

Financial Year 2008
Interim Pillar 3 Disclosures UK

December 31, 2008 (Unaudited)

Investments and services are offered through Morgan Stanley Group



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1. MORGAN STANLEY INTERNATIONAL LIMITED

The principal activity of Morgan Stanley International Limited and all of its subsidiary and associated undertakings (together the 'MSI Group') is the provision of financial services to corporations, governments, financial institutions and individual investors.

The following entities within the MSI Group are regulated by the Financial Services Authority (FSA):

- Morgan Stanley & Co. International plc
- Morgan Stanley Bank International Limited
- Morgan Stanley Securities Limited
- Morgan Stanley & Co. Limited
- Morgan Stanley Capital Group Limited
- Morgan Stanley Investment Management Limited

The MSI Group calculates capital requirements in accordance with the regulatory capital requirements of the FSA and, in turn, with guidelines described under the Basel II accord.

The MSI Group's ultimate parent undertaking and controlling entity is Morgan Stanley, a Delaware corporation, which, together with the MSI Group and Morgan Stanley's other consolidated subsidiaries, form the Morgan Stanley Group. Morgan Stanley is a 'Financial Holding Company' as defined by the Bank Holding Company Act of 1956, as amended, and is subject to regulation by the Board of Governors of the Federal Reserve System ('Fed').

2. BASEL II ACCORD

The Basel II Accord has been implemented in the European Union via the Banking Consolidation Directive and the Capital Adequacy Directive collectively known as the Capital Requirements Directive (CRD).

The framework consists of three 'pillars'. Pillar 1 of the new standards sets out the minimum capital requirements firms will be required to meet for credit, market and operational risk. Under Pillar 2, firms and supervisors are required to assess the appropriateness of the Pillar 1 level of capital the Firm requires, taking into account risks not covered in Pillar 1 and must take action accordingly. The aim of Pillar 3 is to encourage market discipline by developing a set of disclosure requirements which will allow market participants to assess certain specified information in relation to capital adequacy, particular risk exposures and risk management processes.

3. THIS DOCUMENT: INTERIM PILLAR 3 DISCLOSURES

This document represents the annual public Pillar 3 qualitative disclosures required by the FSA prudential sourcebook rules for Banks, Building Societies and Investment Firms (BIPRU). The required quantitative disclosures will follow in 2009 with the publishing of the annual financial statements of the MSI Group.

No entity within the MSI Group has third party equity investors and no entity, currently, issues any capital instruments, as defined in the glossary to the FSA handbook, to parties outside the Morgan Stanley Group. As a result, for capital adequacy, risk exposure and risk management policy information investors and market participants should consult the public disclosures of Morgan Stanley Group.

Morgan Stanley is listed on the New York Stock Exchange and is required, by the U.S. Securities and Exchange Commission (SEC), to file public disclosures, including Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q and Current Reports on Form 8-K. These disclosures can be found at http://www.morganstanley.com/about/ir/sec_filings.html.

Public disclosures, including those required under Pillar 3 both by the Fed and FSA, will continue to evolve over time.

4. APPLICATION OF THE PILLAR 3 FRAMEWORK

The application of the Pillar 3 framework applies to the MSI Group and all its subsidiaries. The basis of consolidation for prudential purposes is, in the main, the same as consolidation for accounting purposes. The MSI Group completes its prudential consolidation in compliance with the FSA handbook 'Prudential sourcebook for Banks, Building Societies and Investment Firms' ('BIPRU') Chapter 8.

The principal subsidiary undertakings of the MSI Group can be found in the annual financial statements of the MSI Group. The most significant of these subsidiaries is Morgan Stanley & Co. International plc ('MSIP'), the results of which are so material to the group that the risk profile is materially the same as the MSI Group, and risk management policy and procedure are applied consistently, therefore no separate disclosure for MSIP individually will be provided.

The MSI Group has policies in place to assess the appropriateness of its disclosures, including their verification and frequency.

5. CAPITAL RESOURCES

Under FSA supervision, the MSI Group is required to maintain a minimum ratio of total capital resources to capital requirements. As of December 31, 2008, the MSI Group was in full compliance with the FSA capital requirements as required by BIPRU. The full FSA handbook can be found at <http://fsahandbook.info/FSA/html/handbook/BIPRU>.

There are no current or foreseen material practical or legal impediments to the prompt transfer of capital resources or repayment of liabilities among the parent undertaking and its subsidiary undertakings.

6. CAPITAL REQUIREMENTS

The MSI Group calculates Pillar 1 capital requirements in accordance with the regulatory capital requirements of the FSA which implemented the EU Capital Requirements Directive.

Credit and Counterparty risk capital components reflect capital charges attributable to the risk of loss arising from a borrower or counterparty failing to meet its financial obligations. Risk weighted exposures are determined using either an Internal Ratings-Based Approach ("IRB"), which reflects the Company's internal estimate of a borrower or counterparty's credit worthiness, or a Standardized Approach. For a further discussion see *Appendix 1*.

Market risk capital components reflect capital charges attributable to the risk of loss resulting from adverse changes in market prices and other factors. The market risk capital of the MSI Group comprises of capital associated with the FSA approved models based approach and that associated with the standardised approach. For a further discussion see *Appendix 2*.

Operational risk capital charges are designed to account for the risk of losses due to inadequate or failed internal processes, people and systems, or external events and take into account legal risk. Capital requirements for operational risk are currently calculated under the Basic Indicator Approach in accordance with Basel standards.

The risk capital calculations will evolve over time as the MSI Group enhances its risk management strategy and incorporate improvements in modelling techniques while maintaining compliance with the regulatory requirements.

7. APPLICATION OF THE PILLAR 2 FRAMEWORK

The MSI Group employs an Economic Capital framework, in order to meet its obligations under BIPRU 2.2 ‘Internal capital adequacy standards’, whereby incremental capital for stress losses is held in addition to capital requirements under FSA regulation where required.

The Economic Capital framework is used to ensure that the MSI Group carries, or has access to, sufficient capital to support all material risks residing within the MSI Group, by providing a ‘cross check’ on UK regulatory capital, based on regional management’s own risk assessment. The MSI Group’s UK Economic Capital framework has been approved by FSA.

8. RISK MANAGEMENT OBJECTIVES AND POLICIES

Risk is an inherent part of both Morgan Stanley’s and the MSI Group’s business activity and is managed by the MSI 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 MSI Group’s own risk management objectives, policies and procedures are consistent with those of the Morgan Stanley Group.

As noted previously Morgan Stanley is required to make quarterly filings with the SEC. For a further discussion of the Morgan Stanley Group’s risk management objectives, policies and procedures, see “Quantitative Disclosures and Qualitative Disclosures about Market Risk – Risk Management” in Part II, Item 7A of Morgan Stanley’s Annual Report on Form 10-K (the “Form 10-K”):

The Form 10-K can be found at http://www.morganstanley.com/about/ir/sec_filings.html

9. VALUATION AND ACCOUNTING POLICIES

Detail of fair value accounting, impairment provisions and the accounting for held-for-sale assets (including equity investments) can be found in the financial statements of the MSI Group and MSIP.

10. APPENDIX 1: CREDIT RISK CAPITAL COMPONENT

Credit risk capital components reflect capital charges attributable to the risk of loss arising from a borrower or counterparty failing to meet its financial obligations. Risk weighted exposures are determined using either an Internal Ratings-Based Approach (“IRB”), which reflects the Company's internal estimate of a borrower or counterparty's credit worthiness, or a Standardised Approach.

10.1. Risk Reporting and Measurement Systems

Transactions that generate pre-settlement exposure are monitored and managed using metrics including current and potential exposure.

The methodology for calculating the potential exposure consists of three primary components: (a) market factor simulation model that generates the potential future values or scenarios of relevant market factors; (b) pricing models that value the trades; and (c) the aggregation model that combines the trade values and produces the exposure statistics.

The limit framework is based on Maximum Potential Exposure at a 95% confidence interval derived from the above process.

10.2. Ratings Overview

As a core part of its responsibility for the independent management of credit risk arising from credit risk transactions in the Institutional Securities businesses, the Credit Department evaluates the credit risk of counterparties and the structure of credit facilities, both at inception and periodically thereafter. Credit Professionals execute this responsibility by assessing all institutional securities counterparties with exposure above the department's materiality threshold.

The Credit Department expresses the creditworthiness of each counterparty by assigning it a rating, on a scale from AAA to D. Credit Committees assess and approve ratings proposed to them by Credit Professionals. Counterparty ratings establish the probability of default (PD) “through the cycle”. Each rating is linked to an exposure limit.

Credit Professionals rate counterparties based on analysis of all qualitative and quantitative factors relevant to credit standing in that industry or sector. The rating process typically includes analysis of the counterparty's financial statements, evaluation of its market position, strategy, management, legal, and environmental issues, and consideration of industry dynamics affecting its performance. Credit Professionals also consider security prices and other financial data reflecting a market view of the counterparty, and carry out due diligence with the counterparty's management as needed. Credit Professionals interact with business unit personnel covering their counterparties to maintain awareness of market developments.

10.3. Internal Ratings-Based Approach

The MSI Group has been granted permission by the FSA to use the Foundation Internal Rating Based (‘FIRB’) approach for the calculation of Counterparty Credit Risk capital requirements. The permission covers exposures generated by the Institutional Securities business and is applicable to all exposures to Central Governments, Central Banks, all Institutions and Corporates.

Rating Process

The Credit Department assigns counterparty ratings at the highest level in the counterparty's corporate structure. Subsidiaries of the holding company will often carry the same rating as the holding company, but a child's rating may vary based on a variety of factors considered and documented during the rating process.

Credit ratings may be no higher than the sovereign ceiling in countries where a sovereign ceiling applies, unless there are mitigating circumstances allowing the counterparty rating to pierce the ceiling.

Guaranteed counterparties are assigned the rating of the guarantor, unless the guarantee limitations make this inadvisable in the view of the Credit Professional. All guarantors must be rated according to standard Credit Department policies.

Ratings for Special Purpose Vehicles (SPVs) reflect the Credit Department's assessment of the risk that the SPV will default to Morgan Stanley. The rating therefore incorporates Morgan Stanley's

relative position in the counterparty's payment structure as well as the default risk associated with the underlying assets. Ratings are often 'tranche specific,' linked to the specific liability being swapped (i.e. the AAA rated senior tranche or the BBB subordinated tranche).

Ratings for some pension funds also incorporate the MSI Group's senior position in the payment waterfall for both ongoing payments and termination payments.

Principals of Rating Process

The Credit Department's ratings process addresses the following 5 key issues:

i) Granularity

The rating process is based on standardized and consistent gradations of credit risk. The internal rating scale uses similar nomenclature to that employed by Standard & Poors for its long-term debt designation. The annual validation of the ratings system ensures that the rating scale remains suitable in terms of differentiation of ratings given the universe of rated counterparties.

ii) Consistency and Transparency

Consistency and transparency are based on the use of a shared process that produces substantially similar evaluation and ratings results across counterparties, industries, regions, and ratings committees.

iii) Timeliness

All ratings are reviewed at least annually.

iv) Communication

Ratings are communicated to senior management through the Firms management information and business unit reporting.

v) Monitoring and Control

The Credit Department follows established review and verification mechanisms to ensure that counterparty ratings are in place.

Control Mechanisms for Rating Systems

The performance of the Rating System is validated on a Quarterly basis. This includes a review of key performance measures including comparison of internal ratings versus agency ratings, ratings of defaulted parties, transitions across grades and comparisons versus credit spreads.

The Credit Department will not approve exposure to a counterparty if the analyst has inadequate information to set a rating. If counterparty information is adequate but incomplete, the analyst will apply a conservative rating to reflect uncertainty arising from the missing information. The Credit Department will not approve transactions with undisclosed principals.

Equity Exposure outside the Trading Book

The approach assigned for Equity exposures, falling outside of the trading book, is as defined in the IRB section of the BIPRU prudential sourcebook. For the purposes of risk weighting these Equity exposures the MSI Group relies on external ratings prepared by three nominated external credit assessment institutions (ECAIs); Moodys, Standard & Poors and Fitch.

10.4. Standardised Approach

A Standardized Approach is used for certain asset categories, including receivables (e.g. fees and interest), non trading book loans, unsettled trades, and other assets.

The calculation of Risk Weighted Assets relies on external ratings prepared by three nominated external credit assessment institutions (ECAIs); Moodys, Standard & Poors and Fitch. The MSI Group complies with the credit quality assessment scale.

10.5. Credit Risk Mitigation

The MSI Group applies a number of credit risk mitigation techniques, including netting, collateral and credit derivatives.

Netting

The Firm has policies and procedures in place for recording instances where netting agreements have been entered into with clients. The impact of on and off balance sheet netting is material.

In addition, there are policies and procedures in place to review the legal enforceability of netting. In instances where there is material doubt over legal enforceability of an agreement, the benefit of netting will not be taken.

Collateral

Morgan Stanley actively manages its credit exposure through the application of collateral arrangements and readily available market instruments such as credit derivatives. The use of collateral in managing OTC derivative risk is standard in the market place, governed by an annex in the governing ISDA documentation. In line with these standards, Morgan Stanley generally accepts only cash and G7 government bonds (such as US Treasury securities) as eligible collateral. Other securities may be accepted in securities lending, repo and prime brokerage, subject to conservative haircuts based on assessments of collateral volatility and liquidity. There is an established and robust infrastructure within institutional securities to manage, maintain and value collateral on a daily basis.

For specific transactions or counterparties, the MSI Group will accept Letters of Credit and Guarantees following an appropriate level of due diligence. In such instances, the exposure is assumed to be to the provider of the Letter of Credit or Guarantee.

Credit Derivatives

Where a market in credit derivatives exist, the MSI Group may chose to purchase default protection in the form of a Credit Derivative from a third party. The reported counterparty exposure to the name referenced in the credit derivative is reduced by the reporting system. The counterparty risk to the third party protection provider is monitored and managed in the normal way by Institutional Securities Credit.

10.6. Credit Reserves

The MSI Group does not hold material positions for the purpose of investment and does not have any material credit reserves.

10.7. Wrong Way Risk

Specific Wrong-Way Risk arises when a transaction is structured in such a way that the exposure to the counterparty is positively correlated with the probability of default of the counterparty. For example, a counterparty writing put options on its own stock or a counterparty collateralized by its own or related party stocks. Morgan Stanley considers these matters when approving transactions. General Wrong Way Risk arises when the counterparty exposure is correlated, for non-specific reason, with the market or macroeconomic factors that affect the value of the counterparty's trades. Once again, the credit assessment process looks to identify these correlations and monitor accordingly.

11. APPENDIX 2: MARKET RISK CAPITAL REQUIREMENTS

The market risk capital of the MSI Group comprises of capital associated with FSA approved models based approach and that associated with the standardised approach.

11.1. Value-at-Risk (VaR)

The MSI 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.

The methodology, assumptions and limitations of the MSI Groups VaR model are consistent with those of the Morgan Stanley Group. For a further discussion see “Quantitative Disclosures and Qualitative Disclosures about Market Risk – Risk Management” in Part II, Item 7A of the Form 10-K.

The Form 10-K can be found at http://www.morganstanley.com/about/ir/sec_filings.html

11.2. Interest Rate Risk in the Non Trading Book

A subset of the overall portfolio included in VaR relates to the non-trading book, the market risk associated with certain Treasury activities is not included in VaR.