

1

Registered Number: 2068222

Registered Office:

25 Cabot Square

Canary Wharf

London E14 4QA

MORGAN STANLEY & CO. INTERNATIONAL plc

Report and financial statements

31 December 2010

CONTENTS

	Page
Directors' report	1
Directors' responsibility statement	8
Independent auditor's report	9
Consolidated income statement	11
Consolidated statement of comprehensive income	12
Consolidated statement of changes in equity	13
Consolidated statement of financial position	15
Consolidated statement of cash flows	16
Notes to the consolidated financial statements	17
Company balance sheet	86
Notes to the Company financial statements	87

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 2010. 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 \$247 million (2009: \$125 million).

During the year the Company paid an interim dividend of \$400 million on the ordinary shares (2009: \$200 million). No final dividend is proposed (2009: \$nil). A dividend of \$21 million was paid on the Class B preference shares during the year (2009: \$31 million). A dividend of \$1 million was paid on the Class C preference shares during the year (2009: \$1 million).

PRINCIPAL ACTIVITY

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

The Company operates branches in the Dubai International Financial Centre, France, Greece, Korea, the Netherlands, New Zealand, Poland (opened on 1 October 2010), the Qatar Financial Centre and Switzerland (opened on 8 February 2010).

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

BUSINESS REVIEW

Global market and economic conditions continued to improve, and global capital markets continued to recover during 2010 and 2009, as compared with the severe economic and financial downturn that occurred in 2008. Although the modest economic recovery initiated in 2009 continues to be evident in the wider economy, the Group continues to be impacted by challenging market conditions. These conditions present difficulties and uncertainty for the business outlook which may adversely impact the financial performance of the Group in the future. The consolidated income statement for the year is set out on page 11. The Group's profit after tax for the year has increased by \$122 million to \$247 million, compared to the year ended 31 December 2009.

The Group's revenues are best reviewed across the aggregate of 'Net gains on financial instruments classified as held for trading', 'Net gains on financial instruments designated at fair value through profit or loss', 'Net gains on available-for-sale financial assets', 'Interest income', 'Interest expense' and any 'Other income'. Aggregate revenues have improved in 2010 in line with the improvement in economic conditions and are driven by the institutional securities businesses. Improved results were reported within fixed income sales and trading, partially offset by a small decrease in equity sales and trading. The Group's net interest expense has decreased by 55% to \$101 million, with interest income and interest expense reducing by 8% and 10% respectively driven by reductions in interest rates. The Group's other expenses have remained in line with the prior year.

DIRECTORS' REPORT (CONTINUED)

The consolidated statement of financial position presented on page 15 of the financial statements shows increases in the Group's total assets and total liabilities of 16% as at 31 December 2010 when compared to 31 December 2009. This increase has been driven by increases of \$28,852 million and \$36,762 million in reverse repurchase agreements and repurchase agreements respectively, due to increased activity in these products during the year. There have also been increases of \$26,921 million and \$17,238 million in financial assets classified as held for trading and financial liabilities classified as held for trading respectively, primarily due to increases in the Group's derivative instrument assets and liabilities, driven by market volatility in the year. Net derivative positions have not moved significantly year on year. During 2010, the Group has continued to review and actively manage its capital position. As part of this capital management, the Group has issued \$2,500 million of class D preference share capital, repaid \$644 million of subordinated loans and paid dividends totalling of \$422 million.

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 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.

Special purpose entities and securitisation exposures

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 2010 the total assets of SPEs in which the Group has an interest, but which are not consolidated by the Group, are \$135 million (2009: \$3,669 million) and the Group's maximum exposure to loss relating to such SPEs is \$59 million (2009: \$43 million). The decrease in non-consolidated SPE assets is due to the unwind of a structured trade where the Group's retained interest, and therefore related maximum exposure to loss, was small, although the total assets of the SPE were large. The Group's consolidated balance sheet includes \$4,252 million of assets arising from consolidated SPEs (2009: \$3,474 million). The Group's maximum exposure to loss relating to these assets is \$2,036 million (2009: \$1,813 million).

The Group has exposure to mortgage-related risk. As at 31 December 2010 the amount recognised on the Group statement of financial position in relation to residential mortgage backed securities ("RMBS") was \$783 million (2009: \$468 million). The increase in RMBS is mainly due to the purchase of retained interests in securitisations from other Morgan Stanley Group undertakings. The Group continues to have exposure to commercial mortgage-backed securities ("CMBS") arising from its trading activities. As at 31 December 2010 the amount recognised on the statement of financial position in relation to CMBS is \$812 million (2009: \$610 million). The increase in CMBS is mainly due to increased trading positions and the positive impact of improving market conditions.

Bank payroll tax

On 8 April 2010 the UK government enacted legislation as part of the 2010 Finance Act imposing a bank payroll tax. The tax applies to discretionary bonuses over a certain amount awarded to certain employees within scope ("Banking Employees") in the period from 9 December 2009 to 5 April 2010. The liability for the tax is for the entity that benefits from the services of the Banking Employees, rather than the employing entity. The charge incurred by the Group for the bank payroll tax and recognised in the consolidated income statement for the year ended 31 December 2010 was \$239 million (2009: \$nil).

Bank levy

During June 2010, the UK government announced the intention to introduce a bank levy, effective from 1 January 2011, in respect of certain equity and liabilities on the consolidated balance sheets of 'UK Banking Groups' as defined under the bank levy legislation, which is expected to be enacted during 2011. The Morgan Stanley Group continues to evaluate the impact of the draft legislation and to assess which entities will specifically bear the associated cost, hence no estimated Group impact is disclosed. The charge for the bank levy is expected to be recognised in 2011, based on the aggregated balance sheets of the Morgan Stanley 'UK Bank Group' as at 31 December 2011.

DIRECTORS' REPORT (CONTINUED)

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.

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

Credit risk

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

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

Liquidity 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)

Risk management (continued)

Liquidity and funding risk (continued)

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

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

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

Operational risk

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

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

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

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

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

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

MORGAN STANLEY & CO. INTERNATIONAL plc

DIRECTORS' REPORT (CONTINUED)

Risk management (continued)

Operational risk (continued)

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

Legal and regulatory risk

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

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

Significant changes in the way that major financial services institutions are regulated are occurring in the UK, the rest of Europe, the US and worldwide. The reforms being discussed and, in some cases, already implemented, include several that contemplate comprehensive restructuring of the regulation of the financial services industry. Such measures will likely lead to stricter regulation of financial institutions generally, and heightened prudential requirements for systemically important firms in particular. Such measures could include taxation of financial transactions, liabilities and employee compensation as well as reforms of the over-the-counter ("OTC") derivatives markets, such as mandated exchange trading and clearing, position limits, margin, capital and registration requirements.

Many of these reforms, if enacted, may materially affect the Group's and the Morgan Stanley Group's business, financial condition, results of operations and cash flows in the future.

Basel II Pillar 3 disclosures

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

Going concern

During 2010, economic conditions, while improving, have remained challenging. These conditions present difficulties and uncertainty for the business outlook which may adversely impact the financial performance of the Group in the future.

DIRECTORS' REPORT (CONTINUED)

Going concern (continued)

During the year ended 31 December 2010, Morgan Stanley has continued to actively manage its capital and liquidity position to ensure adequate resources are available to support the activities of the Morgan Stanley Group, to enable the Morgan Stanley Group to withstand market stresses, and to meet regulatory stress testing requirements proposed by regulators globally. In August 2010, the Morgan Stanley Group strengthened its capital position by converting \$5.6 billion of subordinated debentures issued to China Investment Corporation Limited into \$5.6 billion of equity shares. Throughout the year, the Morgan Stanley Group has been focussed on the composition of its funding liabilities, reducing reliance on short term funding in favour of more diverse and durable funding sources. This remains an ongoing objective of the Morgan Stanley Group.

The risk management section above 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.

Taking all of the above factors into consideration, 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.

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	
M C Bowe	(appointed 16 November 2010)
W A Chammah	(resigned 3 March 2011)
A Classen	(resigned 21 June 2010)
L G P M Francois	(appointed 9 August 2010)
G G Lynch	(resigned 21 March 2011)
D R Nicol	(resigned 17 June 2010)
F R Petitgas	
R Rooney	(appointed 24 August 2010)
D Siniscalco	(resigned 11 August 2010)
C E Woodman	

DIRECTORS' LIABILITY INSURANCE

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

QUALIFYING THIRD PARTY INDEMNITY PROVISIONS

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

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 MSI regulated 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 MSI Board on a quarterly basis.

POST BALANCE SHEET EVENTS

There have been no significant events since the balance sheet date.

POLICY AND PRACTICE ON PAYMENT OF CREDITORS

The Group's and the Company's trade creditor 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.

DIRECTORS' REPORT (CONTINUED)

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.

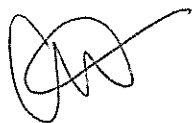
Statement as to disclosure of information to auditors

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 CLARE WOODMAN



Director

21 April 2011

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 6 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 **CLARE WOODMAN**



Director

21 April 2011

INDEPENDENT AUDITOR'S 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 2010, which comprise the consolidated income statement, the consolidated statement of comprehensive income, the consolidated statement of changes in equity, the consolidated statement of financial position and the consolidated statement of cash flows and the parent company balance sheet and the related notes 1 to 33 for the consolidated financial statements and the related notes 1 to 20 for the parent 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 parent 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 auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of Directors and auditors

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

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Group's and the parent 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 parent Company's affairs as at 31 December 2010 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 parent 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 AUDITOR'S 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 matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent 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 FCA (Senior Statutory Auditor)
for and on behalf of Deloitte LLP
Chartered Accountants and Statutory Auditor
London
21 April 2011

MORGAN STANLEY & CO. INTERNATIONAL plc

CONSOLIDATED INCOME STATEMENT

Year ended 31 December 2010

	Note	2010 \$millions	2009 \$millions
Net gains on financial instruments classified as held for trading		3,652	3,833
Net gains on financial instruments designated at fair value through profit or loss		318	57
Net gains on available-for-sale financial assets		59	16
Interest income	4	3,852	4,181
Interest expense	4	(3,953)	(4,403)
Other income	5	188	239
Other expense	6	(3,353)	(3,326)
PROFIT BEFORE TAX		<u>763</u>	<u>597</u>
Income tax expense	7	(516)	(472)
PROFIT FOR THE YEAR		<u>247</u>	<u>125</u>
Attributable to:			
Equity holders of the Company		246	120
Non-controlling interests		1	5
PROFIT FOR THE YEAR		<u>247</u>	<u>125</u>

All operations were continuing in the current and prior year.

The notes on pages 17 to 85 form an integral part of the financial statements.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
Year ended 31 December 2010

	Note	2010 \$millions	2009 \$millions
PROFIT FOR THE YEAR		<u>247</u>	<u>125</u>
OTHER COMPREHENSIVE INCOME			
Currency translation reserve:			
Foreign currency translation differences arising on foreign operations during the year		(30)	(38)
Fair value reserve:			
<i>Available-for-sale financial assets:</i>			
Net change in fair value recognised directly in equity		4	(7)
Net amount transferred to consolidated income statement		(3)	-
Actuarial losses on defined benefit pension plans	32	(3)	(2)
Income tax relating to components of other comprehensive income	7	2	2
OTHER COMPREHENSIVE INCOME AFTER INCOME TAX		<u>(30)</u>	<u>(45)</u>
TOTAL COMPREHENSIVE INCOME		<u>217</u>	<u>80</u>
Attributable to:			
Equity holders of the Company		216	73
Non-controlling interests		1	7
TOTAL COMPREHENSIVE INCOME		<u>217</u>	<u>80</u>

The notes on pages 17 to 85 form an integral part of the financial statements.

MORGAN STANLEY & CO. INTERNATIONAL plc

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
Year ended 31 December 2010

2010	Share capital	Share premium	Currency translation reserve	Capital redemption reserve	Capital contribution reserve	Fair value reserve	Retained earnings	Equity attributable to equity holders of the Company	Non-controlling interest	Total equity
	\$millions	\$millions	\$millions	\$millions	\$millions	\$millions	\$millions	\$millions	\$millions	\$millions
Balance at 1 January 2010	3,078	513	(62)	1,399	3	(3)	1,815	6,743	74	6,817
Reclassification from currency translation reserve to retained earnings net of income tax (see note 20)	-	-	(45)	-	-	-	45	-	-	-
Profit for the year	-	-	-	-	-	-	246	246	1	247
Other comprehensive income:										
Foreign currency translation differences on foreign operations	-	-	(30)	-	-	-	-	(30)	-	(30)
Reclassification adjustment on disposal of foreign operation	-	-	(14)	-	-	-	14	-	-	-
Net change in fair value of available-for-sale assets recognised directly in equity	-	-	-	-	-	4	-	4	-	4
Net fair value amount transferred to consolidated income statement	-	-	-	-	-	(3)	-	(3)	-	(3)
Actuarial losses on defined benefit pension plans	-	-	-	-	-	-	(3)	(3)	-	(3)
Income tax relating to components of other comprehensive income	-	-	2	-	-	-	-	2	-	2
Total comprehensive income	-	-	(87)	-	-	1	302	216	1	217
Transactions with owners:										
Preference shares issued	2,500	-	-	-	-	-	-	2,500	-	2,500
Dividends to equity holders of the Company	-	-	-	-	-	-	(401)	(401)	-	(401)
Repayment of capital	-	-	-	-	-	-	-	-	(2)	(2)
Balance at 31 December 2010	5,578	513	(149)	1,399	3	(2)	1,716	9,058	73	9,131

The notes on pages 17 to 85 form an integral part of the financial statements.

MORGAN STANLEY & CO. INTERNATIONAL plc

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
Year ended 31 December 2010

2009	Share capital	Share premium	Currency translation reserve	Capital redemption reserve	Capital contribution reserve	Fair value reserve	Retained earnings	Equity attributable to equity holders of the Company	Non-controlling interest	Total equity
	\$millions	\$millions	\$millions	\$millions	\$millions	\$millions	\$millions	\$millions	\$millions	\$millions
Balance at 1 January 2009	4,328	513	(22)	149	3	2	3,098	8,071	67	8,138
Profit for the year	-	-	-	-	-	-	120	120	5	125
Other comprehensive income:										
Foreign currency translation differences on foreign operations	-	-	(40)	-	-	-	-	(40)	2	(38)
Net change in fair value of available-for-sale assets recognised directly in equity	-	-	-	-	-	(7)	-	(7)	-	(7)
Actuarial losses on defined benefit pension plans	-	-	-	-	-	-	(2)	(2)	-	(2)
Income tax relating to components of other comprehensive income	-	-	-	-	-	2	-	2	-	2
Total comprehensive income	-	-	(40)	-	-	(5)	118	73	7	80
Transactions with owners:										
Preference share repurchase	(1,250)	-	-	1,250	-	-	(1,250)	(1,250)	-	(1,250)
Net capital contribution	-	-	-	-	-	-	50	50	-	50
Dividends to equity holders of the Company	-	-	-	-	-	-	(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 17 to 85 form an integral part of the financial statements.

CONSOLIDATED STATEMENT OF FINANCIAL POSITION
As at 31 December 2010

	Note	2010 \$millions	2009 \$millions
ASSETS			
Loans and receivables:			
Cash at bank	8	10,436	13,580
Securities borrowed		27,852	25,394
Reverse repurchase agreements		112,183	83,331
Trade receivables		64,027	51,642
Other receivables	9	13,567	16,184
		<u>228,065</u>	<u>190,131</u>
Financial assets classified as held for trading (of which approximately \$51,974 million (2009: \$54,185 million) were pledged to various parties)	10	270,994	244,073
Financial assets designated at fair value through profit or loss	11	9,359	1,907
Available-for-sale financial assets	12	44	43
Current tax		377	558
Deferred tax assets	18	48	47
Prepayments and accrued income		29	19
Property, plant and equipment	13	12	16
Joint venture		7	7
TOTAL ASSETS		<u>508,935</u>	<u>436,801</u>
LIABILITIES AND EQUITY			
Financial liabilities at amortised cost:			
Bank loans and overdrafts		60	126
Securities loaned		53,059	44,306
Repurchase agreements		102,528	65,766
Trade payables		75,639	64,557
Other payables	14	24,557	33,748
Subordinated loans	15	7,906	8,550
Preference shares	16	786	786
		<u>264,535</u>	<u>217,839</u>
Financial liabilities classified as held for trading	10	220,793	203,555
Financial liabilities designated at fair value through profit or loss	11	13,713	7,879
Provisions	17	29	22
Current tax		434	381
Deferred tax liabilities	18	5	7
Accruals and deferred income		291	297
Retirement benefit obligations	32	4	4
TOTAL LIABILITIES		<u>499,804</u>	<u>429,984</u>
EQUITY ATTRIBUTABLE TO EQUITY HOLDERS OF THE COMPANY			
Share capital	20	5,578	3,078
Share premium account		513	513
Other reserves		1,251	1,337
Retained earnings		1,716	1,815
		<u>9,058</u>	<u>6,743</u>
Non-controlling interest		73	74
TOTAL EQUITY		<u>9,131</u>	<u>6,817</u>
TOTAL LIABILITIES AND EQUITY		<u>508,935</u>	<u>436,801</u>

These financial statements were approved by the Board and authorised for issue on 21 April 2011:
Signed on behalf of the Board

Director



CLARE WOODMAN

The notes on pages 17 to 85 form an integral part of the financial statements.

MORGAN STANLEY & CO. INTERNATIONAL plc

CONSOLIDATED STATEMENT OF CASH FLOWS
Year ended 31 December 2010

	Note	2010 \$millions	2009 \$millions
NET CASH FLOWS USED IN OPERATING ACTIVITIES	22(b)	(4,347)	(424)
INVESTING ACTIVITIES			
Purchase of property, plant and equipment		(1)	(1)
Purchase of available-for-sale financial assets		(7)	-
Dividends received from available-for-sale financial assets		56	16
Proceeds from sale of available-for-sale financial assets		10	38
Proceeds from sale of associates and joint ventures		-	4
Net capital contribution arising from MSSB joint venture		-	50
NET CASH FLOWS FROM INVESTING ACTIVITIES		<u>58</u>	<u>107</u>
FINANCING ACTIVITIES			
Issue / (repayments) of preference shares		2,500	(1,250)
Dividends paid to preference share holders of the Company		(21)	(31)
Repayments of subordinated loans		(644)	(4,400)
Interest paid on subordinated loans		(142)	(305)
Dividends paid to equity holders of the Company		(401)	(201)
Capital repayment to non-controlling interests		(2)	-
NET CASH FLOWS GENERATED / (USED) IN FINANCING ACTIVITIES		<u>1,290</u>	<u>(6,187)</u>
NET DECREASE IN CASH AND CASH EQUIVALENTS		(2,999)	(6,504)
Currency translation differences on foreign currency cash balances		(79)	421
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE YEAR		13,454	19,537
CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR	22(a)	<u>10,376</u>	<u>13,454</u>

The notes on pages 17 to 85 form an integral part of the financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
Year ended 31 December 2010

1. CORPORATE INFORMATION

The principal activity of the Group is the provision of financial services to corporations, governments, and financial institutions. 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

a. Statement of compliance

The Group has prepared its consolidated annual financial statements (the "financial statements") in accordance with International Financial Reporting Standards ("IFRS"), as issued by the International Accounting Standards Board ("IASB") and adopted by the European Union ("EU"), Interpretations issued by the International Financial Reporting Interpretations Committee ("IFRIC") and the United Kingdom Companies Act 2006. The primary financial statements in this document are presented in accordance with International Accounting Standards ("IAS") 1 'Presentation of Financial Statements'.

b. 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.

IFRS 3 '*Business combinations*' was revised by the IASB in January 2008 and endorsed by the EU in June 2009, for prospective application in accounting periods beginning on or after 1 July 2009.

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

For application in accounting periods beginning on or after 1 July 2009:

- IFRS 2 'Share-based payment' and
- IAS 38 'Intangible assets'

For application in accounting periods beginning on or after 1 January 2010:

- 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' and
- IAS 39 'Financial instruments: Recognition and measurement'

These *Annual Improvements to IFRS* were endorsed by the EU in March 2010.

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

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
Year ended 31 December 2010

2. BASIS OF PREPARATION (CONTINUED)

c. 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 issued by the IASB but not yet mandatory. Except where otherwise stated, 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.

An amendment to IFRS 7 '*Financial instruments: Disclosures – Transfers of financial assets*' was issued by the IASB in October 2010 for prospective application in annual periods beginning on or after 1 July 2011.

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

An amendment to IAS 12 '*Income taxes*' was issued by the IASB in December 2010 for retrospective application in annual periods beginning on or after 1 January 2012.

IAS 24 '*Related party disclosures*' was revised by the IASB in November 2009 for retrospective application in annual periods beginning on or after 1 January 2011. The revised standard was endorsed by the EU in July 2010.

An amendment to IAS 32 '*Financial instruments: presentation – classification of rights issues*' was issued by the IASB in October 2009 for retrospective application in annual periods beginning on or after 1 February 2010. The amendment was endorsed by the EU in December 2009.

As part of the May 2010 *Improvements to IFRSs*, the IASB made amendments to the following standards that are relevant to the Group's operations: IFRS 3 '*Business combinations*' and IAS 27 '*Consolidated and separate financial statements*' (for application in accounting periods beginning on or after 1 July 2010), and IFRS 7 '*Financial instruments: disclosures*' and IAS 1 '*Presentation of Financial Statements*' (for application in accounting periods beginning on or after 1 January 2011).

An amendment to IFRIC 14 '*Prepayments of a minimum funding requirement*' was issued by the IASB in November 2009 for retrospective application in annual periods beginning on or after 1 January 2011. The amendment was endorsed by the EU in July 2010.

IFRIC 19 '*Extinguishing financial liabilities with equity instruments*' was issued by the IASB in November 2009 for retrospective application in annual periods beginning on or after 1 July 2010 and was endorsed by the EU in July 2010.

d. 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.

e. 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 7. 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.

MORGAN STANLEY & CO. INTERNATIONAL plc

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Year ended 31 December 2010

2. BASIS OF PREPARATION (CONTINUED)

f. Use of estimates and sources of uncertainty

The preparation of financial information requires the Group to make judgements, 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 reasonable, relevant and reliable. Actual results could differ from these estimates.

g. 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 2010. The financial statements for the subsidiaries are prepared for the same reporting period as the Group, using consistent accounting policies. The financial statements of subsidiaries which are presented in currencies other than US dollars are translated into US dollars as described in note 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.

Non-controlling 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 Company 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 branches and subsidiaries with functional currencies other than US dollars 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' in equity. Foreign exchange differences on available-for-sale financial assets are recorded in the 'Fair value reserve' in equity, with the exception of translation differences on the amortised cost of monetary available-for-sale financial assets, which are recognised through the consolidated income statement. All other translation differences are taken through the consolidated income statement. Exchange differences recognised in the consolidated income statement are presented in 'Other income' or 'Other expense', except where noted in 3(c) below.

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

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
Year ended 31 December 2010

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

With the exception of loans, 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'.

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

For all financial instruments classified as held for trading, transaction costs are excluded from the initial fair value measurement of the financial instrument. These costs are recognised in the consolidated 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 subsequent changes in fair value, foreign exchange differences, interest and dividends, are reflected in the consolidated income statement in 'Net gains / losses from 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'.

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
Year ended 31 December 2010

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(iii) Available-for-sale financial assets

Financial assets classified as available-for-sale are non-derivative financial assets that are either designated in this category or not classified in any of the other categories of financial instruments. Financial assets classified as available-for-sale are recorded on trade date and are initially recognised and subsequently measured at fair value.

For debt instruments, interest calculated using the effective interest method (see note 3(c)(iv)) below, impairment losses and reversals of impairment losses and foreign exchange differences on the amortised cost of the asset are recorded in the consolidated income statement in 'Net gains / losses on available-for-sale financial assets'. For equity instruments, dividend income and impairment losses are recorded in the consolidated income statement in 'Net gains / losses on available-for-sale financial assets'. All other gains and losses on debt and equity instruments classified as available-for-sale are recognised in the 'Fair value reserve' within equity. Transaction costs that are directly attributable to the acquisition of the 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 / losses on available-for-sale financial assets'.

(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 method. Transaction costs that are directly attributable to the acquisition of the financial asset 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 'Other expense'.

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 method as described above. Transaction costs that are directly attributable to the issue of the financial liability are added to or deducted from the fair value on initial recognition.

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.

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
Year ended 31 December 2010

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

d. Fair value of financial instruments

Fair value measurement

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

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

The availability of observable inputs can vary from product to product and is affected by a wide variety of factors, including, for example, the type of product, whether the product is new and not yet established in the marketplace, the liquidity of markets and other characteristics particular to the transaction. To the extent that valuation is based on models or inputs that are less observable or unobservable in the market, the determination of fair value requires more judgement.

The Group uses prices and inputs that are current as of the measurement date, including during periods of market dislocation. In periods of market dislocation, the observability of prices and inputs may be reduced for many instruments. In addition, a downturn in market conditions could lead to further declines in the valuation of many instruments.

Valuation techniques

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

Fair value is a market-based measure considered from the perspective of a market participant rather than an entity-specific measure. Therefore, even when market assumptions are not readily available, the Group's own assumptions are set to reflect those that the Group believes market participants would use in pricing the asset or liability at the measurement date.

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

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.

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
Year ended 31 December 2010

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

d. Fair value of financial instruments (continued)

Gains and losses on inception (continued)

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.

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). Any reversal is limited to the extent that the value of the asset may not exceed the original amortised cost of the asset had no impairment occurred.

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.

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
Year ended 31 December 2010

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. The interest capitalisation rate is based on the Morgan Stanley Group's blended funding rates.

For premises held under operating leases, a reinstatement provision is recognised for the estimated cost to reinstate the premises at the end of the lease period (see note 3(l) 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. Investment in joint venture

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

Under the equity method, the investment in the joint venture is recognised in 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 joint venture. The Group's share of its 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 joint venture. Profits and losses resulting from transactions between the Group and the joint venture are eliminated to the extent of the interest in the joint venture. Distributions received from the joint venture reduce the carrying amount of the investment.

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.

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.

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
Year ended 31 December 2010

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

j. Income tax (continued)

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.

k. Operating leases

Rentals payable under operating leases are charged to 'Other expense' 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 to 'Other income' 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.

l. 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.

m. Employee compensation plans

(i) Equity-settled share based compensation plans

Morgan Stanley operates equity-based compensation plans on behalf of the Group and, in relation to which, the Group pays Morgan Stanley in consideration of the procurement of the transfer of shares 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 'Other expense' in 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.

(ii) Other deferred compensation plans

Morgan Stanley also maintains deferred compensation plans for the benefit of certain employees that provide a return to the participating employees based upon the performance of various referenced investments. Liabilities for these awards are recognised over time, in accordance with the awards' vesting conditions, within 'Accruals and Deferred Income' 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'.

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Year ended 31 December 2010

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

n. Retirement benefits

The Group operates a number of defined contribution and defined benefit retirement plans. Contributions due in relation to the Group's defined contribution plan are recognised in 'Other expense' in the consolidated income statement when payable.

For the Group's defined benefit retirement plans, 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 carried 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 \$21 million paid on the Class B preference shares during the year (2009: \$31 million).

5. OTHER INCOME

	2010 \$millions	2009 \$millions
Fee and commission income		
Advisory fees	108	147
Trust and other fiduciary activities	76	92
Foreign exchange gains	4	-
	<u>188</u>	<u>239</u>

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
Year ended 31 December 2010

6. OTHER EXPENSE

	2010 \$millions	2009 \$millions
Fee and commission expense:		
Brokerage fees	437	410
Direct staff costs	170	189
Management recharges relating to staff costs borne by other Morgan Stanley Group undertakings	1,492	1,630
Bank payroll tax	239	-
Management recharges from other Morgan Stanley Group undertakings relating to other services	306	307
Operating lease rentals	9	9
Depreciation on property, plant and equipment	5	7
Foreign exchange losses	-	25
Business development and corporate services	418	473
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
Other operating expense	273	271
	<u>3,353</u>	<u>3,326</u>

Included within both direct staff costs and management recharges relating to staff costs borne by other Morgan Stanley Group undertakings is an amount of \$170 million (2009: \$230 million) in relation to equity-settled share-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 year. Also included within direct staff costs and management recharges relating to staff costs borne by other Morgan Stanley Group undertakings is an amount of \$59 million (2009: \$49 million) in relation to defined contribution pension plans.

On 8 April 2010 the UK government enacted legislation as part of the 2010 Finance Act imposing a bank payroll tax. The tax applies to discretionary bonuses over a certain amount awarded to certain employees within scope ("Banking Employees") in the period from 9 December 2009 to 5 April 2010. The charge incurred by the Group for the bank payroll tax and recognised in the consolidated income statement for the year ended 31 December 2010 was \$239 million (2009: \$nil).

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

	2010 Number	2009 Number
Company and institutional securities infrastructure	157	159
Business units and other	197	192
	<u>354</u>	<u>351</u>

The costs of staff are analysed below:

	2010 \$millions	2009 \$millions
Wages and salaries, including termination costs	150	166
Social security costs	15	21
Pension costs	5	2
	<u>170</u>	<u>189</u>

The Group paid no remuneration to the Company's Directors during the current or prior year 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 33.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Year ended 31 December 2010

7. INCOME TAX EXPENSE

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.

	2010	2009
	\$millions	\$millions
Current tax expense		
United Kingdom corporation tax charge		
– current year	463	195
– adjustments in respect of prior years	(36)	(2)
Double taxation relief		
– current year	(63)	(39)
– adjustments in respect of prior years	(12)	49
Overseas tax		
– current year	165	151
– adjustment in respect of prior years	5	(7)
	<u>522</u>	<u>347</u>
Deferred tax expense		
Origination and reversal of temporary differences	(8)	97
Adjustment in respect of prior years	2	28
	<u>516</u>	<u>472</u>

Reconciliation of effective tax rate

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

	2010	2009
	\$millions	\$millions
Profit before income tax	763	597
Income tax using the standard rate of corporation tax in the UK of 28%	214	167
Impact on tax of:		
Expenses not deductible for tax purposes	4	8
Interest not deductible	2	2
Group relief surrendered for nil / no cash consideration	146	176
Effect of tax rates in foreign jurisdictions	3	24
(Utilisation) / Carry forward tax losses	(2)	6
Tax (over) / under provided in prior years	(44)	68
Tax exempt income	1	1
Non deductible preference share dividends shown as interest expense	6	9
Withholding tax expensed	(3)	(9)
Non deductible bank payroll tax	67	-
Tax reserves	118	-
Other	4	20
Total income tax expense in the consolidated income statement	<u>516</u>	<u>472</u>

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 (2009: \$2 million).

MORGAN STANLEY & CO. INTERNATIONAL plc

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Year ended 31 December 2010

7. INCOME TAX EXPENSE (CONTINUED)

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

In addition to the amount charged to the consolidated income statement, the aggregate amount of current and deferred tax relating to each component of other comprehensive income was as follows:

	Before tax \$millions	2010 Tax benefit \$millions	Net of tax \$millions	Before tax \$millions	2009 Tax benefit \$millions	Net of tax \$millions
Foreign currency translation differences on foreign operations	(30)	2	(28)	(40)	-	(40)
Fair value reserve:						
Net change in fair value of available-for-sale assets	1	-	1	(7)	2	(5)
Actuarial (losses) on defined benefit pension plans	(3)	-	(3)	(2)	-	(2)
Other comprehensive income	(32)	2	(30)	(49)	2	(47)

8. CASH AT BANK

Included within cash at bank is an amount of \$7,238 million (2009: \$7,962 million) which represents segregated client money, held in accordance with the FSA's Client Money Rules, and an amount of \$40 million (2009: \$235 million) which represents other client money.

9. OTHER RECEIVABLES

	2010 \$millions	2009 \$millions
Amounts held at exchanges	193	169
Amounts due from other Morgan Stanley Group undertakings	10,758	14,136
Other	2,616	1,879
	13,567	16,184

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.

	2010 Assets \$millions	2010 Liabilities \$millions	2009 Assets \$millions	2009 Liabilities \$millions
Fair value				
Government debt securities	16,371	15,105	12,871	11,859
Corporate equities	46,188	14,029	44,703	15,667
Corporate and other debt	22,096	4,721	20,504	6,476
Derivatives	186,339	186,938	165,995	169,553
	270,994	220,793	244,073	203,555

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Year ended 31 December 2010

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.

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

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

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

	2010	2010	2009	2009
	Assets	Liabilities	Assets	Liabilities
	\$millions	\$millions	\$millions	\$millions
Prepaid OTC contracts	4,909	3,708	1,784	2,213
Structured notes	-	492	-	670
Other financial assets and liabilities	4,450	9,513	123	4,996
	<u>9,359</u>	<u>13,713</u>	<u>1,907</u>	<u>7,879</u>

The carrying amount of financial liabilities designated at fair value was \$8 million lower than the contractual amount due at maturity (2009: \$190 million higher).

The change in fair value recognised through the consolidated income statement attributable to own credit risk is a loss of \$1 million (2009: \$203 million loss) and cumulatively is \$121 million gain (2009: \$122 million gain). This change is determined as the amount of change in fair value that is not attributable to changes in market conditions that give rise to market risk.

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
Year ended 31 December 2010

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	2010 \$millions	2009 \$millions
At the beginning of the year	43	87
Additions	7	-
Changes in fair value		
- recognised in the fair value reserve	4	(7)
Disposals	(10)	(38)
Foreign exchange retranslation recognised in the currency translation reserve	-	1
At the end of the year	<u>44</u>	<u>43</u>

Included in 'Available-for-sale financial assets' are listed investments of \$4 million (2009: \$1 million).

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
Year ended 31 December 2010

13. PROPERTY, PLANT AND EQUIPMENT

	Leasehold improvements \$millions	Fixtures, fittings and equipment \$millions	Total \$millions
2010			
Cost			
At 1 January 2010	24	21	45
Additions	-	1	1
Disposals	-	(1)	(1)
At 31 December 2010	<u>24</u>	<u>21</u>	<u>45</u>
Depreciation			
At 1 January 2010	13	16	29
Charge for the year	3	2	5
Disposals	-	(1)	(1)
At 31 December 2010	<u>16</u>	<u>17</u>	<u>33</u>
Net book value			
At 31 December 2010	<u>8</u>	<u>4</u>	<u>12</u>
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	<u>24</u>	<u>21</u>	<u>45</u>
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	<u>13</u>	<u>16</u>	<u>29</u>
Net book value			
At 31 December 2009	<u>11</u>	<u>5</u>	<u>16</u>

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
Year ended 31 December 2010

14. OTHER PAYABLES

	2010 \$millions	2009 \$millions
Amounts owing to other Morgan Stanley Group undertakings	21,442	30,328
Other	3,115	3,420
	<u>24,557</u>	<u>33,748</u>

15. SUBORDINATED LOANS

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

Counterparty	Repayment Date	Interest Rate	2010 \$millions	2009 \$millions
Morgan Stanley Strategic Funding Limited	29 October 2026	LIBOR plus 2.00%	-	644
Morgan Stanley International Finance S.A.	31 October 2025	LIBOR plus 1.25%	7,906	7,906
			<u>7,906</u>	<u>8,550</u>

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 to refuse consent to repayment.

On 29 November 2010 the Group repaid \$644 million under its loan facility with Morgan Stanley Strategic Funding Limited.

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

16. PREFERENCE SHARES

**Class B
non-cumulative
preference shares of
\$1 each:
\$millions**

Allotted and fully paid:

At 31 December 2009 and 31 December 2010

786

At 31 December 2010 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 non-cumulative preference shares shall rank in priority to any other class of share (see note 20).

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
Year ended 31 December 2010

17. PROVISIONS

	Property \$millions	Litigation \$millions	Total \$millions
At 1 January 2010	3	19	22
Additional provisions	-	25	25
Provisions utilised	-	(18)	(18)
At 31 December 2010	3	26	29

Property

Property provisions represent the net present value of expected future costs of excess office space and the net present value of expected future costs of reinstating leasehold improvements at the end of the lease term that are released when the reinstatement obligations have been fulfilled. The related asset for lease reinstatement provisions is included in 'Leasehold improvements' within 'Property, plant and equipment' (note 13).

Litigation matters

During the year the Group has been involved in various continuing and other litigation matters.

On 25 September 2009, the Group was named as a defendant in a lawsuit styled *Citibank, N.A. v. Morgan Stanley & Co. International, PLC*, which is pending in the United States District Court for the Southern District of New York. The lawsuit relates to a credit default swap entered into by the Group referencing the Capmark VI CDO, ("Capmark") which was structured by Citibank, N.A. ("Citi N.A."). At issue is whether, as part of the swap agreement, Citi N.A. was obligated to obtain the Group's prior written consent before it exercised its rights to liquidate Capmark upon the occurrence of certain contractually-defined credit events. Citi N.A. is seeking approximately \$245 million in compensatory damages plus interest and costs. On 8 October 2010, the court issued an order denying Citi N.A.'s motion for judgement on the pleadings as to the Group's counterclaim for reformation and granting Citi N.A.'s motion for judgement on the pleadings as to the Group's counterclaim for estoppel. The Group moved for summary judgement on 17 December 2010. Citi N.A. opposed the Group's motion and cross moved for summary judgement on 21 January 2011. A litigation provision has not been made in relation to Capmark. In compliance with the intra-group policies discussed in note 33, revenues and costs related to the Capmark deal referenced above, including any potential litigation costs, are transferred to other Morgan Stanley Group undertakings outside the Group.

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

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Year ended 31 December 2010

18. 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:

	2010		2009	
	Deferred tax asset \$millions	Deferred tax liability \$millions	Deferred tax asset \$millions	Deferred tax liability \$millions
At the beginning of the year	47	(7)	173	(9)
Amount recognised in the consolidated income statement	4	2	(127)	1
Amount recognised in equity	(2)	-	1	1
Impact of tax rate changes	(1)	-	-	-
As at 31 December	48	(5)	47	(7)

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	Deferred tax liability	Consolidated Income statement	Deferred tax asset	Deferred tax liability	Consolidated Income statement
	2010 \$millions	2010 \$millions	2010 \$millions	2009 \$millions	2009 \$millions	2009 \$millions
Depreciation - temporary differences	7	-	-	7	-	2
Deferred compensation	24	-	6	19	-	6
Tax losses carried forward	-	-	-	-	-	(135)
Available-for-sale financial assets	1	-	-	1	-	-
Forecast currency hedges	-	(5)	-	-	(5)	1
Amounts not recognised due to unobservable market data	15	-	-	17	-	-
Impact of tax rate changes	(1)	-	-	-	-	-
Other temporary differences	2	-	-	3	(2)	1
	48	(5)	6	47	(7)	(125)

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.

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

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
Year ended 31 December 2010

18. DEFERRED TAX ASSETS AND LIABILITIES (CONTINUED)

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

	2010	2009
	\$millions	\$millions
Unused tax losses	104	153
	<u>104</u>	<u>153</u>

The aggregate amount of temporary differences associated with investments in subsidiaries, branches and joint ventures, for which deferred tax liabilities have not been recognised is \$nil (2009: \$nil).

19. 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.

	2010	2009
	\$millions	\$millions
Minimum lease payments under non-cancellable operating leases recognised as an expense in the year	<u>9</u>	<u>9</u>

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

	2010	2009
	\$millions	\$millions
Within one year	7	8
In two to five years	19	22
Over five years	-	1
	<u>26</u>	<u>31</u>

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

	2010	2009
	\$millions	\$millions
Contingent commitments	1,194	1
Underwriting commitments	128	-
Loan commitments	682	26
Forward starting reverse repurchase agreements	29,784	18,458

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
Year ended 31 December 2010

20. EQUITY

Share capital

	Ordinary shares of \$1 each: \$millions	Ordinary shares of £1 each: \$millions	Class C, non- cumulative, preference shares of \$1 each: \$millions	Class D, non- cumulative, preference shares of \$1 each: \$millions	Total shares: \$millions
Issued and fully paid:					
At 1 January 2009	2,998	30	1,300	-	4,328
Repurchased in the year: 23 December 2009	-	-	(1,250)	-	(1,250)
At 31 December 2009	<u>2,998</u>	<u>30</u>	<u>50</u>	<u>-</u>	<u>3,078</u>
Issued in the year: 29 November 2010	-	-	-	2,500	2,500
At 31 December 2010	<u>2,998</u>	<u>30</u>	<u>50</u>	<u>2,500</u>	<u>5,578</u>

At 31 December 2010 the total issued share capital equated to \$5,578 million (2009: \$3,078 million) comprising 2,998,332,648 ordinary shares of \$1 each, 17,615,107 ordinary shares of £1 each, 50,000,000 Class C non-redeemable non-cumulative preference shares of \$1 each and 2,500,000,000 Class D non-redeemable non-cumulative preference 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 and Class D non-redeemable non-cumulative preference shares of \$1 each are entitled to receive a LIBOR based dividend in priority to the ordinary shares in accordance with the Company's articles of association. The holders of each class 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 and Class D non-redeemable non-cumulative preference shares shall rank in priority to the ordinary shares.

Other shares classified as financial liabilities

The terms of other shares classified as financial liabilities are detailed in note 16, 'Preference shares'.

Currency translation reserve

The 'currency translation reserve' comprises all foreign exchange differences arising from the translation of the net assets of foreign operations.

The Group hedges foreign exchange exposure arising from its investments in foreign branch operations by utilising forward foreign currency exchange contracts (synthetic hedges) effected through intercompany accounts with the ultimate parent company, Morgan Stanley. Prior to the conversion to IFRS on 1 December 2006 and the related adoption of IAS 39 *Financial instruments: recognition and measurement* ('IAS 39'), the Group reported foreign exchange gains or losses arising on the synthetic hedges directly in reserves, in accordance with United Kingdom Generally Accepted Accounting Practice. A gain of \$63 million in respect of foreign exchange movement on the synthetic hedges for the period from 1 December 2006 to 31 December 2009 was transferred from the 'currency translation reserve' to 'retained earnings' as a reclassification adjustment to opening reserves as at 1 January 2010. The reclassification adjustment properly presents the cumulative foreign exchange gain arising on the synthetic hedges in accordance with IAS 39. A related current tax charge of \$18 million was reclassified from the 'currency translation reserve' to retained earnings.

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Year ended 31 December 2010

20. EQUITY (CONTINUED)

Currency translation reserve (continued)

On 28 September 2010, the Group liquidated its wholly owned foreign subsidiary, Morgan Stanley Neudorf S.a.r.l.. As a consequence, the net assets of Morgan Stanley Neudorf S.a.r.l. were distributed to its parent company, Morgan Stanley & Co. International plc, and a foreign exchange gain amounting to \$14m was reclassified from the 'currency translation reserve' to retained earnings.

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.

21. DIVIDENDS

The following amounts represent the dividends paid in the current and prior year:

	2010		2009	
	Per Share	Total	Per Share	Total
	\$	\$millions	\$	\$millions
Interim dividends on ordinary shares of £1 each	0.13	4	0.11	2
Interim dividends on ordinary shares of \$1 each	0.13	396	0.07	198
Dividend on class C preference shares	0.02	1	0.03	1
		<u>401</u>		<u>201</u>

The Directors have not recommended the payment of a final dividend out of the reserves available at 31 December 2010 (2009: \$nil).

MORGAN STANLEY & CO. INTERNATIONAL plc**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****Year ended 31 December 2010****22. 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:

	2010 \$millions	2009 \$millions
Cash at bank	10,436	13,580
Bank loans and overdrafts	(60)	(126)
	<u>10,376</u>	<u>13,454</u>

Included within 'Cash at bank' is \$7,278 million (2009: \$8,197 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

	2010 \$millions	2009 \$millions
Profit for the year	247	125
Adjustments for:		
Depreciation on property, plant and equipment	5	7
Net gains on available-for-sale investments	(59)	(16)
Interest income	(3,852)	(4,181)
Interest expense	3,953	4,403
Income tax expense	516	472
Other expenses	(3)	(2)
Profit before changes in operating assets and liabilities	<u>807</u>	<u>808</u>
Change in operating assets		
Net increase in loans and receivables	(41,074)	(26,698)
Net (increase) / decrease in financial assets classified as held for trading	(26,920)	41,583
Net increase in financial assets designated at fair value through profit or loss	(7,452)	(512)
	<u>(75,446)</u>	<u>14,373</u>
Change in operating liabilities		
Net increase in financial liabilities at amortised cost	47,416	19,558
Net increase / (decrease) in financial liabilities classified as held for trading	17,238	(36,649)
Net increase in financial liabilities designated at fair value through profit or loss	5,834	2,001
Net increase / (decrease) in provisions	7	(7)
	<u>70,495</u>	<u>(15,097)</u>
Effect of foreign exchange movements	51	(460)
Cash used in operating activities	<u>(4,093)</u>	<u>(376)</u>
Interest received	3,838	4,156
Interest paid	(3,807)	(4,024)
Income taxes paid	(285)	(180)
Net cash flows used in operating activities	<u>(4,347)</u>	<u>(424)</u>

MORGAN STANLEY & CO. INTERNATIONAL plc

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Year ended 31 December 2010

23. EXPECTED MATURITY OF FINANCIAL ASSETS AND LIABILITIES

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

At 31 December 2010	Less than twelve months	Equal to or more than twelve months	Total
	\$millions	\$millions	\$millions
ASSETS			
Loans and receivables:			
Cash at bank	10,436	-	10,436
Securities borrowed	27,852	-	27,852
Reverse repurchase agreements	112,183	-	112,183
Trade receivables	64,027	-	64,027
Other receivables	13,374	193	13,567
	<u>227,872</u>	<u>193</u>	<u>228,065</u>
Financial assets designated at fair value through profit or loss	2,419	6,940	9,359
Available-for-sale financial assets	-	44	44
	<u>230,291</u>	<u>7,177</u>	<u>237,468</u>
LIABILITIES			
Financial liabilities at amortised cost:			
Bank loans and overdrafts	60	-	60
Securities loaned	52,752	307	53,059
Repurchase agreements	100,636	1,892	102,528
Trade payables	75,639	-	75,639
Other payables	24,557	-	24,557
Subordinated loans	-	7,906	7,906
Preference shares	-	786	786
	<u>253,644</u>	<u>10,891</u>	<u>264,535</u>
Financial liabilities designated at fair value through profit or loss	9,578	4,135	13,713
	<u>263,222</u>	<u>15,026</u>	<u>278,248</u>

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
Year ended 31 December 2010

23. EXPECTED MATURITY OF FINANCIAL ASSETS AND LIABILITIES (CONTINUED)

At 31 December 2009	Less than twelve months	Equal to or more than twelve months	Total
	\$millions	\$millions	\$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
	<u>189,962</u>	<u>169</u>	<u>190,131</u>
Financial assets designated at fair value through profit or loss	269	1,638	1,907
Available-for-sale financial assets	-	43	43
	<u>190,231</u>	<u>1,850</u>	<u>192,081</u>
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
	<u>208,003</u>	<u>9,836</u>	<u>217,839</u>
Financial liabilities designated at fair value through profit or loss	5,461	2,418	7,879
	<u>213,464</u>	<u>12,254</u>	<u>225,718</u>

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
Year ended 31 December 2010

24. SEGMENT REPORTING

Segment information is presented in respect of the Group's business and geographical segments. The business segments and geographical segments are based on the Group's management and internal reporting structure. Transactions between business segments are on normal commercial terms and conditions.

Business segments

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 and financial institutions including sales, trading, financing and market-making activities in equity and fixed income securities and related products, including foreign exchange.

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

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
Year ended 31 December 2010

24. SEGMENT REPORTING (CONTINUED)

Business segments (continued)

2010

Consolidated income statement information

	Institutional Securities \$millions	Other \$millions	Total \$millions
Net gains on financial instruments classified as held for trading	3,620	32	3,652
Net gains on financial instruments designated at fair value through profit or loss	318	-	318
Net gains on available-for-sale financial assets	59	-	59
Net interest	(121)	20	(101)
Other income	179	9	188
External revenues net of interest expense	4,055	61	4,116
Other expense	(3,253)	(100)	(3,353)
Profit / (loss) before tax	802	(39)	763
Income tax (expense) / credit	(545)	29	(516)
Profit / (loss) for the year	257	(10)	247

Consolidated statement of financial position information

Segment assets	503,600	5,328	508,928
Joint venture	7	-	7
Total assets	503,607	5,328	508,935
Segment liabilities	496,503	3,301	499,804
Total Liabilities	496,503	3,301	499,804

Other segment information

Property, plant and equipment capital expenditure	1	-	1
Depreciation on property, plant and equipment	5	-	5

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
Year ended 31 December 2010

24. SEGMENT REPORTING (CONTINUED)

Business segments (continued)

2009	Institutional Securities \$millions	Other \$millions	Total \$millions
Consolidated income statement information			
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) before tax	615	(18)	597
Income tax (expense) / credit	(477)	5	(472)
Profit / (loss) for the year	138	(13)	125
Consolidated statement of financial position information			
Segment assets	432,087	4,707	436,794
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

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
Year ended 31 December 2010

24. SEGMENT REPORTING (CONTINUED)

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	
	2010 \$millions	2009 \$millions	2010 \$millions	2009 \$millions	2010 \$millions	2009 \$millions	2010 \$millions	2009 \$millions
External revenues net of interest	3,991	3,921	98	(8)	27	10	4,116	3,923
Profit / (loss) before income tax	675	787	77	(92)	11	(98)	763	597
Total assets	401,829	340,856	58,653	54,647	48,453	41,298	508,935	436,801

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
Year ended 31 December 2010

25. 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 2010, credit exposure was concentrated in North America and Western European countries. In addition, the Group pays particular attention to smaller exposures in emerging markets given their higher risk profile. Country ceiling ratings are derived using methodologies generally consistent with those employed by external rating agencies.

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

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.

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
Year ended 31 December 2010

25. FINANCIAL RISK MANAGEMENT (CONTINUED)

Credit risk (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 2010 is disclosed below, based on the carrying amount of the financial assets the Group believes is subject to credit risk, without taking account of any collateral held or any other credit enhancement. Exposure arising from financial instruments not recognised on the consolidated 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.

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
Year ended 31 December 2010

25. FINANCIAL RISK MANAGEMENT (CONTINUED)

Credit risk (continued)

Exposure to credit risk by class

Class	Gross credit exposure 2010 \$millions	Gross credit exposure 2009 \$millions
Loans and receivables:		
Cash at bank	10,436	13,580
Securities borrowed	27,852	25,394
Reverse repurchase agreements	112,183	83,331
Trade receivables	39,632	34,112
Other receivables	13,437	15,948
Financial assets classified as held for trading:		
OTC Derivatives	171,386	151,578
Financial assets designated at fair value through profit or loss	9,359	1,907
	<u>384,285</u>	<u>325,850</u>
Unrecognised financial instruments		
Contingent commitments	1,194	1
Lease commitments	26	31
Underwriting commitments	128	-
Loan commitments	682	26
Unsettled reverse repurchase agreements	29,784	18,458
	<u>416,099</u>	<u>344,366</u>

Maximum exposure to credit risk by credit rating⁽¹⁾

Credit rating	Gross credit exposure 2010 \$millions	Gross credit exposure 2009 \$millions
AAA	34,944	11,351
AA	99,461	107,219
A	230,416	170,854
BBB	22,707	14,126
BB	7,402	3,551
B	5,932	24,876
CCC	7,984	5,336
D	-	1
Unrated	7,253	7,052
Total	<u>416,099</u>	<u>344,366</u>

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

At 31 December 2010 there were no financial assets past due but not impaired (2009: None). At 31 December 2010 there were no financial assets individually impaired (2009: None).

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Year ended 31 December 2010

25. 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 ongoing 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 as do all other Morgan Stanley subsidiaries.

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

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

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
Year ended 31 December 2010

25. 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 2010. Repayments of financial liabilities that are subject to immediate notice are treated as if notice were given immediately and are classified as on demand. This presentation is considered by the Group to appropriately reflect the liquidity risk arising from those financial liabilities, presented in a way that is consistent with how the liquidity risk on these financial liabilities is managed by the Group.

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
Year ended 31 December 2010

25. FINANCIAL RISK MANAGEMENT (CONTINUED)

Liquidity risk (continued)

Maturity analysis

	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 2010	\$millions	\$millions	\$millions	\$millions	\$millions	\$millions	\$millions
Financial liabilities							
Financial liabilities at amortised cost:							
Bank loans and overdrafts	60	-	-	-	-	-	60
Securities loaned	43,335	1,366	4,450	3,601	307	-	53,059
Repurchase agreements	30,380	51,130	13,073	6,105	1,894	-	102,582
Trade payables	75,639	-	-	-	-	-	75,639
Other payables	10,157	-	-	11,187	2,137	1,076	24,557
Subordinated loans	-	10	20	92	491	9,114	9,727
Preference shares *	-	-	-	18	80	1,287	1,385
Financial liabilities classified as held for trading:							
Derivatives	186,937	-	-	-	-	-	186,937
Other	33,856	-	-	-	-	-	33,856
Financial liabilities designated at fair value through profit or loss	8,012	627	208	732	3,131	1,003	13,713
Total financial liabilities	388,376	53,133	17,751	21,735	8,040	12,480	501,515
Unrecognised financial instruments							
Contingent commitments	1,194	-	-	-	-	-	1,194
Lease commitments	7	-	-	-	19	-	26
Underwriting commitments	-	-	128	-	-	-	128
Loan commitments	682	-	-	-	-	-	682
Unsettled reverse repurchase agreements	29,784	-	-	-	-	-	29,784
Total unrecognised financial instruments	31,667	-	128	-	19	-	31,814

* Preference shares are assumed to be redeemed in 20 years

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

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
Year ended 31 December 2010

25. FINANCIAL RISK MANAGEMENT (CONTINUED)

Liquidity risk (continued)

Maturity analysis

	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							
Contingent commitments	1	-	-	-	-	-	1
Lease commitments	8	-	-	-	-	23	31
Underwriting commitments	-	-	-	-	-	-	-
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 letters of credits and loan commitments will be required.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Year ended 31 December 2010

25. FINANCIAL RISK MANAGEMENT (CONTINUED)

Market risk

Market risk refers to the risk that a change in the level of one or more market prices, rates, indices, implied volatilities (the price volatility of the underlying instrument imputed from option prices), correlations or other market factors, such as liquidity, will result in losses for a position or portfolio.

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

To execute these responsibilities, the Morgan Stanley Group monitors the market risk of the firm against limits on aggregate risk exposures, performs a variety of risk analyses, routinely reports risk summaries and maintains the Value at Risk ("VaR") system. These limits are designed to control price and market liquidity risk. Market risk is monitored through various measures: statistically (using VaR and related analytical measures); by measures of position sensitivity; and through routine stress testing 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.

Risk and capital management initiative

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

Primary market risk exposures and market risk management

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

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

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Year ended 31 December 2010

25. FINANCIAL RISK MANAGEMENT (CONTINUED)

Market risk (continued)

The Group, as part of the Morgan Stanley Group's global market risk management framework manages its trading positions by employing a variety of risk mitigation strategies. These strategies include diversification of risk exposures and hedging. Hedging activities consist of the purchase or sale of positions in related securities and financial instruments, including a variety of derivative products (e.g., futures, forwards, swaps and options). Hedging activities may not always provide effective mitigation against trading losses due to differences in the terms, specific characteristics or other basis risks that may exist between the hedge instrument and the risk exposure that are being hedged. The Group manages the market risk associated with its trading activities on a Group basis, on a entity-wide basis, on a worldwide trading division level and on an individual product strategy. The Group manages and monitors its market risk exposures in such a way as to maintain a portfolio that the Group believes is well-diversified in the aggregate with respect to market risk factors and that reflects the aggregate risk tolerance of key entities within the Group as established by the Group's senior management.

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

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

VaR

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

VaR methodology, assumptions and limitations

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

The Group's VaR model generally takes into account linear and non-linear exposures to 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).

25. FINANCIAL RISK MANAGEMENT (CONTINUED)

Market risk (continued)

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

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

VaR for the year ended 31 December 2010

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

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

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

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Year ended 31 December 2010

25. FINANCIAL RISK MANAGEMENT (CONTINUED)

Market risk (continued)

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

95% Total VaR primary market risk category	95% / one-day VaR at 31 December 2010				95% / one-day VaR at 31 December 2009			
	Period		High \$'m	Low \$'m	Period		High \$'m	Low \$'m
	End \$'m	Average \$'m			End \$'m	Average \$'m		
Interest rate and credit spread	55	60	79	35	38	37	61	27
Equity price	26	21	53	11	12	14	22	10
Foreign exchange rate	10	9	18	3	7	9	19	3
Commodity price	2	3	9	2	3	2	4	1
Subtotal	93	93	159	51	60	62	106	41
Less diversification benefit(1)	(24)	(26)	(61)	(10)	(16)	(22)	(33)	(15)
Total trading VaR	69	67	98	41	44	40	73	26
Total non-trading VaR	12	9	18	5	18	21	24	15
Aggregate VaR	71	69	98	49	53	54	84	30

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

The Group's average Trading VaR for the year ended 31 December 2010 was \$67 million compared with \$40 million for the year ended 31 December 2009. Excluding the counterparty portfolio, which has been reclassified from Non-Trading VaR to Trading VaR for the year ended 31 December 2010, the Group's Average Trading VaR for 2010 would have been \$60 million. The increase, excluding the counterparty portfolio reclassification, has been driven primarily by an increase in interest rate and credit spread risk combined with an increased equity price risk.

Interest rate risk

The Group's VaR excludes certain funding liabilities and money market transactions. As at 31 December 2010, the net notional amount of such funding liabilities and money market activities was approximately \$12 billion, compared to \$1.2 billion as at 31 December 2009. The application of a parallel shift in interest rates of 50 basis points increase or decrease to these positions would result in a net gain or loss of approximately \$2.5 million, compared to a net gain or loss of \$5.5 million as at 31 December 2009.

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

MORGAN STANLEY & CO. INTERNATIONAL plc

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Year ended 31 December 2010

25. FINANCIAL RISK MANAGEMENT (CONTINUED)

Market Risk (continued)

Currency risk

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

The analysis below details this foreign currency exposure for the Group, by foreign currency, and calculates the impact on other 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 the Company or by other members of the Morgan Stanley Group.

Foreign currency exposure	2010			2009		
	Sensitivity to applied percentage change in currency (+/-)			Sensitivity to applied percentage change in currency (+/-)		
		Percentage change applied %	Other comprehensive income \$millions		Percentage change applied %	Other comprehensive income \$millions
	\$millions			\$millions		
Australian Dollar	(6)	27%	2	(5)	27%	1
Euro	366	7%	25	394	5%	20
British Pound	44	29%	13	120	29%	35
New Taiwan Dollar	60	8%	5	92	3%	3
New Zealand Dollar	2	24%	-	2	24%	-
Singapore Dollar	4	9%	-	3	2%	-
South Korean Won	183	42%	77	138	42%	58
Swedish Krona	15	23%	3	14	23%	3
Swiss Franc	5	10%	-	-	-	-
	<u>673</u>			<u>758</u>		

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

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
Year ended 31 December 2010

26. 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.

	2010 \$millions	2009 \$millions
Government debt securities	13,777	9,958
Corporate equities	38,711	42,108
Corporate and other debt	13,062	10,107
	<u>65,550</u>	<u>62,173</u>

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

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

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

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 2010 was \$202,562 million (2009: \$162,214 million). Of this amount \$171,194 million (2009: \$134,615 million) has been sold or repledged to third parties in connection with financing activities, or to comply with commitments under short sale transactions.

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
Year ended 31 December 2010

28. FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE

a. Fair value hierarchy

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

- *Quoted prices (unadjusted) in an active market for identical assets or liabilities (Level 1)* - valuations based on quoted prices in active markets for identical assets or liabilities that the Morgan Stanley Group has the ability to access. Valuation adjustments and block discounts are not applied to Level 1 instruments. Since valuations are based on quoted prices that are readily and regularly available in an active market, valuations of these products does not entail a significant degree of judgement.
- *Valuation techniques using observable inputs (Level 2)* - valuations based on one or more quoted prices in markets that are not active or for which all significant inputs are observable, either directly or indirectly.
- *Valuation techniques with significant non-observable inputs (Level 3)* - valuations based on inputs that are unobservable and significant to the overall fair value measurement.

Fair Value Control Processes

The Group employs control processes to validate the fair value of its financial instruments, including those derived from pricing models. These control processes are designed to assure that the values used for financial reporting are based on observable inputs wherever possible. In the event that observable inputs are not available, the control processes are designed to assure that the valuation approach utilised is appropriate and consistently applied and that the assumptions are reasonable. These control processes include reviews of the pricing model's theoretical soundness and appropriateness by Morgan Stanley Group personnel with relevant expertise who are independent from the trading desks.

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

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
Year ended 31 December 2010

28. FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE (CONTINUED)

a. Fair value hierarchy (continued)

Financial assets and liabilities recognised at fair value

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

2010	Quoted prices in active market (Level 1)	Valuation techniques using observable inputs (Level 2)	Valuation techniques with significant non-observable inputs (Level 3)	Total
	\$millions	\$millions	\$millions	\$millions
Financial assets classified as held for trading:				
- Government debt securities	12,369	4,002	-	16,371
- Corporate equities	44,908	1,134	146	46,188
- Corporate and other debt	110	18,627	3,359	22,096
- Derivatives	968	183,006	2,365	186,339
Total financial assets classified as held for trading	58,355	206,769	5,870	270,994
Financial assets designated at fair value through profit or loss	-	8,830	529	9,359
Available-for-sale financial assets:				
- Corporate equities	4	-	40	44
Total financial assets measured at fair value	58,359	215,599	6,439	280,397
Financial liabilities classified as held for trading:				
- Government debt securities	11,944	3,161	-	15,105
- Corporate equities	13,571	447	11	14,029
- Corporate and other debt	-	4,695	26	4,721
- Derivatives	924	182,150	3,864	186,938
Total financial liabilities classified as held for trading	26,439	190,453	3,901	220,793
Financial liabilities designated at fair value through profit or loss	-	12,858	855	13,713
Total financial liabilities measured at fair value	26,439	203,311	4,756	234,506

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
Year ended 31 December 2010

28. FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE (CONTINUED)

a. Fair value hierarchy (continued)

Financial assets and liabilities recognised at fair value (continued)

2009

	Quoted prices in active market (Level 1) \$millions	Valuation techniques using observable inputs (Level 2) \$millions	Valuation techniques with significant non- observable inputs (Level 3) \$millions	Total \$millions
Financial assets classified as held for trading:				
- Government debt securities	11,921	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 ⁽¹⁾	-	496	1,411	1,907
Available-for-sale financial assets:				
- Corporate equities	1	-	42	43
Total financial assets measured at fair value	55,520	182,414	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
Total financial liabilities designated at fair value through profit and loss ⁽¹⁾	-	6,987	892	7,879
Total financial liabilities measured at fair value	26,149	178,490	6,795	211,434

(1) Certain financial assets designated at fair value through profit or loss and financial liabilities designated at fair value through profit or loss have been reclassified from Level 1 to Level 2.

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
Year ended 31 December 2010

28. FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE (CONTINUED)

a. Fair value hierarchy (continued)

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

- *Government debt securities*

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

- *Corporate equities*

Exchange-Traded Equity Securities. Exchange traded equity securities are generally valued based on quoted prices from the exchange. To the extent these securities are actively traded, valuation adjustments are not applied and they are categorised in Level 1 of the fair value hierarchy; otherwise, they are categorised in Level 2.

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

After initial recognition, in determining the fair value of internally and externally managed funds, the Group considers the net asset value of the fund provided by the fund manager to be the best estimate of fair value. For direct private investments and privately held investments within internally managed funds, fair value after initial recognition is based on an assessment of each underlying investment, considering rounds of financing third party transactions, discounted cash flow analyses and market-based information, including comparable company transactions, trading multiples and changes in market outlook, among other factors. If the investments are exchange-traded they will be categorised as Level 1, otherwise they will be categorised as Level 3.

- *Corporate and other debt*

Corporate Bonds. The fair value of corporate bonds is estimated using recently executed transactions, market price quotations (where observable), bond spreads or credit default swap spreads adjusted for any basis difference between cash and derivative instruments. The spread data used are for the same maturity as the bond. If the spread data does not reference the issuer, then data that reference a comparable issuer are used. When observable price quotations are not available, fair value is determined based on cash flow models with yield curves, bond or single name credit default swap spreads and recovery rates as significant inputs. Corporate bonds are generally categorised in Level 2 of the fair value hierarchy; in instances where prices, spreads or any other of the aforementioned key inputs are unobservable, they are categorised in Level 3 of the fair value hierarchy.

Residential Mortgage-Backed Securities ("RMBS"), Commercial Mortgage-Backed Securities ("CMBS"), and other Asset-Backed Securities ("ABS"). RMBS, CMBS and other ABS may be valued based on external price or spread data. When position-specific external price data are not observable, the valuation is based on prices of comparable bonds. Valuation levels of RMBS and CMBS indices are used as an additional data point for benchmarking purposes or to price outright index positions.

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

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

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
Year ended 31 December 2010

28. FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE (CONTINUED)

a. Fair value hierarchy (continued)

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

- *Corporate and other debt (continued)*

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

- *Derivatives*

Listed Derivative Contracts. Listed derivatives that are actively traded are valued based on quoted prices from the exchange and are categorised in Level 1 of the fair value hierarchy. Listed derivatives that are not actively traded are valued using the same approaches as those applied to OTC derivatives; they are generally categorised in Level 2 of the fair value hierarchy.

OTC Derivative Contracts. OTC derivative contracts include forward, swap and option contracts related to interest rates, foreign currencies, credit standing of reference entities, equity prices or commodity prices.

Depending on the product and the terms of the transaction, the fair value of OTC derivative products can be either observed or modelled using a series of techniques, and model inputs from comparable benchmarks, including closed-form analytical formulas such as the Black-Scholes option pricing model, and simulation models or a combination thereof. Many pricing models do not entail material subjectivity because the methodologies employed do not necessitate significant judgement, and the pricing inputs are observed from actively quoted markets, as is the case for generic interest rate swaps, certain option contracts and certain credit default swaps. In the case of more established derivative products, the pricing models used are widely accepted by the financial services industry. A substantial majority of OTC derivative products valued using pricing models fall into this category and are categorised within Level 2 of the fair value hierarchy.

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

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

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
Year ended 31 December 2010

28. FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE (CONTINUED)

a. Fair value hierarchy (continued)

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

- *Derivatives (continued)*

OTC Derivative Contracts (continued)

Derivative interests in mortgage-related CDOs, and credit default swaps, for which observability of external price data is extremely limited, are valued based on an evaluation of the market and model input parameters sourced from similar positions as indicated by primary and secondary market activity. Each position is evaluated independently taking into consideration the underlying collateral performance and pricing, behaviour of the tranche under various cumulative loss and prepayment scenarios, deal structures (e.g., non-amortising reference obligations, call features) and liquidity. While these factors may be supported by historical and actual external observations, the determination of their value as it relates to specific positions nevertheless requires significant judgement.

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

The Group trades various derivative structures with commodity underlyings. Depending on the type of structure, the model inputs generally include interest rate yield curves, commodity underlier curves, implied volatility of the underlying commodities and, in some cases, the implied correlation between these inputs. The fair value of these products is estimated using executed trades and broker and consensus data to provide values for the aforementioned inputs. Where these inputs are unobservable, relationships to observable commodities and data points, based on historic and / or implied observations, are employed as a technique to estimate the model input values. Commodity derivatives are generally categorised in Level 2 of the fair value hierarchy; in instances where significant inputs are unobservable, they are categorised in Level 3 of the fair value hierarchy.

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

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

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

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

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
Year ended 31 December 2010

28. 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 2010:

	Balance at 1 January 2010	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 2010	Unrealised gains or (losses) for level 3 assets / liabilities outstanding as at 31 December 2010 (2)
	\$millions	\$millions	\$millions	\$millions	\$millions	\$millions	\$millions	\$millions	\$millions	\$millions
Financial assets classified as held for trading:										
- Government debt securities	2	-	-	-	-	-	-	(2)	-	-
- Corporate equities	49	42	-	126	(120)	-	-	49	146	27
- Corporate and other debt	2,351	131	-	1,468	(907)	-	(114)	430	3,359	67
Total financial assets classified as held for trading	2,402	173	-	1,594	(1,027)	-	(114)	477	3,505	94
Financial assets designated at fair value through profit or loss	1,411	-	-	527	-	-	-	(1,409)	529	-
Available-for-sale financial assets:										
- Corporate equities	42	-	1	7	(10)	-	-	-	40	-
Total financial assets measured at fair value	3,855	173	1	2,128	(1,037)	-	(114)	(932)	4,074	94
Financial liabilities classified as held for trading:										
- Corporate equities	(3)	1	-	-	(48)	-	50	(11)	(11)	1
- Corporate and other debt	(4)	4	-	-	(108)	-	73	9	(26)	-
- Net derivative contracts (3)	(1,662)	(41)	-	-	-	-	191	13	(1,499)	(313)
Total financial liabilities classified as held for trading	(1,669)	(36)	-	-	(156)	-	314	11	(1,536)	(312)
Financial liabilities designated at fair value through profit or loss	(892)	(167)	-	-	121	(105)	39	149	(855)	(258)
Total financial liabilities measured at fair value	(2,561)	(203)	-	-	(35)	(105)	353	160	(2,391)	(570)

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

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
Year ended 31 December 2010

28. FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE (CONTINUED)

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

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 classified as 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
Total financial assets classified as held for trading	2,764	173	-	1,001	(835)	-	-	(701)	2,402	199
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	-
Total financial assets measured at fair value	3,982	816	(7)	1,004	(873)	-	(283)	(784)	3,855	842
Financial liabilities classified as 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
Total financial liabilities classified as held for trading	(3,439)	1,554	-	-	(28)	-	68	176	(1,669)	1,018
Financial liabilities designated at fair value through profit or loss	(515)	30	-	-	-	(380)	215	(242)	(892)	30
Total financial liabilities measured at fair value	(3,954)	1,584	-	-	(28)	(380)	283	(66)	2,561	1,048

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
Year ended 31 December 2010

28. FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE (CONTINUED)

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

As disclosed in note 33 the Morgan Stanley Group operates a number of intra-group policies to ensure that, where possible, revenues and related costs are matched. Where the trading positions included in the above gains or losses are risk managed using financial instruments across a number of Morgan Stanley Group entities, these policies potentially result in the recognition of offsetting gains or losses in the Group.

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

During the year ended 31 December 2009, the Group reclassified approximately \$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.

During the year ended 31 December 2009, 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.

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

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

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

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

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

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
Year ended 31 December 2010

28. FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE (CONTINUED)

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

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

2010	Effect of reasonably possible alternative assumptions		
	Fair Value \$millions	Increase in fair value \$millions	Decrease in fair value \$millions
Financial assets classified as held for trading:			
- Government debt securities	-	-	-
- Corporate equities	146	3	(3)
- Corporate and other debt	3,359	211	(210)
Financial assets designated at fair value through profit or loss:			
- Prepaid OTC contracts	-	-	-
- Structured notes	-	-	-
- Other	529	11	(6)
Available-for-sale financial assets:			
- Corporate equities	40	1	(1)
Financial liabilities classified as held for trading:			
- Government debt securities	-	-	-
- Corporate equities	(11)	-	(1)
- Corporate and other debt	(26)	1	(1)
- Net derivatives contracts ⁽¹⁾	(1,499)	126	(147)
Financial liabilities designated at fair value through profit or loss:			
- Prepaid OTC contracts	(3)	-	-
- Structured notes	-	-	-
- Other	(852)	8	(8)

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

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
Year ended 31 December 2010

28. FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE (CONTINUED)

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

2009	Effect of reasonably possible alternative assumptions		
	Fair Value \$millions	Increase in fair value \$millions	Decrease in fair value \$millions
Financial assets classified as held for trading:			
- Government debt securities	2	-	-
- Corporate equities	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)
- Structured notes	(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.

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
Year ended 31 December 2010

28. FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE (CONTINUED)

e. Financial instruments valued using unobservable market data

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

	2010 \$millions	2009 \$millions
At 1 January	215	281
New transactions	94	42
Amounts recognised in the consolidated income statement during the period	(49)	(108)
At 31 December	260	215

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.

29. FINANCIAL INSTRUMENTS NOT MEASURED AT FAIR VALUE

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

31 December 2010	Carrying value \$millions	Fair value \$millions	Unrecognised gain / (loss) \$millions
Financial assets			
Termed reverse repurchase agreements	71,990	72,016	26
Financial liabilities			
Subordinated loans	7,906	6,088	1,818
Preference shares	786	588	198
Termed repurchase agreements	72,147	72,151	(4)
 31 December 2009	 Carrying value \$millions	 Fair value \$millions	 Unrecognised gain / (loss) \$millions
Financial assets			
Termed reverse repurchase agreements	75,352	75,354	2
Financial liabilities			
Subordinated loans	8,550	6,874	1,676
Preference shares	786	677	109
Termed repurchase agreements	59,262	59,266	(4)

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

MORGAN STANLEY & CO. INTERNATIONAL plc

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Year ended 31 December 2010

30. CAPITAL MANAGEMENT

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

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

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

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

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

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

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

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

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

The Group considers the below to be its managed capital:

	2010 \$millions	2009 \$millions
Ordinary share capital	3,028	3,028
Preference share capital	2,550	50
Subordinated loans	7,906	8,550
Preference shares classified as debt instruments	786	786
Reserves	3,480	3,665
	<u>17,750</u>	<u>16,079</u>

During 2010, the Group has continued to review and actively manage its capital position. As part of this capital management, the Group has repaid \$644 million of intercompany subordinated debt, issued \$2,500 million of the Group's class D non-redeemable non-cumulative preference share capital, and paid dividends of \$422 million.

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
Year ended 31 December 2010

31. SHARE-BASED PAYMENT TRANSACTIONS

As described in note 33, 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 several equity-based compensation plans. The plans provide for the deferral of a portion of certain key employees' discretionary compensation with awards made in the form of a right to receive unrestricted shares of common stock in the future ("restricted stock units"). Awards under these plans are generally subject to vesting over time contingent upon continued employment and to restrictions on sale, transfer or assignment until the end of a specified period, generally two to three years from date of grant. All or a portion of an award may be cancelled if employment is terminated before the end of the relevant restriction period. All or a portion of a vested award also may be cancelled in certain limited situations, including termination for cause during the relevant restriction period. Recipients of deferred stock awards generally have voting rights and receive dividend equivalents.

During the year, Morgan Stanley granted 464,505 units of restricted common stock to employees of the Group with a weighted average fair value per unit of \$29.24 (2009: 102,226 units, weighted average fair value \$20.87 per unit) based on the market value of Morgan Stanley shares at grant date. Units granted in respect of employees' 2009 discretionary compensation were granted in January 2010, therefore the 2009 number of units do not include a full year's awards.

- **Stock option awards**

Morgan Stanley has also granted 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.

There were no options granted during the year (2009: none).

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

	2010		2009	
	Number of options '000s	Weighted average exercise price \$	Number of options '000s	Weighted average exercise price \$
Options outstanding at 1 January	325	53.47	478	50.78
Forfeited during the year	-	-	(1)	66.73
Expired during the year	(62)	60.79	(152)	44.95
Options outstanding at 31 December	<u>263</u>	<u>51.74</u>	<u>325</u>	<u>53.47</u>
Options exercisable at 31 December	<u>263</u>	<u>51.74</u>	<u>276</u>	<u>51.10</u>

No stock options were exercised during the year (2009: none).

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
Year ended 31 December 2010

31. SHARE-BASED PAYMENT TRANSACTIONS (CONTINUED)

• **Stock option awards (continued)**

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

Range of exercise prices	2010			2009		
	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	59	36.25	2.0	66	36.25	2.9
\$40.00 - \$49.99	104	47.42	2.4	108	47.43	3.3
\$50.00 - \$59.99	10	55.61	0.1	14	54.33	0.7
\$60.00 - \$69.99	90	66.31	5.5	137	66.45	4.6
Total	263	51.74	3.3	325	53.47	3.6

Other deferred compensation plans

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

During the year, the Group granted awards with a value of \$7 million (2009: \$5 million) to employees. The Group recognised an expense of \$5 million (2009: \$16 million) within 'Other expense' in the consolidated income statement in relation to the current and prior years awards. The liability to employees at the end of the year, reported within 'Accruals and Deferred Income' in the statement of financial position, is \$22 million (2009: \$14 million).

The Group economically hedges the exposure created by these deferred compensation schemes by entering into derivative transactions with other Morgan Stanley Group undertakings. The derivative balance at the end of the year, recognised within 'Financial assets classified as held for trading' in relation to these deferred compensation schemes is \$3 million (2009: \$1 million) and the related profit and loss recorded within 'Net gains / losses on financial instruments classified as held for trading' for the year is \$1 million gain (2009: \$41 million gain).

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Year ended 31 December 2010

32. 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 \$1 million for the year (2009: \$1 million) of which \$nil was accrued at 31 December 2010 (2009: \$nil).

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 (Indemnités de Fin de Carrière)
- Morgan Stanley France (SAS) Leaving Indemnity Plan (Indemnités de Fin de Carrière)
- Morgan Stanley & Co International plc (Athens Branch) Retirement Indemnity
- Morgan Stanley Asia (Taiwan) Limited Retirement Scheme
- Morgan Stanley Asia (Taiwan) Limited Book Reserve Plan
- Personalvorsorgestiftung der Bank Morgan Stanley AG Plan
- Morgan Stanley Dubai End of Service Gratuity

The group also operated the Morgan Stanley & Co International plc Seoul Branch Severance Pay Plan until 1 October 2010, when the plan converted to a defined contribution plan and all defined benefit obligations settled.

During the year Bank Morgan Stanley AG transferred its institutional securities business to the Zurich Branch but its employees remained in the same Personalvorsorgestiftung der Bank Morgan Stanley AG Plan, together with all remaining Bank Morgan Stanley AG employees. The plan was considered as transferred into the Zurich Branch with the difference between assets and liabilities at initial recognition included in other comprehensive income.

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:

	2010 \$millions	2009 \$millions
Current service cost	3	2
Interest on obligation	1	-
Defined benefit plan expense	<u>4</u>	<u>2</u>

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 \$3 million loss (2009: \$2 million loss).

MORGAN STANLEY & CO. INTERNATIONAL plc

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Year ended 31 December 2010

32. 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.

	2010 \$millions	2009 \$millions
Retirement benefit liability:		
Present value of funded defined benefit obligation	(13)	(6)
Fair value of plan assets	11	3
	(2)	(3)
Present value of unfunded defined benefit obligation	(2)	(1)
Retirement benefit liability recognised in the consolidated statement of financial position	(4)	(4)

Contributions for the year to the defined benefit plan totalled \$6 million (2009: \$2 million), of which \$nil was accrued at 31 December 2010 (2009: \$nil). The Group expects to contribute \$2 million (2009: \$1 million) in the next financial year, based upon the current funded status, and the expected return assumptions for the next financial year.

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

	2010 \$millions	2009 \$millions
Reconciliation of defined benefit obligations:		
Defined benefit obligations at 1 January	7	5
Current service cost	3	2
Interest cost	1	-
Actuarial loss	1	2
Transfer in	11	-
Benefits paid	(1)	(2)
Liabilities extinguished on settlements	(7)	-
Defined benefit obligations at 31 December	15	7

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

	2010 \$millions	2009 \$millions
Reconciliation of fair value of plan assets:		
Fair value of plan assets at 1 January	3	3
Transfer in	9	-
Assets distributed on settlements	(7)	-
Employer contributions	6	2
Benefits paid	(1)	(2)
Expected return on plan assets	1	-
Fair value of plan assets at end of the year	11	3
Actual return / (deficit) on fund assets	-	-

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
Year ended 31 December 2010

32. RETIREMENT BENEFITS (CONTINUED)

Retirement benefit obligation (continued)

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

	Fair value of assets	
	2010	2009
	\$millions	\$millions
Cash	4	3
Equity securities	3	-
Fixed income securities	4	-
	<u>11</u>	<u>3</u>

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.

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

The following table presents the principal actuarial assumptions at the end of the reporting period:

	2010	2009
Discount rate	2.00%- 7.05%	2.25%- 7.05%
Rate of increase in salaries	2.50%- 5.50%	2.50%-5.50%
Inflation assumption	1.50%- 2.00%	2.00%
Expected long-term rate of return on plan assets:		
- At 1 January	2.25%- 3.50%	0%- 2.25%
- At 31 December	2.50%- 4.60%	2.50%- 3.50%

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
Year ended 31 December 2010

32. RETIREMENT BENEFITS (CONTINUED)

Retirement benefit obligation (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 2010					
Switzerland	Unadjusted BVG 2005 Mortality Table	82.9	82.9	86.0	86.0
Taiwan	2002 Taiwan Standard Ordinary Mortality Table	N/A	N/A	N/A	N/A
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

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

Taiwan Plan

Assumption	Change in assumption	Impact on scheme liabilities
Discount rate	Increase / decrease by 0.5%	Decrease by 4.6% / increase by 4.8%
Inflation assumption	N/A	N/A
Rate of increase in salaries	Increase / decrease by 0.5%	Decrease by 0% / increase by 0%
Rate of mortality	N/A	N/A

Switzerland Plan

Assumption	Change in assumption	Impact on scheme liabilities
Discount rate	Increase / decrease by 0.5%	Decrease by 7.5% / increase by 8.4%
Inflation assumption	Increase / decrease by 0.5%	Increase by 4.2% / decrease by 3.0%
Rate of increase in salaries	Increase / decrease by 0.5%	Increase by 0.7% / decrease by 0.7%
Rate of mortality	Increase by 1 year	Increase by 0.6%

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

	31 December 2010 \$millions	31 December 2009 \$millions	30 December 2008 \$millions	30 November 2007 \$millions	30 November 2006 \$millions
Present value of defined benefit obligation	(15)	(7)	(5)	(8)	(6)
Fair value of plan assets	11	3	3	4	3
Deficit	(4)	(4)	(2)	(4)	(3)
Experience adjustments on plan liabilities:					
Amount	1	(1)	(1)	-	-
Percentage of plan liabilities (%)	4.38%	(12.48%)	(15.85%)	0.31%	(4.26%)
Experience adjustments on plan assets:					
Amount	-	-	-	-	-
Percentage of plan liabilities (%)	(1.30%)	2.22%	(3.79%)	0.77%	0.31%

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
Year ended 31 December 2010

32. RETIREMENT BENEFITS (CONTINUED)

Retirement benefit obligation (continued)

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 (2009: \$9 million).

For the purposes of IAS19 disclosure, the defined benefit section of the UK Plan as a whole, is presented below.

Defined benefit plan expense

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

	2010 \$millions	2009 \$millions
Expected return on fund assets	(6)	(6)
Interest on obligation	8	8
Defined benefit plan expense	<u>2</u>	<u>2</u>

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

	2010 \$millions	2009 \$millions
Retirement benefit liability:		
Present value of funded defined benefit obligation	(145)	(148)
Fair value of plan assets	167	151
Adjustment for ceiling	(22)	(3)
Retirement benefit liability recognised in the consolidated statement of financial position	<u>-</u>	<u>-</u>

Contributions for the year to the defined benefit plan by Morgan Stanley UK totalled \$9 million (2009: \$9 million), of which \$nil was accrued at 31 December 2010 (2009: \$nil). Morgan Stanley UK expects to contribute \$9 million (2009: \$9 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:

	2010 \$millions	2009 \$millions
Reconciliation of defined benefit obligations:		
Defined benefit obligations at 1 January	148	131
Interest cost	8	8
Actuarial gain	(2)	(3)
Benefits paid	(3)	(2)
Foreign exchange rate changes	(6)	14
Defined benefit obligations at 31 December	<u>145</u>	<u>148</u>

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
Year ended 31 December 2010

32. RETIREMENT BENEFITS (CONTINUED)

Retirement benefit obligation (continued)

Plans operated by fellow subsidiary undertakings (continued)

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

	2010 \$millions	2009 \$millions
Reconciliation of fair value of plan assets:		
Fair value of plan assets at 1 January	151	149
Expected return on plan assets	6	6
Actuarial gains / (losses)	9	(27)
Employer contributions	9	9
Benefits paid	(3)	(2)
Foreign exchange rate changes	(5)	16
Fair value of plan assets at end of the year	167	151
Actual return / (deficit) on plan assets	15	(21)

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

	Fair value of assets 2010 \$millions	2009 \$millions
Equity securities	3	2
Fixed income securities	164	149
	167	151

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

	2010	2009
Pre-retirement discount rate	5.60%	5.70%
Post-retirement discount rate	4.30%	4.50%
Inflation assumption	3.60%	3.80%
Expected rate of return on plan assets:		
- Equity securities	7.00%	7.00%
- Fixed income securities	4.30%	4.40%

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

	Life expectancy at age 65 for a male member currently: Aged 65 Aged 40		Life expectancy at age 65 for a female member currently: Aged 65 Aged 40	
31 December 2010				
UK	89.2	92.1	91.7	94.7
31 December 2009				
UK	88.1	91.7	90.6	92.7

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
Year ended 31 December 2010

32. RETIREMENT BENEFITS (CONTINUED)

Retirement benefit obligation (continued)

Plans operated by fellow subsidiary undertakings (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
Discount rate	Increase by 0.5%	Decrease by 15%
Inflation assumption	Increase by 0.5%	Increase by 4.0%
Rate of mortality	Increase by 1 year	Increase by 4.0%

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

	2010	2009	2008	2007	2006
	\$millions	\$millions	\$millions	\$millions	\$millions
Present value of defined benefit obligation	(145)	(148)	(131)	(170)	(151)
Fair value of plan assets	167	151	149	195	161
Surplus	<u>22</u>	<u>3</u>	<u>18</u>	<u>25</u>	<u>10</u>
Experience adjustments on plan liabilities:					
Amount (\$millions)	<u>(10)</u>	<u>-</u>	<u>-</u>	<u>(6)</u>	<u>-</u>
Percentage of plan liabilities (%)	<u>(7.12%)</u>	<u>0%</u>	<u>0%</u>	<u>(3.51%)</u>	<u>0%</u>
Experience adjustments on plan assets					
Amount (\$millions)	<u>(9)</u>	<u>27</u>	<u>1</u>	<u>5</u>	<u>(5)</u>
Percentage of plan assets (%)	<u>(5.18%)</u>	<u>17.86%</u>	<u>0.68%</u>	<u>2.74%</u>	<u>(3.05%)</u>

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
Year ended 31 December 2010

33. 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.

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 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 Dover Investments Limited	United Kingdom	100%	Ordinary Shares	100%	Investment company
Morgan Stanley Kochi Limited	United Kingdom	100%	Ordinary Shares	100%	Investment company
Morgan Stanley Langton Limited	United Kingdom	100%	Ordinary Shares	100%	Investment company
Morgan Stanley Longcross Limited	United Kingdom	100%	Ordinary Shares	100%	Investment company
Morgan Stanley Mandarin Limited	United Kingdom	100%	Ordinary Shares	100%	Investment company
Morgan Stanley Piccadilly Limited	Cayman Islands	100%	Ordinary Shares	100%	Investment company
Morgan Stanley Rivelino Investments Limited	United Kingdom	100%	Ordinary Shares	100%	Investment company
Morgan Stanley Silvermere Limited	United Kingdom	100%	Ordinary Shares	100%	Investment company
Morgan Stanley Taiwan Limited	Taiwan	100%	Ordinary Shares	100%	Financial Services
Morgan Stanley Turnberry Limited	United Kingdom	100%	Ordinary Shares	100%	Investment company
Morgan Stanley Waterloo 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.

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Year ended 31 December 2010

33. RELATED PARTY DISCLOSURES (CONTINUED)

Key management compensation

Key management personnel are 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:

	2010 \$millions	2009 \$millions
Short-term employee benefits	31	38
Post-employment benefits	1	1
Share-based payments	21	47
Other long-term employee benefits	11	16
Termination benefits	2	-
	<u>66</u>	<u>102</u>

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.

Key management personnel compensation is borne by other Morgan Stanley Group undertakings in both the current and prior years.

Directors' emoluments

	2010 \$millions	2009 \$millions
Total emoluments of all Directors:		
Aggregate emoluments	11	12
Long term incentive schemes	3	-
	<u>14</u>	<u>12</u>
Disclosures in respect of the highest paid Director:		
Aggregate emoluments excluding pension contributions	4	4
Long term incentive schemes	2	-
	<u>2</u>	<u>-</u>
Aggregate compensation paid to Directors for loss of office	2	-

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

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

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Year ended 31 December 2010

33. RELATED PARTY DISCLOSURES (CONTINUED)

Key management compensation (continued)

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 (2009: six). 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 (2009: one). In addition, one Director has benefits accruing under the Alternative Retirement Plan, a defined benefit scheme, operated by Morgan Stanley UK Limited (2009: one). Three directors have benefits accruing under the Morgan Stanley non-UK defined benefits schemes (2009: three).

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

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 on an arm's length basis 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 not recognised any expense and has made no provision for bad and doubtful debts related to the amount of outstanding balances from related parties (2009: nil).

Funding

The Group receives funding from and provides funding 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 funding requirements, or for general intra group funding purposes. General intra group funding is repayable on demand, or in accordance with agreed repayment terms that range between 120 days to 365 days. 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 funding its business.

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

	2010		2009	
	Interest \$millions	Balance \$millions	Interest \$millions	Balance \$millions
Amounts due from the Group's direct and indirect parent companies	61	7,667	29	7,635
Amounts due from other Morgan Stanley Group undertakings	118	3,082	433	6,419
	<u>179</u>	<u>10,749</u>	<u>462</u>	<u>14,054</u>
Amounts due to the Group's direct and indirect parent companies	228	1,017	759	14,174
Amounts due to other Morgan Stanley Group undertakings	369	20,414	411	16,039
	<u>597</u>	<u>21,431</u>	<u>1,170</u>	<u>30,213</u>

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
Year ended 31 December 2010

33. RELATED PARTY DISCLOSURES (CONTINUED)

Funding (continued)

• *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 15. The interest rates are established by the Morgan Stanley Group treasury function based on available market information at the time the loan is provided.

Trading and risk management

In the course of funding 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 year are shown in the table below:

	2010		2009	
	Interest \$millions	Balance \$millions	Interest \$millions	Balance \$millions
Amounts due from other Morgan Stanley Group undertakings	1,326	43,349	2,694	41,130
	<u>1,326</u>	<u>43,349</u>	<u>2,694</u>	<u>41,130</u>
Amounts due to other Morgan Stanley Group undertakings	1,910	77,471	3,495	72,952
	<u>1,910</u>	<u>77,471</u>	<u>3,495</u>	<u>72,952</u>

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:

	2010 \$millions	2009 \$millions
Amounts due from the Group's direct and indirect parent companies on unsettled securities and derivatives transactions	1,449	1,195
Amounts due from other Morgan Stanley Group undertakings on unsettled securities and derivatives transactions	<u>57,023</u>	<u>50,819</u>
	<u>58,472</u>	<u>52,014</u>
Amounts due to the Group's direct and indirect parent companies on unsettled securities and derivatives transactions	1,515	1,164
Amounts due to other Morgan Stanley Group undertakings on unsettled securities and derivatives transactions	<u>55,484</u>	<u>51,090</u>
	<u>56,999</u>	<u>52,254</u>

MORGAN STANLEY & CO. INTERNATIONAL plc

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Year ended 31 December 2010

33. RELATED PARTY DISCLOSURES (CONTINUED)

Trading and risk management (continued)

The Group has received collateral of \$5,084 million (2009: \$5,092 million) from other Morgan Stanley Group undertakings and has pledged collateral of \$5,306 million (2009: \$4,676 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 2010, a net loss of \$810 million was recognised in the consolidated income statement arising from such policies (2009: \$2,805 million loss).

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:

	2010		2009	
	Staff costs \$millions	Other services \$millions	Staff costs \$millions	Other services \$millions
Amounts recharged from the Group's direct and indirect parent companies	-	181	-	239
Amounts recharged from other Morgan Stanley Group undertakings	1,731	125	1,630	68
	<u>1,731</u>	<u>306</u>	<u>1,630</u>	<u>307</u>

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 under derivative contracts of 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 to Morgan Stanley & Co. International plc. All entities are fellow Morgan Stanley Group undertakings. As at 31 December 2010, no call had been made by the Group under this arrangement.

COMPANY BALANCE SHEET

31 December 2010

	Note	2010 \$millions	2009 \$millions
FIXED ASSETS			
Tangible assets	3	8	11
Investments:			
- Available-for-sale financial assets	4	44	41
- Subsidiary undertakings	4	88	127
		<u>140</u>	<u>179</u>
CURRENT ASSETS			
Financial assets classified as held for trading (of which approximately \$51,974 million (2009: \$54,185 million) were pledged to various parties)	5	252,602	226,393
Financial assets designated at fair value through profit or loss	6	9,359	1,907
Loans and receivables:			
- Cash at bank	7	10,225	13,378
- Debtors	8	225,686	212,821
Other assets	9	311	343
		<u>498,183</u>	<u>454,842</u>
CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR			
Financial liabilities classified as held for trading	5	216,527	198,394
Financial liabilities designated at fair value through profit or loss	6	11,306	5,907
Financial liabilities at amortised cost	11	252,400	234,529
Other creditors	12	434	267
		<u>480,667</u>	<u>439,097</u>
NET CURRENT ASSETS		<u>17,515</u>	<u>15,745</u>
TOTAL ASSETS LESS CURRENT LIABILITIES		<u>17,655</u>	<u>15,924</u>
CREDITORS: AMOUNTS FALLING DUE AFTER MORE THAN ONE YEAR			
Financial liabilities at amortised cost	11	8,692	9,336
PROVISIONS FOR LIABILITIES AND CHARGES	13	28	21
NET ASSETS EXCLUDING PENSION LIABILITY		<u>8,935</u>	<u>6,567</u>
Pension liability		4	4
NET ASSETS		<u>8,931</u>	<u>6,563</u>
CAPITAL AND RESERVES			
Called up share capital	14	5,578	3,078
Share premium account	15	513	513
Capital redemption reserve	15	1,399	1,399
Foreign currency revaluation reserve	15	(66)	(18)
Fair value reserve	15	(3)	(4)
Capital contribution reserve	15	3	3
Pension reserve	15	(5)	(2)
Profit and loss account	15	1,512	1,594
SHAREHOLDERS' FUNDS		<u>8,931</u>	<u>6,563</u>

These financial statements were approved by the Board and authorised for issue on 21 April 2011

Signed on behalf of the Board

Director  CLARE WOODMAN

The notes on pages 87 to 108 form an integral part of the financial statements.

MORGAN STANLEY & CO. INTERNATIONAL plc

NOTES TO THE COMPANY FINANCIAL STATEMENTS

Year ended 31 December 2010

1. ACCOUNTING POLICIES

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

a. Basis of preparation

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

The Company's ultimate UK parent undertaking, Morgan Stanley International Limited, presents information in accordance with Financial Reporting Standard ("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 7.

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.

On disposal of an overseas branch, the related cumulative gain or loss in the 'Foreign currency revaluation reserve' is transferred to the profit and loss account and reported in 'Gain / (loss) on disposal of branch or subsidiary'.

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE COMPANY FINANCIAL STATEMENTS

Year ended 31 December 2010

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; investments in subsidiary and associated undertakings 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

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

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

For all financial instruments classified as held for trading, transaction costs are excluded from the initial fair value measurement of the financial instrument. These costs are recognised in the 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 (see note 1(f) below). All subsequent changes in fair value, foreign exchange differences, interest and dividends, are reflected in the profit and loss account in 'Net gains / (losses) on financial instruments designated at fair value through profit or loss'. Transaction costs are excluded from the initial fair value measurement of the financial instrument. These costs are recognised in the profit and loss account in 'Other Expense'.

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE COMPANY FINANCIAL STATEMENTS

Year ended 31 December 2010

1. ACCOUNTING POLICIES (CONTINUED)

e. Financial instruments (continued)

(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 debt instruments, interest calculated using the effective interest method (see note 1(e)(v) below), impairment losses and reversals of impairment losses and exchange differences on the amortised cost of the asset are recorded in the profit and loss account in 'Net gains / (losses) on fixed asset investments in available-for-sale financial assets'.

For equity instruments, dividend income and impairment losses are recorded in the profit and loss account in 'Net gains / (losses) on fixed asset investments in available-for-sale financial assets'. All other gains and losses on debt and equity instruments classified as available-for-sale are recognised in the 'Fair value reserve' within equity.

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

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

(iv) Investments in subsidiary and associated undertakings

Investments in subsidiary and associated undertakings outside the scope of FRS 26 *Financial instruments: recognition and measurement* ("FRS 26"), are recorded within 'Investments in subsidiary and associated undertakings' and are stated at cost, less provision for any impairment. Interest (recognised on an accruals basis), dividend income (recognised when the Company's right to receive payment is established), impairment losses, reversals of impairment losses, and foreign exchange differences on monetary investments are all reported in the profit and loss account in 'Net gains / (losses) on fixed asset investments in subsidiary and associated undertakings'.

All other investments in Morgan Stanley 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 method. Transaction costs that are directly attributable to the acquisition or issue of the financial asset are added to or deducted from the fair value on initial recognition.

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.

MORGAN STANLEY & CO. INTERNATIONAL plc

NOTES TO THE COMPANY FINANCIAL STATEMENTS

Year ended 31 December 2010

1. ACCOUNTING POLICIES (CONTINUED)

e. Financial instruments (continued)

(v) Loans and receivables and financial liabilities at amortised cost (continued)

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 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. Transaction costs that are directly attributable to the issue of the financial liability are added to or deducted from the fair value on initial recognition.

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.

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 and establishes a hierarchy for inputs used in measuring fair value that maximises the use of relevant observable inputs and minimises the use of unobservable inputs by requiring that the most observable inputs be used when available. Observable inputs are inputs that market participants would use in pricing the asset or liability developed based on market data obtained from sources independent of the Company. Unobservable inputs are inputs that reflect the Company's assumptions about the assumptions other market participants would use in pricing the asset or liability, developed based on the best information available in the circumstances.

The availability of observable inputs can vary from product to product and is affected by a wide variety of factors, including, for example, the type of product, whether the product is new and not yet established in the marketplace, the liquidity of the markets and other characteristics particular to the transaction. To the extent that valuation is based on models or inputs that are less observable or unobservable in the market, the determination of fair value requires more judgement.

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

Valuation techniques

Fair value for many cash and over-the-counter ("OTC") contracts, is derived using pricing models. Pricing models take into account the contract terms (including the maturity), as well as multiple inputs including, where applicable, commodity prices, equity prices, interest rate yield curves, credit curves, correlation, creditworthiness of the counterparty, option volatility and currency rates. Where appropriate, valuation adjustments are made to account for various factors such as liquidity risk (bid-ask adjustments), credit quality and model uncertainty.

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE COMPANY FINANCIAL STATEMENTS

Year ended 31 December 2010

1. ACCOUNTING POLICIES (CONTINUED)

f. Fair value of financial instruments

Valuation techniques (continued)

Credit valuation adjustments are applied to both cash instruments and OTC derivatives. For cash instruments, the impact of changes in own credit spreads is considered when measuring the fair value of liabilities and the impact of changes in the counterparty's credit spreads is considered when measuring the fair value of assets. For OTC derivatives, the impact of changes in both the Company's and the counterparty's credit standing is considered when measuring fair value. In determining the expected exposure, the Company considers collateral held and legally enforceable master netting agreements that mitigate the Company's exposure to each counterparty. All valuation adjustments are subject to judgement, are applied on a consistent basis and are based upon observable inputs where available. The 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 derivative products can be either observed or modelled using a series of techniques, and model inputs from comparable benchmarks, including closed-form analytic formulas such as the Black-Scholes option pricing model, and simulation models or a combination thereof. Many pricing models do not entail material subjectivity because the methodologies employed do not necessitate significant judgement, and the pricing inputs are observed from actively quoted markets, as is the case for generic interest rate swaps, certain option contracts and certain credit default swaps. In the case of more established derivative products, the pricing models used by the Company are widely accepted by the financial services industry.

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/ (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.

MORGAN STANLEY & CO. INTERNATIONAL plc

NOTES TO THE COMPANY FINANCIAL STATEMENTS

Year ended 31 December 2010

1. ACCOUNTING POLICIES (CONTINUED)

g. Impairment of financial assets (continued)

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

h. Tangible fixed assets

Tangible fixed assets are stated at cost net of depreciation and any provision for impairment in value, which are included within 'Other Expense'. 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. The interest capitalisation rate is based on the Morgan Stanley Group's blended funding rates.

For premises held under operating leases, a reinstatement provision is recognised for the estimated cost to reinstate the premises at the end of the lease period. When the reinstatement provision is established, 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

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

i. Fees and commissions

Fees and commissions classified within 'Other income' in the profit and loss 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.

j. Operating leases

Rentals payable under operating leases are charged to 'Other expense' in 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 'Other income' in 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.

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE COMPANY FINANCIAL STATEMENTS

Year ended 31 December 2010

1. ACCOUNTING POLICIES (CONTINUED)

k. Taxation

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

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

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

l. Employee compensation plans

(i) Equity settled share based 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 credit to reserves is reduced to the extent that payments are due to Morgan Stanley in respect of these awards.

(ii) Other deferred compensation plans

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

m. Retirement benefits

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

The Company also operates defined benefit pension schemes. For the defined benefit schemes, 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 and the unwinding of the discount on the scheme liabilities are presented net and recognised within either 'Interest income' or 'Interest expense'. Actuarial gains and losses are recognised in full in the period in which they occur in the statement of recognised gains and losses. They are not recycled into the profit and loss account in subsequent periods.

Details of the plans are given in note 18 to these financial statements.

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE COMPANY FINANCIAL STATEMENTS

Year ended 31 December 2010

1. ACCOUNTING POLICIES (CONTINUED)

n. Cash flow statement

The Company's ultimate parent undertaking produces consolidated financial statements in which the Company is included and which are publicly available. Accordingly, the Company, which is a wholly-owned subsidiary, has elected to avail itself of the exemption provided in 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 profit after tax for the year ended 31 December 2010 of \$274 million (2009: \$548 million loss).

3. TANGIBLE FIXED ASSETS

	Leasehold improvements \$millions	Fixtures, fittings and equipment \$millions	Total \$millions
Cost			
At 1 January 2010	17	13	30
Additions	-	1	1
Disposals	-	(1)	(1)
At 31 December 2010	<u>17</u>	<u>13</u>	<u>30</u>
Depreciation			
At 1 January 2010	9	10	19
Charge for the year	2	2	4
Disposal	-	(1)	(1)
At 31 December 2010	<u>11</u>	<u>11</u>	<u>22</u>
Net book value			
At 31 December 2009	<u>8</u>	<u>3</u>	<u>11</u>
At 31 December 2010	<u>6</u>	<u>2</u>	<u>8</u>

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE COMPANY FINANCIAL STATEMENTS

Year ended 31 December 2010

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 year are as follows:

	2010 \$millions	2009 \$millions
Fair value		
At 1 January	41	63
Additions	7	-
Disposals	(8)	(20)
Foreign exchange revaluation on monetary assets	-	1
Changes in fair value:		
- recognised in the 'Fair value reserve'	4	(3)
At 31 December	<u>44</u>	<u>41</u>

Included in 'Available-for-sale financial assets' are listed investments of \$4 million (2009: \$nil).

Fixed asset investments in subsidiary undertakings

	Subsidiary undertakings \$millions	Total \$millions
Cost		
At 1 January 2010	1,121	1,121
Capital Reduction	(39)	(39)
At 31 December 2010	<u>1,082</u>	<u>1,082</u>
Impairment provisions		
At 1 January 2010	(994)	(994)
At 31 December 2010	<u>(994)</u>	<u>(994)</u>
Net book value		
At 31 December 2009	<u>127</u>	<u>127</u>
At 31 December 2010	<u>88</u>	<u>88</u>

Details of the significant subsidiary undertakings are provided in note 33 of the consolidated financial statements. A full list of the Company's subsidiary undertakings will be annexed to the Company's next annual return and filed with the Registrar of Companies.

During the year, a subsidiary entity reduced its capital by \$39 million, returning the capital to the Company.

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE COMPANY FINANCIAL STATEMENTS

Year ended 31 December 2010

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:

	2010		2009	
	Assets \$millions	Liabilities \$millions	Assets \$millions	Liabilities \$millions
Fair value				
Derivative financial instruments (listed and OTC):				
- Interest rate and currency swaps and options, credit derivatives and other fixed income securities contracts	110,726	106,151	132,844	146,310
- Foreign exchange forward contracts and options	16,084	16,280	11,292	11,487
- Equity securities contracts (including equity swaps, warrants and options)	38,091	43,025	1,711	2,394
- Commodity forwards, options and swaps	21,024	20,487	18,316	9,554
	<u>185,925</u>	<u>185,943</u>	<u>164,163</u>	<u>169,745</u>
Government debt securities	16,369	15,105	12,867	11,859
Corporate equities	30,553	11,218	29,133	13,737
Corporate and other debt	19,755	4,261	20,230	3,053
	<u></u>	<u></u>	<u></u>	<u></u>
Total financial instruments classified as held for trading	<u>252,602</u>	<u>216,527</u>	<u>226,393</u>	<u>198,394</u>

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

	2010		2009	
	Assets \$millions	Liabilities \$millions	Assets \$millions	Liabilities \$millions
Fair value				
Prepaid OTC contracts	4,909	4,137	1,784	2,214
Structured notes	-	492	-	659
Other financial assets and liabilities	4,450	6,677	123	3,034
	<u></u>	<u></u>	<u></u>	<u></u>
Total financial instruments designated at fair value through profit or loss	<u>9,359</u>	<u>11,306</u>	<u>1,907</u>	<u>5,907</u>

The carrying amount of financial liabilities designated at fair value was \$8 million lower than the contractual amount due at maturity (2009: \$190 million higher).

The change in fair value recognised through the consolidated income statement attributable to own credit risk is a loss of \$1 million (2009: \$203 million loss) and cumulatively is \$121 million gain (2009: \$122 million gain). This change is determined as the amount of change in its fair value that is not attributable to changes in market conditions that give rise to market risk.

7. CASH AT BANK

Included within 'Cash at bank' is an amount of \$7,238 million (2009: \$7,962 million) which represents segregated client money, held in accordance with the FSA's Client Money Rules, and an amount of \$40 million (2009: \$235 million) which represents other client money.

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE COMPANY FINANCIAL STATEMENTS

Year ended 31 December 2010

8. DEBTORS

	2010	2009
	\$millions	\$millions
Debtors classified within loans and receivables at amortised cost		
Trade debtors:		
- External counterparties	46,490	36,211
- Group undertakings	16,616	14,983
Securities purchased under agreements to resell and cash collateral on stocks borrowed:		
- External counterparties	92,793	74,641
- Group undertakings	54,009	45,841
Other amounts due from Group undertakings	13,099	39,332
Other debtors classified within loans and receivables	2,679	1,813
	<u>225,686</u>	<u>212,821</u>

9. OTHER ASSETS

	2010	2009
	\$millions	\$millions
Corporation tax	158	208
Deferred taxation (see note 10)	27	27
Prepayments and accrued income	126	108
	<u>311</u>	<u>343</u>

10. DEFERRED TAX

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

	2010	2009
	\$millions	\$millions
Accelerated capital allowances	7	7
Other timing differences	20	20
	<u>27</u>	<u>27</u>

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

	Asset
	\$millions
At 1 January 2010	27
Amounts recognised in the profit and loss account:	
- Current period timing differences	3
Amounts recognised in equity through the statement of total recognised gains and losses:	
- Current period timing differences	(2)
Prior year timing difference	(1)
At 31 December 2010	<u>27</u>

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

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE COMPANY FINANCIAL STATEMENTS

Year ended 31 December 2010

11. FINANCIAL LIABILITIES AT AMORTISED COST

	2010 \$millions	2009 \$millions
Financial liabilities at amortised cost falling due within one year		
Bank loans and overdrafts	60	128
Trade creditors:		
- External counterparties	56,576	52,394
- Group undertakings	19,519	12,840
Securities sold under agreements to repurchase and cash collateral on stocks loaned:		
- External counterparties	74,234	44,916
- Group undertakings	75,754	65,380
Other amounts owing to Group undertakings	23,170	55,482
Other financial liabilities	3,088	3,389
	<u>252,401</u>	<u>234,529</u>
 Financial liabilities at amortised cost falling due after more than one year		
Financial instruments issued:		
- Subordinated loans	7,906	8,550
- Preference shares	786	786
	<u>8,692</u>	<u>9,336</u>
 Total financial liabilities at amortised cost	<u>261,093</u>	<u>243,865</u>

Included within Other amounts owing to Group undertakings are amounts of \$4,925 million (2009: \$5,052 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	2010 \$millions	2009 \$millions
Morgan Stanley Strategic Funding Limited	29 October 2026	LIBOR plus 2.00%	-	644
Morgan Stanley International Finance S.A.	31 October 2025	LIBOR plus 1.25%	7,906	7,906
			<u>7,906</u>	<u>8,550</u>

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 29 November 2010 the Group repaid \$644 million under its loan facility with Morgan Stanley Strategic Funding Limited.

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

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE COMPANY FINANCIAL STATEMENTS

Year ended 31 December 2010

11. FINANCIAL LIABILITIES AT AMORTISED COST (CONTINUED)

Preference shares

**Class B non-cumulative
preference shares of \$1 each:
\$millions**

Allotted and fully paid:

At 31 December 2009 and 31 December 2010 786

At 31 December 2010 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 non-cumulative preferred shares shall rank in priority to any other class of share.

During the year, dividends of \$21 million (2009: \$31 million) were paid to the holders of the Class B redeemable non-cumulative preference shares.

12. OTHER CREDITORS

	2010 \$millions	2009 \$millions
Amounts falling due within one year		
Corporation tax	238	65
Accruals and deferred income	196	202
	<u>434</u>	<u>267</u>

13. PROVISIONS FOR LIABILITIES AND CHARGES

	Property \$millions	Litigation \$millions	Total \$millions
At 1 January	2	19	21
Additional provisions	-	25	25
Provision utilised	-	(18)	(18)
At 31 December 2010	<u>2</u>	<u>26</u>	<u>28</u>

Litigation Matters

During the year 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'.

On 25 September 2009, the Company was named as a defendant in a lawsuit styled *Citibank, N.A. v. Morgan Stanley & Co. International, PLC*, which is pending in the United States District Court for the Southern District of New York. The lawsuit relates to a credit default swap entered into by the Company referencing the Capmark VI CDO, ("Capmark") which was structured by Citibank, N.A. ("Citi N.A."). At issue is whether, as part of the swap agreement, Citi N.A. was obligated to obtain the Company's prior written consent before it exercised its rights to liquidate Capmark upon the occurrence of certain contractually-defined credit events. Citi N.A. is seeking approximately \$245 million in compensatory damages plus interest and costs. On 8 October 2010, the court issued an order denying Citi N.A.'s motion for judgement on the pleadings as to the Company's counterclaim for reformation and granting Citi N.A.'s motion for judgement on the pleadings as to the Group's counterclaim for estoppel. The Group moved for summary judgement on 17 December 2010. Citi N.A. opposed the Company's motion and cross moved for summary judgement on 21 January 2011. A litigation provision has not been made in relation to Capmark. In compliance with the intra-group policies, revenues and costs related to the Capmark deal referenced above, including any potential litigation costs, are transferred to other Morgan Stanley Group undertakings outside the Company.

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

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE COMPANY FINANCIAL STATEMENTS

Year ended 31 December 2010

14. SHARE CAPITAL

	2010 \$millions	2009 \$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	50
2,500,000,000 class D non-redeemable non-cumulative preferred shares of \$1 each	2,500	-
Allotted and fully paid:	<u>5,578</u>	<u>3,078</u>

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 29 November 2010, the Company issued 2,500,000,000 non-redeemable non-cumulative \$1 preference shares (Class D preference shares). The holders of both the Class C and Class D non-redeemable non-cumulative preference shares of \$1 each are entitled to receive a LIBOR based dividend in priority to the ordinary shares in accordance with the Company's articles of association. The holders of each class 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 and Class D non-redeemable non-cumulative preference shares shall rank in priority to the ordinary shares.

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'.

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE COMPANY FINANCIAL STATEMENTS

Year ended 31 December 2010

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
Balance at 1 January 2009	4,328	513	(14)	3	149	(1)	(1)	3,633	8,610
Loss for the year	-	-	-	-	-	-	-	(548)	(548)
Other comprehensive income:									
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)
Total comprehensive loss	-	-	(4)	-	-	(3)	(1)	(548)	(556)
Transactions with owners:									
Dividends	-	-	-	-	-	-	-	(201)	(201)
Preference share repurchase	(1,250)	-	-	-	1,250	-	-	(1,250)	(1,250)
Net capital contribution	-	-	-	-	-	-	-	(40)	(40)
Balance at 31 December 2009	3,078	513	(18)	3	1,399	(4)	(2)	1,594	6,563
Reclassification from currency translation reserve to retained earnings net of income tax (see note below)	-	-	(45)	-	-	-	-	45	-
Profit for the year	-	-	-	-	-	-	-	274	274
Other comprehensive income:									
Foreign exchange differences arising on translation of net assets in overseas branches	-	-	(5)	-	-	-	-	-	(5)
Available-for-sale financial assets – net change in fair value recognised directly in equity	-	-	-	-	-	1	-	-	1
Pension reserve movement	-	-	-	-	-	-	(3)	-	(3)
Income tax relating to components of other comprehensive income	-	-	2	-	-	-	-	-	2
Total comprehensive (loss) / income	-	-	(48)	-	-	1	(3)	319	269
Transactions with owners:									
Dividends	-	-	-	-	-	-	-	(401)	(401)
Preference share issue	2,500	-	-	-	-	-	-	-	2,500
Balance at 31 December 2010	5,578	513	(66)	3	1,399	(3)	(5)	1,512	8,931

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE COMPANY FINANCIAL STATEMENTS

Year ended 31 December 2010

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

Currency translation reserve

The 'currency translation reserve' comprises all foreign exchange differences arising from the translation of the net assets of foreign operations.

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

16. COMMITMENTS AND CONTINGENCIES

During the next year the Company is committed to pay \$7 million (2009: \$10 million) in respect of operating leases as follows:

	Land and buildings 2010 \$millions	Land and buildings 2009 \$millions
Maturity of lease:		
Within one year	-	4
In two to five years	7	6
Over five years	-	-
	<u>7</u>	<u>10</u>

17. SHARE-BASED PAYMENT TRANSACTIONS

Deferred stock awards

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

During the year Morgan Stanley granted 446,483 units of restricted common stock to employees of the Company with a weighted average fair value per unit of \$29.10 (2009: 102,226 units, weighted average fair value \$20.87), based on the market value of Morgan Stanley shares at grant date. Units granted in respect of employees' 2009 discretionary compensation were granted in January 2010.

Stock option awards

Morgan Stanley has also granted 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 year (2009: none).

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE COMPANY FINANCIAL STATEMENTS

Year ended 31 December 2010

17. 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 Company:

	2010		2009	
	Number of options '000s	Weighted average exercise price \$	Number of options '000s	Weighted average exercise price \$
Options outstanding at 1 January	169	55.53	226	51.17
Forfeited during the year	-	-	(1)	66.73
Expired during the year	(58)	60.48	(56)	37.70
Options outstanding at 31 December	<u>111</u>	<u>52.93</u>	<u>169</u>	<u>55.53</u>
Options exercisable at 31 December	<u>111</u>	<u>52.93</u>	<u>139</u>	<u>53.07</u>

No stock options were exercised throughout the year (2009: none).

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

	2010			2009		
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	19	36.33	2.0	26	36.30	2.6
\$40.00 - \$49.99	44	47.11	2.5	48	47.15	3.3
\$50.00 - \$59.99	7	55.61	0.0	12	54.18	0.6
\$60.00 - \$69.99	41	66.69	5.8	83	66.71	3.5
Total	<u>111</u>	<u>52.93</u>	<u>3.4</u>	<u>169</u>	<u>55.53</u>	<u>3.11</u>

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE COMPANY FINANCIAL STATEMENTS

Year ended 31 December 2010

17. SHARE-BASED PAYMENT TRANSACTIONS (CONTINUED)

Other deferred compensation plans

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

During the year, the Company granted awards with a value of \$7 million (2009: \$5 million) to employees. The Company recognised an expense of \$4 million (2009: \$12 million) within 'Other expense' in the consolidated income statement in relation to current and prior years awards. The liability to employees at the end of the year, reported within 'Financial liabilities at amortised cost' in the statement of financial position, is \$14 million (2009: \$9 million).

The Company economically hedges the exposure created by these deferred compensation schemes by entering into derivative transactions with other Morgan Stanley Group undertakings. The derivative balance at the end of the year, recognised within 'Financial assets classified as held for trading' in relation to these deferred compensation schemes is \$2 million (2009: \$ nil) and the related profit and loss recorded within 'Net gains / losses on financial instruments classified as held for trading' for the year is \$1 million gain (2009: \$41 million gain).

18. RETIREMENT BENEFITS

Defined contribution schemes

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

The defined contribution schemes 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 \$1 million (2009: \$1 million) of which \$nil was accrued at 31 December 2010 (2009: \$nil).

Defined benefit schemes

The Company also operates several Morgan Stanley defined benefit schemes, 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 schemes are as follows:

- Morgan Stanley & Co International plc Paris Branch IFC (Indemnités de Fin de Carrière)
- Morgan Stanley Dubai End of Service Gratuity
- Personalvorsorgestiftung der Bank Morgan Stanley AG Plan

The Company also operated the Morgan Stanley & Co International plc Seoul Branch Severance Pay Plan until 1 October 2010, when the plan converted to a defined contribution plan and all defined benefit obligations settled.

During the year Bank Morgan Stanley AG transferred its institutional securities business to the Zurich Branch but its employees remained in the same Personalvorsorgestiftung der Bank Morgan Stanley AG Plan together with all remaining Bank Morgan Stanley AG employees. The plan was considered as transferred into the Zurich Branch with the difference between assets and liabilities at initial recognition included in other comprehensive income.

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE COMPANY FINANCIAL STATEMENTS

Year ended 31 December 2010

18. RETIREMENT BENEFITS (CONTINUED)

Defined benefit schemes (continued)

The most recent full actuarial valuations of the defined benefit schemes were carried out at 31 December 2010. 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 schemes are as follows:

	2010 \$millions	2009 \$millions
Current service cost	2	1
Interest on obligation	1	-
Total defined benefit scheme expense	<u>3</u>	<u>1</u>

Of the charge for the year, \$2 million (2009: \$2 million) has been included in 'Other expenses' and \$1 million (2009: \$nil) in 'Interest expense'. Actuarial gains and losses of \$3 million loss (2009: \$2 million loss) have been recognised in reserves.

The cumulative amount of actuarial gains and losses is \$5 million loss (2009: \$2 million loss).

Retirement benefit liability

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

	2010 \$millions	2009 \$millions
Present value of funded defined benefit obligation	(13)	(5)
Fair value of scheme assets	<u>11</u>	<u>2</u>
	(2)	(3)
Present value of unfunded defined benefit obligation	(2)	(1)
Retirement benefit liability recognised in the balance sheet	<u>(4)</u>	<u>(4)</u>

Contributions for the year to the closed defined benefit section of the Plan totalled \$6 million (2009: \$2 million), of which \$nil was accrued at 31 December 2010 (2009: \$nil). The Company expects to contribute \$1 million (2009: \$1 million) in the next financial year, based upon the current funded status and the expected return assumptions for the next financial year.

Reconciliation of defined benefit scheme liabilities

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

	2010 \$millions	2009 \$millions
Defined benefit obligation at 1 January	6	4
Current service cost	2	1
Interest cost	1	-
Net transfer in / (out)	11	-
Liabilities extinguished on settlements	(7)	-
Actuarial loss	1	2
Benefits paid	(1)	(2)
Foreign exchange rate changes	-	1
Defined benefit obligation at 31 December	<u>13</u>	<u>6</u>

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE COMPANY FINANCIAL STATEMENTS

Year ended 31 December 2010

18. RETIREMENT BENEFITS (CONTINUED)

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

	2010 \$millions	2009 \$millions
Fair value of scheme assets at 1 January	2	2
Employer contributions	6	2
Benefits paid	(1)	(2)
Net transfer in	9	-
Assets distributed on settlements	(7)	-
Expected return on plan assets	1	-
Foreign exchange losses	(1)	-
Fair value of scheme assets at 31 December	9	2
Actual return on scheme assets	-	-

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

	Expected return		Fair value of assets	
	2010 %	2009 %	2010 \$millions	2009 \$millions
Equity securities	7.65%	-	3	-
Fixed income securities	1.87%	-	4	-
Real estate / property	6.56%	-	-	-
Other – insurance deposit	-	3.50%	-	2
Other – primarily cash	1.88%	-	2	-
			9	2

The expected long-term rate of return on assets represents the Company's best estimate of the long-term return on scheme 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 schemes 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.

Actuarial assumptions

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

	2010	2009
Discount rate	2.75%-7.05%	5.80%-7.05%
Rate of increase in salaries	3.50%-5.50%	3.50%-5.50%
Inflation assumption	1.50%-3.5%	2.00%
Expected long-term rate of return on scheme assets	-	3.5%

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE COMPANY FINANCIAL STATEMENTS

Year ended 31 December 2010

18. RETIREMENT BENEFITS (CONTINUED)

The mortality assumptions used give the following life expectations:

	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 2010					
Switzerland	Unadjusted BVG 2005 Mortality Table	82.9	82.9	86.0	86.0
31 December 2009					
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:

Switzerland Plan

	Change in assumption	Impact on scheme liabilities
Discount rate	Increase / decrease by 0.5%	Decrease by 7.5% / increase by 8.4%
Inflation assumption	Increase / decrease by 0.5%	Increase by 4.2% / decrease by 3.0%
Rate of increase in salaries	Increase / decrease by 0.5%	Increase by 0.7% / decrease by 0.7%
Rate of mortality	Increase by 1 year	Increase by 0.6%

Surplus / (deficit) and experience adjustments

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

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

	31 December 2010 \$millions	31 December 2009 \$millions	30 December 2008 \$millions	30 November 2007 \$millions	30 November 2006 \$millions
Present value of defined benefit obligation	13	6	4	5	5
Fair value of scheme assets	9	2	2	2	2
Deficit	(4)	(4)	(2)	(3)	(3)
Experience adjustments on scheme liabilities:					
Amount (\$'000)	592	(1,197)	132	(108)	155
Percentage of scheme liabilities (%)	4%	(19%)	3%	(2%)	3%
Experience adjustments on scheme assets:					
Amount (\$'000)	(125)	112	(134)	(48)	(8)
Percentage of scheme assets (%)	(1%)	6%	(7%)	(2%)	(1%)

MORGAN STANLEY & CO. INTERNATIONAL plc
NOTES TO THE COMPANY FINANCIAL STATEMENTS

Year ended 31 December 2010

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. 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.