Morgan Stanley

Pillar 3

Disclosure (UK)

TABLE OF CONTENTS

1. Basel II Accord

The Basel II Accord as detailed in "International Convergence of Capital Measurement and Capital Standards: A Revised Framework – Comprehensive Version" June 2006, 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, 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.

The Basel II Accord was updated in 2010 to strengthen the global capital and liquidity rules following the financial crisis through a number of reforms collectively known as Basel III. This has been implemented in the European Union through a new Directive and Regulation collectively known as the Capital Requirements Directive IV ("CRDIV"). These new requirements have taken effect from 1 January 2014.

This disclosure is composed based on the rules in place at the time i.e. Basel II. However, even though the Basel III rules make significant changes to the calculation of capital resources and requirements, the MSSBH UK Group remains well capitalised.

2. Background to Pillar 3 Disclosures

The ultimate parent undertaking and controlling entity of Morgan Stanley Smith Barney Holdings (UK) Limited ("MSSBH") and its subsidiary undertaking (together the "MSSBH UK Group") is Morgan Stanley, a Delaware corporation, which, together with its consolidated subsidiaries, form the Morgan Stanley Group ("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.

The Morgan Stanley Group and its U.S. Banks became subject to U.S. Basel III from 1 January 2014. For more details see the latest Morgan Stanley Group Pillar 3 disclosure at http://www.morganstanley.com/about/ir/regulated_information.html

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.

The information disclosed in this document is not indicative of the Morgan Stanley Group as a whole, nor is it comprehensively representative of the Morgan Stanley Group's activity in any particular region. Investors, stakeholders, creditors or other users seeking information on capital adequacy, risk exposure and risk management policies should consult the public disclosures of Morgan Stanley Group, as this will provide a more comprehensive view.

Public disclosures, including those required under Pillar 3 by the Financial Conduct Authority ("FCA"), will continue to evolve over time. The qualitative and quantitative information contained in this document represents the position of the MSSBH UK Group as at 31 December 2013. Amendments to the MSSBH UK Group's operating model and risk management procedures that have occurred following this date are not discussed in this document.

The majority of the numerical disclosures in this document are calculated by reference to the FCA's methodology for risk exposure and are not necessarily the primary exposure measures used by internal management. The calculation of exposure in this document is based on the calculation methodology for regulatory risk exposure prescribed in the FCA handbook. This document does not constitute a set of financial statements. The MSSBH UK Group's 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"). Information disclosed in the MSSBH UK Group's financial statements will not necessarily be consistent with information disclosed in this document. Trading Book and Non Trading Book definitions used in this document refer to the regulatory view and may differ from the accounting definitions.

3. Application of the Pillar 3 Framework

This document represents the annual public Pillar 3 qualitative and quantitative disclosures required by the FCA Prudential Sourcebook for Banks, Building Societies and Investment Firms ("BIPRU") in relation to the MSSBH UK Group.

The basis of consolidation for prudential purposes is materially the same as consolidation for accounting purposes. The MSSBH UK Group completes its prudential consolidation in compliance with BIPRU8 – Group risk consolidation. Morgan Stanley Private Wealth Management Limited ("MSPWM"), the sole subsidiary of MSSBH, is FCA regulated. This subsidiary undertaking is listed in the annual financial statements of the MSSBH UK Group, Company disclosures note 6. In this document references to annual financial statements refers to the audited financial statements for the year ended 31 December 2013.

On 31 May 2013, Morgan Stanley sold the Europe, Middle East and Africa ("EMEA") based portion of its Executive Investment Services business and its EMEA Global Stock Plan Services business (together the "EIS/GSPS business"). In addition, on 27 March 2013, Morgan Stanley announced it had reached an agreement to sell substantially all of the non-Swiss EMEA Private Wealth Management business ("EMEA PWM business") to Credit Suisse. The first closing of the sale was on 2 December 2013; client and employee migration will continue until the end of the second quarter of 2014. Following this, the Company will transition any remaining clients to other Morgan Stanley Group entities and will perform an orderly wind-down of the business. This process is expected to extend into 2015.

The Company operated branches in Germany, Spain and the Dubai International Financial Centre ("DIFC"). As a result of the sale of the EMEA PWM business, the branches have now been closed.

The MSSBH UK Group has a policy in place to assess the appropriateness of its Pillar 3 disclosures, including their verification and frequency.

4. Morgan Stanley Smith Barney Holdings (UK) Limited

The principal activity of the MSSBH UK Group is the provision of financial services to individual investors and corporations.

The FCA regulated MSSBH UK Group includes both entities that form part of the accounting consolidation group, MSSBH and MSPWM.

The MSSBH UK Group calculates capital requirements in accordance with the regulatory capital requirements of the FCA and, in turn, with guidelines described under the Basel II Accord.

5. Capital Resources

Under FCA supervision, the MSSBH UK Group is required to maintain a minimum ratio of total capital resources to capital requirements. The FCA handbook can be found at http://fshandbook.info/FS/html/FCA. All capital resources are included in Tiers 1 and 2 and are of standard form. The main terms and conditions of the capital instruments disclosed below are disclosed in the MSSBH UK Group's financial statement, see note 17 for subordinated loan disclosures and note 20 for equity share capital disclosures.

The table below shows the financial resources of the MSSBH UK Group as at 31 December 2013 based upon the audited financial statements.

Capital Resources Table

AS AT 31/12/2013	MSSBH UK GROUP 2013 $000'S	MSSBH UK GROUP 2012 $000'S
Permanent share capita	–	–
Profit and loss account and other reserves	55,639	(82,798)
Share premium account	180,551	180,551
Externally verified interim net profits[1]	–	134,914
Less: Intangible assets	–	(16,926)
Tier 1 capital after deductions	236,190	215,741
Tier 2 capital after deductions[2]	20,000	20,000
Less deductions from total capital	–	–
Total capital resources after deductions	256,190	235,741

1. Externally verified interim net profits relate to the profits of the MSSBH UK solo company from 01 January 2012 – 30 June 2012, incorporating the sale of its investment in Quilter
2. Tier 2 capital consists of subordinated loans

Permanent share capital and subordinated loans included in financial resources are consistent with MSSBH UK Group financial statements. The General Prudential sourcebook ("GENPRU") sections 1 and 2 define the items that are included or deducted from the profit and loss account and other reserves to arrive at total financial resources. As a result, the profit and loss account and other reserves balance noted above may differ to the MSSBH UK Group financial statements.

There are no current or foreseen material practical or legal impediments to the prompt transfer of capital resources or repayment of liabilities within the MSSBH UK Group.

Management reviews capital levels on an ongoing basis in light of changing business needs and the external environment. Management ensures that appropriate levels of capital are maintained to support business needs whilst remaining in compliance with the target operating range established by the relevant governing bodies and applicable regulatory requirements.

6. Regulatory Capital Requirements

The MSSBH UK Group calculates Pillar 1 capital requirements in accordance with the regulatory capital requirements of the FCA. As at 31 December 2013 the MSSBH UK Group had the following capital requirements:

Capital Requirements Table

AS AT END OF DECEMBER	MSSBH UK GROUP 2013 $000'S	MSSBH UK GROUP 2012 $000'S
Credit risk	6,987	6,451
Counterparty risk	–	–
Market risk	549	195
Operational risk	18,403	17,639
Total variable capital requirement	25,939	24,285

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 the standardised approach (see section 10 on Credit Risk).

The Market risk capital requirement reflects capital charges attributable to the risk of loss resulting from adverse changes in market prices and other factors. The market risk capital requirement of the MSSBH UK Group is determined using the standardised approach (see section 11 on Market Risk).

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 using the Basic Indicator Approach ("BIA") (see section 12 on Operational Risk).

7. Application of the Pillar 2 Framework

The MSSBH UK Group employs a Required Capital Framework in order to meet its obligations under BIPRU 2.2 'Internal capital adequacy standards', whereby additional capital for stress losses is calculated and held. The Required Capital Framework is used to ensure that the MSSBH UK Group carries, or has access to, sufficient capital to support all material risks residing within the MSSBH UK Group, and is based on management's own risk assessment.

8. Risk Management Objectives and Policies

Risk is an inherent part of the MSSBH UK Group's business activity. The MSSBH UK 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 MSSBH UK Group has developed its own risk management policy framework, which leverages the risk management policies and procedures of the Morgan Stanley Group, and which include escalation to the Group's Board of directors and to appropriate senior management personnel of the MSSBH UK Group as well as oversight through the MSSBH UK Group's Board of directors. For more detail on the MSSBH UK Group's approach to risk management, see note 22 of the MSSBH UK Group 2013 audited financial statements.

As noted previously, Morgan Stanley is required to make quarterly filings with the SEC. For further discussion of Morgan Stanley's risk management objectives, policies and procedures, see pages 111-135 of 31 December 2013 Form 10-K.

9. Accounting Policies

The MSSBH UK Group's financial statements have been prepared in accordance with applicable UK law and IFRS as adopted by the EU. Further information regarding the accounting policies of MSSBH UK Group, including measurement considerations, can be found in note 3 of the notes to the consolidated financial statements of the MSSBH UK Group.

10. Credit Risk

10.1 CREDIT EXPOSURE

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

The MSSBH UK Group's business is exposed to credit risk through margin lending to its MSPWM clients. The MSPWM margin loan book is housed on the UK broker dealer, Morgan Stanley & Co International plc ("MSIP"). The full business economics are transferred to MSPWM. Demand loans are callable with short notice periods. Proposed loans are subject to review and approval by the appropriate risk and credit committees. The MSSBH UK Group has dedicated staff to carry out its credit risk management in accordance with the direction set by the MSSBH UK Group's Risk Management and Firm Risk Management functions. There are strict controls around collateral management, including the type of collateral, collateral levels and legal title.

Policies on the impairment of financial and non-financial assets are in the MSSBH UK Group's financial statement notes to the consolidated financial statements, notes 3f and 3g. For accounting purposes 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 cash flows of an asset and the expected impact can be reliably estimated. Non-financial 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. There were no impaired exposures for the period reported, therefore no provisions were made for impaired exposures.

10.2 COUNTERPARTY AND CREDIT RISK CAPITAL COMPONENT ("CRCC")

The Counterparty and credit risk capital component reflects capital requirements attributable to the risk of loss arising from a borrower or counterparty failing to meet its obligations. Risk weighted exposures are determined using the standardised approach to credit risk.

The FCA industry type is aligned with the classifications set out in BIPRU. Institutions include financial institutions and credit institutions. A standardised approach is used for all asset categories. The nominated external credit assessment institution ("ECAI") is Standard and Poor's ("S&P") which has been used for all standardised credit risk exposure classes.

The MSSBH UK Group is not exposed to counterparty risk as the MSSBH UK Group does not operate a trading book.

10.3 CREDIT EXPOSURE BREAKDOWN TABLE

Standardised Approach Exposure Table

AS AT 31/12/2013	CREDIT QUALITY STEP	TOTAL GROSS EXPOSURE $000'S	TOTAL EXPOSURE VALUE COVERED BY ELIGIBLE FINANCIAL COLLATERAL $000'S	EXPOSURE VALUE AFTER CREDIT MITIGATION $000'S	CREDIT RISK CAPITAL COMPONENT $000'S
Administrative Bodies & Non-commercial Undertakings	3	6,203	4,266	1,937	152
Central Governments or Central Banks	1	688	–	688	–
	3	33	–	33	3
Collective Investment Undertakings	1	10,017	–	10,017	160
	3	992	17	975	78
Corporates	3	13,011	87	12,924	1,036
Institutions	1	134,137	–	134,137	2,146
	2	142,159	–	142,159	2,275
	3	5,702	–	5,702	104
	4	63	–	63	3
Other	3	2,952	–	2,952	236
Regional Governments or Local Authorities	2	56,635	50,794	5,841	794
Total		**372,952**	**55,164**	**317,428**	**6,987**

Gross credit exposure reported above is based on the regulatory definition as defined by the FCA on a product by product basis, prior to netting and collateral being applied, but after regulatory eliminations and exemptions are applied. Where appropriate this also includes prescribed haircuts. These exposures are therefore different to those presented in the MSSBH UK Group's financial statements. Exposures are consistent with regulatory returns.

Exposure value covered by eligible financial collateral represents the positive market value against which collateral has been received and for which the required legal agreements exist in order to enable collateral to be applied. Exposure value after credit mitigation is the exposure at default ("EAD") calculated under the rules prescribed in BIPRU.

Geographical breakdown of EAD

AS AT 31/12/2013	AMERICAS $000'S	EMEA $000'S	ASIA $000'S	TOTAL $000'S
Central Governments or Central Banks	–	721	–	721
Regional Governments or Local Authorities	–	5,841	–	5,841
Administrative Bodies & Non-Commercial Undertakings	1,873	64	–	1,937
Institutions	173,793	107,870	398	282,061
Corporate	7,698	5,204	22	12,924
Collective Investment Undertakings	10,544	448	–	10,992
Other	–	2,952	–	2,952
Total	**193,908**	**123,100**	**420**	**317,428**

As well as assessing and monitoring its credit exposure and risk at the individual counterparty level, the MSSBH UK Group also reviews its credit exposure and risk to geographic regions. As at 31 December 2013, credit exposure was concentrated in North America and Western European countries. In addition, the Group pays particular attention to smaller exposures in emerging markets and exposures in Greece, Ireland, Italy, Portugal and Spain ("GIIPS") 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 2013, the Group's material credit exposure was to corporate entities, financial institutions and collective investment undertakings.

10.4 CREDIT RISK MITIGATION

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

Netting

The MSSBH UK Group has procedures in place for recording netting agreements with clients. Where credit is taken on MSSBH UK there is a process to review the legal enforceability of the relevant agreements, in some instances based on an assessment of the materiality of that risk. In instances where there is doubt over the legal enforceability of an agreement, the benefit of netting is not applied for the purposes of capital reporting. See the Standardised Approach Exposure table in section 10.3 for the impact of netting and collateral.

Collateral

The amount and type of collateral required by the MSSBH UK Group depends on an assessment of the credit risk of the counterparty. Collateral held is managed in accordance with the MSSBH UK 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.

The Morgan Stanley Group actively manages its credit exposure through the application of collateral arrangements. The use of collateral in managing OTC derivative risk is standard in the market place, and is governed by appropriate documentation, for example, the Credit support Annex to the ISDA documentation. In line with these standards, the Morgan Stanley Group generally accepts only cash and G7 government bonds, corporate debt and main index equities as eligible collateral. Other securities may be accepted in securities lending, repo, prime brokerage and private wealth management subject to conservative haircuts based on assessments of collateral volatility and liquidity. There is an established and robust infrastructure to manage, maintain and value collateral on a daily basis.

Collateralised EAD relates to margin loans that are callable on demand. Unsecured EAD relates mainly to cash balances and intercompany receivable balances. All EAD has a maturity less than one year.

11. Market Risk

Sound market risk management is an integral part of the Morgan Stanley Group's culture. The business units are responsible for ensuring that market risk exposures are well managed and prudent. The control groups help ensure that these risks are measured and closely monitored and are made transparent to senior management. 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.

11.1 MARKET RISK IN THE NON-TRADING BOOK

The MSSBH UK Group has foreign currency exposure arising from its branches that operate in currencies other than US dollars. The majority of the foreign currency risk has been hedged by other members of Morgan Stanley Group, primarily Morgan Stanley, by utilising both forward foreign currency exchange contracts and non-US dollar denominated debt. For the MSSBH UK Group, typically, margin lending is matched with intercompany resulting in little direct market risk.

11.2 INTEREST RATE RISK IN THE NON-TRADING BOOK

The MSSBH UK Group is exposed to minimal interest rate risk as a result of deposits with highly rated banks. All deposits are on demand and therefore short term in nature.

12. Operational Risk

12.1 OVERVIEW

Operational risk is defined as the risk of loss, or damage to Morgan Stanley's reputation, resulting from inadequate or failed processes, people and systems or from external events. This definition includes legal risk, but excludes strategic risk. Effective operational risk management reduces the likelihood or impact of operational incidents and mitigates legal, compliance, regulatory, franchise and reputational risks.

Operational risk management policies and procedures for the MSSBH UK Group are consistent with those of the Morgan Stanley Group and include escalation to the MSSBH UK Group's Board of directors and appropriate senior management personnel. Operational risk may be incurred across the MSSBH UK Group's full scope of business activities, including revenue-generating activities (e.g., advisory and discretionary activities) and support functions (e.g., IT and facilities management). The operational risk management framework operates to identify, measure, monitor and control risk in the context of an approved a risk tolerance appetite set by the Board of directors.