Registration No. 3584019

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MORGAN STANLEY INTERNATIONAL LIMITED

Report and financial statements

31 December 2009

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MORGAN STANLEY INTERNATIONAL LIMITED

DIRECTORS' REPORT

The Directors present their report and the consolidated financial statements of Morgan Stanley International Limited (the "Company") and all of its subsidiary and associated undertakings (together the "Group"), together with the Company's balance sheet and related notes for the year ended 31 December 2009. The prior accounting period is a thirteen month period to 31 December 2008, due to a change in the accounting reference date in the prior period and therefore comparatives are not entirely comparable with amounts shown for the current period.

RESULTS AND DIVIDENDS

The Group's profit for the year, after tax and minority interests, was $613 million (2008: $532 million).

No dividends were paid to the holders of the ordinary shares (2008: $nil).

PRINCIPAL ACTIVITY

The principal activity of the Group is the provision of financial services to corporations, governments and financial institutions. As part of the previously announced transaction to combine Morgan Stanley's Global Wealth Management Group ("GWM") and the businesses of Citigroup Inc's Smith Barney operations, the Group's European, Middle East and Africa ("EMEA") GWM introducing broker activities were reorganised and transferred to a consolidated joint venture, Morgan Stanley Smith Barney LLC ("MSSB") (see note 37), from 1 June 2009. Other than this, there have not been any significant changes in the Group's principal activity during the year and no other significant changes in the Group's principal activity are expected. Certain of the Group's subsidiaries are authorised and regulated by the Financial Services Authority ("FSA") or by other financial services regulatory authorities.

The Group operates in the Europe, Middle East and Africa ("EMEA"), Americas and Asia markets. The Group operates branches in the Dubai International Financial Centre, France, Germany, Greece, Italy, Korea, Netherlands, New Zealand and the Qatar International Financial Centre. A further branch was opened in Switzerland on 8 February 2010.

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

BUSINESS REVIEW

The consolidated profit and loss account for the year is set out on page 8. Comparing the year to 31 December 2009 to the 13 month period to 31 December 2008, the Group's profit for the year after tax and minority interest has increased by $81 million to $613 million. The Group's revenues improved across all businesses during 2009, however the Group's performance continued to be impacted by challenging market conditions. As a consequence of the Morgan Stanley Group's improved performance during 2009, revenues have been negatively impacted by the narrowing of own credit spreads on certain of the Group's issued financial instruments that are accounted for at fair value.

The Group's net interest expense has reduced by 35% to $562 million. Interest income and interest expense have reduced by 80% and 78% respectively. This decrease is driven by significant reductions in secured financing activity, coupled with declining interest rates. Net gains on available-for-sale financial assets decreased by $1,217 million to $16 million; in 2008, the Group received significant dividend income from non-consolidated available for sale investments that have become subsidiaries due to additional investments by the Group in 2008, subsequent to the receipt of the dividend income in the prior period. The Group's other expenses have reduced by 21%, with significant reductions in brokerage costs and other operating costs compared to the prior period.

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

The consolidated balance sheet presented on pages 10-11 of the financial statements shows reductions in the Group's fixed assets and current assets ("total assets"), and total liabilities. Total assets and total liabilities have each decreased by 7% as at 31 December 2009 when compared to 31 December 2008. The reduction in total assets and total creditors has been largely driven by reductions of $48,997 million and $40,175 million in financial assets classified as held for trading and financial liabilities classified as held for trading respectively. These movements are primarily due to reductions in the Group's gross balances from derivative instruments, driven by market volatility in the period, although the change in the net derivatives balance is minor. These reductions have been partially offset on the assets side by an increase of $21,049 million in securities purchased under agreements to resell and cash collateral on stocks borrowed. On the liability side, the movement in financial liabilities classified as held for trading has been partially offset by an increase of $13,945 million in securities sold under agreements to repurchase and cash collateral on stocks. Although repurchase and reverse repurchase agreements have increased compared to 31 December 2008, the current positions remain significantly lower than the average position during 2008.

During 2009, the Group has continued to review and actively manage its capital position. As part of this capital management, the Group has repaid $4,400 million of subordinated loans, and redeemed the Adjustable Redeemable Capital Securities ("ARCS") at par value of $125 million. In addition there was a decrease in minority interest from $2,345 million to $2,079 million. This was driven by the redemption of $1,080 million of equity preference shares issued by a subsidiary entity of the Group and held by another Morgan Stanley Group undertaking. Prior to redemption a dividend of $170 million was paid to the minority interest holders of the preference shares. This decrease was partially offset by the purchase, by another Morgan Stanley Group undertaking, of an investment in equity preference shares of $811 million issued by a subsidiary of the Group.

During the year a subsidiary of the Group repurchased and cancelled 1,250,000,000 Class C non-redeemable non-cumulative preference shares of $1 each which had been issued to another Group subsidiary. The repurchase was made out of distributable reserves and accordingly an amount of $1,250 million was transferred from retained earnings to the capital redemption reserve.

The performance of the Group is included in the results of the Morgan Stanley Group which are disclosed in the Morgan Stanley Group's Annual Report on Form 10-K to the United States Securities and Exchange Commission. The Morgan Stanley Group manages its key performance indicators on a global basis but in consideration of individual legal entities. For this reason, the Company's Directors believe that providing performance indicators for the Group itself would not enhance an understanding of the development, performance or position of the business of the Group.

Current market conditions

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

During the period ended 31 December 2008, the Morgan Stanley Group took certain steps to respond to the stresses experienced in global financial markets and to strengthen the Morgan Stanley Group's overall capital and liquidity position, including participation in the US Government's Troubled Asset Relief Program ("TARP"). In mid 2009, as a result of its strong capital position, Morgan Stanley received approval from the US Treasury to repay the $10 billion TARP investment received in 2008. Morgan Stanley continues to actively manage its capital and liquidity position to ensure adequate resources are available to support the activities of the Morgan Stanley Group, including its subsidiary entities. The risk management section below sets out the Group's and the Morgan Stanley Group's policies for the management of liquidity and cash flow risk and other significant business risks. Note 29 to the consolidated financial statements provides qualitative and quantitative disclosures about the Group's management and exposure to risks, including liquidity risk.

The Group has exposure to mortgage-related risk. As at 31 December 2009 the amount recognised on the Group balance sheet in relation to residential mortgage-backed securities ("RMBS") is $1,220 million (2008: $1,178 million). The Group continues to have exposure to commercial mortgage-backed securities ("CMBS") arising from its trading activities. As at 31 December 2009 the amount recognised on the balance sheet in relation to CMBS is $672 million (2008: $771 million).

Current market conditions (continued)

The Group is involved with various entities in the normal course of business that may be deemed to be special purpose entities ("SPEs"). The Group's interests in SPEs include debt and equity interests and derivative instruments, and these interests primarily arise from trading activity and structured transactions. Consolidation of SPEs is determined in accordance with the Group's accounting policies. As at 31 December 2009 the total assets of SPEs in which the Group has an interest, but which are not consolidated by the Group, are $3,669 million (2008: $7,673 million) and the Group's maximum exposure to loss relating to such SPEs is $43 million (2008: $124 million). The Group's consolidated balance sheet includes $3,477 million of assets arising from consolidated SPEs (2008: $3,807 million). The Group's maximum exposure to loss relating to these assets is $1,800 million (2008: $1,892 million).

Risk management

Risk is an inherent part of both Morgan Stanley's and the Group's business activity and is managed by the Group within the context of the broader Morgan Stanley Group. The Morgan Stanley Group seeks to identify, assess, monitor and manage each of the various types of risk involved in its business activities on a global basis, in accordance with defined policies and procedures and in consideration of the individual legal entities. The Group's own risk management policies and procedures are consistent with those of the Morgan Stanley Group.

Market risk

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

The Group is managed within the Morgan Stanley Group's global framework. The market risk management policies and procedures of the Group are consistent with those of Morgan Stanley Group, including reporting of material risks identified to appropriate key management personnel of the Group. Sound market risk management is an integral part of the Group's culture. The various business units and trading desks are responsible for ensuring that market risk exposures are well-managed and prudent. The market risk department is responsible for ensuring transparency of material market risks, monitoring compliance with established limits, and escalating risk concentrations to appropriate senior management. To execute these responsibilities, the Morgan Stanley Group monitors its market risk against limits on aggregate risk exposures, performs a variety of risk analyses and maintains the Value at Risk ("VaR") system. A variety of limits are designed to control price and liquidity risk. Market risk is monitored through various measures: statistically (using VaR and related analytical measures); by measures of position sensitivity; and through routine stress testing and scenario analyses. The material risks identified by these processes are summarised and reported to senior management.

The Group's trading VaR at 31 December 2009 is $55 million compared with $36 million at 31 December 2008. The increase in trading VaR is primarily due to increased interest rate and credit spread VaR. The overall change in VaR reflects the Group's strategy across its businesses to take advantage of the opportunities presented by market conditions.

Credit risk

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

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

Risk management (continued)

Liquidity 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.

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

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

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

Basel II Pillar 3 disclosures

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

DIRECTORS

In 2010, the Group conducted a review of its corporate governance arrangements. As a result, the size of the board of Directors has been reduced.

The following Directors held office throughout the year (except where otherwise shown):

M C Bowe	(appointed 1 September 2010)
C D S Bryce	
W A Chammah (Chairman)	
K Clark	(resigned 30 June 2009, appointed 1 September 2010)
A Classen	(resigned 11 August 2010)
J D Dilworth	(resigned 4 March 2009)
L G P M Francois	(appointed 16 July 2010)
R Hoornweg	(left on 17 December 2009)
L Isasi Fernández de Bobadilla	(resigned 22 June 2010)
G G Lynch	(appointed 26 August 2009)
A J Mack	(appointed 13 March 2009, resigned 30 June 2010)
G Makhoul	(resigned 17 September 2009)
D McCarthy	(resigned 29 January 2009)
D Moore	(resigned 21 July 2010)
D R Nicol	(resigned 17 June 2010)
F R Petitgas	
P Ponsolle	(resigned 30 September 2009)
L R Raettig	(resigned 18 June 2010)
S C T Robey	(resigned 9 August 2010)
R P Rooney	(appointed 26 July 2010)
R R Simonyan	(resigned 8 July 2010)
D Siniscalco	(resigned 21 June 2010)
C E Woodman	(appointed 12 March 2009)

DIRECTORS LIABILITY INSURANCE

Qualifying indemnity provisions (as defined in section 234 of the Companies Act 2006) were in force during the year and at the date of the Directors' report for the benefit of all the Directors of the Company and its subsidiaries under a Directors' and Officers' Liability Insurance policy taken out by Morgan Stanley, the Company's ultimate parent company and pursuant to the provisions of the Company's articles of association.

EMPLOYEES

Both the Company and the Morgan Stanley Group place considerable value on the investment in their employees and have continued their practice of keeping employees informed on matters affecting them. Employees are encouraged to present their suggestions and views on Morgan Stanley Group's performance to management and employees participate directly in the success of the business through Morgan Stanley Group's various compensation incentive plans.

Every effort is also made to ensure that disabled applicants, or those existing employees that are disabled or may have become disabled, are treated as fairly as possible on terms comparable with those of other employees. Appropriate training is arranged for disabled persons, including retraining for alternative work for employees who become disabled, to promote their career development within the organisation.

CHARITABLE CONTRIBUTIONS

During the year subsidiaries of the Company made donations to various charities totalling $3.4 million (Thirteen month period ended 31 December 2008: $5.2 million).

POST BALANCE SHEET EVENTS

On 9 December 2009 the UK government announced proposed legislation in its Pre-Budget Report imposing a Bank Payroll Tax. The legislation was enacted on 8 April 2010 as part of the Finance Act. The tax applies to discretionary bonuses over a certain amount awarded to certain employees within scope ("Banking Employees") in the period from 9 December 2009 to 5 April 2010. The liability for the tax is that of the entity that benefits from the services of the Banking Employees, rather than the employing entity. Management's best estimate of the amount required to settle the liability is $357 million and a charge has been recognised in 2010 when the legislation was enacted.

On 26 April 2010, a subsidiary entity of the Group bought back a proportion of its equity shares in issue, held by a minority interest. This minority interest, which was bought back, was included in the 31 December 2009 Minority Interest balance at $140 million.

On 22 September 2010, a subsidiary entity of the Group:

- paid a dividend of $66.8 million to minority interest holders of its equity shares.
- bought back and cancelled a proportion of its equity shares in issue, held by a minority interest.

This minority interest was included in the 31 December 2009 Minority Interest balance at $632 million.

On 28 April 2010, the Group paid a dividend of $1 billion on its ordinary shares. This dividend has not been accrued in the financial statements.

POLICY AND PRACTICE ON PAYMENT OF CREDITORS

The Group's and the Company's trade creditors balances are comprised primarily of unsettled securities transactions with exchanges, clearing houses, market counterparties, individual investors and other Morgan Stanley Group undertakings. It is the Company's policy that these transactions are settled in accordance with the standard terms of the relevant exchange or market and disclosure of creditor days is not considered a relevant measure.

DIRECTORS' REPORT (CONTINUED)

AUDIT COMMITTEE

The Company has an Audit Committee to assist the Board of the Company itself and the Boards of its regulated subsidiaries in meeting their responsibilities in ensuring an effective system of internal control and compliance, and in meeting their external financial reporting obligations. The Audit Committee meets regularly and reports to the Board of the Company on a quarterly basis.

AUDITORS

Deloitte LLP have expressed their willingness to continue in office as auditors of the Company and subject to s485 to s488 of the Companies Act 2006, will be deemed to be reappointed.

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.

STATEMENT OF DIRECTORS' RESPONSIBILITIES

The Directors are responsible for preparing the annual report and the financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare financial statements for each financial year. Under that law the Directors have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law). Under company law the Directors must not approve the financial statements unless they are satisfied that they 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 year. In preparing these financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgments and accounting estimates that are reasonable and prudent;
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- 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 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.

Approved by the Board and signed on its behalf by CLARE WOODMAN

Director

27 September 2010

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF MORGAN STANLEY INTERNATIONAL LIMITED

We have audited the Group and Company financial statements (the "financial statements") of Morgan Stanley International Limited for the year ended 31 December 2009 which comprise the consolidated profit and loss account, the consolidated statement of total recognised gains and losses, the consolidated and Company balance sheets and the related notes 1 to 39 for the Group financial statements and the related notes 1 to 11 for the Company financial statements. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of Directors and auditors

As explained more fully in the Directors' responsibilities 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 the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's (APB's) Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Directors; and the overall presentation of the financial statements.

Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view of the state of the Group's and the Company's affairs as at 31 December 2009 and of the Group's profit for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

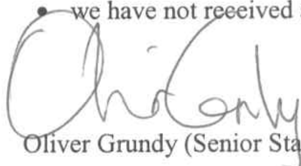
Opinion on other matters prescribed by the Companies Act 2006

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.

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, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of Directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.



Oliver Grundy (Senior Statutory Auditor)

For and on behalf of Deloitte LLP
Chartered Accountants and Statutory Auditors
London, England
28th September 2010

CONSOLIDATED PROFIT AND LOSS ACCOUNT
Year ended 31 December 2009

	Note	Year ended 31 December 2009 $millions	1 December 2007 to 31 December 2008 $millions
Net gains on financial instruments classified as held for trading		4,939	2,785
Net gains on financial instruments designated at fair value through profit or loss		57	1,319
Net gains on fixed asset investments:			
- Available-for-sale financial assets	2	16	1,233
Interest income	3	4,513	22,666
Interest expense	4	(5,075)	(23,533)
Other income	5	1,235	1,807
Other expense	6	(4,471)	(5,634)
PROFIT ON ORDINARY ACTIVITIES BEFORE TAXATION		1,214	643
Share of losses of associates and joint venture	7	-	(25)
Gain on disposal of subsidiary		-	41
PROFIT BEFORE INCOME TAXATION		1,214	659
Tax on profit on ordinary activities	10	(601)	(114)
PROFIT FOR THE FINANCIAL YEAR / PERIOD		613	545
Equity minority interests	27	-	(13)
PROFIT ATTRIBUTABLE TO SHAREHOLDERS FOR THE FINANCIAL YEAR / PERIOD		613	532

All operations were continuing in the current year and prior period.

A reconciliation of the movement in shareholders' funds is disclosed in note 27 to the accounts.

The notes on pages 12 to 77 form an integral part of the financial statements.

CONSOLIDATED STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES
Year Ended 31 December 2009

	Note	Year ended 31 December 2009 $millions	1 December 2007 to 31 December 2008 $millions
PROFIT FOR THE FINANCIAL YEAR / PERIOD		613	545
Currency translation differences on foreign currency net investments	27	257	(1,081)
Fair value reserve:			
Available for sale financial assets:			
Net change in fair value of available for sale financial assets recognised directly in equity	13	(3)	(31)
Net amount transferred to profit and loss account		-	(23)
Actuarial loss recognised on post-retirement benefit schemes	24	(10)	(3)
TOTAL RECOGNISED GAINS AND LOSSES RELATING TO THE YEAR / PERIOD		857	(593)

The notes on pages 12 to 77 form an integral part of the financial statements.

MORGAN STANLEY INTERNATIONAL LIMITED
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CONSOLIDATED BALANCE SHEET
As at 31 December 2009

	Note	31 December 2009 $millions	31 December 2008 $millions
FIXED ASSETS			
Intangible assets	11	24	38
Tangible assets	12	870	984
Investments:			
- Available-for-sale financial assets	13	163	193
- Associates and joint venture	13	7	13
		1,064	1,228
CURRENT ASSETS			
Financial assets classified as held for trading (of which $57,877 million (2008: $51,439 million) were pledged to various parties)	14	255,651	304,648
Financial assets designated at fair value through profit or loss	15	1,908	1,649
Loans and receivables			
- Cash at bank	16	14,480	20,887
- Debtors	17	171,277	148,342
Other assets	18	1,124	1,388
		444,440	476,914
CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR			
Financial liabilities held for trading	14	(209,502)	(249,677)
Financial liabilities designated at fair value through profit or loss	15	(7,879)	(7,346)
Financial liabilities at amortised cost	20	(202,180)	(190,552)
Other creditors	21	(2,338)	(2,937)
		(421,899)	(450,512)
NET CURRENT ASSETS		22,541	26,402
TOTAL ASSETS LESS CURRENT LIABILITIES		23,605	27,630
CREDITORS (INCLUDING CONVERTIBLE SECURITIES): AMOUNTS FALLING DUE AFTER MORE THAN ONE YEAR	22	(10,642)	(15,033)
PROVISIONS FOR LIABILITIES AND CHARGES	23	(119)	(126)
NET ASSETS EXCLUDING PENSION LIABILITIES		12,844	12,471
Pension liabilities	24	(8)	(5)
NET ASSETS INCLUDING PENSION LIABILITIES		12,836	12,466

MORGAN STANLEY INTERNATIONAL LIMITED
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CONSOLIDATED BALANCE SHEET (CONTINUED)
As at 31 December 2009

	Note	31 December 2009 $millions	31 December 2008 $millions
CAPITAL AND RESERVES			
Called up share capital	26	1,614	1,614
Adjustable Redeemable Capital Securities ("ARCS")	27	-	114
Capital redemption reserve	27	1,400	150
Foreign currency revaluation reserve	27	(387)	(641)
Capital contribution reserve	27	141	141
Pension reserve	27	(98)	(88)
Fair value reserve	27	(32)	(29)
Profit and loss account	27	8,119	8,860
EQUITY SHAREHOLDERS' FUNDS		10,757	10,121
MINORITY INTERESTS	27	2,079	2,345
TOTAL EQUITY		12,836	12,466

These financial statements were approved by the Board and authorised for issue on 27 September 2010.

Signed on behalf of the Board

Director
CLARE WOODMAN

The notes on pages 12 to 77 form an integral part of the financial statements.

1. ACCOUNTING POLICIES

a. Basis of preparation

The Group 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 consolidated financial statements of the Group comprise the financial statements of the Company and its subsidiaries made up to 31 December 2009. The financial statements for consolidated subsidiaries are prepared for the same reporting period as the Group, using consistent accounting policies. Subsidiaries are consolidated from the date that the Group gains control until the date that control ceases.

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

Intra-group balances, transactions, income and expenses and profits and losses resulting from intra-group transactions are eliminated in preparing the consolidated financial statements. Minority interests represent the portion of profit or loss and net assets not owned, directly or indirectly, by the Group and are presented separately in the consolidated profit and loss account and within equity in the consolidated balance sheet, separately from parent shareholders' equity.

b. 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 6. 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. This framework is expected to continue 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

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 Directors' report and the financial statements are rounded to the nearest million US dollars.

1. ACCOUNTING POLICIES (CONTINUED)

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 and all other translation differences are taken through the consolidated profit and loss account, with the exception of non-monetary financial investments classified as available-for-sale, where foreign exchange differences and the related tax amounts are recorded in the fair value reserve in equity until the investment is sold. Exchange differences recognised in the profit and loss account are presented in 'Other income' or 'Other expense', except where noted in 1(e) below.

e. Financial instruments

The Group classifies its financial assets into the following categories on initial recognition: financial assets classified as held for trading; financial assets designated at fair value through profit or loss; available-for-sale fixed asset investments; other fixed asset investments and loans and receivables.

The Group classifies its financial liabilities into the following categories on initial recognition: financial liabilities classified as held for trading, financial liabilities designated at fair value through profit or loss and financial liabilities at amortised cost.

More information regarding these classifications is included below:

i) Financial instruments classified as held for trading

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

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

The Group has designated certain financial assets and financial liabilities at fair value through profit or loss when either:

- the financial assets or financial liabilities are managed, evaluated and reported internally on a fair value basis;
- the designation at fair value eliminates or significantly reduces an accounting mismatch which would otherwise arise; or
- the financial asset or financial liability contains an embedded derivative that significantly modifies the cash flows that would otherwise be required under the contract.

From the date the transaction in a financial instrument designated at fair value is entered into (trade date) until settlement date, the Group recognises any unrealised fair value changes in the contract as financial instruments designated at fair value through profit or loss. On settlement date, the fair value of consideration given or received is recognised as a financial instrument designated at fair value through profit or loss. All related gains and losses, including foreign exchange differences, are reflected in the consolidated profit and loss account in 'Net gains on financial instruments designated at fair value through profit or loss'. Transaction costs are excluded from the initial fair value measurement of the financial instrument. These costs are recognised in the consolidated profit and loss account in 'Other expense'.

1. ACCOUNTING POLICIES (CONTINUED)

e. **Financial instruments (continued)**

iii) Available-for-sale financial assets

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

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

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

iv) Investments in associated undertakings and joint venture

Investments in associates and joint ventures outside the scope of FRS 26 are recorded within 'Investments in associates and joint ventures' and are accounted for using the equity method of accounting. An associate is an entity in which the Group considers it has significant influence and which is neither a subsidiary nor a joint venture.

Under the equity method, the investment in the associate or joint venture is carried on the consolidated balance sheet at cost, including attributable goodwill, and is adjusted for post-acquisition changes in the Group's share of total assets less total liabilities of the associate. The Group's share of its associates' and joint ventures post-acquisition profits or losses is recognised in the consolidated profit and loss account; its share of post-acquisition movements in equity is recognised in equity. Profits and losses resulting from transactions between the Group and the associate or the joint venture are eliminated to the extent of the interest in the associate or joint venture. Distributions received from associates or joint ventures reduce the carrying amount of the investment.

v) 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 profit and loss account, using the effective interest rate method. Transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability are added to or deducted from the fair value on initial recognition.

The effective interest rate method is a method of calculating the amortised cost of a financial asset or a financial liability (or a group of financial assets or financial liabilities) and of allocating the interest income or interest expense over the expected life of the financial asset or financial liability. The effective interest rate is the rate that exactly discounts the estimated future cash payments and receipts through the expected life of the financial asset or liability (or, where appropriate, a shorter period) to the carrying amount of the financial asset or liability. The effective interest rate is established on initial recognition of the financial asset and liability. The calculation of the effective interest rate includes all fees and commissions paid or received, transaction costs, and discounts or premiums that are an integral part of the effective interest rate. Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial asset or liability.

Impairment losses and reversals of impairment losses on financial assets classified as loans and receivables are recognised in the consolidated profit and loss account in either 'Other expense' or 'Other income'.

Financial liabilities held at amortised cost are initially recognised on settlement date at fair value and subsequently measured at amortised cost. Interest is recognised in the profit and loss account in 'Interest expense' using the effective interest rate method as described above. Foreign exchange differences on financial liabilities held at amortised cost are recognised in the profit and loss account in 'Other income' or 'Other expense' as appropriate.

1. ACCOUNTING POLICIES (CONTINUED)

e. Financial instruments (continued)

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

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 balance sheet.

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 profit and loss account in 'Interest expense' using the effective interest rate method.

f. Fair value of financial instruments

Fair value measurement

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

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

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

The Group uses prices and inputs that are current as of the measurement date, including during periods of market dislocation. In periods of market dislocation, the observability of prices and inputs may be reduced for many instruments.

Valuation techniques

Fair value for many cash and Over the Counter ("OTC") contracts is derived using pricing models. Pricing models take into account the contract terms (including maturity), as well as multiple inputs including, where applicable, equity prices, interest rate yield curves, credit curves, correlation, creditworthiness of the counterparty, option volatility and currency rates. The impact of the Group's own credit spread is also considered when measuring the fair value of liabilities, including OTC derivative contracts. Where appropriate, valuation adjustments are made to account for various factors such as liquidity risk (bid-ask adjustments), credit quality, and model uncertainty. These adjustments are subject to judgement, are applied on a consistent basis and are based upon observable inputs where available. The Group generally subjects all valuations and models to a review process initially and on a periodic basis thereafter.

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

1. ACCOUNTING POLICIES (CONTINUED)

f. Fair value of financial instruments (continued)

Gains and losses on inception

In the normal course of business, the fair value of a financial instrument on initial recognition is the transaction price (i.e. the fair value of the consideration given or received). In certain circumstances, however, the fair value will be based on other observable current market transactions in the same instrument, without modification or repackaging, or on a valuation technique whose variables include only data from observable markets. When such evidence exists, the Group recognises a gain or loss on inception of the transaction.

When unobservable market data has a significant impact on determining fair value at the inception of the transaction, the entire initial change in fair value indicated by the valuation technique as at the transaction date is not recognised immediately in the consolidated 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 or loans and receivables. Impairment losses are recognised if an event has occurred which will have an adverse impact on the expected future cash flows of an asset and the expected impact can be reliably estimated.

Impairment losses on available-for-sale fixed asset investments are measured as the difference between cost (net of any principal repayment and amortisation) and the current fair value. When a decline in the fair value of an available-for-sale financial asset has been recognised through the statement of total recognised gains and losses and there is evidence that the asset is impaired, the cumulative loss that had been recognised through the statement of total recognised gains and losses is removed from reserves and recognised in the profit and loss account within 'Net gains and losses on fixed asset investments in available-for-sale financial assets'.

Impairment losses on loans and receivables carried at amortised cost are measured as the difference between the carrying amount of the financial asset and the present value of estimated cash flows discounted at the asset's original effective interest rate. Such impairment losses are recognised in the profit and loss account within 'Other expenses' and are reflected against the carrying amount of the impaired asset on the balance sheet. Interest on the impaired asset continues to be accrued on the reduced carrying amount based on the original effective interest rate of the asset.

Subsequent increases in fair value of previously impaired equity available-for-sale financial assets are reported as fair value gains in the profit and loss account and not separately identified as an impairment reversal. For loans and receivables, 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).

h. Fees and commissions

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

1. ACCOUNTING POLICIES (CONTINUED)

i. Tangible fixed assets

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

For premises held under operating leases, a reinstatement provision is recognised for the estimated cost to reinstate the premises at the end of the lease period. When the reinstatement provision is established, an equivalent asset is recognised and included in the cost of leasehold improvements at the initial present value of any reinstatement obligations. The discount effect included in the reinstatement provision is reversed over time using a constant effective yield method and included within 'Interest expense' in the profit and loss account. The reinstatement asset is depreciated over the useful economic life of the relevant leasehold improvement asset and this depreciation is included within 'Other expense'.

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:

Freehold property	-	3 to 39 years
Leasehold improvements, including reinstatement assets	-	shorter of remaining lease term and 39 years
Fixtures, fittings and equipment	-	3 to 8 years

Freehold land is not depreciated. 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.

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.

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.

1. ACCOUNTING POLICIES (CONTINUED)

l. Intangible fixed assets

Purchased goodwill, being the difference between the purchase consideration and the fair value of net assets acquired, is amortised over a period of between five to twenty years in respect of subsidiary undertakings, being the periods for which the Directors expect the values of the underlying businesses acquired to exceed the value of the underlying net assets. Goodwill is assessed for impairment if events or changes in circumstances indicate that its carrying value may not be recoverable in full.

m. Retirement benefits

The Group operates both defined benefit and defined contribution schemes. Contributions due under defined contribution schemes are recognised in 'Other expense' in the profit and loss account when payable.

For the defined benefit schemes, scheme 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. Scheme assets are measured at their fair value at the reporting date. A surplus or deficit of scheme assets over liabilities is recognised in the consolidated balance sheet 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 scheme. The current service cost and any past service costs together with the expected return on scheme assets less the unwinding of the discount on the scheme liabilities is charged to 'Other expense' in the consolidated profit and loss account. Actuarial gains and losses that arise in calculating the Group's obligation in respect of a scheme are recognised in other comprehensive income, in the period in which they occur.

n. Employee compensation plans

Morgan Stanley operates equity based compensation plans on behalf of the Group and, in relation to which, the Group pays Morgan Stanley in consideration of the procurement of the transfer of shares to employees. The cost of equity based transactions with employees is measured based on the fair value of the equity instruments at grant date. Fair value of stock unit awards is based on the market price of Morgan Stanley shares and fair value of stock option awards is estimated using the Black-Scholes option pricing model, which takes into account the option's exercise price, its expected term, the risk free interest rate and the expected volatility of the market price of Morgan Stanley shares. Non-market vesting conditions are not taken into account when measuring fair value, but are reflected by adjusting over time the number of equity instruments included in the measurement of the transaction such that the amount ultimately recognised reflects the number that actually vest. The expense for FRS 20 *Share-based payment* ("FRS 20") purposes is taken directly to the consolidated profit and loss account; the corresponding increase in reserves is reduced to the extent that payments are due to Morgan Stanley in respect of these awards.

Morgan Stanley also maintains deferred compensation plans for the benefit of certain employees that provide a return to the participating employees based upon the performance of various referenced investments. Such awards are recognised over time, in accordance with the awards' vesting conditions, within 'Other payables' in the consolidated balance sheet and are remeasured to fair value at the end of each reporting period. The related expense is recorded within 'Other expense' in the consolidated profit and loss account. 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'.

o. Cash flow statement

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

2. NET GAINS ON INVESTMENTS IN AVAILABLE-FOR-SALE FINANCIAL ASSETS

	Year ended 31 December 2009 $millions	1 December 2007 to 31 December 2008 $millions
Net fair value gains transferred from equity on disposal of asset	-	23
Dividends receivable	16	1,210
	16	1,233

3. INTEREST INCOME

	Year ended 31 December 2009 $millions	1 December 2007 to 31 December 2008 $millions
Interest income from loans to other Morgan Stanley Group undertakings	2,083	7,675
Expected return on retirement benefits scheme assets	6	9
Other interest income	2,424	14,982
	4,513	22,666

Other interest income includes $14 million (2008: $1 million) of interest income accrued on impaired loans and receivables.

4. INTEREST EXPENSE

	Year ended 31 December 2009 $millions	1 December 2007 to 31 December 2008 $millions
Interest expense on bank loans	19	51
Interest expense on loans from other Morgan Stanley Group undertakings	3,833	12,681
Interest expense in respect of retirement benefits scheme	9	9
Other interest expense	1,214	10,792
	5,075	23,533

5. OTHER INCOME

	Year ended 31 December 2009 $millions	1 December 2007 to 31 December 2008 $millions
Fees and commission income	993	1,596
Operating lease rentals receivable	60	66
Other foreign exchange gains	-	24
Other	182	121
	1,235	1,807

6. OTHER EXPENSE

	Year ended 31 December 2009 $millions	1 December 2007 to 31 December 2008 $millions
Direct staff costs (note 8)	1,481	1,376
Management recharges relating to staff costs borne by other Morgan Stanley Group undertakings	987	920
Management recharges from other Morgan Stanley Group undertakings relating to other services	69	121
Impairment losses on loans and receivables (note 29)	123	34
Realised losses on loans and receivables	28	37
Operating lease rentals	63	101
Depreciation on property, plant and equipment (note 12)	176	202
Amortisation of goodwill (note 11)	14	16
Auditors remuneration:		
- Fees payable to the Company's auditors for the audit of the subsidiaries' accounts	4	5
- Fees payable to the Company's auditors for other services:		
Tax	-	1
Other foreign exchange losses	56	-
Brokerage fees	502	895
Business development and corporate services	485	743
Other operating expense	483	1,183
	4,471	5,634

Included within both direct staff costs and management recharges relating to staff costs borne by other Morgan Stanley Group undertakings is an amount of $281 million (2008: $487 million) in relation to equity-settled share-based payment transactions. 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.

Fees payable to the Company's auditors for the audit of the Company's annual accounts is $97,000 (2008: $77,000).

7. SHARE OF LOSSES OF ASSOCIATES AND JOINT VENTURE

	Year ended 31 December 2009 $millions	1 December 2007 to 31 December 2008 $millions
Share of losses of associates and joint venture	-	(25)
	-	(25)

8. STAFF COSTS

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

	Year ended 31 December 2009	1 December 2007 to 31 December 2008
Company and institutional securities infrastructure	2,968	3,238
Business units and other	1,378	1,672
	4,346	4,910

The costs of the staff including Directors, are analysed below:

	Year ended 31 December 2009 $millions	1 December 2007 to 31 December 2008 $millions
Wages and salaries	1,316	1,199
Social security costs	127	113
Pension costs	38	64
	1,481	1,376

9. DIRECTORS' EMOLUMENTS

	Year ended 31 December 2009 $millions	1 December 2007 to 31 December 2008 $millions
Total emoluments of all Directors:		
Aggregate emoluments excluding pension contributions	30	34
Long term incentive schemes	1	-
Group contributions to pension schemes	-	1
Disclosures in respect of the highest paid Director:		
Aggregate emoluments excluding pension contributions	4	5

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

All Directors who are employees of the Group are eligible for shares and share options of the parent company, Morgan Stanley, awarded under the Group's equity based long term incentive schemes. In accordance with Schedule 5 paragraph 1(3)(a) of The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008, the above disclosures include neither the value of shares or share options awarded, nor the gains made on exercise of share options. During the year no Directors exercised share options awarded under these incentive schemes, including the highest paid Director (2008: nine).

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.

Of the Directors serving during the year, there were thirteen to whom retirement benefits were accruing under a money purchase scheme (2008: fourteen) and one director has benefits accruing under a US money purchase scheme (2008: one).

The Morgan Stanley UK Group Pension Plan operated a defined benefit pension scheme, which closed in September 1996. Two Directors have deferred defined benefits under the scheme (2008: two). In addition one Director serving during the year has benefits accruing under the Alternative Retirement Plan, a defined benefit scheme, operated by Morgan Stanley UK Limited (2008: one).

10. TAX ON PROFIT ON ORDINARY ACTIVITIES

Analysis of charge in the year

	Year ended 31 December 2009 $millions	1 December 2007 to 31 December 2008 $millions
UK corporation tax at 28% (2008: 28.62%)		
- Current year charge / (credit)	175	(269)
- Adjustment in respect of prior years	162	(15)
	337	(284)
Double taxation relief		
- Current year credit	(63)	(66)
- Adjustment in respect of prior years	49	14
Foreign Tax		
- Current year charge	226	508
- Adjustment in respect of prior years	(6)	(5)
Total current tax	543	167
Deferred taxation		
- Current year charge / (credit)	2	(52)
- Adjustment in respect of prior years	56	(1)
Tax on profit on ordinary activities	601	114

10. TAX ON PROFIT ON ORDINARY ACTIVITIES (CONTINUED)

Factors affecting the tax charge for the year

The current year UK taxation charge is higher (2008: lower) than that resulting from applying the standard UK corporation tax rate of 28% (2008: 28.62%). The main differences are explained below:

	Year ended 31 December 2009 $millions	1 December 2007 to 31 December 2008 $millions
Profit on ordinary activities before tax	1,214	659
Profit on ordinary activities multiplied by the standard rate of corporation tax in the UK of 28% (2008: 28.62%)	340	189
Effects of:		
Expenses not deductible for tax purposes	20	50
Non deductible interest expense	2	23
Depreciation for the year in excess of / (lower than) capital allowances	3	(5)
Non-taxable gain on sale of fixed asset investments	-	(18)
(Utilisation) / Carry forward of tax losses	(172)	173
Net Group relief surrendered for nil consideration to associated UK companies	25	73
Higher / (lower) rate taxes on overseas earnings	30	(144)
Adjustments to the tax charge in respect of prior periods	80	(8)
Reversal of / (Originating) timing differences relating to compensation	29	(131)
Underlying dividend withholding tax	-	4
Other income not subject to UK taxes	(8)	(23)
Withholding tax rebate	(9)	-
Tax reserves movement relating to prior periods	125	5
Currency translation on tax	5	(4)
Other timing difference	81	-
Other	(8)	(17)
Current tax charge for the year	543	167

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 undertakings outside the Group.

11. INTANGIBLE FIXED ASSETS

	Purchased goodwill $millions
Cost	
At 31 December 2008 and 31 December 2009	151
Amortisation	
At 31 December 2008	(113)
Charge for the year	(14)
At 31 December 2009	(127)
Net book value	
At 31 December 2009	24
At 31 December 2008	38

12. TANGIBLE FIXED ASSETS

	Freehold land and property $millions	Leasehold improve-ments $millions	Assets in the course of construction $millions	Fixtures, fittings and equipment $millions	Total $millions
Cost					
At 1 January 2009	3	910	36	742	1,691
Additions	-	1	44	21	66
Disposals	-	(109)	-	(8)	(117)
Transfers	-	53	(58)	5	-
At 31 December 2009	3	855	22	760	1,640
Depreciation					
At 1 January 2009	-	232	-	475	707
Charge for the year	-	91	-	85	176
Disposals	-	(106)	-	(7)	(113)
At 31 December 2009	-	217	-	553	770
Net book value					
At 31 December 2008	3	678	36	267	984
At 31 December 2009	3	638	22	207	870

Interest capitalised on assets in the course of construction included within additions during the year / period amounted to $2 million (2008: $2 million). The cumulative amount of interest capitalised in the total cost of tangible fixed assets amounts to $23 million (2008: $21 million). The interest capitalisation rate is based on the internal Group funding rates.

13. TANGIBLE FIXED ASSETS

Fixed asset investments classified as available-for-sale:

Fixed asset investments classified as available-for-sale are summarised in the table below:

	31 December 2009 $millions	31 December 2008 $millions
Corporate equities	163	193
	163	193

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

	31 December 2009 $millions	31 December 2008 $millions
Fair value		
At 1 January 2009 and 1 December 2007	193	6,379
Additions	-	6,684
Disposals	(38)	(11,440)
Changes in fair value:		
- recognised in equity	(3)	(31)
- recognised through the profit and loss account	-	(23)
Foreign exchange revaluation	11	(1,376)
At 31 December 2009 / 31 December 2008	163	193

Foreign exchange revaluation arises from assets held in entities with a non US dollar functional currency being translated into US dollars on consolidation by the Group.

All available-for-sale financial assets are expected to be held for a period of more than twelve months.

Investments in associated undertakings and joint venture

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

During the year, the Group sold its 40% interest in NBK Investment Management Limited ('NBKIM') which resulted in no gain or loss on disposal.

The remaining investment is a joint venture where the Group does not consolidate its 50% holding as it has significant influence rather than control.

The following illustrates the Group's aggregate investments in associates and joint venture:

	31 December 2009 $millions	31 December 2008 $millions
At the beginning of the year / period	13	209
Addition	-	8
Disposal	(6)	(179)
Share of loss for the year / period	-	(25)
At the end of the year / period	7	13

14. FINANCIAL ASSETS AND FINANCIAL LIABILITIES HELD FOR TRADING

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

	31 December 2009 Assets $millions	31 December 2009 Liabilities $millions	31 December 2008 Assets $millions	31 December 2008 Liabilities $millions
Government debt securities	15,091	(11,859)	13,051	(5,406)
Corporate equities	48,321	(17,563)	49,233	(13,463)
Corporate and other debt	24,281	(7,512)	19,086	(1,980)
Derivatives	167,958	(172,568)	223,278	(228,828)
	255,651	(209,502)	304,648	(249,677)

The fair value of the Group's derivative assets and liabilities (both listed and OTC) are summarised by class in the table below:

	31 December 2009 Assets $millions	31 December 2009 Liabilities $millions	31 December 2008 Assets $millions	31 December 2008 Liabilities $millions
Interest rate and currency swaps and options, credit derivatives and other fixed income securities contracts	93,150	(90,630)	116,859	(133,102)
Foreign exchange forward contracts and options	11,571	(11,774)	23,311	(24,312)
Equity securities contracts (including equity swaps, warrants and options)	44,552	(52,033)	67,421	(64,281)
Commodity forwards, options and swaps	18,685	(18,131)	15,687	(7,133)
	167,958	(172,568)	223,278	(228,828)

There were 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 Group.

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

Financial instruments designated at fair value through profit or loss consist primarily of the following financial assets and financial liabilities:

Prepaid Over the Counter ("OTC") contracts: The risk on these financial instruments, both financial assets and financial liabilities, is primarily hedged using financial instruments categorised as held for trading including equity securities and interest rate swaps. These prepaid OTC contracts are designated at fair value as such contracts, as well as the financial instruments with which they are hedged, are risk managed on a fair value basis as part of the Group's trading portfolio, and the risk is reported to key management personnel on this basis.

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

Other financial assets and liabilities: These include financial assets and liabilities such as those that arise upon the consolidation of certain special purpose entities 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:

	31 December 2009 Assets $millions	31 December 2009 Liabilities $millions	31 December 2008 Assets $millions	31 December 2008 Liabilities $millions
Prepaid OTC contracts	1,784	(2,213)	1,205	(1,213)
Structured notes	-	(670)	20	(1,273)
Other financial assets and liabilities	124	(4,996)	424	(4,860)
	1,908	(7,879)	1,649	(7,346)

Included within financial liabilities designated at fair value is an amount of $1,924 million (2008: $1,416 million) that is expected to be settled after more than twelve months.

The carrying amount of financial liabilities designated at fair value through profit or loss is $190 million higher than the contractual amount due at maturity. The change in fair value recognised through the consolidated profit and loss account attributable to own credit risk is a loss of $203 million (2008: $307 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.

16. CASH AT BANK

Included within cash at bank is an amount of $7,977 million (2008: $10,627 million) which represents segregated client money, held in accordance with the FSA's Client Money Rules, and an amount of $235 million (2008: $269 million) which represents other client money.

17. DEBTORS

	31 December 2009 $millions	31 December 2008 $millions
Debtors classified within loans and receivables at amortised cost		
Trade debtors:		
- External counterparties	40,304	41,212
- Morgan Stanley Group undertakings	13,122	12,354
Securities purchased under agreements to resell and cash collateral on stocks borrowed:		
- External counterparties	73,992	47,827
- Morgan Stanley Group undertakings	34,691	39,807
Corporate loans	2,723	1,218
Other amounts due from Morgan Stanley Group undertakings	4,674	4,649
Other debtors classified within loans and receivables	1,771	1,275
	171,277	148,342

Amounts falling due after more than one year included above are:

	31 December 2009 $millions	31 December 2008 $millions
Corporate loans: between one and five years	2,555	956
Corporate loans: over five years	168	262
	2,723	1,218

18. OTHER ASSETS

	31 December 2009 $millions	31 December 2008 $millions
Deferred taxation (see note 19)	130	195
Corporation tax	443	467
Other tax	254	416
Prepayments and accrued income	297	310
	1,124	1,388

19. DEFERRED TAX

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

	31 December 2009 $millions	31 December 2008 $millions
Accelerated capital allowances	(19)	(24)
Tax losses carried forward	-	172
Deferred compensation	121	92
Hedges of forecast currency transactions	(8)	(15)
Amounts not recognised due to unobservable market data	16	19
Other timing differences	31	(20)
Unrealised losses	(11)	(29)
	130	195

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

	$millions
At 1 January 2009	195
Current year timing differences	118
Prior year timing differences	(4)
Tax losses utilised	(172)
Amounts recognised in equity	(2)
Foreign exchange revaluation	(5)
At 31 December 2009	130

As at 31 December 2009, a total deferred tax asset of $78 million (2008: $27 million) in respect of losses carried forward at nil value has not been recognised due to uncertainty of the recoverability of the asset.

20. FINANCIAL LIABILITIES AT AMORTISED COST

	31 December 2009 $millions	31 December 2008 $millions
Financial liabilities at amortised cost falling due within one year		
Bank loans and overdrafts	427	906
Trade creditors:		
- External counterparties	54,545	48,540
- Morgan Stanley Group undertakings	10,766	7,296
Securities sold under agreements to repurchase and cash collateral on stocks loaned:		
- External counterparties	46,786	26,570
- Morgan Stanley Group undertakings	67,927	74,198
Corporate deposits	3,122	3,036
Other amounts owing to Morgan Stanley Group undertakings	14,782	27,335
Other financial liabilities	3,825	2,671
	202,180	190,552

Included in other amounts owing to Morgan Stanley Group undertakings are amounts of $3,309 million (2008: $4,714 million) representing cash collateral received as security for open trading positions held with other Morgan Stanley Group undertakings.

21. OTHER CREDITORS

	31 December 2009 $millions	31 December 2008 $millions
Amounts falling due within one year		
Corporation tax	512	249
Other taxes and social security costs	365	314
Accruals and deferred income	1,461	2,374
	2,338	2,937

22. CREDITORS (INCLUDING CONVERTIBLE SECURITIES): AMOUNTS FALLING DUE AFTER MORE THAN ONE YEAR

	31 December 2009 $millions	31 December 2008 $millions
Financial instruments issued:		
Subordinated loan agreements	10,591	14,937
Adjustable Redeemable Capital Securities ("ARCS")	-	44
Other long term creditors	51	52
	10,642	15,033

Subordinated loan agreements

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

Counterparty	Repayment date	Interest rate	31 December 2009 $millions	31 December 2008 $millions
Morgan Stanley International Holdings Inc.	31 July 2019	3 month LIBOR plus 1.25%	404	365
Morgan Stanley International Finance S.A.	30 Oct 2020	3 month LIBOR plus 1.25%	820	820
Morgan Stanley International Holdings Inc.	31 Oct 2021	6 month LIBOR plus 1.25%	1,300	1,300
Morgan Stanley International Holdings Inc.	15 Dec 2021	3 month LIBOR plus 1.25%	161	146
Morgan Stanley International Finance S.A.	31 Oct 2025	3 month LIBOR plus 1.25%	-	850
Morgan Stanley International Finance S.A.	31 Oct 2025	3 month LIBOR plus 1.25%	7,906	7,906
Morgan Stanley International Holdings Inc.	31 Oct 2026	LIBOR plus 1%	-	3,550
			10,591	14,937

All amounts outstanding are repayable at any time at the Group's option, subject to prior consent from the Financial Services Authority ("FSA").

22. CREDITORS (INCLUDING CONVERTIBLE SECURITIES): AMOUNTS FALLING DUE AFTER MORE THAN ONE YEAR (CONTINUED)

Movements in the Group's subordinated loan facilities in the year have been as follows:

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

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

ARCS

The ARCS were subordinated convertible securities issued by the Group and were due to mature in 40 years from the date of issue, which was 26 February 1997. They were convertible into ordinary $1 shares at any time at the option of the holder, subject to approval by the FSA. The ARCS prior to redemption would be convertible into 15,785,625 ordinary $1 shares of the issuer. The ARCS incurred interest equal to and payable at the time of any dividends paid on the shares into which the ARCS were convertible. If the holder did not convert the ARCS, the Group would be obligated to pay $125,000,000 on the maturity date, being 26 February 2037.

On 7 August 2009, the Group redeemed the ARCS held by Morgan Stanley International Holdings Inc, in accordance with an early redemption option. Under the terms of the ARCS, as they were not converted by the holder, the Group paid $125,000,000 in cash consideration on redemption.

Interest to accrete the value of the liability component of the ARCS was recognised in accordance with FRS 25 *Financial Instruments.* On the redemption date, the fair value of the liability component was calculated as $27 million and the balance restated to this amount. This resulted in a reversal of interest accreted in prior periods of $18m which is included within interest income in the consolidated profit and loss account.

On the redemption date, the fair value of the equity component was calculated as $98 million and the balance restated to this amount. This resulted in a gain of $16 million being recognised in reserves.

The liability and equity components were extinguished on payment of the $125,000,000 cash consideration.

23. PROVISIONS FOR LIABILITIES AND CHARGES

	Property $millions	Litigation $millions	Total $millions
At 1 January 2009	98	28	126
Additional provisions	45	15	60
Provisions utilised	(49)	(23)	(72)
Unwind of discount	3	-	3
Change in accounting estimates	(5)	-	(5)
Foreign exchange movements	6	1	7
At 31 December 2009	98	21	119

Property

Property provisions relate to the net present value of expected future costs of excess office space and to the expected future costs of reinstating premises held under operating leases at the end of the lease period. Provisions made are released in line with actual costs incurred.

23. PROVISIONS FOR LIABILITIES AND CHARGES (CONTINUED)

Litigation Matters

During the year the Group has been involved in various continuing litigation matters and provisions have been recognised and disclosed in accordance with FRS 12. The Directors are of the opinion that it would be seriously prejudicial to the position of the Group to disclose details of these individual continuing litigation matters and the amounts provided in respect of them.

On 25 September 2009, a subsidiary entity of 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 13 May 2010, the court granted Citi N.A.'s motion for judgement on the pleadings on its claim for breach of contract. The Group plans to appeal that decision and has asserted equitable counterclaims which are still pending. 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 Group.

24. RETIREMENT BENEFITS

The Group operates both defined benefit and defined contribution schemes for its employees. Details of the plans are below.

Defined contribution schemes

The Group operates or contributes to the following defined contribution schemes:

- the Morgan Stanley UK Group Pension Plan (the "Plan") and the Morgan Stanley UK Group Top-Up Pension Plan (the "Top-Up Plan"), which require contributions to be made to funds held in trust, separate from the assets of the Company
- the Morgan Stanley Investment Management (Athens Branch) Group Insurance Policy
- the Morgan Stanley Investment Management Luxembourg Branch Supplementary Pension Scheme
- 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
- Paschi Previdenza (a Milan multi employer defined contribution scheme)

Charges for the year in respect of Group defined contribution schemes, including management charges, totalled $59 million (2008: $88 million) of which $nil was accrued at 31 December 2009 (2008: $6 million).

24. RETIREMENT BENEFITS (CONTINUED)

Defined benefit plans

Morgan Stanley UK Group Defined Benefit Pension Plan

The Morgan Stanley UK Group Pension Plan has both defined benefit and defined contribution sections. On 1 October 1996 the defined benefit section of the Morgan Stanley UK Group Pension Plan was closed to new members and paid up in respect of existing members. On the same date the defined contribution section of the Morgan Stanley UK Group Pension Plan commenced, and active members of the Morgan Stanley UK Group Pension Plan were given the option to convert their accrued rights from the defined benefit section to the defined contribution section.

Under the Morgan Stanley UK Group's defined benefits plans, the amount of the pension benefit that a member is entitled to receive is dependent on factors such as years of service and salary. The Plan has been closed to new members since 1997. The Plan was previously open to permanent employees employed in the UK and, with the consent of the Trustees, other Morgan Stanley employees employed outside the UK who had at some point been members of the MSUK Group plan.

The pension scheme assets relating to the defined benefits section of the Plan are held in a separate Trustee-administered fund to meet long-term pension liabilities. The trustees of the Plan are required to act in the best interest of the Plan's beneficiaries. The appointment of trustees to the Plan is determined by the scheme's trust documentation. The Group has a policy that one third of trustees should be nominated by members of the Plan.

The most recent actuarial valuation of the defined benefit section of the Plan was carried out at 31 December 2009. The liabilities of the scheme 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. At the balance sheet date the accumulated benefit obligation was $148 million (2008: $132 million).

Defined benefit scheme expense

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

	2009 $millions	2008 $millions
Expected return on scheme assets	(6)	(9)
Interest on obligation	8	9
Total defined benefit scheme expense	2	-

The amounts as disclosed above have been included in interest income and interest expense respectively. Actuarial losses, of $8 million (2008: $6 million) after the impact of the surplus cap, have been recognised in the 'Statement of total recognised gains and losses'.

The cumulative amount of actuarial losses recognised in the 'Statement of total recognised gains and losses' before the impact of the surplus cap is $97 million (2008: $90 million).

24. RETIREMENT BENEFITS (CONTINUED)

Defined benefit plans (continued)

Retirement benefit asset

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:

	2009 $millions	2008 $millions
Present value of funded defined benefit obligation	(148)	(132)
Fair value of scheme assets	151	149
	3	17
Adjustment for ceiling	(3)	(17)
Retirement benefit asset recognised in the balance sheet	-	-

Contributions for the year to the closed defined benefit section of the Plan totalled $9 million (2008: $6 million), of which $nil was accrued at 31 December 2009 (2008: $nil). The Group expects to contribute $10 million (2008: $9 million) in the next financial year, based upon the current funded status and the expected return assumptions for the next financial year.

Following the actuarial valuation of the defined benefit scheme as at 31 December 2008, the Group's monthly contributions rate increased, with effect from 1 March 2009, from £258,000 to £500,000. The next actuarial valuation is due to be completed as at 31 December 2010. The Company will monitor funding levels on an annual basis. The Company considers that the contribution rates agreed with trustees are sufficient to eliminate the deficit over the agreed period and that regular contributions, which are based on service costs, will not increase significantly.

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

	2009 $millions	2008 $millions
Reconciliation of defined benefit obligations		
Opening defined benefit obligations	132	170
Interest cost	8	9
Actuarial (gain) / loss	(4)	6
Benefits paid	(3)	(1)
Foreign exchange rate changes	15	(52)
Benefit obligations at end of year / period	148	132

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

	2009 $millions	2008 $millions
Reconciliation of fair value of scheme assets		
Opening fair value of scheme assets	149	195
Expected return on scheme assets	6	9
Actuarial loss	(27)	-
Employer contributions	9	6
Benefits paid	(3)	(1)
Foreign exchange rate changes	17	(60)
Fair value of scheme assets at end of year / period	151	149
Actual return on fund assets	(21)	10

24. RETIREMENT BENEFITS (CONTINUED)

Defined benefit plans (continued)

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	
	2009	2008	2009	2008
	%	%	$millions	$millions
Equity securities	7.0	-	2	-
Fixed income securities	4.4	3.80	149	149
			151	149

The expected long-term rate of return on assets represents the Group'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 actual asset allocations. 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 stabilize plan contributions over the long run.

In conjunction with the trustees, the Group has recently conducted an asset-liability review for its major schemes. These studies are used to assist the trustees and the Group to determine the optimal long-term asset allocation with regard to the structure of liabilities within the scheme. The results of the study are used to determine the pension plans investment strategy by managing the risk of significant increases in the deficit and the volatility of the investment performance.

24. RETIREMENT BENEFITS (CONTINUED)

Defined benefit plans (continued)

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

	2009	2008
Pre retirement discount rate	5.70%	5.80%
Post retirement discount rate	4.50%	3.90%
Rate of increase in pensions in deferment	3.80%	2.90%
Inflation assumption	3.80%	2.90%
Expected long-term rate of return on plan assets:		
Bonds	4.40%	3.80%
Equities	7.00%	N/A

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

	Life expectancy at age 65 for a male member currently:		Life expectancy at age 65 for a female member currently:	
	Aged 65	Aged 45	Aged 65	Aged 45
31 December 2009				
UK	89.2	93.0	91.4	93.5
31 December 2008				
UK	87.9	91.6	90.5	92.6

The sensitivities regarding the principal assumptions used to measure the scheme liabilities 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%
Rate of increase in salaries	N/A	N/A
Rate of mortality	Increase by 1 year	Increase by 2%

The five year history of experience adjustments is as follows:

	2009 $millions	2008 $millions	2007 $millions	2006 $millions	2005 $millions
Present value of defined benefit obligation	148	132	170	151	120
Fair value of scheme assets	151	149	195	161	129
Surplus	3	17	25	10	9
Experience adjustments on scheme liabilities:					
Amount ($ millions)	-	-	(6)	-	-
Percentage of scheme liabilities (%)	-	-	3%	-	-
Experience adjustments on scheme assets					
Amount ($ millions)	27	-	3	(6)	(11)
Percentage of scheme assets (%)	18%	0%	(2)%	4%	8%

24. RETIREMENT BENEFITS (CONTINUED)

Defined benefit plans (continued)

Other Defined Benefits Schemes in the Group

In addition to the Morgan Stanley UK Group Pension Plan, the Group also operates several other defined benefits plans which provide post employment benefits dependent 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:

- a defined benefit multi-employer scheme operated by a fellow Morgan Stanley Group subsidiary and utilised by employees of the German branch of a Group subsidiary
- Morgan Stanley Bank International Ltd Milan Branch Termination Indemnity Plan
- Morgan Stanley Bank International Ltd Milan Branch Leaving Indemnity Plan
- Morgan Stanley Bank International Ltd Korean Branch Severance Pay Scheme
- Morgan Stanley & Co. International plc Paris Branch IFC (Indemnites de Fin de Carriere)
- Morgan Stanley France (SAS) Leaving Indemnity Plan (Indemnites de Fin de Carriere)
- Morgan Stanley & Co. International plc Seoul Branch Severance Pay Plan
- Morgan Stanley & Co. International plc Athens Branch Retirement Indemnity
- Morgan Stanley Investment Management Ltd Athens Branch Retirement Indemnity
- Morgan Stanley Asia (Taiwan) Limited Retirement Scheme
- Morgan Stanley & Co International plc Dubai Branch End of Service Gratuity Plan

Disclosures in respect of the above plans have been made on an aggregated basis.

Employees of the German Branch of the Group are part of a multi-employer defined benefits scheme. The scheme liabilities are re-insured with third party insurance companies. As the scheme is re-insured, no significant surplus or deficit exists. Contributions of $10,000 have been made to the scheme during the year (2008: $9,000).

Defined benefit scheme expense

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

	2009 $millions	2008 $millions
Current service cost	2	4
Interest on obligation	1	-
Total defined benefit scheme expense	3	4

Of the charge for the year, the amounts as disclosed above have been included in interest expense. Actuarial losses of $2 million (2008: $3 million gain) have been recognised in the 'Statement of total recognised gains and losses'.

The cumulative amount of actuarial gains and losses recognised in the 'Statement of total recognised gains and losses' is $nil (2008: $3 million gain).

24. RETIREMENT BENEFITS (CONTINUED)

Defined benefit plans (continued)

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 defined benefits schemes in the Group, excluding the MSUK Group Pension Plan:

	2009 $millions	2008 $millions
Present value of funded defined benefit obligation	(7)	(5)
Fair value of scheme assets	4	4
	(3)	(1)
Present value of unfunded defined benefit obligation	(6)	(5)
Deficit	(9)	(6)
Related deferred tax asset	1	1
Retirement benefit liability recognised in the balance sheet	(8)	(5)

Total contributions for the period to the Group's defined benefits plans totalled $2 million (2008: $4 million), of which $nil was accrued at 31 December 2009 (2008: $nil). The Group expects to contribute $1 million (2008: $1 million) in the next financial year, based upon the current funded status, and the expected return assumptions for the next financial year.

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

	2009 $millions	2008 $millions
Reconciliation of defined benefit obligations		
Opening defined benefit obligations	10	14
Current service cost	2	3
Interest cost	1	1
Actuarial loss / (gain)	2	(3)
Benefits paid	(1)	(3)
Liabilities extinguished on settlements	(2)	-
Foreign exchange rate changes	1	(2)
Benefit obligations at end of year / period	13	10

24. RETIREMENT BENEFITS (CONTINUED)

Defined benefit plans (continued)

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

Reconciliation of fair value of scheme assets	2009 $millions	2008 $millions
Opening fair value of scheme assets	4	4
Expected return on scheme assets	-	-
Actuarial gain / (loss)	-	-
Employer contributions	2	4
Benefits paid	(1)	(3)
Assets distributed on settlements	(2)	-
Foreign exchange rate changes	1	(1)
Fair value of scheme assets at 31 December	4	4
Actual return on fund 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	
	2009 %	2008 %	2009 $millions	2008 $millions
Insurance deposit	3.50%	0% - 5.50%	2	2
Bank deposit	2.5%	2.25%	2	2
			4	4

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

	2009	2008
Discount rate	2.25% - 7.05%	1.85% - 7.75%
Rate of increase in salaries	2.50% - 5.50%	2.25% - 6.25%
Inflation assumption	2.00%	2.00% - 5.00%
Expected long-term rate of return on plan assets	0% - 5.50%	0% - 5.75%

24. RETIREMENT BENEFITS (CONTINUED)

Defined benefit plans (continued)

Mortality assumptions are detailed for the respective Schemes below:

	2009	2008
Korean Plan	Korea Life Table 2006	Korea Life Table 2005
Taiwan Plan	Taiwan Standard Ordinary Mortality Table 2002	Taiwan Standard Ordinary Mortality Table 2002

The five year history of experience adjustments is as follows:

	2009 $millions	2008 $millions	2007 $millions	2006 $millions	2005 $millions
Present value of defined benefit obligation	13	10	14	76	44
Fair value of scheme assets	4	4	4	67	33
Deficit	(9)	(6)	(10)	(9)	(11)
Experience adjustments on scheme liabilities:					
Gain	(1)	(2)	-	-	(1)
Percentage of scheme liabilities (%)	0%-25%	-135%-45%	-18%-10%	-47%-63%	-1%
Experience adjustments on scheme assets					
Gain	-	-	-	2	3
Percentage of scheme assets (%)	-8%-6%	-7%-1%	-2%-4%	-5%-4%	8%

25. SHARE BASED PAYMENTS

Deferred stock awards

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

During the year Morgan Stanley granted 687,555 units of restricted common stock to employees of the Company with a weighted average fair value per unit of $27.91 (2008: 7,730,014 units, weighted average fair value $39.66), based on the market value of Morgan Stanley shares at grant date. The thirteen month reporting period in 2008 includes units of restricted stock granted for two fiscal year end awards. Units granted in respect of employees' 2009 discretionary compensation have been granted in January 2010.

Stock option awards

Morgan Stanley has also made stock option awards in the form of stock options on Morgan Stanley's common stock. The stock options generally have an exercise price of not less than the fair value of Morgan Stanley's common stock on the date of grant and generally become exercisable over a three year period, expiring ten years from the date of grant, subject to accelerated expiration upon termination of employment. Stock option awards have vesting, restriction and cancellation provisions that are similar to those in deferred stock awards.

The fair value of options granted has been determined using the Black Scholes Merton pricing model.

The expected option life has been determined based upon historical experience and the expected stock price volatility has been implied from options traded on Morgan Stanley stock.

The following table shows activity relating to the Group's stock option awards:

	2009	2009	2008	2008
	Number of options millions	Weighted average exercise price $	Number of options millions	Weighted average exercise price $
Options outstanding at 1 December 2007 and 1 January 2009	8	50.43	10	48.84
Transactions during the year / period				
Forfeited during the year / period	-	66.73	-	67.27
Exercised during the year / period	-	-	(1)	28.93
Expired during the year / period	(2)	45.19	(1)	47.18
Options outstanding at 31 December 2009 and 2008	6		8	
Options exercisable at end of year / period	6		8	

25. SHARE BASED PAYMENTS (CONTINUED)

There were no stock options exercised during the year. Stock options were exercised on a regular basis throughout 2008 of which the weighted average share price on exercise was $49.95.

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

	2009			2008		
Range of Exercise Prices	Number of options millions	Weighted average exercise price $	Weighted average remaining life in years	Number of options millions	Weighted average exercise price $	Weighted average remaining life in years
$30.00 - $39.99	1	36.18	2.91	2	34.49	2.7
$40.00 - $49.99	3	47.41	3.23	3	47.34	4.1
$50.00 - $59.99	1	55.09	0.90	1	53.69	1.6
$60.00 - $69.99	1	66.52	5.32	2	66.25	6.7
Total	6			8		

26. CALLED UP SHARE CAPITAL

	2009 Number millions	2008 Number millions
Authorised:		
Equity shares		
1,000 ordinary shares of £1 each	-	-
3,000,000,000 ordinary shares of $1 each	3,000	3,000

	31 December 2009 $millions	31 December 2008 $millions
Allotted and fully paid:		
Equity shares		
2 ordinary shares of £1 each	-	-
1,614,167,000 ordinary shares of $1 each	1,614	1,614
	1,614	1,614

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

27. RECONCILIATION OF SHAREHOLDERS' FUNDS AND MOVEMENTS ON RESERVES

Group

	Called up share capital $millions	Adjustable Redeemable Capital Securities $millions	Capital redemption reserve $millions	Foreign currency revaluation reserve $millions	Capital contribution reserve $millions	Pension reserve $millions	Fair value reserve $millions	Profit and loss account $millions	Minority Interest $millions	Total $millions
At 1 December 2007	1,614	114	150	440	141	(85)	25	8,314	585	11,298
Recognised gains and losses for the period	-	-	-	(1,081)	-	(3)	(54)	532	13	(593)
Share based payment transactions	-	-	-	-	-	-	-	14	-	14
Capital infusion	-	-	-	-	-	-	-	-	1,747	1,747
At 1 January 2009	1,614	114	150	(641)	141	(88)	(29)	8,860	2,345	12,466
Recognised gains and losses for the year	-	-	-	254	-	-	(3)	613	3	867
Preference share repurchase	-	-	1,250	-	-	-	-	(1,250)	-	-
Restatement of equity component of ARCs	-	(16)	-	-	-	-	-	16	-	-
ARCS Redemption	-	(98)	-	-	-	-	-	-	-	(98)
Actuarial loss	-	-	-	-	-	(10)	-	-	-	(10)
Capital infusion from entities under common control (see note 37)	-	-	-	-	-	-	-	50	-	50
Redemption of equity preference shares held by minority interest	-	-	-	-	-	-	-	-	(1,080)	(1,080)
Capital infusion by minority interest into preference shares	-	-	-	-	-	-	-	-	811	811
Dividends on preference shares held by minority interest	-	-	-	-	-	-	-	(170)	-	(170)
At 31 December 2009	1,614	-	1,400	(387)	141	(98)	(32)	8,119	2,079	12,836

Capital redemption reserve

The opening capital redemption reserve arose on a transfer from the profit and loss account of the par value of certain sterling preference shares, translated into US dollars at the rate prevailing at their redemption dates.

On 23 December 2009, a subsidiary of the Group repurchased and cancelled 1,250,000,000 Class C non-redeemable non-cumulative preference shares of $1 each which had been issued to another Group subsidiary. The repurchase was made out of distributable reserves and accordingly an amount of $1,250 million was transferred from retained earnings to the capital redemption reserve and is retained within the Group as it represents a non-distributable reserve in accordance with the Companies Act 2006.

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

Capital contribution reserve

The capital contribution reserve is non-distributable and was received from the Group's former immediate parent undertaking, to finance various Group acquisitions.

Foreign currency revaluation reserve

Currency exposures generated by subsidiaries and branches denominated in currencies other than US dollars are hedged by Morgan Stanley. Accordingly, the effect of such hedging activity is not reflected in these financial statements.

Minority interest

During the year, $1,080 million of equity preference shares issued by a subsidiary entity of the Group and held by a minority interest were redeemed.

This decrease was partially offset by the purchase by another Morgan Stanley Group entity, of an investment in equity preference shares of $811 million issued by a subsidiary of the Group.

28. SEGMENTAL REPORTING

Segment information is presented in respect of the Group's business and geographical segments. Both the primary format, business segments, and geographical segments are based on the Group's management and internal reporting structure.

Business segment

Morgan Stanley structures its business segments primarily based upon the nature of the financial products and services provided to customers and Morgan Stanley's internal management structure. The Group's own business segments are consistent with those of Morgan Stanley. The Group has one reportable business segment, Institutional Securities, which provides financial services to corporations, governments, financial institutions and individual investors including sales, trading, financing and market-making activities in equity and fixed income securities and related products, including foreign exchange.

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

Consolidated profit and loss account information **Year ended 31 December 2009**	**Institutional Securities** **$millions**	**Other** **$millions**	**Total** **$millions**
Net gains on financial instruments held for trading	4,827	112	4,939
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	(602)	40	(562)
Other income	909	326	1,235
External revenues net of interest expense	5,207	478	5,685
Other expense	(4,135)	(336)	(4,471)
Profit on ordinary activities before taxation	1,072	142	1,214
Balance sheet information			
Net assets	11,960	876	12,836

28. SEGMENTAL REPORTING (CONTINUED)

Business segment (continued)

Consolidated profit and loss account information 13 months ended 31 December 2008	**Institutional Securities $millions**	**Other $millions**	**Total $millions**
Net gains on financial instruments held for trading	2,739	46	2,785
Net gains on financial instruments designated at fair value through profit or loss	1,319	-	1,319
Net gains on available-for-sale financial assets	1,233	-	1,233
Net interest	(973)	106	(867)
Other income	1,048	759	1,807
External revenues net of interest expense	5,366	911	6,277
Other expense	(4,783)	(851)	(5,634)
Profit on ordinary activities	583	60	643
Share of losses of associate and joint venture	(25)	-	(25)
Net gain on disposal of subsidiary	41	-	41
Profit before taxation	599	60	659
Balance sheet information			
Net assets	11,444	1,022	12,466

28. SEGMENTAL REPORTING (CONTINUED)

Geographical Segment

The Group operates in both the Europe, Middle East and Africa ("EMEA") and non-EMEA markets. The following table presents selected profit and loss account and balance sheet information by geographic area. The operating profit or loss, profit or loss before tax and net assets disclosed in the following table reflect the regional view of the Group's operations, on a managed basis. The basis for attributing operating profit or loss, profit or loss before tax and net assets disclosed in the following table reflect the regional view of the Group's operations, on a managed basis determined by a combination of client and trading desk location.

Consolidated profit and loss account information Year ended 31 December 2009	**EMEA $millions**	**Americas $millions**	**Asia $millions**	**Total $millions**
Net gains / (losses) on financial instruments held for trading	5,078	(90)	(49)	4,939
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	(859)	99	198	(562)
Other income	779	408	48	1,235
External revenues net of interest expense	5,071	417	197	5,685
Other expense	(3,898)	(390)	(183)	(4,471)
Profit / (Loss) on ordinary activities before taxation	1,173	27	14	1,214
Balance sheet information				
Net assets	10,205	1,262	1,369	12,836

28. SEGMENTAL REPORTING (CONTINUED)

Geographical Segment (continued)

Consolidated profit and loss account information 13 months ended 31 December 2008	**EMEA $millions**	**Americas $millions**	**Asia $millions**	**Total $millions**
Net gains on financial instruments held for trading	2,314	175	296	2,785
Net gains on financial instruments designated at fair value through profit or loss	1,323	(4)	-	1,319
Net gains on available-for-sale financial assets	1,233	-	-	1,233
Net interest	(1,292)	178	247	(867)
Other income	1,593	211	3	1,807
External revenues net of interest expense	5,171	560	546	6,277
Other expense	(5,342)	(15)	(277)	(5,634)
(Loss) / profit on ordinary activities	(171)	545	269	643
Share of losses of associate and joint venture	(25)	-	-	(25)
Net gain on disposal of subsidiary	41	-	-	41
(Loss) / profit before taxation	(155)	545	269	659
Balance sheet information				
Net assets	4,402	2,046	6,018	12,466

29. FINANCIAL RISK MANAGEMENT

Risk is an inherent part of both Morgan Stanley's and the Group's business activity and is managed by the Group within the context of the broader Morgan Stanley Group. The Morgan Stanley Group seeks to identify, assess, monitor and manage each of the various types of risk involved in its business activities in accordance with defined policies and procedures. The Group's own risk management policies and procedures are consistent with those of the Morgan Stanley Group.

Significant risks faced by the Group resulting from its trading, financing and investment activities are set out below.

Credit risk

Credit risk refers to the risk of loss arising from a borrower or counterparty default.

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

The Group is exposed primarily to significant single-name credit risk, requiring credit analysis of specific counterparties, both initially and on an ongoing basis. Credit risk management takes place at the transaction, counterparty and portfolio levels. In order to help protect the Group from losses resulting from its business activities, the Group analyses all material lending and derivative transactions and ensures that the creditworthiness of the Group's counterparties and borrowers is reviewed regularly and that credit exposure is actively monitored and managed. The Group assigns obligor credit ratings to its counterparties and borrowers which are intended to assess a counterparty's probability of default and are derived using methodologies generally consistent with those used by external rating agencies. For lending transactions, the Group evaluates the relative position of its particular exposure in the borrower's capital structure and relative recovery prospects. Where applicable, the Group also considers collateral arrangements and other structural elements of the particular transaction. The Group has credit guidelines that limit potential credit exposure to any one borrower or counterparty and to aggregates of borrowers or counterparties; these limits are monitored and credit exposures relative to these limits are reported to key management personnel.

As well as assessing and monitoring its credit exposure and risk at the individual counterparty level, the Group also reviews its credit exposure and risk to geographic regions. As at 31 December 2009, credit exposure was concentrated in North America and Western European countries. In addition, the Group pays particular attention to smaller exposures in emerging markets given their higher risk profile. Country ceiling ratings are derived using methodologies generally consistent with those employed by external rating agencies.

The Group also reviews its credit exposure and risk to types of customers. At 31 December 2009, the Group's material credit exposure was to corporate entities (including financial institutions) and sovereign-related entities.

Collateral and other credit enhancements

The amount and type of collateral required by the Group depends on an assessment of the credit risk of the counterparty. Collateral held is managed in accordance with the Group's guidelines and the relevant underlying agreements. The market value of securities received as collateral is monitored on a daily basis and securities provided as collateral generally are not recognised on the consolidated balance sheet.

29. 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 2009 is disclosed below, based on the carrying amount of the financial assets the Group believes is subject to credit risk, without taking account of any collateral held or any other credit enhancement. Exposure arising from financial instruments not recognised on the consolidated balance sheet 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.

29. FINANCIAL RISK MANAGEMENT (CONTINUED)

Credit risk (continued)

Exposure to credit risk by class

Class	Gross credit exposure 31 December 2009 $millions	Gross credit exposure 31 December 2008 $millions
Loans and receivables:		
Cash at bank	14,480	20,887
Trade debtors:		
- External counterparties	22,140	30,114
- Morgan Stanley Group undertakings	15,127	13,534
Securities purchased under agreements to resell and cash collateral on stocks borrowed:		
- External counterparties	73,992	47,827
- Morgan Stanley Group undertakings	34,691	39,807
Other amounts due from Morgan Stanley Group undertakings	4,674	4,688
Other debtors	1,771	1,275
Financial assets held for trading;		
- OTC Derivatives	153,018	196,939
Financial instruments designated at fair value through profit or loss	1,908	1,649
	321,801	356,720
Unrecognised financial instruments		
Letters of credit	23	142
Lease commitments	106	131
Loan commitments	985	46
Unsettled reverse repos	18,458	11,994
	341,373	369,033

Maximum exposure to credit risk by credit rating

Credit rating	Gross credit exposure 31 December 2009 $millions	Gross credit exposure 31 December 2008 $millions
AAA	12,414	9,481
AA	88,705	126,962
A	178,827	167,096
BBB	14,222	8,182
BB	3,551	6,324
B	25,243	15,181
CCC	5,336	602
D	1	45
Unrated	13,074	35,160
Total	341,373	369,033

29. FINANCIAL RISK MANAGEMENT (CONTINUED)

Credit risk (continued)

At 31 December 2009, there were no loans and receivables past due but not impaired (2008: None). The carrying amount of renegotiated loans that would otherwise be past due or impaired totalled $1 million (2008: $25 million).

Loans and receivables individually impaired

The breakdown of the carrying amount of individually impaired loans and receivables by class are as follows:

2009	Loans and advances to banks $millions	Loans and advances to customers $millions	Total $millions
Carrying value before deducting impairment	-	198	198
Impairment loss	-	(123)	(123)
Carrying value after deducting impairment loss	-	75	75

2008	Loans and advances to banks $millions	Loans and advances to customers $millions	Total $millions
Carrying value before deducting impairment	36	-	36
Impairment loss	(34)	-	(34)
Carrying value after deducting impairment loss	2	-	2

The main considerations for the impairment assessment include whether there are any known difficulties in the cash flows of counterparties, credit rating downgrades, or infringement of the original terms of the contract. The Group determines the allowance appropriate for each individually significant loan and receivable on an individual basis. Items considered when determining the allowance amount include the sustainability of the counterparty's business plan, the counterparty's ability to improve performance once a financial difficulty has arisen, the realisable value of collateral, and the timing of expected cash flows. The impairment losses are evaluated at least at each reporting date. There is no collateral held by the Group in respect of loans and receivables individually impaired at 31 December 2009 (2008: $nil).

29. 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 and funding risk management tool. The CFP models multiple scenarios related to idiosyncratic, systemic or a combination of both types of events, across various time horizons. The CFP and liquidity risk exposures are evaluated on an on-going basis and reported to the Firm Risk Committee, Asset / Liability Management Committee, and other appropriate risk committees including the European Financial Risk Committee.

CFP is produced on a Morgan Stanley Group as well as major group and subsidiary level, including the Group, to capture specific cash requirements and cash availability at various legal entities. The CFP assumes that Morgan Stanley does not have access to cash that may be held at certain subsidiaries due to regulatory, legal or tax constraints but that the Group does have access to the cash or liquidity reserve held by Morgan Stanley along with all other Morgan Stanley subsidiaries.

The Morgan Stanley Group's and the Group's CFP model incorporates scenarios with a wide range of potential cash outflows during a liquidity stress event, including, but not limited to, the following: (i) repayment of all unsecured debt maturing within one year and no incremental unsecured debt issuance; (ii) maturity roll-off of outstanding letters of credit with no further issuance and replacement of cash collateral; (iii) return of unsecured securities borrowed and any cash raised against these securities; (iv) additional collateral that would be required by counterparties in the event of a multi-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; (viii) discretionary unsecured debt buybacks; (ix) no government support; and (x) limited access to the foreign exchange swap markets.

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

29. 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 balance sheet, 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 instruments held as part of the Group's trading activities are disclosed on demand and presented at fair value, consistent with how these financial liabilities are managed. Financial liabilities designated at fair value are disclosed according to their earliest contractual maturity; all such amounts are presented at their fair value, consistent with how these financial liabilities are managed. All other amounts represent undiscounted cash flows payable by the Group arising from its financial liabilities to earliest contractual maturities as at 31 December 2009. Repayments of financial liabilities that are subject to immediate notice are treated as if notice were given immediately and are classified as on demand. This presentation is considered by the Group to appropriately reflect the liquidity risk arising from those financial liabilities, presented in a way that is consistent with how the liquidity risk on these financial liabilities is managed by the Group.

29. FINANCIAL RISK MANAGEMENT (CONTINUED)

Liquidity risk (continued)

	On demand	Less than one 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	427	-	-	-	-	-	427
Trade Creditors:							
External counterparties	54,543	-	-	-	-	-	54,543
Group undertakings	10,766	-	-	-	-	-	10,766
Securities sold under agreements to repurchase and cash collateral on stocks loaned:							
External counterparties	2,221	37,195	5,938	957	500	-	46,811
Group undertakings	67,927	-	-	-	-	-	67,927
Other amounts owing to Morgan Stanley Group undertakings	12,410	-	2,373	-	-	-	14,783
Corporate deposits	3,122	-	-	-	-	-	3,122
Other financial liabilities	3,826	-	-	-	-	-	3,826
Other creditors	2,427	-	-	-	-	-	2,427
Creditors: amounts falling due after more than one year	-	13	26	119	636	12,178	12,972
Financial instruments:							
Derivatives	172,568	-	-	-	-	-	172,568
Other	36,934	-	-	-	-	-	36,934
Financial liabilities designated at fair value through profit or loss	4,745	104	91	521	1,293	1,125	7,879
Total financial liabilities	371,916	37,312	8,428	1,597	2,429	13,303	434,985
Unrecognised financial instruments							
Letters of credit	23	-	-	-	-	-	23
Lease commitments	-	1	2	8	24	71	106
Loan commitments	985	-	-	-	-	-	985
Unsettled reverse repurchase agreements	18,458	-	-	-	-	-	18,458
Total unrecognised financial instruments	19,466	1	2	8	24	71	19,572

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

29. FINANCIAL RISK MANAGEMENT (CONTINUED)

Liquidity risk (continued)

	On demand	Less than one 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 2008	**$millions**	**$millions**	**$millions**	**$millions**	**$millions**	**$millions**	**$millions**
Financial liabilities							
Financial liabilities at amortised cost:							
Bank loans and overdrafts	906	-	-	-	-	-	906
Trade Creditors:							
External counterparties	48,540	-	-	-	-	-	48,540
Group undertakings	7,296	-	-	-	-	-	7,296
Securities sold under agreements to repurchase and cash collateral on stocks loaned:							
External counterparties	6,307	14,194	3,996	2,115	-	-	26,612
Group undertakings	74,198	-	-	-	-	-	74,198
Other amounts owing to Morgan Stanley Group undertakings	27,335	-	-	-	-	-	27,335
Corporate deposits	3,036	-	-	-	-	-	3,036
Other financial liabilities	2,671	-	-	-	-	-	2,671
Other creditors	2,937	-	-	-	-	-	2,937
Creditors: amounts falling due after more than one year	54	32	64	290	1,547	19,293	21,280
Financial instruments:							
Derivatives	228,828	-	-	-	-	-	228,828
Other	20,849	-	-	-	-	-	20,849
Financial liabilities designated at fair value through profit or loss	5,031	24	116	758	964	453	7,346
Total financial liabilities	427,988	14,250	4,176	3,163	2,511	19,746	471,834
Unrecognised financial instruments							
Letters of credit	-	33	15	94	-	-	142
Lease commitments	-	2	5	20	35	69	131
Loan commitments	46	-	-	-	-	-	46
Unsettled reverse repurchase agreements	11,994	-	-	-	-	-	11,994
Total unrecognised financial instruments	12,040	35	20	114	35	69	12,313

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

29. FINANCIAL RISK MANAGEMENT (CONTINUED)

Market Risk

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

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

To execute these responsibilities, the Morgan Stanley Group monitors the market risk of the firm against limits on aggregate risk exposures, performs a variety of risk analyses and maintains the Value at Risk ("VaR") system. A variety of limits are designed to control price and liquidity risk. Market risk is monitored through various measures: statistically (using VaR and related analytical measures); by measures of position sensitivity; and through routine stress testing and scenario analyses. The material risks identified by these processes are summarised and reported to senior management.

The Group is managed within the Morgan Stanley Group's global framework. The market risk management policies and procedures of the Group are consistent with those of the Morgan Stanley Group, including reporting of material risks identified to appropriate key management personnel of the Group.

Primary market risk exposures and market risk management

During the year ended 31 December 2009, the Group had exposures to a wide range of interest rates, equity prices, foreign exchange rates and commodity prices and the associated implied volatilities and spreads, related to the global markets in which it conducts its trading activities. The Group is exposed to interest rate and credit spread risk as a result of its market-making activities and other trading in interest rate sensitive financial instruments (e.g. risk arising from changes in the level or implied volatility of interest rates, the shape of the yield curve and credit spreads). The activities from which those exposures arise and the markets in which the Group is active include, but are not limited to, the following: government debt, investment grade and non-investment grade corporate debt, interest rate derivatives, emerging market corporate and government debt, and distressed corporate debt.

The Group is exposed to equity price and implied volatility risk as a result of making markets in equity securities and derivatives as well as maintaining proprietary positions. The Group is exposed to foreign exchange rate and implied volatility risk as a result of making markets in foreign currencies and foreign currency derivatives and from holding non U.S. dollar-denominated financial instruments. The Group is exposed to commodity price and implied volatility risk as a result of market-making activities and maintaining positions in physical commodities (such as base metals) and related derivatives. Commodity exposures are subject to periods of high price volatility as a result of changes in supply and demand. These changes can be caused by physical production, transportation and storage issues; or geopolitical and other events that affect the available supply and level of demand for these commodities.

The Group, as part of the Morgan Stanley Group's global market risk management framework manages its trading positions by employing a variety of risk mitigation strategies. These strategies include diversification of risk exposures and hedging. Hedging activities consist of the purchase or sale of positions in related securities and financial instruments, including a variety of derivative products (e.g., futures, forwards, swaps and options). The Group manages the market risk associated with its trading activities on a Group basis, on a trading division level and on an individual product basis. The Group manages and monitors its market risk exposures in such a way as to maintain a portfolio that the Group believes is well-diversified in the aggregate with respect to market risk factors and that reflects the aggregate risk tolerance of key entities within the Group as established by the Group's key management personnel.

29. FINANCIAL RISK MANAGEMENT (CONTINUED)

Market Risk (continued)

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

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

VaR

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

VaR methodology, assumptions and limitations

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

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

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

29. FINANCIAL RISK MANAGEMENT (CONTINUED)

Market risk (continued)

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

VaR for the year ended 31 December 2009

The table below presents the Group's Trading, Non-trading and Aggregate VaR for each of the Group's primary market risk exposures at 31 December 2009 and 31 December 2008, incorporating substantially all financial instruments generating market risk that are managed by the Group's trading businesses. This measure of VaR incorporates most of the Group's trading-related market risks. However, a small proportion of trading positions generating market risk is not included in VaR, and the modelling of the risk characteristics of some positions relies upon approximations that, under certain circumstances, could produce different VaR results from those produced using more precise measures. Also, the non-trading VaR excludes the Group's own credit risk generated through counterparty trades and through primary issuance.

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

29. 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 As at 31 December 2009 Aggregate $millions	Trading $millions	Non-trading $millions	As at 31 December 2008 Aggregate $millions	Trading $millions	Non-trading $millions
Interest rate and credit spread	58	48	19	38	39	17
Equity price	13	13	2	15	15	3
Foreign exchange rate	8	8	2	7	5	3
Commodity price	3	3	-	1	1	-
Subtotal	82	72	23	61	60	23
Less diversification benefit(1)	17	17	4	23	24	6
Total VaR	65	55	19	38	36	17

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

The Group's trading VaR at 31 December 2009 was $55 million compared with $36 million at 31 December 2008. The increase in trading VaR is primarily due to increased interest rate and credit spread risk combined with reduced diversification benefit within the Group.

The Group views average trading VaR over the fiscal year as more representative of trends in the business than VaR at any single point in time. The table below, which presents the high, low and average 95%/one-day trading VaR during the year to 31 December 2009, represents substantially all of the Group's trading activities. Certain market risks included in the aggregate VaR discussed above are excluded from these measures.

95% One-day high/low/average Trading VaR primary market risk category	Year ended 31 December 2009 High $millions	Low $millons	Average $millions	13 month period ended 31 December 2008 High $millions	Low $millions	Average $millions
Interest rate and credit spread	72	39	51	50	20	31
Equity price	22	11	14	48	9	25
Foreign exchange rate	19	4	9	20	3	9
Commodity price	4	1	2	3	1	2
Trading VaR	87	36	53	60	29	41

Average Trading VaR for 2009 was $53 million, $12 million higher than the average trading VaR for the 13 month period to 31 December 2008, driven by an increase in interest rate and credit spread VaR, partially offset by reduced average equity VaR.

29. FINANCIAL RISK MANAGEMENT (CONTINUED)

Market Risk (continued)

Interest rate risk

The Group's VaR excludes certain funding liabilities and money market transactions. As at 31 December 2009, the net notional amount of such funding liabilities and money market activities was approximately $7.4 billion net asset compared to $24.5 billion net liability as at 31 December 2008. The application of a parallel shift (increase) in interest rates of 50 basis points to these positions would result in a net gain to the Group of approximately $9.2 million compared to $8.6 million as at 31 December 2008. A parallel shift (decrease) in interest rates of 50 basis points to these positions would result in a net loss of approximately $9.2 million compared to $8.6 million as at 31 December 2008.

Currency risk

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

The analysis below details the Group's foreign currency denominated monetary assets / (liabilities) at the end of the reporting period, by foreign currency, and calculates the impact on total comprehensive income of a reasonably possible parallel shift of the foreign currency against the US dollar, with all other variables held constant. This analysis does not take into account the effect of any foreign currency hedges held by other members of the Morgan Stanley Group

Foreign currency exposure	As at 31 December 2009 $millions	Parallel shift %	Sensitivity $millions	As at 31 December 2008 $millions	Parallel shift %	Sensitivity $millions
Australian Dollar	(5)	27%	1	(4)	27%	1
Euro	437	5%	22	(386)	5%	19
British Pound	1,867	29%	541	2,664	29%	773
Chinese Yuan	160	8%	13	172	8%	14
New Taiwan Dollar	92	3%	3	100	3%	3
New Zealand Dollar	2	24%	-	1	24%	-
Russian Rouble	269	24%	65	220	24%	53
Singapore Dollar	3	2%	-	8	2%	-
South Korean Won	347	42%	146	340	42%	143
Swedish Krona	14	23%	3	12	23%	3
	3,186			3,127		

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

30. FINANCIAL ASSETS ACCEPTED AS COLLATERAL

The Group accepts financial assets as collateral which, dependent on the terms of the arrangement, the Group is allowed to sell or repledge. The majority of the financial assets accepted as collateral are received as part of reverse repurchase agreements or securities borrowing and are mostly conducted under standard documentation used by financial market participants.

The fair value of collateral accepted under such arrangements as at 31 December 2009 was $156,057 million (2008: $112,828 million). Of this amount $129,613 million (2008: $109,945 million) has been sold or repledged to third parties in connection with financing activities, or to comply with commitments under short sale transactions.

31. 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 assets.

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 balance sheet.

	31 December 2009 $millions	31 December 2008 $millions
Government debt securities	9,655	11,704
Corporate and other debt	10,950	8,134
Corporate equities	45,260	36,678
	65,865	56,516

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.

32. FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE

a. *Fair value hierarchy*

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

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

Fair Value Control Processes

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

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

Financial assets and liabilities recognised at fair value

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

32. FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE (CONTINUED)

a. *Fair value hierarchy (continued)*

	As at 31 December 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 held for trading:				
- Government debt securities	11,920	3,169	2	15,091
- Corporate equities	47,352	857	112	48,321
- Corporate and other debt	10	20,677	3,594	24,281
- Derivatives	1,145	162,358	4,455	167,958
Total financial assets held for trading	60,427	187,061	8,163	255,651
Financial assets designated at fair value through profit or loss	-	497	1,411	1,908
Available-for-sale financial assets	-	-	163	163
Total financial assets held at fair value	60,427	187,558	9,737	257,722
Financial liabilities held for trading:				
- Government debt securities	10,585	1,274	-	11,859
- Corporate equities	16,125	1,434	4	17,563
- Corporate and other debt	69	7,405	38	7,512
- Derivatives	1,352	165,230	5,986	172,568
Total financial liabilities held for trading	28,131	175,343	6,028	209,502
Financial liabilities designated at fair value through profit or loss	-	6,987	892	7,879
Total financial liabilities at fair value	28,131	182,330	6,920	217,381

32. FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE (CONTINUED)

a. Fair value hierarchy (continued)

	As at 31 December 2008			
	Quoted prices in active market (Level 1) $millions	Valuation techniques using observable inputs (Level 2) $millions	Valuation techniques with significant non-observable inputs (Level 3) $millions	Total $millions
Financial assets held for trading:				
- Government debt securities	8,722	4,327	2	13,051
- Corporate equities	38,628	10,149	456	49,233
- Corporate and other debt	32	14,480	4,574	19,086
- Derivatives	1,115	211,500	10,663	223,278
Total financial assets held for trading	48,497	240,456	15,695	304,648
Financial assets designated at fair value through profit or loss(1)	-	513	1,136	1,649
Available-for-sale financial assets	4	-	189	193
Total financial assets held at fair value	48,501	240,969	17,020	306,490
Financial liabilities held for trading:				
- Government debt securities	3,368	2,038	-	5,406
- Corporate and other debt	17	1,643	320	1,980
- Corporate equities	11,967	1,459	37	13,463
- Derivatives	932	214,001	13,895	228,828
Total financial liabilities held for trading	16,284	219,141	14,252	249,677
Financial liabilities designated at fair value through profit or loss	-	6,481	865	7,346
Total financial liabilities at fair value	16,284	225,622	15,117	257,023

(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 represented as Level 2.

32. FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE (CONTINUED)

a. Fair value hierarchy (continued)

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

Government debt securities

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

Corporate equities and available-for-sale financial assets

- 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 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.

Corporate and other debt

- 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.

32. FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE (CONTINUED)

a. Fair value hierarchy (continued)

Corporate and other debt (continued)

- Corporate Bonds. The fair value of corporate bonds is estimated using recently executed transactions, market price quotations (where observable), bond spreads or credit default swap spreads adjusted for any basis difference between cash and derivative instruments. The spread data used are for the same maturity as the bond. If the spread data does not reference the issuer, then data that reference a comparable issuer is used. When observable price quotations are not available, fair value is determined based on cash flow models with yield curves, bond or single name credit default swap spreads and recovery rates based on collateral values as significant inputs. Corporate bonds are generally categorised in Level 2 of the fair value hierarchy; in instances where significant inputs are unobservable, they are categorised in Level 3 of the hierarchy.
- Collateralised Debt Obligations ("CDOs"). The Group holds CDOs where the collateral primarily is synthetic and references either a basket credit default swap or CDO-squared. The correlation input between reference credits within the collateral is unobservable and is benchmarked to standardized proxy baskets for which correlation data are available. The other model inputs such as credit spreads, interest rates and recovery rates are observable. CDOs are categorised in Level 2 of the fair value hierarchy when the correlation input is insignificant. In instances where the correlation input is deemed to be significant, these instruments are categorised in Level 3 of the fair value hierarchy.
- Corporate Loans and other lending commitments. The fair value of corporate loans is estimated using recently executed transactions, market prices quotations (where observable) and market observable loan credit default swap spread levels adjusted for any basis difference between cash and derivative instruments, along with proprietary valuation models and default recovery analysis where such transactions and quotations are unobservable. The fair value of contingent corporate loan commitments is estimated by using executed transactions on comparable loans and the anticipated market price based on pricing indications from syndicate banks and customers. The valuation of these commitments also takes into account certain fee income. Corporate loans and loan commitments are generally categorised in Level 2 of the fair value hierarchy; in instances where significant inputs are unobservable they are categorised in Level 3 of the hierarchy.

Derivatives

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

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

Depending on the product and the terms of the transaction, the fair value of OTC financial instruments can be modelled using a series of techniques, including closed-form analytic formulae such as the Black-Scholes option pricing model, simulation models or a combination thereof. Many pricing models do not entail material subjectivity because the methodologies employed do not necessitate significant judgement, and the pricing inputs are observed from actively quoted markets. In the case of more established derivative products, the pricing models used by the Group are widely accepted by the financial services industry. A substantial majority of OTC derivative products valued by the Group using pricing models are categorised within Level 2 of the fair value hierarchy.

32. FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE (CONTINUED)

a. Fair value hierarchy (continued)

Derivatives (continued)

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

Derivative interests in mortgage-related CDOs, for which observability of external price data is extremely limited, are valued based on an evaluation of the market for similar positions as indicated by primary and secondary market activity in the cash CDO and synthetic CDO markets. Each position is evaluated independently taking into consideration the underlying collateral performance and pricing, behaviour of the tranche under various cumulative loss and prepayment scenarios, deal structures (e.g., non-amortising reference obligations, call features) and liquidity. While these factors may be supported by historical and actual external observations, the determination of their value as it relates to specific positions nevertheless requires significant judgment and these interests are generally included in Level 3 of the fair value hierarchy.

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

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

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

Structured notes and prepaid OTC derivatives designated as fair value through profit or loss

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

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.

32. FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE (CONTINUED)

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

The following table presents the changes in the fair value of the Group's Level 3 financial assets and financial liabilities for the year ended 31 December 2009:

2009 $millions	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)
Financial assets held for trading:										
- Government debt securities	2	-	-	-	-	-	-	-	2	-
- Corporate equities	456	(63)	-	130	(131)	-	-	(280)	112	(34)
- Corporate and other debt	4,574	188	-	1,019	(996)	-	(123)	(1,068)	3,594	207
Financial assets designated at fair value through profit or loss:	1,136	643	-	3	-	-	(288)	(83)	1,411	643
Available-for-sale financial assets:										
- Corporate equities	189	11	(3)	-	(38)	-	-	4	163	-
Financial liabilities held for trading:										
- Government debt securities	-	-	-	-	-	-	-	-	-	-
- Corporate equities	(37)				(10)		33	10	(4)	-
- Corporate and other debt	(320)	6	-	-	(18)	-	275	19	(38)	(24)
- Net derivative contracts (3)	(3,232)	1,547	-	-	-	-	(3)	157	(1,531)	1,041
Financial liabilities designated at fair value through profit or loss:	(865)	30	-	-	-	(380)	565	(242)	(892)	30
	1,903	2,362	(3)	1,152	(1,193)	(380)	459	(1,483)	2,817	1,863

(1) For financial assets and financial liabilities that were transferred into and out of Level 3 during the year, gains or (losses) are presented as if the assets or liabilities had been transferred into or out of Level 3 as at the beginning of the year.

(2) Amounts represent unrealized gains or (losses) for the year ended 31 December 2009 related to assets and liabilities still outstanding at 31 December 2009.

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

32. FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE (CONTINUED)

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

For the period ended 31 December 2008, the total amount of the change in fair value of financial instruments held by the Group estimated using a valuation technique that includes unobservable market data was a net loss of $3,196 million.

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

During the year, the Group reclassified approximately $95 million of derivative contracts and structured notes from Level 2 to Level 3. The reclassifications primarily related to equity linked notes and were due to certain significant inputs for the fair value measurement becoming unobservable. The Group reclassified $43 million of loans and advances to customers from Level 2 to Level 3. The reclassifications were due to a reduction in the volume of recently executed transactions and market price quotations for these instruments, or a lack of available broker quotes, such that certain unobservable inputs became significant to the fair value measurement or certain significant inputs for the fair value measurement becoming unobservable.

During the year, the Group reclassified approximately $772 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. The Group reclassified $1,088 million of loans and advances to customers from Level 3 to Level 2. The reclassifications were mainly related to residential mortgages and were due to an increase in market price transparency of comparable instruments and portfolio specific refinancing activities which enables the significant observable inputs to be sourced from the market and specific transactional activities to be utilised for the fair value measurement.

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

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

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

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

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

32. FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE (CONTINUED)

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

The following table presents the sensitivity of the fair value of Level 3 financial assets and financial liabilities as at 31 December 2009 to reasonably possible alternative assumptions.

2009		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	112	3	(5)
- Corporate and other debt	3,594	150	(137)
Financial assets designated at fair value through profit or loss:			
- Prepaid OTC contracts	1,411	8	(8)
Available-for-sale financial assets:			
- Corporate equities	163	-	-
Financial liabilities classified as held for trading:			
- Government debt securities	-	-	-
- Corporate equities	(4)	-	-
- Corporate and other debt	(38)	3	(6)
- Net derivatives contracts[(1)]	(1,531)	217	(206)
Financial liabilities designated at fair value through profit or loss:			
- Prepaid OTC contracts	(188)	1	(1)
- Structured notes	(64)	1	(1)
- Other	(640)	30	(30)

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

For the period ended 31 December 2008, the potential impact of using reasonably possible alternative assumptions for the valuation techniques including unobservable market data was quantified as approximately $397 million, which could be either positive or negative.

32. FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE (CONTINUED)

e. Financial instruments valued using unobservable market data

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

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

The balance above predominantly relates to derivatives.

The balance sheet 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.

33. 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 2009	Carrying value $millions	Fair value $millions	Unrecognised gain / (loss) $millions
Financial assets and liabilities			
Subordinated loans	10,591	8,476	2,115
Termed reverse repurchase agreements	75,352	75,354	2
Termed repurchase agreements	59,262	59,267	(5)

31 December 2008	Carrying value $millions	Fair value $millions	Unrecognised gain / (loss) $millions
Financial assets and liabilities			
Subordinated loans	14,937	8,054	6,883
ARCS	44	18	26
Termed reverse repurchase agreements	37,864	37,869	5
Termed repurchase agreements	16,665	16,670	(5)

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

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

The Group considers the below to be its managed capital:

	2009 $millions	2008 $millions
Ordinary share capital	1,614	1,614
Subordinated loans	10,591	14,937
Reserves	9,143	8,507
	21,348	25,058

During 2009, the Group has continued to review and actively manage its capital position. As part of this capital management, the Group has repaid $4,400 million of intercompany subordinated debt.

35. COMMITMENTS AND CONTINGENCIES

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

Contingent liabilities	**31 December 2009 $millions**	**31 December 2008 $millions**
Letters of credit	23	142
	23	142

Commitments	**31 December 2009 $millions**	**31 December 2008 $millions**
Lease commitments	106	131
Loan commitments	985	46
Unsettled reverse repos	18,458	11,994
	19,549	12,171

During the next year, the Group is committed to pay $106 million (2008: $131 million) in respect of operating leases which expire:

	Land and buildings 2009 $millions	**Land and buildings 2008 $millions**
Maturity of lease:		
Within one year	11	27
In two to five years	24	35
Over five years	71	69
	106	131

36. ACQUISITION OF SUBSIDIARIES

On 22 December 2009, the Group purchased the entire share capital of Suffolk Trading B.V., for a consideration of $425 million, paid in cash. No goodwill arose as a result of this acquisition. For each class of identifiable asset and liability of the acquired entity, the carrying value immediately prior to acquisition equalled the fair value at acquisition.

The details of the combined value of assets and liabilities of the acquired entity at the date of purchase are as follows:

Total assets less total liabilities acquired	**Carrying value immediately prior to / Fair value on acquisition $millions**
ASSETS	
Amounts due from Morgan Stanley Group undertakings	451
Other receivables	7
TOTAL ASSETS	458
LIABILITIES	
Amounts due to other Morgan Stanley Group undertakings	26
Other payables	7
TOTAL LIABILITIES	33
NET ASSETS	425

Since acquisition, the acquired entity has contributed a gain of $nil to the Group's income for the year to 31 December 2009. Had this business combination been effected at 1 January 2009, the profit of the Group for year to 31 December 2009 would have increased by $11 million.

37. MORGAN STANLEY SMITH BARNEY

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

As part of the transaction, on 1 June 2009, the Group's European GWM introducing broker activities were reorganised and transferred to MSSB. The transaction occurred between entities which were considered under common control for accounting purposes and gave rise to recognition within equity of a net capital contribution of $50 million received from other Morgan Stanley Group companies. The Group will continue to provide certain ongoing services to support the European GWM business and will retain an interest in GWM in Asia. In the period from 1 January 2009 to 1 June 2009, GWM contributed an $11 million loss to the Group's results (13 months to 31 December 2008: $21 million profit).

38. RELATED PARTY TRANSACTIONS

The Group is exempt from the requirement to disclose transactions with fellow Morgan Stanley Group undertakings under paragraph 3(c) of FRS 8 *Related Party Disclosures.*

Fees in respect of investment management services of $794,000 (2008: $1,710,000) were earned during the year from NBK Investment Management Limited, a company which was an associated undertaking of the Company, until its disposal during the year. Of these amounts $230,000 (2008: $700,000) was outstanding at the balance sheet date.

There were no other related party transactions requiring disclosure.

39. POST BALANCE SHEET EVENTS

On 8 April 2010 the UK government enacted legislation as part of the 2010 Finance Act imposing a Bank Payroll Tax. The tax applies to discretionary bonuses over a certain amount awarded to certain employees within scope ("Banking Employees") in the period from 9 December 2009 to 5 April 2010. The liability for the tax is that of the entity that benefits from the services of the Banking Employees, rather than the employing entity. Management's best estimate of the amount required to settle the liability is $357 million and a charge has been recognised in 2010 when the legislation was enacted.

On 26 April 2010, a subsidiary entity of the Group bought back a proportion of its equity shares in issue, held by a minority interest. This minority interest, which was bought back, was included in the 31 December 2009 Minority Interest balance at $140 million.

On 22 September 2010, a subsidiary entity of the Group:

- paid a dividend of $66.8 million to minority interest holders of its equity shares.
- bought back and cancelled a proportion of its equity shares in issue, held by a minority interest.

This minority interest was included in the 31 December 2009 Minority Interest balance at $632 million.

On 28 April 2010, the Group paid a dividend of $1 billion on its ordinary shares. This dividend has not been accrued in the financial statements.

MORGAN STANLEY INTERNATIONAL LIMITED
Registration No. 3584019

COMPANY BALANCE SHEET
As at 31 December 2009

	Note	31 December 2009 $millions	31 December 2008 $millions
FIXED ASSETS			
Investments	3	4,113	4,113
		4,113	4,113
CURRENT ASSETS			
Debtors	4	10,960	12,730
		10,960	12,730
CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR	5	(11,073)	(13,390)
NET CURRENT LIABILITIES		(113)	(660)
TOTAL ASSETS LESS CURRENT LIABILITIES		4,000	3,453
CREDITORS: AMOUNTS FALLING DUE AFTER MORE THAN ONE YEAR	6	(1,900)	(1,300)
		2,100	2,153
CAPITAL AND RESERVES			
Called up share capital	7	1,614	1,614
Capital contribution reserve	8	138	138
Profit and loss account	8	348	401
EQUITY SHAREHOLDERS' FUNDS		2,100	2,153

These financial statements were approved by the Board and authorised for issue on 27 September 2010.

Signed on behalf of the Board

Director
CLARE WOODMAN

The notes on pages 79 to 83 form an integral part of the financial statements.

NOTES TO THE COMPANY FINANCIAL STATEMENTS
Year ended 31 December 2009

1. ACCOUNTING POLICIES

a) Basis of preparation

The financial statements are prepared under the historical cost convention and in accordance with applicable United Kingdom company law and accounting standards.

b) The going concern assumption

The Company is parent to a group of companies with a significant level of capital and resources, and operates within the global liquidity management framework of the Morgan Stanley Group. Accordingly 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 Company accounts and the notes to the Company accounts 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. Transactions in currencies other than US dollars are recorded at the rates prevailing at the dates of the transactions. All translation differences are taken through the profit and loss account.

e) Recognition of income and expense

i) Interest income and expense

Interest income and interest expense is recognised on an accruals basis.

ii) Dividend income

Dividend income is recognised when the Company's right to receive payment is established.

f) Fixed asset investments

Fixed asset investments are stated at cost, less provision for any impairment.

g) 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.

NOTES TO THE COMPANY FINANCIAL STATEMENTS
Year ended 31 December 2009

1. ACCOUNTING POLICIES (CONTINUED)

h) Cash flow statement

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

2. PROFIT FOR THE YEAR

The Company has taken advantage of the exemption, as permitted by section 408 of the Companies Act 2006, from presenting its own profit and loss account. The Company's loss after taxation for the year ended 31 December 2009 was $53 million (2008: $332 million profit). During the year, no dividends were paid to the holders of ordinary shares (2008: $nil). A $53 million loss will be carried to reserves (2008: $332 million profit carried to reserves).

3. FIXED ASSET INVESTMENTS

The Company's investments in subsidiary undertakings are as follows:

	$millions
Cost and net book value	
At 31 December 2008 and 2009	4,113

The principal subsidiary undertakings of the Company are as follows:

Name of company	Country of incorporation(if not incorporated within Great Britain)	Holding (per share class)	Type of shares held	Proportion of voting rights	Nature of business
Morgan Stanley & Co. International plc		100%	Ordinary shares*	100%	Financial services
Morgan Stanley Securities Limited		100%	Ordinary shares*	100%	Financial services
Morgan Stanley Bank International Limited		100%	Ordinary shares*	100%	Financial services
Morgan Stanley & Co. Limited		100%	Ordinary shares*	100%	Financial services
Morgan Stanley Equity Finance (Malta) Limited		100%	Ordinary shares*	100%	Financial services
Morgan Stanley Group(Europe)		100%	Ordinary shares	100%	Intermediate holding company
Morgan Stanley Strategic Funding Limited (formerly Morgan Stanley Dean Witter Trustee Limited)		100%	Ordinary shares	100%	Funding company
Morgan Stanley Investment Management Limited		100%	Ordinary shares*	100%	Financial services
Morgan Stanley UK Group		100%	Ordinary shares*	100%	Service company
Morgan Stanley UK Limited		100%	Ordinary shares*	100%	Service company
OOO Morgan Stanley Bank	Russian Federation	100%	Participation shares*	100%	Financial services

An * denotes shareholdings attributed to the Company which are held indirectly by the Company.

A full list of the Company's subsidiary and associate undertakings will be annexed to the Company's next Annual Return and filed with the Registrar of Companies.

4. DEBTORS

	2009 $millions	2008 $millions
Amounts due from Morgan Stanley Group undertakings	1,608	1,331
Amounts due from Group undertakings	9,352	11,399
	10,960	12,730

5. OTHER CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR

	31 December 2009 $millions	31 December 2008 $millions
Amounts owing to Morgan Stanley Group undertakings	4,714	11,249
Amounts owing to Group undertakings	6,359	2,141
	11,073	13,390

6. CREDITORS: AMOUNTS FALLING DUE AFTER MORE THAN ONE YEAR

	31 December 2009 $millions	31 December 2008 $millions
Subordinated loan agreements	1,300	1,300
Amounts due to Group undertakings		
- Long term loan	600	-
	1,900	1,300

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

Counterparty	Repayment date	Interest rate	31 December 2009 $millions	31 December 2008 $millions
Morgan Stanley International Holdings Inc.	31 Oct 2021	6 month LIBOR plus 1.25%	1,300	1,300
			1,300	1,300

All amounts outstanding are repayable at any time at the borrower's option, subject to prior consent from the Financial Services Authority ("FSA").

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

6. CREDITORS: AMOUNTS FALLING DUE AFTER MORE THAN ONE YEAR (CONTINUED)

Details of the remaining balance of the long term loan as at 31 December 2009 is as follows:

Counterparty	Repayment date	Interest rate	31 December 2009 $millions	31 December 2008 $millions
Morgan Stanley Finance (C.I.) Limited	Repayable on thirteen months notice by the counterparty	LIBOR-related managed rate	600	-
			600	-

7. CALLED UP SHARE CAPITAL

	31 December 2009 Number millions	31 December 2008 Number millions
Authorised:		
Equity shares		
1,000 ordinary shares of £1 each	-	-
3,000,000,000 ordinary shares of $1 each	3,000	3,000

	31 December 2009 $millions	31 December 2008 $millions
Allotted and fully paid:		
Equity shares		
1,614,167,000 ordinary shares of $1 each	1,614	1,614
	1,614	1,614

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

8. RECONCILIATION OF SHAREHOLDERS' FUNDS AND MOVEMENTS ON RESERVES

	Called up share capital $millions	Capital contribution reserve $millions	Profit and loss account $millions	Total $millions
At 1 December 2007	1,614	138	69	1,821
Profit for the period	-	-	332	332
At 1 January 2009	1,614	138	401	2,153
Loss for the year	-	-	(53)	(53)
At 31 December 2009	1,614	138	348	2,100

Capital contribution reserve

The capital contribution reserve is non-distributable and was received from the Group's former immediate parent undertaking, to finance various Group acquisitions.

9. COMMITMENTS AND CONTINGENCIES

The Company has provided a letter of financial support to two Morgan Stanley Group undertakings. In addition these undertakings have letters of support from the Group's ultimate parent. This support had not been called upon. It is considered unlikely that the letters of support would be called upon as these undertakings are funded by short-term loans from other Morgan Stanley Group undertakings. The maximum amount of support potentially required by the Company is $11,300 million, before taking into account the support provided to these entities by the Group's ultimate parent Morgan Stanley.

10. RELATED PARTY TRANSACTIONS

The Company is exempt from the requirement to disclose transactions with fellow Morgan Stanley undertakings under paragraph 3(c) of FRS 8 *Related Party Disclosures.*

11. PARENT UNDERTAKINGS

The Company's ultimate parent undertaking and controlling entity, and the largest group of which the Group 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. Copies of its financial statements can be obtained from 25 Cabot Square, Canary Wharf, London E14 4QA.