Morgan Stanley

Pillar 3 *Disclosure*

As at December 2011 and June 2012

1. BASEL II ACCORD

The Basel II Accord as detailed in "International Convergence of Capital Measurement and Capital Standards: A Revised Framework – Comprehensive Version" June 2006, has been implemented in the European Union via the Banking Consolidation Directive and the Capital Adequacy Directive collectively known as the Capital Requirements Directive ("CRD").

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

2. BACKGROUND TO PILLAR 3 DISCLOSURES

Morgan Stanley Smith Barney Holdings (UK) Limited and its subsidiaries ("MSSBH UK Group") ultimate parent undertaking and controlling entity is Morgan Stanley, a Delaware corporation, which, together with its consolidated subsidiaries, form the Morgan Stanley Group ("Morgan Stanley Group"). Morgan Stanley is a "Financial Holding company" as defined by the Bank Holding Company Act of 1956, as amended, and is subject to regulation by the Board of Governors of the Federal Reserve System.

Morgan Stanley currently calculates its capital ratios and risk-weighted assets in accordance with the capital adequacy standards for Financial Holding companies adopted by the Federal Reserve, which are based upon a framework described in the "International Convergence of Capital Measurement and Capital Standards," July 1988, as amended, also referred to as "Basel I". U.S. banking regulators are in the process of incorporating the Basel II Accord into the existing risk–based capital requirements and Morgan Stanley is working with its regulators accordingly to transition to these requirements.

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

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

Public disclosures, including those required under Pillar 3 by the Financial Services Authority ("FSA"), will continue to evolve over time. The qualitative and quantitative information contained in this document represents the position of MSSBH UK Group as at 31 December 2011 and as at 30 June 2012. Amendments to MSSBH UK Group's operating model and risk management procedures that have occurred following this date are not discussed in this document.

The majorities of the numerical disclosures in the document are calculated by reference to FSA's methodology for risk exposure and are not necessarily the primary exposure measures used by internal management. The calculation of exposure in this document is based on the calculation methodology for regulatory risk exposure prescribed in the FSA handbook.

This document does not constitute a set of financial statements. MSSBH UK Group's financial statements have been prepared in accordance with applicable United Kingdom ("UK") law and International Financial Reporting Standards ("IFRS") as adopted by the European Union ("EU"). Information disclosed in MSSBH UK Group financial statements will not necessarily be consistent with information disclosed in this document. Trading Book and Non Trading Book definitions used in this document refer to the regulatory view and may differ from the accounting definitions.

3. APPLICATION OF THE PILLAR 3 FRAMEWORK

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

The basis of consolidation for prudential purposes is materially the same as consolidation for accounting purposes. MSSBH UK Group completes its prudential consolidation in compliance with BIPRU8. MSPWM and Quilter (as defined below) are significant subsidiaries of MSSBH UK Group. Therefore both capital and capital requirements have been disclosed at a subsidiary level. The principal subsidiary undertakings of MSSBH UK Group are listed in the annual financial statements of MSSBH UK Group, Company disclosures note 4. In this document references to annual financial statements refers to the audited financial statements for the year ended 31 December 2011.

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

4. MORGAN STANLEY SMITH BARNEY HOLDINGS (UK) LIMITED

The principal activity of MSSBH UK is the provision of financial services to individual investors, corporations and financial institutions on a discretionary or advisory basis.

As at 31 December 2011 the following entities within MSSBH UK Group were regulated by the FSA:

- Morgan Stanley Private Wealth Management Limited ("MSPWM")
- Quilter & Co Limited
- Quilter Fund Management Limited

In April 2012 Quilter & Co Limited and Quilter Fund Management Limited ("Quilter") was sold to Bridgepoint, a private equity company. The Quilter businesses were contributed into MSSBH UK on the 1st of June 2009. Quilter is a Wealth Management business focused on the mass affluent market segment. The sale of Quilter was the result of MSSBH UK's decision to focus on ultra high net worth clients in Wealth Management.

The FSA regulated MSSBH UK Group includes all the entities that form part of the accounting consolidation group. As at 31 December 2011 and as at 30 June 2012, there were no entities which were deducted from MSSBH UK Group's capital resources. MSSBH UK Group calculates capital requirements in accordance with the regulatory capital requirements of the FSA and, in turn, with guidelines described under the Basel II Accord.

5. CAPITAL RESOURCES

Under FSA supervision, MSSBH UK Group is required to maintain a minimum ratio of total capital resources to capital requirements. The FSA handbook can be found at **http://fsahandbook.info/FSA/html/handbook/BIPRU**. All capital resources are included in Tiers 1 and 2 and are of standard form. The main terms and conditions of the capital instruments disclosed below are disclosed in MSSBH UK Group financial statement, see note 17 for subordinated debt disclosures and note 21 for share capital disclosures.

The table below shows the financial resources of MSSBH UK Group as at 31 December 2011 based upon the audited financial statements and as at 30 June 2012 based on the management accounts.

Capital Resources Table

As at 31/12/2011	Quilter 2011 $'000	MSPWM 2011 $'000	MSSBH UK Group 2011 $'000
Permanent share capital	14,748	1	–
Profit and loss account and other reserves	65,573	(23,422)	12,489
Share premium account	–	80,550	180,551
Less: Intangible assets	(945)	(17,434)	(30,191)
Tier 1 capital resources	79,376	39,695	162,849
Tier 2 capital resources	-	19,911	20,000
Tier 1 plus tier 2 capital after deductions	79,376	59,606	182,849
Tier 3 capital resources	–	–	–
Less: Deductions from total capital	(40)	–	(40)
Total capital resources, net of deductions	**79,336**	**59,606**	**182,809**

As at 30/06/2012	MSPWM June 2012 $'000	MSSBH UK Group June 2012 $'000
Permanent share capital	1	–
Profit and loss account and other reserves	57,173	16,401
Share premium account	30,000	180,551
Less: Intangible assets	(17,180)	(17,180)
Tier 1 capital resources	69,994	179,772
Tier 2 capital resources	20,000	20,000
Tier 1 plus tier 2 capital after deductions	89,994	199,772
Tier 3 capital resources	–	–
Less: Deductions from total capital	–	–
Total capital resources, net of deductions	**89,994**	**199,772**

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

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

6. REGULATORY CAPITAL REQUIREMENTS

MSSBH UK Group calculates Pillar 1 capital requirements in accordance with the regulatory capital requirements of the FSA. As at 31 December 2011 and as at 30 June 2012, MSSBH UK Group had the following capital requirements:

Capital Requirements Table

As at 31/12/2011	Quilter 2011 $'000	MSPWM 2011 $'000	MSSBH UK Group 2011 $'000
Credit risk capital component	7,383	3,651	11,670
Counterparty risk capital component	71	0	71
Market risk capital component	378	545	3,152
Operational risk - Basic Indicator Approach	14,863	19,312	34,175
Total capital requirements	**22,695**	**23,508**	**49,068**

As at 30/06/2012	MSPWM June 2012 $'000	MSSBH UK Group June 2012 $'000
Credit risk capital component	3,731	8,028
Market risk capital component	443	539
Operational risk - Basic Indicator Approach	18,244	18,244
Total capital requirements	**22,418**	**26,811**

Credit and counterparty risk capital components reflect capital charges attributable to the risk of loss arising from a borrower or counterparty failing to meet its financial obligations. Risk weighted exposures are determined using the standardised approach (see section 10 on Credit Risk).

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

Operational risk capital charges are designed to account for the risk of losses due to inadequate or failed internal processes, people and systems, or external events and take into account legal risk. Capital requirements for operational risk are currently calculated using the Basic Indicator Approach ("BIA") (see section 12 on Operational Risk).

7. APPLICATION OF THE PILLAR 2 FRAMEWORK

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

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

8. RISK MANAGEMENT OBJECTIVES AND POLICIES

Risk is an inherent part of MSSBH UK Group's business activity and is managed by MSSBH UK Group within the context of the Morgan Stanley Group global framework. 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. MSSBH UK Group's own risk management objectives, policies and procedures are consistent with those of Morgan Stanley Group.

As noted previously, Morgan Stanley is required to make quarterly filings with the SEC. For further discussion of Morgan Stanley's risk management objectives, policies and procedures, see pages 100-124 of 31 December 2011 Form 10-K.

9. ACCOUNTING POLICIES

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

10. CREDIT RISK

10.1 Credit Exposure

Morgan Stanley Group manages credit risk exposure on a global basis, but in consideration of each individual legal entity. The credit risk management policies and procedures of Morgan Stanley Group includes 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 MSSBH UK Group are consistent with those of Morgan Stanley Group and include escalation to appropriate key management personnel of MSSBH UK Group.

MSSBH UK Group is exposed primarily to 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 MSSBH UK Group from losses resulting from its business activities, MSSBH UK Group analyses all material lending and ensures that the creditworthiness of MSSBH UK Group's counterparties and borrowers is reviewed regularly and that credit exposure is actively monitored and managed.

For lending transactions, MSSBH UK Group evaluates the relative position of its particular exposure in the borrower's capital structure and relative recovery prospects. Where applicable, MSSBH UK Group also considers collateral arrangements and other structural elements of the particular transaction. MSSBH UK Group business is exposed to credit risk through margin lending to its MSPWM clients. MSPWM margin loan book is housed on the UK broker dealer, Morgan Stanley & Co International plc ("MSIP"). The full business economics are transferred to MSPWM. Demand loans are callable with short notice periods. Proposed loans are subject to review and approval by the appropriate risk and credit committees. MSSBH UK Group has dedicated staff to carry out its credit risk management in accordance with the direction set by MSSBH UK Group Risk Management and Firm Risk Management functions. There are strict controls around collateral management, including the type of collateral, collateral levels and legal title.

Details on the impairment of financial and non-financial assets are in MSSBH UK Group financial statement notes to the consolidated financial statements, notes 3e and 3f. For accounting purposes at each reporting date an assessment is made as to whether there is any objective evidence of impairment in the value of a financial asset classified as either available-for-sale or loans and receivables. Impairment losses are recognised if an event has occurred which will have an adverse impact on the expected cash flows of an asset and the expected impact can be reliably estimated. Non-financial assets that are subject to amortization are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. There were no impaired exposures for the period reported, therefore no provisions were made for impaired exposures.

10.2 Counterparty and Credit Risk Capital Component ("CRCC")

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

The FSA industry type is aligned with the classifications set out in BIPRU. Institutions include financial institutions and credit institutions. A standardised approach is used for all asset categories. The nominated external credit assessment institution ("ECAI") is Standard and Poor's ("S&P") which has been used for all standardised credit risk exposure classes. Note that where a counterparty is unrated and has a risk weight of 100%, a Credit Quality Step of 3 has been assigned.

10.3 Credit Exposure Breakdown table

Standardised Approach Exposure Table

As at 31/12/2011	Credit Quality Step	Total Gross Exposure $'000	Total Exposure Value Covered by Eligible Financial Collateral $'000	Exposure Value after Credit Mitigation $'000	Credit Risk Capital Component $'000
Collective investment undertakings	1	12,017	0	12,017	192
Collective investment undertakings	3	19,916	18,041	1,875	150
Corporate	3	137,842	114,569	23,273	1,862
Institutions	2	90,040	0	90,040	1,441
Institutions	3	50,864	2,119	48,745	954
Other	1	27	0	27	0
Other	3	15,787	0	15,788	1,353
Retail	3	71,479	0	71,479	5,718
Total		**397,972**	**134,729**	**263,244**	**11,670**

As at 30/06/2012	Credit Quality Step	Total Gross Exposure $'000	Total Exposure Value Covered by Eligible Financial Collateral $'000	Exposure Value after Credit Mitigation $'000	Credit Risk Capital Component $'000
Collective investment undertakings	1	10,017	0	10,017	160
Collective investment undertakings	3	4,790	2,922	1,868	149
Corporate	3	124,908	104,189	20,719	1,657
Institutions	1	139,151	0	139,151	2,226
Institutions	2	205,947	0	205,947	3,295
Institutions	3	7,916	1,000	6,916	220
Institutions	4	344	0	344	13
Other	1	139	0	139	0
Other	3	2,570	0	2,570	308
Total		**495,782**	**108,111**	**387,671**	**8,028**

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

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

Geographical breakdown of EAD

Geographical breakdown of EAD

As at 31/12/2011	Americas $'000	EMEA $'000	Asia $'000	Total $'000
Collective investment undertakings	12,017	1,821	54	13,892
Institutions	5,543	132,408	834	138,785
Corporate	293	22,946	34	23,273
Other	0	15,815	0	15,815
Retail	0	71,479	0	71,479
Total	**17,853**	**244,469**	**922**	**263,244**

Geographical breakdown of EAD

As at 30/06/2012	Americas $'000	EMEA $'000	Asia $'000	Total $'000
Collective investment undertakings	10,017	1,817	50	11,885
Institutions	3,931	348,035	392	352,358
Corporate	867	19,816	37	20,719
Other	0	2,709	0	2,709
Total	**14,815**	**372,377**	**479**	**387,671**

As well as assessing and monitoring its credit exposure and risk at the individual counterparty level, MSSBH UK Group also reviews its credit exposure and risk to geographic regions. As at 31 December 2011 and as at 30 June 2012, credit exposure was concentrated in Western Europe. In addition, MSSBH UK Group pays particular attention to exposures in emerging markets and exposures in Greece, Ireland, Italy, Portugal and Spain ("GIIPS") given their higher risk profile.

MSSBH UK Group also reviews its credit exposure and risk to different types of customers. As at 31 December 2011, the MSSBH UK Group's material credit exposure was to institutions, retail (which are primarily individuals) and corporate. As at 30 June 2012, the MSSBH UK Group's material credit exposure was to institutions, corporate and collective investment undertakings.

10.4 Credit Risk Mitigation

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

Netting

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

Collateral

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

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

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

11. MARKET RISK

Sound market risk management is an integral part of the Morgan Stanley Group's culture. The business units are responsible for ensuring that market risk exposures are well managed and prudent. The control groups help ensure that these risks are measured and closely monitored and are made transparent to senior management. The Market Risk department is responsible for ensuring transparency of material market risks, monitoring compliance with established limits and escalating risk concentrations to appropriate senior management.

11.1 Market Risk in the Trading Book

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

11.2 Interest Rate Risk in the Non-trading Book

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

12. OPERATIONAL RISK

12.1 Overview

Operational risk refers to the risk of financial or other loss, or potential damage to the firm's reputation, resulting from inadequate or failed internal processes, people, resources, or systems, or from other internal or external events (e.g. internal or external fraud, legal and compliance risks and damage to physical assets). MSSBH UK Group may incur operational risk across its full scope of business activities, including revenue generating activities (e.g. advisory and discretionary activities) and support functions (e.g. information technology and facilities management). Legal, residual, regulatory, reputational and valuation risk are included in the scope of operational risk. Operational risk is an inherent part of the business and activities of MSSBH UK Group. The extent to which MSSBH UK group properly identifies, assesses, monitors and mitigates the operational risks associated with business activities is critical to its soundness and profitability. For completeness, all legal entities, business and support divisions within MSSBH UK Group are considered for operational risk and capital adequacy purposes.