. Following settlement date, all related gains and losses, including foreign exchange differences, are reflected in the profit and loss account.

iii) Available-for-sale fixed asset investments

Fixed asset investments categorised 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 equity instruments, dividend income and impairment losses are recorded in the profit and loss account. All other gains and losses on debt and equity instruments classified as available-for-sale are recognised in the 'Fair value reserve' in 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 profit and loss account.

1. ACCOUNTING POLICIES (CONTINUED)

e. Financial instruments (continued)

iv) Investments in subsidiary and associated undertakings

Investments in subsidiary and associated undertakings outside the scope of FRS 26 are recorded within 'Investments in subsidiary and associated undertakings' and are stated at cost, less provision for any impairment. Interest recognised is on an accruals basis, dividend income is recognised when the Company's right to receive payment is established, impairment losses and reversals of impairment losses, and foreign exchange differences on monetary investments, are reported in the profit and loss account.

All other investments in group undertakings are classified as available-for-sale fixed asset investments and accounted for as described in note 1(e)(iii).

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 profit and loss account in 'Interest income', using the effective interest rate method. Transaction costs that are directly attributable to the acquisition or issue of the financial asset or 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 profit and loss account in either 'Other expense' or 'Other income' as appropriate.

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 profit and loss account in 'Interest expense' using the effective interest rate method as described above. Foreign exchange differences on financial liabilities held at amortised cost are recognised in the profit and loss account in 'Other income' or 'Other expense' as appropriate.

In the course of financing its business and as part of its trading activities, the Company 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 Company, 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 Company under resale arrangements and securities borrowing arrangements are generally not recognised on the balance sheet.

The redeemable preference shares issued by the Company 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 profit and loss account.

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 Company uses various valuation approaches. A hierarchy of inputs is used in measuring fair value that maximises the use of 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 Company. Unobservable inputs are inputs that reflect the Company's assumptions about the assumptions 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 Company 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.

Valuation techniques

Fair value for many financial instruments, including over-the-counter ("OTC") financial instruments, is derived using pricing models. Pricing models take into account the contract terms (including the maturity), as well as multiple inputs including, where applicable, equity prices, interest rate yield curves, credit curves, correlation, creditworthiness of the counterparty, option volatility and currency rates. The impact of the Company's own credit spreads is also considered when measuring the fair value of liabilities, including OTC derivative contracts. Where appropriate, valuation adjustments are made to account for various factors such as liquidity risk (bid-ask adjustments), credit quality and model uncertainty. These adjustments are subject to judgement, are applied on a consistent basis and are based upon observable inputs where available. The Company 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 Company's own assumptions are set to reflect those that the Company believes market participants would use in pricing the asset or liability at the measurement date.

Depending on the product and the terms of the transaction, the fair value of OTC financial instruments can be modelled using a series of techniques, including closed-form analytic formulae such as the Black-Scholes option pricing model, 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. In the case of more established derivative products, the pricing models used by the Company are widely accepted by the financial services industry.

1. ACCOUNTING POLICIES (CONTINUED)

f. Fair value of financial instruments (continued)

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 Company 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 profit and loss account and is recognised instead when the market data becomes observable.

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 profit and loss account within 'Net gains and losses on fixed asset investments in available-for-sale financial assets'.

Impairment losses on fixed asset investments in subsidiary and associated undertakings, measured as the difference between cost and the current estimated recoverable amount, are recognised within the profit and loss account in 'Net gains and losses on fixed asset investments in subsidiary and associated undertakings' and are reflected against the carrying amount of the impaired asset on the balance sheet.

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 profit and loss account within 'Other expenses' and are reflected against the carrying amount of the impaired asset on the 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 profit and loss account 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 and v).

1. ACCOUNTING POLICIES (CONTINUED)

h. Tangible fixed assets

Tangible fixed assets are stated at cost net of depreciation and any provision for impairment in value. For assets in the course of construction (generally fit out costs), interest that is directly attributable to the construction of the qualifying asset is capitalised as a cost of the asset.

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, 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 'Other expense' in the profit and loss account. The reinstatement asset is depreciated over the useful economic life of the relevant leasehold improvement asset.

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:

Leasehold improvements	- shorter of remaining lease term and 25 years
Fixtures, fittings and equipment	- 3 to 8 years

i. Operating leases

Rentals payable under operating leases are charged to the 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 the 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.

j. 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.

k. Employee compensation plans

Morgan Stanley operates equity based compensation plans on behalf of the Company, in relation to which, the Company pays Morgan Stanley in consideration of the procurement of the transfer of shares to employees. The cost of equity based 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 the 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 FRS 20 *Share-based payment* ("FRS 20") purposes is taken directly to 'Other expense' in the profit and loss account; the corresponding increase in reserves is reduced to the extent that payments are due to Morgan Stanley in respect of these awards.

1. ACCCOUNTING POLICIES (CONTINUED)

k. Employee compensation plans (continued)

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. Such awards are recognised over time, in accordance with the awards' vesting conditions, within the balance sheet and are remeasured to fair value at each reporting date. The Company economically hedges the exposure created by these deferred compensation schemes by entering into derivative transactions with other Morgan Stanley undertakings. The derivatives are recognised within financial instruments classified as held for trading.

l. Retirement benefits

The Company operates defined contribution schemes. The contributions due are recognised in the profit and loss account when payable.

The Company also operates defined benefit pension schemes. For the defined benefit scheme, liabilities are measured on an actuarial basis using the projected unit 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 scheme liabilities. Scheme assets are measured at their fair value. A surplus of scheme assets over liabilities is recognised in the balance sheet as an asset where recoverable. Where scheme liabilities exceed scheme assets, the deficit is recognised in the balance sheet as a liability. The current service cost and any past service costs is charged to 'Other expense'. The expected return on scheme assets less the unwinding of the discount on the scheme liabilities is recognised within 'Interest income' / '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 18 to these financial statements.

m. Cash flow statement

The Company's ultimate parent undertaking produces a cash flow statement. Accordingly, the Company, which is a wholly-owned subsidiary, has elected to avail itself of the exemption provided in FRS 1 (Revised 1996) *Cash Flow Statements* and not present a cash flow statement.

2. PROFIT FOR THE PERIOD

As permitted by section 408 of the Companies Act 2006 the Company has elected not to present its own profit and loss account for the period. The Company reported a loss after tax for the year ended 31 December 2009 of $548 million (2008: $55 million loss). Significant impairment provisions made during 2009 drive the Company's loss for the year, see note 4 for further details.

Year ended 31 December 2009

3. TANGIBLE FIXED ASSETS

	Leasehold improvements $millions	Fixtures, fittings and equipment $millions	Total $millions
Cost			
At 1 January 2009	16	12	28
Additions	-	1	1
Foreign exchange revaluation on assets held in overseas branches	1	1	2
Disposals	-	(1)	(1)
At 31 December 2009	17	13	30
Depreciation			
At 1 January 2009	6	8	14
Charge for the year / period	3	2	5
Foreign exchange revaluation on assets held in overseas branches	-	1	1
Disposals	-	(1)	(1)
At 31 December 2009	9	10	19
Net book value			
At 31 December 2008	10	4	14
At 31 December 2009	8	3	11

4. FIXED ASSET INVESTMENTS

Fixed asset investments classified as available-for-sale

Fixed asset investments that are categorised as available-for-sale are corporate equities.

Movements in fixed asset investments classified as available-for-sale during the period are as follows:

	2009 $millions	2008 $millions
Fair value		
At the beginning of the year / period	63	32
Additions	-	46
Disposals	(20)	(7)
Foreign exchange revaluation	1	(3)
Changes in fair value:		
- recognised in equity	(3)	(5)
At the end of the year / period	41	63

Included in 'Available-for-sale financial assets' are listed investments of $nil (2008: $nil).

Fixed asset investments in subsidiary and associated undertakings

	Subsidiary undertakings $millions	Associated undertakings $millions	Total $millions
Cost			
At 1 January 2009	136	4	140
Additions	985	-	985
Disposals	-	(4)	(4)
At 31 December 2009	1,121	-	1,121
Impairment provisions			
At 1 January 2009	(12)	-	(12)
Provisions made during the year	(982)	-	(982)
At 31 December 2009	(994)	-	(994)
Net book value			
At 31 December 2008	124	4	128
At 31 December 2009	127	-	127

During the year the Company waived payment of receivables aggregating $982 million from several of its subsidiary undertakings. These waivers have been recognised as capital contributions for the subsidiaries and a provision for impairment of each subsidiary undertaking has been recognised for the aggregate amount of the capital contribution made.

Details of the significant subsidiary and associated undertakings are provided in note 35 of the consolidated financial statements. A full list of the Company's subsidiary and associated undertakings will be annexed to the Company's next annual return and filed with the Registrar of Companies.

Year ended 31 December 2009

5. FINANCIAL ASSETS AND FINANCIAL LIABILITIES CLASSIFIED AS HELD FOR TRADING

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

	2009		2008	
	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	132,844	146,310	173,018	185,488
Foreign exchange forward contracts and options	11,292	11,487	22,739	23,780
Equity securities contracts (including equity swaps, warrants and options)	1,711	2,394	3,771	2,658
Commodity forwards, options and swaps	18,316	9,554	15,350	6,978
	164,163	169,745	214,878	218,904
Government debt securities	12,867	11,859	11,551	5,406
Corporate equities	29,133	13,737	31,631	9,133
Corporate and other debt	20,230	3,053	14,545	2,383
Total financial instruments classified as held for trading	226,393	198,394	272,605	235,826

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 Company.

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

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

	2009		2008	
	Assets $millions	Liabilities $millions	Assets $millions	Liabilities $millions
Fair value				
Prepaid OTC contracts	1,784	2,214	1,205	1,197
Structured notes	-	659	-	1,164
Other financial assets and liabilities	123	3,034	190	1,685
	1,907	5,907	1,395	4,046

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 Company.

7. CASH AT BANK

Included within cash at bank is an amount of $7,962 million (2008: $10,616 million) which represents segregated client money, held in accordance with the FSA's Client Money Rules, and an amount of $235 million (2008: $269 million) which represents other client money.

Year ended 31 December 2009

8. DEBTORS

	2009 $millions	2008 $millions
Debtors classified within loans and receivables at amortised cost		
Trade debtors:		
External counterparties	36,211	36,113
Group undertakings	14,983	14,972
Securities purchased under agreements to resell and cash collateral on stocks borrowed:		
External counterparties	74,641	46,896
Group undertakings	45,841	45,523
Other amounts due from Group undertakings	39,332	38,074
Other debtors classified within loans and receivables	1,813	1,330
	212,821	182,908

9. OTHER ASSETS

	2009 $millions	2008 $millions
Corporation tax	208	381
Deferred taxation (see note 10)	27	160
Prepayments and accrued income	108	300
	343	841

10. DEFERRED TAX

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

	2009 Asset $millions	2008 Asset $millions
Accelerated capital allowances	7	5
Tax losses carried forward	-	135
Deferred compensation	-	6
Other timing differences	20	14
	27	160

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

	Asset $millions
At 1 January 2009	160
Amounts recognised in the profit and loss account:	
- Current period timing differences	(104)
Amounts recognised in equity through the statement of total recognised gains and losses	
- Current period timing differences	(2)
Future tax charges on transitional accounting adjustments	1
Prior year timing differences	(28)
At 31 December 2009	27

11. FINANCIAL LIABILITIES AT AMORTISED COST

	2009 $millions	2008 $millions
Financial liabilities at amortised cost falling due within one year		
Bank loans and overdrafts	128	451
Trade creditors:		
External counterparties	52,394	47,327
Group undertakings	12,840	8,961
Securities sold under agreements to repurchase and cash collateral on stocks loaned:		
External counterparties	44,916	25,561
Group undertakings	65,380	73,829
Other amounts owing to Group undertakings	55,482	55,019
Other financial liabilities	3,389	2,766
	234,529	213,914
Financial liabilities at amortised cost falling due after more than one year		
Financial instruments issued:		
Subordinated loans	8,550	12,950
Preference shares	786	786
	9,336	13,736
Total financial liabilities at amortised cost	243,865	227,650

Included within Other amounts owing to Group undertakings are amounts of $5,052 million (2008: $8,680 million) representing cash collateral received as security for open trading positions held with other Group undertakings.

Subordinated loans

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

Counterparty	Repayment Date	Interest Rate	2009 $millions	2008 $millions
Morgan Stanley Strategic Funding Limited	29 October 2026	LIBOR plus 2.00%	644	1,494
Morgan Stanley International Finance S.A.	31 October 2025	LIBOR plus 1.25%	7,906	7,906
Morgan Stanley International Holdings Inc	31 October 2026	LIBOR plus 1%	-	3,550
			8,550	12,950

All amounts outstanding under subordinated loan agreements are repayable at any time at the Company's option, subject to seven business days' notice to the FSA, which has the right under the agreement to refuse consent to repayment.

On 20 November 2009 the Group repaid $3,550 million and $850 million under its loan facilities with Morgan Stanley International Holdings Inc and Morgan Stanley Strategic Funding Limited respectively. These repayments were made as part of the Group's capital management activities.

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

11. FINANCIAL LIABILITIES AT AMORTISED COST (CONTINUED)

	2009 $millions	2008 $millions
Allotted and fully paid Class B preference shares of $1 each, classified as financial liabilities		
At the beginning and the end of the period	786	786

At 31 December 2009 the Company's issued share capital included 785,772,500 Class B non-cumulative preference shares of $1 each, classified as liabilities. The holders of the Class B non-cumulative preferred shares of $1 each are entitled to receive a LIBOR-based dividend as defined in the Company's Articles of Association. The shares do not entitle holders to vote at any general meeting of the Company. On a return of capital, the holders of the Class B redeemable non-cumulative preferred shares shall rank equally with the Company's Class C non-redeemable non-cumulative preference shares in priority to any other class of share.

During the year, dividends of $31 million (2008: $42 million) were paid to the holders of the Class B redeemable non-cumulative preference shares

12. OTHER CREDITORS

	2009 $millions	2008 $millions
Amounts falling due within one year		
Corporation tax	65	289
Accruals and deferred income	202	1,290
	267	1,579

13. PROVISIONS FOR LIABILITIES AND CHARGES

	Property $millions	Litigation $millions	Total $millions
At 1 January 2009	2	26	28
Additional provisions	-	15	15
Provision utilised	-	(23)	(23)
Foreign exchange adjustment	-	1	1
At 31 December 2009	2	19	21

Litigation Matters

During the period the Company has been involved in various continuing and other litigation matters and provisions have been recognised and disclosed in accordance with FRS 12 *'Provisions, Contingent Liabilities and Contingent Assets'*. The Directors are of the opinion that it would be seriously prejudicial to the position of the Company to disclose details of individual continuing litigation matters and the amounts provided in respect of them.

14. SHARE CAPITAL

	2009 $millions	2008 $millions
Allotted and fully paid:		
Equity shares		
2,998,332,648 ordinary shares of $1 each	2,998	2,998
17,615,107 ordinary shares of £1 each	30	30
50,000,000 class C non-redeemable non-cumulative preferred shares of $1 each	50	1,300
	3,078	4,328

Equity shares

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

The holders of the ordinary shares, irrespective of currency denomination, are entitled to receive dividends as declared from time to time and are entitled to one vote per share at meetings of the Company in accordance with the Company's articles of association.

On 23 December 2009, the Company repurchased and cancelled 1,250,000,000 Class C non-redeemable non-cumulative preference shares of $1 each, at par value. The holders of the Class C non-redeemable non-cumulative preference shares of $1 each are entitled to receive a LIBOR based dividend in priority to any other class of share in accordance with the Company's articles of association. The holders of such shares in issue shall carry such number of votes in aggregate as represents 10% of the total voting rights of all the members of the Company having a right to attend and vote at general meetings. On a return of capital, the holders of the Class C non-redeemable non-cumulative preference shares shall rank equally with the Class B non-cumulative preference shares (see note 11), in priority to any other class of share.

Other shares classified as financial liabilities

The terms of other shares classified as financial liabilities are detailed in note 11, 'Financial liabilities at amortised cost'.

15. RECONCILIATION OF SHAREHOLDERS' FUNDS AND MOVEMENTS ON RESERVES

	Called up share capital $millions	Share premium account $millions	Foreign currency revaluation reserve $millions	Capital contribution reserve $millions	Capital redemption reserve $millions	Fair value reserve $millions	Pension reserve $millions	Retained earnings $millions	Total $millions
At 1 December 2007	4,328	513	(5)	3	149	4	(1)	3,685	8,676
Foreign exchange differences arising on translation of net assets in overseas branches	-	-	(9)	-	-	-	-	-	(9)
Available-for-sale financial assets – change in fair value recognised directly in equity	-	-	-	-	-	(5)	-	-	(5)
Share based payments	-	-	-	-	-	-	-	3	3
Loss for the period	-	-	-	-	-	-	-	(55)	(55)
At 31 December 2008	4,328	513	(14)	3	149	(1)	(1)	3,633	8,610
Foreign exchange differences arising on translation of net assets in overseas branches	-	-	(4)	-	-	-	-	-	(4)
Available-for-sale financial assets – change in fair value recognised directly in equity	-	-	-	-	-	(3)	-	-	(3)
Pension reserve movement	-	-	-	-	-	-	(1)	-	(1)
Net capital contribution	-	-	-	-	-	-	-	(40)	(40)
Preference share repurchase	(1,250)	-	-	-	1,250	-	-	(1,250)	(1,250)
Loss for the period	-	-	-	-	-	-	-	(548)	(548)
Dividends	-	-	-	-	-	-	-	(201)	(201)
At 31 December 2009	3,078	513	(18)	3	1,399	(4)	(2)	1,594	6,563

16. COMMITMENTS AND CONTINGENCIES

During the next year the Company is committed to pay $10 million (2008: $9 million) in respect of operating leases as follows:

	Land and buildings 2009 $millions	Land and buildings 2008 $millions
Maturity of lease:		
Within one year	4	1
In two to five years	6	1
Over five years	-	7
	10	9

17. SHARE-BASED PAYMENT TRANSACTIONS

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 restricted common stock or 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 a sole vesting condition of service over time 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 vesting period. All or a portion of a vested award may also be cancelled in certain limited situations, including termination for cause during the relevant restriction period.

During the year Morgan Stanley granted 102,226 units of restricted common stock to employees of the Company with a weighted average fair value per unit of $20.87 (2008: 434,231 units, weighted average fair value $40.94), based on the market value of Morgan Stanley shares at grant date. The thirteen month reporting period in 2008 includes units of restricted stock granted in two year end awards. Units granted in respect of employees' 2009 discretionary compensation have been granted in January 2010.

17. SHARE-BASED PAYMENT TRANSACTIONS (CONTINUED)

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.

No options were granted in the current or prior years.

The following table shows activity relating to the Morgan Stanley Group's stock option awards for employees of the Company:

	2009		2008	
	Number of options '000s	Weighted average exercise price $	Number of options '000s	Weighted average exercise price $
Options outstanding at beginning of period	226	51.17	280	47.58
Forfeited during the year / period	1	66.73	2	66.73
Exercised during the year / period	-	-	37	26.11
Expired during the year / period	56	37.70	15	44.44
Options outstanding at end of year / period	169	55.53	226	51.17
Options exercisable at end of year / period	139	53.07	143	42.15

No stock options were exercised throughout the period. The weighted average share price on exercise in 2008 was $49.89.

17. SHARE-BASED PAYMENT TRANSACTIONS (CONTINUED)

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

	2009			2008		
Range of exercise prices	Number of options '000s	Weighted average exercise price $	Weighted average remaining life in years	Number of options '000s	Weighted average exercise price $	Weighted average remaining life in years
$30.00 - $39.99	26	36.30	2.6	60	33.75	2.3
$40.00 - $49.99	48	47.15	3.3	69	46.92	4.7
$50.00 - $59.99	12	54.18	.6	13	54.28	1.7
$60.00 - $69.99	83	66.71	3.5	84	66.71	7.6
Total	169			226		

18. RETIREMENT BENEFITS

Defined contribution plans

The Company operates several Morgan Stanley defined contribution plans which require contributions made to the plans to be held in trust, separate from the assets of the Company.

The defined contribution plans are as follows:

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

The defined contribution pension charge for the year was $531,049 (2008: $563,282) of which $nil was accrued at 31 December 2009 (2008: $51,747). Contributions to the Morgan Stanley & Co International plc, (Greece Branch) Group Insurance Policy ceased during the year due to the winding down of activity in the branch.

Defined benefit plans

The Company also operates several Morgan Stanley defined benefit plans, which provide pension benefits that are based on an actuarial valuation. The Company'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 & Co International plc Paris Branch IFC (Indemnites de Fin de Carriere)

Morgan Stanley & Co International plc Seoul Branch Severance Pay Plan

Morgan Stanley & Co International plc (Athens Branch) Retirement Indemnity

Morgan Stanley Dubai End of Service Gratuity

18. RETIREMENT BENEFITS (CONTINUED)

The most recent actuarial valuations of the defined benefit plans were carried out at 31 December 2009. The liabilities of the schemes are measured by discounting the best estimate of future cash flows to be paid out by the scheme using the projected unit method. The projected unit method is an accrued benefits valuation method in which the scheme liabilities make allowance for projected earnings.

Defined benefit scheme expense

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

	2009 $millions	2008 $millions
Amounts recognised in the profit and loss account:		
Current service cost	1	2
Total charge	1	2

Of the charge for the year, $2 million (2008: $1 million) has been included in 'Other expenses'. Actuarial gains and losses of $2 million (2008: $239,000 gain) and exchange rate changes of $1 million loss ($1 million gain) have been recognised in reserves.

The cumulative amount of actuarial gains and losses is $2 million loss (2008: $180,000 gain).

Retirement benefit liability

	2009 $millions	2008 $millions
Retirement benefit liability:		
Present value of funded defined benefit obligation	(5)	(3)
Fair value of plan assets	2	2
	(3)	(1)
Present value of unfunded defined benefit obligation	(1)	(1)
Retirement benefit liability recognised in the balance sheet	(4)	(2)

Contributions for the year to the Plans totalled $2 million (2008: $2 million), of which $nil was accrued at 31 December 2009 (2008: $nil). The Company expects to contribute $1 million (2008: $1 million) in the next financial year, based upon the current funded status and the expected return assumptions for the next financial year.

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

	2009 $millions	2008 $millions
Reconciliation of defined benefit obligations:		
Defined benefit obligation at 1 January / 1 December	4	5
Current service cost	1	2
Actuarial loss	2	-
Benefits paid	(2)	(1)
Foreign exchange rate changes	1	(2)
Benefit obligation at 31 December	6	4

18. RETIREMENT BENEFITS (CONTINUED)

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

	2009 $millions	2008 $millions
Reconciliation of fair value of plan assets:		
Fair value of scheme assets at 1 January / 1 December	2	2
Employer contributions	2	2
Benefits paid	(2)	(1)
Foreign exchange rate changes	-	(1)
Fair value of scheme assets at 31 December	2	2
Actual return on plan assets	-	-

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

	Expected return 2009 %	Expected return 2008 %	Fair value of assets 2009 $millions	Fair value of assets 2008 $millions
Other – insurance deposit	3.50%	0%	2	2
			2	2

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

	2009	2008
Discount rate	5.80%-7.05%	2.50%-7.75%
Rate of increase in salaries	3.50%-5.50%	3.50%-6.25%
Inflation assumption	2.00%	0%-2.00%
Expected long-term rate of return on plan assets:		
Rate at the beginning of the year used for profit and loss	0.00%	5.50%
Rate at the end of the year	3.50%	0.00%

The expected long-term rate of return on assets represents the Company'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. For plans where there is no established target asset allocation, actual asset allocations were used. 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.

The inflation rate applied to the Paris scheme for the period is 2% (2008: 2%). The inflation rate for the Dubai scheme has been determined not to apply for the current period (2008: 5%). The inflation assumption is not applicable to the remaining schemes included in the disclosure.

18. RETIREMENT BENEFITS (CONTINUED)

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

	Mortality table	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 2009					
Korea	Korean Life Table 2006	81.1	77.6	85.1	83.6
31 December 2008					
Korea	Korean Life Table 2006	81.1	77.6	85.1	83.6

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

Assumption	**Change in assumption**	**Impact on scheme liabilities**
Korean Plan		
Discount rate	Increase by 0.5%	Decrease by 5.75%
Rate of increase in salaries	Increase by 0.5%	Increase by 6.34%
Rate of mortality	Increase by 1 year	Increase by less than 0.02%

The Company has taken advantage of the exemption in paragraph 95C of FRS 17 '*Retirement Benefits*' and has not restated the first of the previous four accounting periods required by FRS 17 paragraph 77(o). Quoted securities have therefore been valued at mid-market value for the first two periods shown and at current bid price for the remaining periods in the table below (the most recent two prior periods have been restated).

The four year history of experience adjustments is as follows:

	31 December 2009 $millions	31 December 2008 $millions	30 November 2007 $millions	30 November 2006 $millions
Present value of defined benefit obligation	6	4	5	5
Fair value of plan assets	2	2	2	2
Deficit	(4)	(2)	(3)	(3)
Experience adjustments on scheme liabilities:				
Amount ($'000)	(1,197)	132	(108)	155
Percentage of plan liabilities (%)	(19%)	3%	(2%)	3%
Experience adjustments on scheme assets				
Amount ($'000)	112	(134)	(48)	(8)
Percentage of plan assets (%)	6%	(7%)	(2%)	(1%)

19. RELATED PARTY TRANSACTIONS

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

20. POST BALANCE SHEET EVENTS

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 will be that of the entity that benefits from the services of the Banking Employees, rather than the employing entity. The Company is still evaluating the impact of this legislation and has recognised a charge of $256 million in 2010, when the legislation was enacted, based on the minimum amount currently estimated will be payable by the Company in August 2010. Due to the ongoing uncertainties regarding the application, scope and implementation of the legislation, the final payment amount may differ from this estimated financial effect.

21. PARENT UNDERTAKINGS

The ultimate parent undertaking and controlling entity and the largest group of which the Company is a member and for which group financial statements are prepared is Morgan Stanley. Morgan Stanley is incorporated in Delaware, the United States of America and copies of its financial statements can be obtained from 25 Cabot Square, Canary Wharf, London E14 4QA.

The parent undertaking of the smallest group of companies for which group financial statements are drawn up and of which the Company is a member is Morgan Stanley International Limited which is registered in England and Wales. Copies of its financial statements can be obtained from the Registrar of Companies for England and Wales, Companies House, Crown Way, Maindy, Cardiff CF14 3UZ.