

Registered Number: 02068222

Registered Office:

25 Cabot Square

Canary Wharf

London E14 4QA

MORGAN STANLEY & CO. INTERNATIONAL plc

Half-yearly financial report

30 June 2013

MORGAN STANLEY & CO. INTERNATIONAL plc

CONTENTS

	Page
Interim management report	1
Directors' responsibility statement	11
Independent review report to Morgan Stanley & Co. International plc	12
Condensed consolidated income statement	13
Condensed consolidated statement of comprehensive income	14
Condensed consolidated statement of changes in equity	15
Condensed consolidated statement of financial position	16
Condensed consolidated statement of cash flows	17
Notes to the condensed consolidated financial statements	18

MORGAN STANLEY & CO. INTERNATIONAL plc

INTERIM MANAGEMENT REPORT

The Directors present their interim management report and the condensed consolidated financial statements (“Interim Financial Statements”) of Morgan Stanley & Co. International plc (the “Company”) and all of its subsidiary and associated undertakings (together the “Group”), for the six month period ended 30 June 2013. This interim management report has been prepared for the Group as a whole and therefore gives greater emphasis to those matters which are significant to the Company and its subsidiary and associated undertakings when viewed as a whole.

The interim management report contains certain forward-looking statements. These statements are made by the Directors in good faith based on the information available at the time of their approval of this report and such statements should be treated with caution due to the inherent uncertainties, including both economic and business risk factors, underlying any such forward-looking information.

RESULTS AND DIVIDENDS

The Group made a loss after tax in the six month period to 30 June 2013 of \$192 million (30 June 2012: \$249 million profit). No interim dividends were paid or declared (30 June 2012: \$nil).

PRINCIPAL ACTIVITY

The principal activity of the Group is the provision of financial services to corporations, governments and financial institutions. There have not been any changes in the Group’s principal activity in the period under review other than on 1 January 2013, on which date the financial advisory business conducted by another United Kingdom (“UK”) Morgan Stanley Group undertaking, Morgan Stanley & Co. Limited (“MSCL”), was contributed to the Group. Further details are provided within the business review section below.

Since 1 April 2013 the Company has been authorised by the Prudential Regulation Authority (“PRA”) and regulated by the Financial Conduct Authority (“FCA”) and the PRA. Prior to 1 April 2013 the Company was authorised and regulated by the Financial Services Authority (“FSA”).

The Company operates branches in the Dubai International Financial Centre, France, Korea, the Netherlands, New Zealand, Poland, the Qatar Financial Centre and Switzerland.

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

The Morgan Stanley Group is a global financial services firm that maintains significant market positions in each of its business segments: Institutional Securities, Wealth Management and Investment Management. The Morgan Stanley Group provides a wide variety of products and services to a large and diversified group of clients and customers, including corporations, governments, financial institutions and individuals. As a key contributor to the execution of the Morgan Stanley Group’s Institutional Securities strategy in Europe, the Middle East and Africa (“EMEA”), the Group provides capital raising; financial advisory services, including advice on mergers and acquisitions, restructurings, real estate and project finance; corporate lending; sales, trading, financing and market-making activities in equity and fixed income securities and related products, including foreign exchange and commodities; and investment activities.

BUSINESS REVIEW

During the six month period ended 30 June 2013, market and economic conditions improved modestly from 2012 year end. The United States (“US”) economy continued to grow moderately despite payroll and income tax increases that were implemented in January 2013. Europe remained in recession, but market strains associated with the European financial crisis continued to ease after temporary concerns that were raised by election results in Italy and developments in Cyprus subsided. Despite these improvements, global market and economic conditions continued to be challenged by investor concerns about the scaling back of the US monetary policy, the remaining European sovereign debt issues, the need to raise the US federal debt ceiling and reduce government spending, and slowing economic growth in emerging markets.

MORGAN STANLEY & CO. INTERNATIONAL plc

INTERIM MANAGEMENT REPORT

BUSINESS REVIEW (CONTINUED)

At 30 June 2013, major European equity market indices were higher compared with the beginning of the year, primarily due to investors' optimism about Europe's progress in addressing its sovereign debt issues. In the euro area, the unemployment rate increased to a record 12.1% in June 2013 from 11.7% at 2012 year end. At 30 June 2013, the Bank of England's benchmark interest rate was 0.5%, which was unchanged from 31 December 2012. To stimulate economic activity in Europe, in early May 2013 the European Central Bank lowered the benchmark interest rate from 0.75% to 0.5% and indicated it will keep open its special liquidity facilities until at least the middle of 2014. Euro area manufacturing expanded in July 2013 for the first time in two years, led by Germany, signalling the euro zone economy is emerging from recession.

The Group continues to actively manage its country risk exposure. Details of its country risk exposures are provided on pages 6 and 7 of the Interim Management Report.

The condensed consolidated income statement for the six month period to 30 June 2013 is set out on page 13. The Group reported a loss after tax for the six month period to 30 June 2013 of \$192 million compared to a profit after tax of \$249 million for the six month period to 30 June 2012.

Included in the current period is a loss on disposal of subsidiaries of \$151 million resulting from a reclassification from the "Currency translation reserve" to the condensed consolidated income statement (see Note 11). The subsidiaries disposed of were non-US dollar functional currency entities and were sold to another Morgan Stanley undertaking outside of the Group for consideration equal to their net book value. This reclassification did not have an impact on the net assets of the Group.

The Group's revenues are best reviewed across the aggregate of 'Net gains on financial instruments classified as held for trading', 'Net losses on financial instruments designated at fair value through profit or loss', 'Interest income', 'Interest expense' and 'Other income' ("aggregate revenues"). Aggregate revenues for the six month period ended 30 June 2013 declined by 5% to \$2,050 million compared to \$2,154 million for the six month period ended 30 June 2012.

Revenues within fixed income sales and trading during the six month period to 30 June 2013 were significantly lower compared to the prior period to 30 June 2012. The main reason for the decrease was due to a reduction in interest rate derivatives and commodities revenues, partially offset by increased securitised products revenues.

The decrease in fixed income revenues was partially offset by increases in investment banking and equity sales and trading revenues. The increase in investment banking revenues reflects the impact of the financial advisory business that was transferred from MSCL to the Group effective from 1 January 2013 and also an improvement in transaction revenue. The increase in equity revenues was driven by increased derivatives revenues.

Other expenses increased from \$1,655 million for the six months ended 30 June 2012, to \$2,035 million for the six month period ended 30 June 2013. The increase is driven by the transfer of the financial advisory business from MSCL to the Group effective from 1 January 2013, in addition to market movements on share based awards.

The Group's tax expense for the six month period ended 30 June 2013 was \$56 million compared to \$250 million for the six month period ended 30 June 2012 (see Note 2).

MORGAN STANLEY & CO. INTERNATIONAL plc

INTERIM MANAGEMENT REPORT

BUSINESS REVIEW (CONTINUED)

The condensed consolidated statement of financial position presented on page 16 reflects increases in the Group's total assets and total liabilities of \$48,821 million and \$48,878 million respectively, increases of 9% as at 30 June 2013 when compared to 31 December 2012. The increase in total assets is driven by an increase of \$38,684 million in trade receivables, \$8,307 million in securities purchased under agreements to resell and \$2,576 million in financial assets classified as held for trading. The increase in total liabilities is driven by increases in trade payables of \$38,940 million, financial liabilities classified as held for trading of \$7,259 million, and other payables of \$2,564 million. The increases in trade receivables and trade payables is attributed to increased trading activity.

The condensed consolidated statement of cash flows presented on page 17 shows a net increase in cash and cash equivalents of \$1,095 million during the six month period to 30 June 2013 (six month period to 30 June 2012: net increase of \$503 million). Net cash flows used in operating activities were \$538 million (six month period to 30 June 2012: \$654 million net cash flows generated), offset by proceeds from disposal of subsidiaries amounting to \$1,835 million. Interest paid on subordinated debt was \$61 million (six month period to 30 June 2012: \$71 million). Excluding segregated client funds, the net increase in cash and cash equivalents for the six month period to 30 June 2013 was \$879 million (six month period to 30 June 2012: net increase of \$820 million).

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.

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's business activities. The Morgan Stanley Group seeks to identify, assess, monitor and manage each of the various types of risk involved in its activities on a global basis, in accordance with defined policies and procedures and in consideration of the individual legal entities. The Group's own risk management policies and procedures are consistent with those of the Morgan Stanley Group. Note 6 to the Interim Financial Statements provides qualitative and quantitative disclosures about the Group's management and exposure to financial risks.

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 Morgan Stanley Group manages the market risk associated with its trading activities on a global basis, at both a trading division and an individual product level, which includes consideration of market risk for each individual legal entity. Generally, the Group is exposed to market risk as a result of trading, investing and client facilitation activities, mainly within the Institutional Securities business segment where the substantial majority of the Group's Value-at-Risk ("VaR") for market risk exposures is generated. The Group uses VaR as one of a range of risk management tools.

During the six month period to 30 June 2013 the Group has seen the average VaR for the Primary Risk Categories decline from an average of \$24 million in the nine months to 31 December 2012, to \$21 million in the six month period to 30 June 2013. This has been driven by reduced risk taking in fixed income products. The average Credit Portfolio VaR has decreased from \$14 million in the nine months to 31 December 2012, to \$10 million in the six month period to 30 June 2013, primarily due to reduced counterparty exposure during the period.

MORGAN STANLEY & CO. INTERNATIONAL plc

INTERIM MANAGEMENT REPORT

Risk management (continued)

Credit risk

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

The Morgan Stanley Group manages credit risk exposure on a global consolidated basis as well as giving consideration to individual legal entities. 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.

Country risk exposure

The Morgan Stanley Group and the Group have exposure to country risk. Country risk exposure is the risk that events within a country, such as currency crises, regulatory changes and other political events, will adversely affect the ability of the sovereign government and/or obligors within the country to honour their obligations to the Group.

Country risk exposure is measured in accordance with the Morgan Stanley Group and the Group's internal risk management standards and includes obligations from sovereign governments, corporations, clearing houses and financial institutions. The Morgan Stanley Group and the Group actively manage country risk exposure through a comprehensive risk management framework that combines credit and market fundamentals as well as scenario analysis, and allows the Group to effectively identify, monitor and limit country risk. Country risk exposure before and after hedges is monitored and managed, with stress testing and scenario analysis conducted on a continuous basis, to identify exposure concentrations, wrong way risk (the risk that occurs when exposure to a counterparty is adversely correlated with the credit quality of that counterparty) and the impact of idiosyncratic events. In addition, indirect exposures are identified through the Group's counterparty credit analysis as having a vulnerability or exposure to another country or jurisdiction. Examples of such counterparties include: mutual funds that invest in a single country, offshore companies whose assets reside in another country to that of the offshore jurisdiction and finance company subsidiaries of corporations. The outcome of such identification can result in a reclassification of country risk, amendment of counterparty limits or exposure mitigation. The Group reduces its country risk exposure through the effect of risk mitigants, such as netting agreements with counterparties that permit the Group to offset receivables and payables with such counterparties, obtaining collateral from counterparties, and by hedging.

The Group's country risk exposure, including the effect of the risk mitigants as at 30 June 2013 is shown across the following two tables. The basis for determining the domicile of the exposure is based on the country of jurisdiction for the obligor or guarantor, factors such as physical location of operations or assets, location and source of cash flows/revenues, and location of collateral (if applicable). Credit Default Swaps ("CDSs") are incorporated in the exposure where protection is both purchased and sold.

MORGAN STANLEY & CO. INTERNATIONAL plc

INTERIM MANAGEMENT REPORT

Risk management (continued)

Country risk exposure (continued)

The Group's sovereign exposures consist of financial instruments entered into with sovereign and local governments. Its non-sovereign exposures comprise exposures to corporations, clearing houses and financial institutions.

Select European Countries

In connection with certain of its Institutional Securities business segment activities, the Group has country risk exposure to many foreign countries. During the six month period ended 30 June 2013, the European Peripherals and France continued to experience challenges to their creditworthiness due to weakness in their economic and fiscal situations.

The following table shows the Group's exposure to European Peripherals and France at 30 June 2013. The majority of the financial instruments included in the table below are classified as held for trading and are measured at fair value or are collateralised borrowings or lendings. As a result, the Group does not have any recognised impairment on the financial instruments included in its country risk exposure to European Peripherals and France. Exposure to other Morgan Stanley Group undertakings has been excluded from the table below.

MORGAN STANLEY & CO. INTERNATIONAL plc

INTERIM MANAGEMENT REPORT

Risk management (continued)

Select European Countries (continued)

Country Risk Exposure to European Peripherals and France

Country	Net Inventory ⁽¹⁾ \$millions	Net Counterparty Exposure ⁽²⁾ \$millions	Funded Lending \$millions	Unfunded Commitments \$millions	CDS Adjustments ⁽³⁾ \$millions	Exposure Before Hedges \$millions	Hedges ⁽⁴⁾ \$millions	Net Exposure ⁽⁵⁾ \$millions
Greece:								
Sovereigns	15	-	-	-	-	15	-	15
Non-sovereigns	41	6	-	-	-	47	-	47
Total Greece	56	6	-	-	-	62	-	62
Ireland:								
Sovereigns	56	3	-	-	5	64	15	79
Non-sovereigns	161	22	-	-	1	184	-	184
Total Ireland	217	25	-	-	6	248	15	263
Italy:								
Sovereigns	373	322	-	-	315	1,010	(254)	756
Non-sovereigns	(17)	348	9	365	19	724	(214)	510
Total Italy	356	670	9	365	334	1,734	(468)	1,266
Spain:								
Sovereigns	451	7	-	-	7	465	(68)	397
Non-sovereigns	(69)	268	-	97	135	431	(78)	353
Total Spain	382	275	-	97	142	896	(146)	750
Portugal:								
Sovereigns	(43)	(1)	-	-	32	(12)	(25)	(37)
Non-sovereigns	(84)	(25)	-	-	12	(97)	(16)	(113)
Total Portugal	(127)	(26)	-	-	44	(109)	(41)	(150)
Sovereigns	852	331	-	-	359	1,542	(332)	1,210
Non-sovereigns	32	619	9	462	167	1,289	(308)	981
Total European Peripherals	884	950	9	462	526	2,831	(640)	2,191
France:								
Sovereigns	(335)	24	-	-	-	(311)	(29)	(340)
Non-sovereigns	(711)	2,502	-	601	10	2,402	(137)	2,265
Total France	(1,046)	2,526	-	601	10	2,091	(166)	1,925

- (1) Net inventory representing exposure to both long and short single name positions (i.e., bonds and equities at fair value and CDS based on notional amount assuming zero recovery adjusted for any fair value receivable or payable).
- (2) Net counterparty exposure (i.e., repurchase transactions, securities lending and OTC derivatives) taking into consideration legally enforceable master netting agreements and collateral.
- (3) CDS adjustments represents credit protection purchased from European Peripherals' banks on European Peripherals' sovereign and financial institution risk, or French banks on French sovereign and financial institution risk. Based on the CDS notional amount assuming zero recovery adjusted for any fair value receivable or payable.
- (4) Represents CDS hedges (purchased and sold) on net counterparty exposure and funding lending executed by trading desks responsible for hedging counterparty and lending credit risk exposures for the Group. Based on the CDS notional amount assuming zero recovery adjusted for any fair value receivable or payable.
- (5) In addition, as at 30 June 2013, the Group had European Peripherals and French exposure for overnight deposits with banks of approximately \$49 million and \$9 million, respectively.

MORGAN STANLEY & CO. INTERNATIONAL plc

INTERIM MANAGEMENT REPORT

Risk management (continued)

Non-UK country risk exposure

The following table shows the Group's significant non-UK country risk exposure at 30 June 2013, excluding select European countries disclosed above. Exposure to other Morgan Stanley Group undertakings has been excluded from the table below.

Country	Net Inventory ⁽¹⁾ \$millions	Net Counterparty Exposure ⁽²⁾ \$millions	Funded Lending \$millions	Exposure Before Hedges \$millions	Hedges ⁽³⁾ \$millions	Net Exposure ⁽⁴⁾ \$millions
Germany:						
Sovereigns	(160)	583	-	423	(616)	(193)
Non-sovereigns	(266)	3,076	27	2,837	(108)	2,729
Total Germany	(426)	3,659	27	3,260	(724)	2,536
Japan:						
Sovereigns	(30)	-	-	(30)	-	(30)
Non-sovereigns	508	406	-	914	-	914
Total Japan	478	406	-	884	-	884
United States:						
Sovereigns	223	16	-	239	-	239
Non-sovereigns	(1,319)	1,994	-	675	(88)	587
Total United States	(1,096)	2,010	-	914	(88)	826
China:						
Sovereigns	217	26	-	243	-	243
Non-sovereigns	398	148	-	546	(8)	538
Total China	615	174	-	789	(8)	781
Netherlands:						
Sovereigns	(27)	4	-	(23)	(237)	(260)
Non-sovereigns	239	774	-	1,013	(143)	870
Total Netherlands	212	778	-	990	(380)	610

- (1) Net inventory representing exposure to both long and short single name positions (i.e., bonds and equities at fair value and CDS based on notional amount assuming zero recovery adjusted for any fair value receivable or payable).
- (2) Net counterparty exposure (i.e., repurchase transactions, securities lending and OTC derivatives) taking into consideration legally enforceable master netting agreements and collateral.
- (3) Represents CDS hedges (purchased and sold) on net counterparty exposure and funded lending executed by trading desks responsible for hedging counterparty and lending credit risk exposures for the Group. Based on the CDS notional amount assuming zero recovery adjusted for any fair value receivable or payable.
- (4) In addition, as at 30 June 2013, the Group had exposure to these countries for overnight deposits with banks of approximately \$1 billion.

MORGAN STANLEY & CO. INTERNATIONAL plc

INTERIM MANAGEMENT REPORT

Risk management (continued)

Liquidity and capital resources

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.

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 the Group, to enable the Morgan Stanley Group to withstand market stresses, and to meet regulatory stress testing requirements proposed by regulators globally.

At 30 June 2013, the Group maintained sufficient liquidity to meet current and contingent funding obligations as modelled in its Liquidity Stress Tests.

During the period the Group complied with all regulatory capital requirements, ensuring sufficient Capital Resources were held.

Operational risk

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

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

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

The Group's operations rely on the secure processing, storage and transmission of confidential and other information in its computer systems. Like other financial services firms, the Group has been and continue to be subject to unauthorised access, mishandling or misuse, computer viruses and other events. Events such as these could have a security impact on the Group's systems and jeopardise the Group's or the Group's clients' or counterparties' personal, confidential, proprietary or other information processed and stored in, and transmitted through, the Group's computer systems. Furthermore, such events could cause interruptions or malfunctions in the Group's, the Group's clients', the Group's counterparties' or third parties' operations, which could result in reputational damage, litigation or regulatory fines or penalties not covered by insurance maintained by the Group, or adversely affect the business, financial condition or results of operations.

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

MORGAN STANLEY & CO. INTERNATIONAL plc

INTERIM MANAGEMENT REPORT

Risk management (continued)

Legal and regulatory risk

Legal risk includes the risk of exposure to fines, penalties, judgements, damages and/or settlements in connection with regulatory or legal actions as a result of non-compliance with applicable legal or regulatory requirements and standards or litigation. Legal risk also includes contractual and commercial risk such as the risk that a counterparty's performance obligations will be unenforceable. The Morgan Stanley Group is generally subject to extensive regulation in the different jurisdictions in which it conducts its business. In the current environment of rapid and possibly transformational regulatory change, the Morgan Stanley Group also views regulatory change as a component of legal risk.

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

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

In December 2010, the Basel Committee reached an agreement on Basel III. In June 2013 the Capital Requirement Directive and Regulation ("CRD") was finalised implementing Basel III in Europe. These rules contain new capital standards that raise the capital requirements and strengthen counterparty credit risk capital requirements, through, for example, new requirements to capture Counterparty Valuation Adjustment risk. The CRD also requires banking organisations, including the Group, to maintain both a capital conversion buffer and, if deployed, a countercyclical capital buffer, above the minimum risk based capital ratios. Failure to maintain such buffers will result in restrictions on the banking organisation's ability to make capital distributions and pay discretionary bonuses to executive officers. The CRD also subjects banking organisations, including the Group, to a minimum leverage ratio of 3%.

The Group will become subject to the CRD beginning on 1 January 2014, with the requirements being phased in over several years.

MORGAN STANLEY & CO. INTERNATIONAL plc

INTERIM MANAGEMENT REPORT

Going Concern

Business risks associated with the uncertain market and economic conditions are being monitored and managed by the Morgan Stanley Group and the Group. Retaining sufficient liquidity and capital to withstand these market pressures remains central to the Morgan Stanley Group's and the Group's strategy. In particular, the Morgan Stanley Group's capital is deemed sufficient to exceed the minimum capital ratio under the most negative stressed scenario reviewed by the US Federal Reserve. The Morgan Stanley Group regularly performs stress testing to ensure both the Morgan Stanley Group and the Group have sufficient resources at their disposal to absorb losses associated with certain stressed scenarios.

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 interim management report and Interim Financial Statements.

Approved by the Board and signed on its behalf by



CDS BRYCE

Director

28 August 2013

MORGAN STANLEY & CO. INTERNATIONAL plc

DIRECTORS' RESPONSIBILITY STATEMENT

The Directors, the names of whom are set out below, confirm that to the best of their knowledge:

- (a) the condensed set of financial statements has been prepared in accordance with International Accounting Standard ("IAS") 34 '*Interim Financial Reporting*' as adopted by the European Union ("EU"), give a true and fair view of the assets, liabilities, financial position and result of the Group; and
- (b) the interim management report includes a fair review of the information required by DTR4.2.7R of the Disclosure and Transparency Rules, being an indication of the important events that have occurred during the period and their impact on the condensed set of financial statements, and a description of the principal risks and uncertainties for the remaining six months of the financial year.

By order of the Board on 28 August 2013



CDS BRYCE

Director

Board of Directors:

C D S Bryce

D O Cannon

(appointed 1 June 2013)

Sir E J W Gieve

T C Kelleher (Chairman)

F R Petitgas

M C Phibbs

(appointed 1 May 2013)

I Plenderleith

R Rooney

D A Russell

C E Woodman

INDEPENDENT REVIEW REPORT TO MORGAN STANLEY & CO. INTERNATIONAL plc

We have been engaged by the Company to review the condensed set of financial statements in the half-yearly financial report for the six month period ended 30 June 2013 which comprises the condensed consolidated income statement, the condensed consolidated statement of comprehensive income, the condensed consolidated statement of changes in equity, the condensed consolidated statement of financial position, the condensed consolidated statement of cash flows and related notes 1 to 13. We have read the other information contained in the half-yearly financial report and considered whether it contains any apparent misstatements or material inconsistencies with the information in the condensed set of financial statements.

This report is made solely to the Company in accordance with International Standard on Review Engagements (UK and Ireland) 2410, "*Review of Interim Financial Information Performed by the Independent Auditor of the Entity*" issued by the Auditing Practices Board. Our work has been undertaken so that we might state to the Company those matters we are required to state to them in an independent review 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, for our review work, for this report, or for the conclusions we have formed.

Directors' responsibilities

The half-yearly financial report is the responsibility of, and has been approved by, the Directors. The Directors are responsible for preparing the half-yearly financial report in accordance with the Disclosure and Transparency Rules of the United Kingdom's Financial Services Authority.

As disclosed in note 1, the annual financial statements of the Group are prepared in accordance with International Financial Reporting Standards ("IFRSs") as adopted by the European Union. The condensed set of financial statements included in this half-yearly financial report has been prepared in accordance with International Accounting Standard 34 "*Interim Financial Reporting*", as adopted by the European Union.

Our responsibility

Our responsibility is to express to the Company a conclusion on the condensed set of financial statements in the half-yearly financial report based on our review.

Scope of review

We conducted our review in accordance with International Standard on Review Engagements (UK and Ireland) 2410, "*Review of Interim Financial Information Performed by the Independent Auditor of the Entity*" issued by the Auditing Practices Board for use in the United Kingdom. A review of interim financial information consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical procedures and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing (UK and Ireland) and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the condensed set of financial statements in the half-yearly financial report for the six month period ended 30 June 2013 is not prepared, in all material aspects, in accordance with International Accounting Standard 34 as adopted by the European Union and the Disclosure and Transparency Rules of the United Kingdom's Financial Services Authority.



Deloitte LLP
Chartered Accountants and Statutory Auditor
London
28 August 2013

MORGAN STANLEY & CO. INTERNATIONAL plc

CONDENSED CONSOLIDATED INCOME STATEMENT

Six months ended 30 June 2013

		Six months ended 30 June 2013 \$millions (unaudited)	Six months ended 30 June 2012 \$millions (unaudited)
Net gains on financial instruments classified as held for trading		2,540	1,985
Net (losses)/gains on financial instruments designated at fair value through profit or loss		(566)	151
Interest income		1,732	1,402
Interest expense		(1,905)	(1,700)
Other income		249	316
Other expense		(2,035)	(1,655)
Net currency translation loss on disposal of subsidiaries	11	(151)	-
(LOSS)/PROFIT BEFORE TAX		<u>(136)</u>	<u>499</u>
Income tax expense	2	(56)	(250)
(LOSS)/PROFIT FOR THE PERIOD		<u><u>(192)</u></u>	<u><u>249</u></u>
Attributable to:			
Owners of the parent		(193)	248
Non-controlling interests		1	1
(LOSS)/PROFIT FOR THE PERIOD		<u><u>(192)</u></u>	<u><u>249</u></u>

All operations were continuing in the current and prior periods.

The notes on pages 18 to 66 form an integral part of the Interim Financial Statements.

MORGAN STANLEY & CO. INTERNATIONAL plc

CONDENSED CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

Six months ended 30 June 2013

	Six months ended 30 June 2013 \$millions (unaudited)	Six months ended 30 June 2012 \$millions (unaudited)
(LOSS)/PROFIT FOR THE PERIOD	<u>(192)</u>	<u>249</u>
OTHER COMPREHENSIVE INCOME, NET OF TAX		
Items that will not be reclassified subsequently to profit or loss:		
Actuarial losses on defined benefit plans	(1)	-
Items that may be reclassified subsequently to profit or loss:		
Currency translation reserve:		
Foreign currency translation differences arising on foreign operations during the period	(16)	1
Net loss reclassified to condensed consolidated income statement	11 151	-
Available-for-sale reserve:		
Net change in fair value of available-for-sale financial assets	1	22
OTHER COMPREHENSIVE INCOME AFTER INCOME TAX	<u>135</u>	<u>23</u>
TOTAL COMPREHENSIVE (LOSS)/ INCOME	<u>(57)</u>	<u>272</u>
Attributable to:		
Owners of the parent	(57)	273
Non-controlling interests	-	(1)
TOTAL COMPREHENSIVE (LOSS)/INCOME	<u>(57)</u>	<u>272</u>

The notes on pages 18 to 66 form an integral part of the Interim Financial Statements.

MORGAN STANLEY & CO. INTERNATIONAL plc

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY Six months ended 30 June 2013

	Share capital \$millions	Share premium \$millions	Currency translation reserve \$millions	Capital redemption reserve \$millions	Capital contribution reserve \$millions	Available - for-sale reserve \$millions	Retained earnings \$millions	Attributable to owners of the parent \$millions	Non- controlling interest \$millions	Total equity \$millions
Balance at 1 January 2013	9,464	513	(105)	1,399	3	4	2,173	13,451	74	13,525
Total comprehensive (loss)/income	-	-	(15)	-	-	1	(194)	(208)	-	(208)
Reclassified foreign currency translation differences on disposal of foreign operations (Note 11)	-	-	151	-	-	-	-	151	-	151
Balance at 30 June 2013 (unaudited)	<u>9,464</u>	<u>513</u>	<u>31</u>	<u>1,399</u>	<u>3</u>	<u>5</u>	<u>1,979</u>	<u>13,394</u>	<u>74</u>	<u>13,468</u>

	Share capital \$millions	Share premium \$millions	Currency translation reserve \$millions	Capital redemption reserve \$millions	Capital contribution reserve \$millions	Available - for-sale reserve \$millions	Retained earnings \$millions	Attributable to owners of the parent \$millions	Non- controlling interest \$millions	Total equity \$millions
Balance at 1 January 2012	9,464	513	(157)	1,399	3	16	2,169	13,407	71	13,478
Total comprehensive income	-	-	3	-	-	22	248	273	(1)	272
Reclassified foreign currency translation differences on liquidation of foreign subsidiaries	-	-	(13)	-	-	-	13	-	-	-
Balance at 30 June 2012 (unaudited)	<u>9,464</u>	<u>513</u>	<u>(167)</u>	<u>1,399</u>	<u>3</u>	<u>38</u>	<u>2,430</u>	<u>13,680</u>	<u>70</u>	<u>13,750</u>

The notes on pages 18 to 66 form an integral part of the Interim Financial Statements.

CONDENSED CONSOLIDATED STATEMENT OF FINANCIAL POSITION
As at 30 June 2013

		30 June 2013	31 December 2012
		\$millions	\$millions
ASSETS	Note	(unaudited)	
Loans and receivables:			
Cash and short term deposits		12,613	11,526
Cash collateral on securities borrowed		30,350	31,303
Securities purchased under agreements to resell		108,089	99,782
Trade receivables		105,122	66,438
Other receivables		4,621	5,676
		<u>260,795</u>	<u>214,725</u>
Financial assets classified as held for trading (of which approximately \$45,899 million (2012: \$42,457 million) were pledged to various parties)	3	344,270	341,694
Financial assets designated at fair value through profit or loss		7,749	7,591
Available-for-sale financial assets		41	40
Current tax assets		188	210
Deferred tax assets		146	91
Prepayments and accrued income		37	53
Property, plant and equipment		6	7
TOTAL ASSETS		<u><u>613,232</u></u>	<u><u>564,411</u></u>
LIABILITIES AND EQUITY			
Financial liabilities at amortised cost:			
Bank loans and overdrafts		15	23
Cash collateral on securities loaned		30,381	29,336
Securities sold under agreements to repurchase		84,650	85,694
Trade payables		122,101	83,161
Subordinated loans		7,906	7,906
Other payables		20,180	17,616
		<u>265,233</u>	<u>223,736</u>
Financial liabilities classified as held for trading	3	321,307	314,048
Financial liabilities designated at fair value through profit or loss		12,797	12,560
Provisions		6	82
Current tax liabilities		233	243
Deferred tax liabilities		4	4
Accruals and deferred income		179	208
Post employment benefit obligations		5	5
TOTAL LIABILITIES		<u><u>599,764</u></u>	<u><u>550,886</u></u>
EQUITY			
Share capital		9,464	9,464
Share premium account		513	513
Currency translation reserve		31	(105)
Capital redemption reserve		1,399	1,399
Capital contribution reserve		3	3
Available-for-sale-reserve		5	4
Retained earnings		1,979	2,173
Equity attributable to owners of the parent		<u>13,394</u>	<u>13,451</u>
Non-controlling interest		<u>74</u>	<u>74</u>
TOTAL EQUITY		<u><u>13,468</u></u>	<u><u>13,525</u></u>
TOTAL LIABILITIES AND EQUITY		<u><u>613,232</u></u>	<u><u>564,411</u></u>

The notes on pages 18 to 66 form an integral part of the Interim Financial Statements.

MORGAN STANLEY & CO. INTERNATIONAL plc

CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS

As at 30 June 2013

	Six months ended 30 June 2013 \$millions (unaudited)	Six months ended 30 June 2012 \$millions (unaudited)
NET CASH FLOWS (USED IN)/ FROM OPERATING ACTIVITIES	4(b) (538)	654
INVESTING ACTIVITIES		
Purchase of available-for-sale financial assets	(6)	(2)
Proceeds from sale of available-for-sale financial assets	6	-
Proceeds from sale of subsidiaries, net of cash disposed	11 1,835	-
NET CASH FLOWS FROM/ (USED IN) INVESTING ACTIVITIES	<u>1,835</u>	<u>(2)</u>
FINANCING ACTIVITIES		
Interest on subordinated loan liabilities	(61)	(71)
NET CASH FLOWS USED IN FINANCING ACTIVITIES	<u>(61)</u>	<u>(71)</u>
NET INCREASE IN CASH AND CASH EQUIVALENTS	1,236	581
Currency translation differences on foreign currency cash balances	(141)	(78)
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE PERIOD	<u>11,503</u>	<u>11,056</u>
CASH AND CASH EQUIVALENTS AT THE END OF THE PERIOD	4(a) <u><u>12,598</u></u>	<u><u>11,559</u></u>

The notes on pages 18 to 66 form an integral part of the Interim Financial Statements.

MORGAN STANLEY & CO. INTERNATIONAL plc

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Six months ended 30 June 2013

1. BASIS OF PREPARATION

a. General information

The information in this interim report does not constitute statutory accounts within the meaning of Section 435 of the United Kingdom Companies Act 2006 (“Companies Act”).

The comparative information for the year ended 31 December 2012 does not constitute statutory accounts as defined in section 434 of the Companies Act. A copy of the statutory accounts for that year has been delivered to the Registrar of Companies. The auditor’s report on those accounts was not qualified, did not include a reference to any matters to which the auditors drew attention by way of emphasis without qualifying the report and did not contain statements under section 498(2) or (3) of the Companies Act.

b. Accounting policies

The Group prepares its annual financial statements in accordance with IFRSs issued by the International Accounting Standards Board (“IASB”) as adopted by the European Union (“EU”), Interpretations issued by the IFRS Interpretations Committee (“IFRIC”) and the Companies Act. The Interim Financial Statements have been prepared in accordance with the Disclosure and Transparency Rules of the Financial Services Authority and in accordance with IAS 34 ‘*Interim Financial Reporting*’, as adopted by the EU.

In preparing these Interim Financial Statements the Group has applied consistently the accounting policies and methods of computation used in the Group’s annual financial statements for the year ended 31 December 2012.

New standards and interpretations adopted during the period

The following standards and amendments to standards relevant to the Group’s operations were adopted during the period. Except where otherwise stated, these standards did not have a material impact on the Group’s condensed financial statements.

An amendment to IAS 1 ‘*Presentation of financial statements*’ (“IAS 1”) was issued by the IASB in June 2011 for application in annual periods beginning on or after 1 July 2012. The revised standard was endorsed by the EU in June 2012. The condensed consolidated statement of comprehensive income now presents items net of tax and analysed between those that may be and those that will not be reclassified subsequently to profit or loss.

An amendment to IAS 19 ‘*Employee benefits*’ was issued by the IASB in June 2011 for retrospective application in annual periods beginning on or after 1 January 2013. The revised standard was endorsed by the EU in June 2012. The amendment requires more extensive disclosures around the characteristics and risks of the Group’s benefit plans, which will be included in the Group’s consolidated financial statements for the year ending 31 December 2013.

IAS 27 ‘*Consolidated and separate financial statements*’ (“IAS 27”) and IAS 28 ‘*Investment in associates and joint ventures*’ (“IAS 28”) were revised by the IASB in May 2011, for application in annual periods beginning on or after 1 January 2013. The revised standards were endorsed by the EU in December 2012 such that a Group shall apply them at the latest from the commencement date of its first financial year starting on or after 1 January 2014. The Group adopted IAS 27 and IAS 28 with effect from 1 January 2013.

An amendment to IFRS 7 ‘*Financial instruments: Disclosures – offsetting financial assets and financial liabilities*’ was issued by the IASB in December 2011 for retrospective application in annual periods beginning on or after 1 January 2013 and interim periods within those annual periods. The amendment was endorsed by the EU in December 2012. The amendments require disclosures regarding the Group’s financial instruments that are either offset in the condensed consolidated statement of financial position or subject to an enforceable master netting arrangement or similar agreement, which are included in Note 7.

MORGAN STANLEY & CO. INTERNATIONAL plc

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Six months ended 30 June 2013

1. BASIS OF PREPARATION (CONTINUED)

New standards and interpretations adopted during the period (continued)

IFRS 10 '*Consolidated financial statements*' ("IFRS 10"), IFRS 11 '*Joint arrangements*' ("IFRS 11") and IFRS 12 '*Disclosure of interests in other entities*' ("IFRS 12") were issued by the IASB in May 2011 for retrospective application in annual periods beginning on or after 1 January 2013. The standards were endorsed by the EU in December 2012 requiring application no later than annual periods starting 1 January 2014. In addition, amendments to IFRS 10, IFRS 11 and IFRS 12 were issued by the IASB in June 2012 for retrospective application in annual periods on or after 1 January 2013. The amendments were endorsed by the EU in April 2013 requiring application no later than annual periods starting 1 January 2014. The Group chose to early adopt IFRS 10, IFRS 11 and IFRS 12 with effect from 1 January 2013. There has been no material impact to the Group as a result of adopting IFRS 10 and IFRS 11. IFRS 12 requires more extensive disclosures on interests held in structured entities, which are included in Note 8.

IFRS 13 '*Fair value measurement*' was issued by the IASB in May 2011 for prospective application in annual periods beginning on or after 1 January 2013 and was endorsed by the EU in December 2012. There was no material impact to the Group as a result of adopting the measurement requirements of IFRS 13. Additional disclosure required by IFRS 13 is included in Note 9 and Note 10.

As part of the May 2012 Improvements to IFRSs, the IASB made amendments to the following standards that are relevant to the Group's operations: IAS 1, IAS 32 '*Financial Instruments: Presentation*' and IAS 34 '*Interim financial reporting*' for application in accounting periods beginning on or after 1 January 2013. The improvements were endorsed by the EU in March 2013.

There were no other standards or interpretations relevant to the Group's operations which were adopted during the period.

New standards and interpretations not yet adopted

At the date of authorisation of these Interim Financial Statements, the following standards relevant to the Group's operations were issued by the IASB but not yet mandatory. Except where otherwise stated, the Group does not expect that the adoption of the following standards will have a material impact on the Group's consolidated financial statements.

An amendment to IAS 32 '*Financial instruments: Presentation – offsetting financial instruments*' was issued by the IASB in December 2011, for retrospective application in annual periods beginning on or after 1 January 2014. The amendment was endorsed by the EU in December 2012.

An amendment to IAS 36 '*Recoverable amount disclosures for non-financial assets*' was issued by the IASB in May 2013, for retrospective application in annual periods beginning on or after 1 January 2014.

IFRS 9 '*Financial instruments*' was issued by the IASB in November 2009 for retrospective application in annual periods beginning on or after 1 January 2015. Although there are expected to be significant changes to the presentation of financial instruments by the Group, there is not expected to be a significant impact on net assets.

Amendments to IFRS 10, IFRS 12 and IAS 27 '*Investment entities*' were issued by the IASB in October 2012 for application in annual periods beginning on or after 1 January 2014.

IFRIC 21 '*Levies*' was issued by the IASB in May 2013 for retrospective application in annual periods beginning on or after 1 January 2014.

c. Use of estimates and sources of uncertainty

The preparation of the Group's condensed consolidated financial statements requires management to make judgements, estimates and assumptions regarding the valuation of certain financial instruments, deferred tax assets, pension obligations, the outcome of litigation and other matters that affect the financial statements and related disclosures. The Group believes that the estimates utilised in preparing the Interim Financial Statements are reasonable, relevant and reliable. Actual results could differ from these estimates.

MORGAN STANLEY & CO. INTERNATIONAL plc

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Six months ended 30 June 2013

1. BASIS OF PREPARATION (CONTINUED)

c. Use of estimates and sources of uncertainty (continued)

For further details on the judgements used in determining whether the Group should consolidate a structured entity and in determining fair value of certain assets and liabilities see Note 8 and Note 9 respectively.

2. INCOME TAX EXPENSE

The Group's tax expense has been accrued based on the expected tax rate that takes into account current expectations concerning allocation of group relief within the Morgan Stanley UK tax group and prevailing tax rates in the jurisdictions in which the Group operates.

The Group's effective tax rate for the six month period ended 30 June 2013 is higher than that resulting from applying the average standard rate of corporation tax in the UK of 23.25%. The main reason for the higher effective tax rate is attributed to the loss on disposal of subsidiaries that is non-tax deductible, and the impact of transferring taxable losses outside the Group.

3. FINANCIAL ASSETS AND FINANCIAL LIABILITIES CLASSIFIED AS HELD FOR TRADING

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

	30 June 2013	30 June 2013	31 December 2012	31 December 2012
	Assets	Liabilities	Assets	Liabilities
	\$millions	\$millions	\$millions	\$millions
Fair value				
Government debt securities	15,145	14,299	18,153	17,009
Corporate equities	30,138	20,306	30,505	16,673
Corporate and other debt	10,231	3,217	10,376	2,096
Derivatives	288,756	283,485	282,660	278,270
	<u>344,270</u>	<u>321,307</u>	<u>341,694</u>	<u>314,048</u>

4. ADDITIONAL CASH FLOW INFORMATION

a. Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise the following balances which have less than three months maturity from the date of acquisition.

	30 June 2013	30 June 2012
	\$millions	\$millions
Cash and short-term deposits	12,613	11,772
Bank loans and overdrafts	(15)	(213)
	<u>12,598</u>	<u>11,559</u>

Included within 'Cash and short-term deposits' is \$8,030 million (30 June 2012: \$7,862 million) of segregated client funds that are not available for use by the Group. The corresponding payable is recognised and included in 'Trade payables' within 'Financial liabilities at amortised cost'.

MORGAN STANLEY & CO. INTERNATIONAL plc

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
Six months ended 30 June 2013

4. ADDITIONAL CASH FLOW INFORMATION (CONTINUED)

b. Reconciliation of cash flows from operating activities

	Six months ended 30 June 2013 \$millions	Six months ended 30 June 2012 \$millions
(Loss)/profit for the period	(192)	249
Adjustments for:		
Depreciation on property, plant and equipment	2	2
Interest income	(1,732)	(1,402)
Interest expense	1,905	1,700
Loss on disposal of subsidiaries	151	-
Income tax expense	56	250
Other expense	1	-
Operating cash flows before changes in operating assets and liabilities	<u>191</u>	<u>799</u>
Change in operating assets		
Increase in loans and receivables, excluding bank loans and overdrafts	(46,370)	(42,289)
(Increase)/Decrease in financial assets classified as held for trading	(2,576)	19,055
(Increase)/Decrease in financial assets designated at fair value through profit or loss	(158)	1,425
	<u>(49,104)</u>	<u>(21,809)</u>
Change in operating liabilities		
Increase in financial liabilities at amortised cost, excluding bank loans and overdrafts	40,948	29,415
Increase/(Decrease) in financial liabilities classified as held for trading	7,259	(7,304)
Increase/(Decrease) in financial liabilities designated at fair value through profit or loss	237	(413)
Decrease in provisions	(76)	(3)
	<u>48,368</u>	<u>21,695</u>
Interest received	1,298	1,089
Interest paid	(1,315)	(1,139)
Income taxes paid	(97)	(61)
Effect of foreign exchange movements	121	80
Net cash flows (used in)/from operating activities	<u><u>(538)</u></u>	<u><u>654</u></u>

MORGAN STANLEY & CO. INTERNATIONAL plc

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Six months ended 30 June 2013

5. SEGMENT REPORTING

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

Business segments

Morgan Stanley structures its business segments primarily based upon the nature of the financial products and services provided to customers and Morgan Stanley's internal management structure. The Group's own business segments are consistent with those of Morgan Stanley.

The Group has one reportable business segment, Institutional Securities which includes the following activities: financial advisory services and capital raising services; corporate lending; sales, trading, financing and market-making activities in equity and fixed income securities and related products, including foreign exchange and commodities; and investment activities

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

Condensed consolidated income statement information	Institutional Securities	Other	Total
Six months ended 30 June 2013	\$millions	\$millions	\$millions
Net gains on financial instruments classified as held for trading	2,540	-	2,540
Net losses on financial instruments designated at fair value through profit or loss	(566)	-	(566)
Loss on disposal of subsidiaries	(151)	-	(151)
Net interest expense	(173)	-	(173)
Other income	234	15	249
External revenues	1,884	15	1,899
Other expense	(2,007)	(28)	(2,035)
Loss before tax	(123)	(13)	(136)
Income tax (expense)/credit	(59)	3	(56)
Loss for the period	(182)	(10)	(192)

Condensed consolidated statement of financial position information	Institutional Securities	Other	Total
As at 30 June 2013	\$millions	\$millions	\$millions
Segment assets	613,227	5	613,232
Total assets	613,227	5	613,232
Segment liabilities	599,763	1	599,764
Total liabilities	599,763	1	599,764

Other segment information

Depreciation on property, plant and equipment	2	-	2
-----------------------------------------------	---	---	---

MORGAN STANLEY & CO. INTERNATIONAL plc

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
Six months ended 30 June 2013

5. SEGMENT REPORTING (CONTINUED)

Business segments (continued)

Condensed consolidated income statement information Six months ended 30 June 2012	Institutional Securities \$millions	Other \$millions	Total \$millions
Net gains on financial instruments classified as held for trading	1,960	25	1,985
Net gains on financial instruments designated at fair value through profit or loss	151	-	151
Net interest (expense)/income	(308)	10	(298)
Other income	311	5	316
External revenues	2,114	40	2,154
Other expense	(1,606)	(49)	(1,655)
Profit/(loss) before tax	508	(9)	499
Income tax (expense)/credit	(252)	2	(250)
Profit/(loss) for the period	256	(7)	249

Condensed consolidated statement of financial position information As at 31 December 2012	Institutional Securities \$millions	Other⁽¹⁾ \$millions	Total \$millions
Segment assets	560,049	4,362	564,411
Total assets	560,049	4,362	564,411
Segment liabilities	547,239	3,647	550,886
Total liabilities	547,239	3,647	550,886

Other segment information

Depreciation on property, plant and equipment	2	-	2
-----------------------------------------------	---	---	---

(1) Other includes the investment management business segment.

MORGAN STANLEY & CO. INTERNATIONAL plc

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Six months ended 30 June 2013

5. SEGMENT REPORTING (CONTINUED)

Geographical segments

The Group operates in three geographic regions as listed below:

- Europe, Middle East and Africa (“EMEA”)
- Americas
- Asia

The following table presents selected condensed consolidated income statement and condensed consolidated statement of financial position information of the Group’s operations by geographic area. The external revenues (net of interest expense) and total assets disclosed in the following table reflect the regional view of the Group’s operations, on a managed basis. The basis for attributing external revenues (net of interest expense) and total assets is determined by a combination of client and trading desk location.

Geographical Segments	EMEA		Americas		Asia		Total	
	30 June 2013	30 June 2012	30 June 2013	30 June 2012	30 June 2013	30 June 2012	30 June 2013	30 June 2012
	\$millions	\$millions	\$millions	\$millions	\$millions	\$millions	\$millions	\$millions
External revenues	1,790	1,929	21	42	88	183	1,899	2,154
(Loss)/ profit before income tax	(122)	330	(31)	11	17	158	(136)	499
	30 June 2013	31 Dec 2012	30 June 2013	31 Dec 2012	30 June 2013	31 Dec 2012	30 June 2013	31 Dec 2012
	\$millions	\$millions	\$millions	\$millions	\$millions	\$millions	\$millions	\$millions
Total assets	479,710	465,666	64,929	55,397	68,593	43,348	613,232	564,411

MORGAN STANLEY & CO. INTERNATIONAL plc

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Six months ended 30 June 2013

6. FINANCIAL RISK MANAGEMENT

Risk management procedures

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

As disclosed in the interim management report, the Group has exposure to European Peripheral countries, which are defined as Portugal, Ireland, Italy, Greece and Spain. The Group's exposure is included within either the credit risk or the market risk disclosures below consistent with how the financial instrument is managed.

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 when a borrower, counterparty or issuer does not meet its financial obligations.

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

The Group incurs credit risk exposure to institutions and sophisticated investors primarily through the Institutional Securities segment. Credit risk incurred through the Institutional Securities business segment may arise from a variety of business activities, including, but not limited to, entering into swap or other derivative contracts under which the counterparties have obligations to make payment to the Group; extending credit to clients through various lending commitments; providing short-term or long-term funding that is secured by physical or financial collateral whose value may at times be insufficient to cover the loan repayment amount; and posting margin and/ or collateral to clearing houses, clearing agencies, exchanges, banks, securities firms and other financial counterparties. The Group also incurs credit risk in traded securities and loan pools, whereby the value of these assets may fluctuate based on realised or expected defaults on the underlying obligations or loans.

Credit risk management takes place at the transaction, counterparty and portfolio levels. In order to protect the Group from losses resulting from these activities, the Credit Risk Management Department ensures lending transactions and derivative exposures are evaluated, that the creditworthiness of the Group's counterparties and borrowers is reviewed regularly and that credit exposure is actively monitored and managed. This includes an assessment of an obligor's probability of default and relative recovery prospects. Where applicable, the Group also considers collateral arrangements and other structural elements of the particular transaction. The Group has limits that manage 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 30 June 2013, credit exposure was concentrated in Asian and Western European countries. In addition, the Group pays particular attention to smaller exposures in emerging markets given their unique risk profile. Country ceiling ratings are derived using methodologies generally consistent with those employed by external rating agencies.

MORGAN STANLEY & CO. INTERNATIONAL plc

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Six months ended 30 June 2013

6. FINANCIAL RISK MANAGEMENT (CONTINUED)

Credit risk (continued)

The Group also reviews its credit exposure and risk to types of customers. At 30 June 2013, the Group's material credit exposure was to corporate entities, sovereign-related entities and financial institutions.

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 received as collateral generally are not recognised on the condensed consolidated statement of financial position.

Securities purchased under agreements to resell and securities borrowed

The Group manages credit exposure arising from securities purchased under agreements to resell 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 securities purchased under agreements to resell and securities borrowed transactions, the Group receives collateral, including US 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 with 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, including collateral provisions, guarantees and hedges. At the transaction level, the Group seeks to mitigate risk through management of key risk elements such as size, tenor, financial covenants, seniority and collateral. The Group actively hedges its derivatives exposure through various financial instruments that may include single name, portfolio and structured credit derivatives. 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 demand collateral, as well as to liquidate collateral and offset receivables and payables covered under the same master netting agreement 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 ("gross credit exposure") of the Group as at 30 June 2013 is disclosed below, based on the carrying amounts of the financial assets the Group believes are subject to credit risk. Exposure arising from financial instruments not recognised on the consolidated statement of financial position is measured as the maximum amount that the Group could have to pay, which may be significantly greater than the amount that would be recognised as a liability. This table does not include receivables arising from pending securities transactions with market counterparties. Where the Group enters into credit enhancements, including receiving cash and security as collateral and master netting agreements, to manage the credit exposure on these financial instruments the financial effect of the credit enhancements is also disclosed below. The net credit exposure represents the credit exposure remaining after the effect of the credit enhancements.

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 Value at Risk ("VaR")-based risk measures included in the market risk disclosure.

MORGAN STANLEY & CO. INTERNATIONAL plc

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Six months ended 30 June 2013

6. FINANCIAL RISK MANAGEMENT (CONTINUED)

Credit risk (continued)

Exposure to credit risk by class

Class	30 June 2013			31 December 2012		
	Gross credit exposure ⁽¹⁾	Credit enhancements	Net credit exposure ⁽²⁾	Gross credit exposure ⁽¹⁾	Credit enhancements	Net credit exposure ⁽²⁾
	\$millions	\$millions	\$millions	\$millions	\$millions	\$millions
Loans and receivables:						
Cash and short term deposits	12,613	-	12,613	11,526	-	11,526
Cash collateral on securities borrowed	30,350	(29,316)	1,034	31,303	(31,201)	102
Securities purchased under agreements to resell	108,089	(103,989)	4,100	99,782	(99,344)	438
Trade receivables ⁽³⁾	50,722	-	50,722	47,246	-	47,246
Other receivables	4,370	-	4,370	5,139	-	5,139
Financial assets classified as held for trading:						
Derivatives	264,483	(252,695)	11,788	266,643	(253,192)	13,451
Financial assets designated at fair value through profit or loss	7,749	(6,755)	994	7,591	(6,174)	1,417
	<u>478,376</u>	<u>(392,755)</u>	<u>85,621</u>	<u>469,230</u>	<u>(389,911)</u>	<u>79,319</u>
Unrecognised financial instruments						
Contingent commitments	2,148	-	2,148	2,172	-	2,172
Letters of credit	1	-	1	5	-	5
Loan commitments	1,077	-	1,077	985	-	985
Underwriting commitments	42	-	42	44	-	44
Unsettled securities purchased under agreements to resell ⁽⁴⁾	30,815	-	30,815	25,370	-	25,370
	<u>512,459</u>	<u>(392,755)</u>	<u>119,704</u>	<u>497,806</u>	<u>(389,911)</u>	<u>107,895</u>

(1) The carrying amount recognised in the condensed consolidated statement of financial position best represents the Group's maximum exposure to credit risk.

(2) Of the residual net credit exposure, intercompany cross product netting arrangements are in place which would allow for an additional \$2,986 million (2012: \$9,897 million) to be offset in the event of default by certain Morgan Stanley counterparties.

(3) Trade receivables include cash collateral pledged against the payable on OTC derivative positions. These derivative liabilities are included within financial liabilities classified as held for trading in the condensed consolidated statement of financial position.

(4) For unsettled securities purchased under agreements to resell, collateral in the form of securities will be received at the point of settlement. Since the value of collateral is determined at a future date it is currently unquantifiable and not included in the table.

MORGAN STANLEY & CO. INTERNATIONAL plc

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Six months ended 30 June 2013

6. FINANCIAL RISK MANAGEMENT (CONTINUED)

Credit risk (continued)

Maximum exposure to credit risk by credit rating (1)

Credit rating	Gross credit exposure	
	30 June 2013 \$millions	31 December 2012 \$millions
AAA	19,756	19,267
AA	116,911	109,840
A	279,510	290,395
BBB	59,690	51,106
BB	19,837	14,478
B	8,730	6,604
CCC	4,616	3,833
D	13	-
Unrated	3,396	2,283
Total	512,459	497,806

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

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 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 Morgan Stanley Group's and the 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 core components of the Morgan Stanley Group's and the Group's liquidity management framework, are the Contingency Funding Plan ("CFP"), Liquidity Stress Tests and the Global Liquidity Reserve, which support the Morgan Stanley Group's, as well as the Group's, target liquidity profile.

Contingency Funding Plan. The CFP describes the data and information flows, limits, targets, operating environment indicators, escalation procedures, roles and responsibilities and available mitigating actions in the event of a liquidity stress. The CFP also sets forth the principal elements of the Morgan Stanley Group's and the Group's liquidity stress testing which identifies stress events of different severity and duration, assesses current funding sources and uses and establishes a plan for monitoring and managing a potential liquidity stress event.

Liquidity Stress Tests. The Morgan Stanley Group uses Liquidity Stress Tests to model liquidity outflows across multiple scenarios over a range of time horizons.

MORGAN STANLEY & CO. INTERNATIONAL plc

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Six months ended 30 June 2013

6. FINANCIAL RISK MANAGEMENT (CONTINUED)

Liquidity risk (continued)

The assumptions underpinning the Liquidity Stress Tests include, but are not limited to, the following: (i) no government support; (ii) no access to unsecured debt markets; (iii) repayment of all unsecured debt maturing within the stress horizon; (iv) higher haircuts and significantly lower availability of secured funding; (v) additional collateral that would be required by trading counterparties and certain exchanges and clearing organisations related to multi-notch credit rating downgrades; (vi) additional collateral that would be required due to collateral substitutions, collateral disputes and uncalled collateral; (vii) discretionary unsecured debt buybacks; (viii) drawdowns on unfunded commitments provided to third parties; (ix) client cash withdrawals and reduction in customer short positions that fund long positions; (x) limited access to the foreign exchange swap markets; (xi) return of securities borrowed on an uncollateralised basis; and (xii) maturity roll-off of outstanding letters of credit with no further issuance.

The Liquidity Stress Tests are produced at the Morgan Stanley Group and major operating subsidiary level, including the Group, as well as major currency levels, to capture specific cash requirements and cash availability at various legal entities. The Liquidity Stress Tests assume that subsidiaries, including the Group, will use their own liquidity first to fund their obligations before drawing liquidity from Morgan Stanley. It is also assumed that Morgan Stanley does not have access to cash that may be held at certain subsidiaries that are subject to regulatory, legal or tax constraints.

The CFP and Liquidity Stress Tests 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 Morgan Stanley International Limited Board Risk Committee.

Global Liquidity Reserve. The Morgan Stanley Group and the Group maintain sufficient liquidity reserves (“the Global Liquidity Reserve”) to cover daily funding needs and meet strategic liquidity targets sized by the CFP and Liquidity Stress Tests. These liquidity targets are based on the Morgan Stanley Group’s risk tolerance, condensed consolidated statement of financial position level and composition, subsidiary funding needs, and upcoming debt maturities, which are subject to change dependent on market and firm-specific events.

The Global Liquidity Reserve is held within Morgan Stanley and the Morgan Stanley Group’s major operating subsidiaries and consists of highly liquid and diversified cash and cash equivalents and unencumbered securities (including US government securities, US agency securities, US agency mortgage-backed securities, Federal Deposit Insurance Corporation (“FDIC”) guaranteed corporate debt and non US government securities). In addition to the Global Liquidity Reserve, the Group maintains a locally managed liquidity reserve which consists of cash and cash equivalents and central bank eligible unencumbered securities. In addition to the liquidity reserve held by the Group, the Group has access to the Global Liquidity Reserve.

Funding management policies

The Morgan Stanley Group manages its funding 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.

The Morgan Stanley Group funds its condensed consolidated statement of financial position on a global basis through diverse sources, which includes consideration of the funding risk of each legal entity. These sources may include the Morgan Stanley Group’s equity capital, long-term debt, securities sold under agreements to repurchase, 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, targeting global investors and currencies.

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
Six months ended 30 June 2013

6. FINANCIAL RISK MANAGEMENT (CONTINUED)

Liquidity risk (continued)

In managing both the Morgan Stanley Group's and the Group's funding risk the composition and size of the entire condensed consolidated statement of financial position, not just financial liabilities, is monitored and evaluated. A substantial portion of the Morgan Stanley Group's total assets consists of liquid marketable securities and short-term collateralised receivables arising from its Institutional Securities business segment's sales and trading activities. The liquid nature of these assets provides the Morgan Stanley Group and the Group with flexibility in funding and managing their business.

Maturity analysis

In the following maturity analysis of financial liabilities, derivative contracts and other financial liabilities held as part of the Group's trading activities are disclosed as on demand and presented at fair value, consistent with how these financial liabilities are managed. Derivatives not held as part of the Group's trading activities and financial liabilities designated at fair value through profit and loss 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 30 June 2013. Repayments of financial liabilities that are subject to immediate notice are treated as if notice were given immediately and are classified as on demand. This presentation is considered by the Group to appropriately reflect the liquidity risk arising from those financial liabilities, presented in a way that is consistent with how the liquidity risk on these financial liabilities is managed by the Group.

MORGAN STANLEY & CO. INTERNATIONAL plc

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
Six months ended 30 June 2013

6. FINANCIAL RISK MANAGEMENT (CONTINUED)

Liquidity risk (continued)

Maturity analysis (continued)

30 June 2013	On demand	Less than 1 month	but less than 3 months	Equal to or more than 1 month	but less than 1 year	Equal to or more than 3 months	year but less than 5 years	Equal to or more than 5 years	Total
	\$millions	\$millions	\$millions	\$millions	\$millions	\$millions	\$millions	\$millions	\$millions
Financial liabilities									
Financial liabilities at amortised cost:									
Bank loans and overdrafts	15	-	-	-	-	-	-	-	15
Cash collateral on securities loaned	27,142	754	1,334	1,151	-	-	-	-	30,381
Securities sold under agreements to repurchase	26,491	30,896	11,096	12,853	3,314	-	-	-	84,650
Trade payables	122,101	-	-	-	-	-	-	-	122,101
Other payables	7,691	3	6	8,995	124	4,135	-	-	20,954
Subordinated loans	-	-	-	137	943	10,963	-	-	12,043
Financial liabilities classified as held for trading:									
Derivatives	283,485	-	-	-	-	-	-	-	283,485
Other	37,822	-	-	-	-	-	-	-	37,822
Financial liabilities designated at fair value through profit or loss									
	7,570	129	321	1,172	2,897	708	-	-	12,797
Total financial liabilities	512,317	31,782	12,757	24,308	7,278	15,806	-	-	604,248
Unrecognised financial instruments									
Contingent commitments	2,148	-	-	-	-	-	-	-	2,148
Lease commitments	-	1	2	5	22	11	-	-	41
Letters of credit	1	-	-	-	-	-	-	-	1
Loan commitments	1,077	-	-	-	-	-	-	-	1,077
Underwriting commitments	42	-	-	-	-	-	-	-	42
Unsettled securities purchased under agreements to resell ⁽¹⁾	30,134	51	630	-	-	-	-	-	30,815
Total unrecognised financial instruments	33,402	52	632	5	22	11	-	-	34,124

(1) The Group enters into forward starting unsettled securities purchased under agreements to resell (agreements which have a trade date at or prior to 30 June 2013 and settle subsequent to period end). These agreements primarily settle within three business days and of the total amount at 30 June 2013, \$30,134 million settled within three business days.

MORGAN STANLEY & CO. INTERNATIONAL plc

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Six months ended 30 June 2013

6. FINANCIAL RISK MANAGEMENT (CONTINUED)

Liquidity risk (continued)

Maturity analysis (continued)

	On demand	Less than 1 month	Equal to or more than 1 month but less than 3 months	Equal to or more than 3 months but less than 1 year	Equal to or more than 1 year but less than 5 years	Equal to or more than 5 years	Total
31 December 2012	\$millions	\$millions	\$millions	\$millions	\$millions	\$millions	\$millions
Financial liabilities							
Financial liabilities at amortised cost:							
Bank loans and overdrafts	23	-	-	-	-	-	23
Cash collateral on securities loaned	24,526	1,396	973	2,137	304	-	29,336
Securities sold under agreements to repurchase	29,916	27,874	11,600	12,283	3,697	324	85,694
Trade payables	83,161	-	-	-	-	-	83,161
Other payables	8,170	1	3	6,234	63	4,160	18,631
Subordinated loans	-	-	-	144	847	10,516	11,507
Financial liabilities classified as held for trading:							
Derivatives	278,270	-	-	-	-	-	278,270
Other	35,778	-	-	-	-	-	35,778
Financial liabilities designated at fair value through profit or loss							
	8,004	69	81	571	3,227	608	12,560
Total financial liabilities	467,848	29,340	12,657	21,369	8,138	15,608	554,960
Unrecognised financial instruments							
Contingent commitments	2,172	-	-	-	-	-	2,172
Lease commitments	-	1	2	5	23	13	44
Letters of credit	5	-	-	-	-	-	5
Loan commitments	985	-	-	-	-	-	985
Underwriting commitments	44	-	-	-	-	-	44
Unsettled securities purchased under agreements to resell ⁽¹⁾	20,648	4,722	-	-	-	-	25,370
Total unrecognised financial instruments	23,854	4,723	2	5	23	13	28,620

(1) The Group enters into forward starting unsettled securities purchased under agreements to resell (agreements which have a trade date at or prior to 31 December 2012 and settle subsequent to period end). These agreements primarily settle within three business days and of the total amount at 31 December 2012, \$20,648 million settled within three business days.

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
Six months ended 30 June 2013

6. 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 market liquidity, will result in losses for a position or portfolio.

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

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

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

Risk and capital management initiative

The Group also performs routine stress testing to more comprehensively monitor the risk in the portfolio. The Group utilises Stress VaR ("S-VaR"), which is a proprietary methodology that comprehensively measures the Group's market and credit risks. S-VaR simulates many stress scenarios based on more than 25 years of historical data and attempts to capture the different liquidities of various types of general and specific risks. Additionally, S-VaR captures event and default risks that are particularly relevant for credit portfolios.

Primary market risk exposures and market risk management

During the six month period ended 30 June 2013, 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: corporate and government debt across both developed and emerging markets and asset-backed debt (including mortgage-related securities).

The Group is exposed to equity price and implied volatility risk as a result of making markets in equity securities and derivatives and maintaining other positions (including positions in non-public entities). Positions in non-public entities may include, but are not limited to, exposures to private equity and other funds. Such positions are less liquid, have longer investment horizons and are more difficult to hedge than listed equities.

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, from maintaining foreign exchange positions and from holding non-US dollar-denominated financial instruments.

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
Six months ended 30 June 2013

6. FINANCIAL RISK MANAGEMENT (CONTINUED)

Market risk (continued)

Primary market risk exposures and market risk management (continued)

The Group is exposed to commodity price and implied volatility risk as a result of market-making activities and maintaining commodity 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 weather conditions; 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). Hedging activities may not always provide effective mitigation against trading losses due to differences in the terms, specific characteristics or other basis risks that may exist between the hedge instrument and the risk exposure that is being hedged. The Group manages the market risk associated with its trading activities on an entity-wide basis, on a worldwide trading division level and on an individual product strategy. The Group manages and monitors its market risk exposures in such a way as to maintain a portfolio that the Group believes is well-diversified in the aggregate with respect to market risk factors and that reflects the Group's aggregate risk tolerance, as established by the Group's senior management.

Aggregate market risk limits have been approved for the Group and major trading divisions worldwide, as well as for the firm globally. 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.

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 enhanced its VaR model during 2012 to make it more responsive to current market conditions while maintaining a longer-term perspective. This enhancement was effective from 1 April 2012 and history before then has not been shown. This enhancement is consistent with regulatory requirements. The current VaR model was approved by the Group's regulators for use in regulatory capital calculations.

The Group estimates VaR using a model based on volatility adjusted historical simulation for general market risk factors and Monte Carlo simulation for name-specific risk in corporate shares, bonds, loans and related derivatives. The model constructs a distribution of hypothetical daily changes in the value of trading portfolios based on the following: historical observation of daily changes in key market indices or other market risk factors; and information on the sensitivity of the portfolio values to these market risk factor changes. The Group's VaR model uses four years of historical data with a volatility adjustment to reflect current market conditions. 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.

MORGAN STANLEY & CO. INTERNATIONAL plc

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Six months ended 30 June 2013

6. FINANCIAL RISK MANAGEMENT (CONTINUED)

Market risk (continued)

VaR methodology, assumptions and limitations (continued)

The Group's VaR model generally takes into account linear and non-linear exposures to equity and commodity price risk, interest rate risk, credit spread risk and foreign exchange rates. The model also takes into account linear exposures to implied volatility risks for all asset classes and non-linear exposures to implied volatility risks for equity, commodity and foreign exchange referenced products. The VaR model also captures certain implied correlation risks associated with portfolio credit derivatives as well as certain basis risks (e.g., corporate debt and related credit derivatives).

Among their benefits, VaR models permit estimation of a portfolio's aggregate market risk exposure, incorporating a range of varied market risks and portfolio assets. One key element of the VaR model is that it reflects risk reduction due to portfolio diversification or hedging activities. However, VaR has various strengths and limitations, which include but are not limited to: use of historical changes in market risk factors, which may not be accurate predictors of future market conditions, and may not fully incorporate the risk of extreme market events that are outsized relative to observed historical market behaviour or reflect the historical distribution of results beyond the 95% confidence interval; and reporting of losses in a single day, which does not reflect the risk of positions that cannot be liquidated or hedged in one day. A small proportion of market risk generated by trading positions is not included in VaR. The modelling of the risk characteristics of some positions relies on approximations that, under certain circumstances, could produce significantly different results from those produced using more precise measures. VaR is most appropriate as a risk measure for trading positions in liquid financial markets and will understate the risk associated with severe events, such as periods of extreme illiquidity. 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 and Group levels.

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. Additionally, the Group continues to evaluate enhancements to the VaR model to make it more responsive to more recent market conditions while maintaining a longer-term perspective.

Since the reported VaR statistics are estimates based on historical 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 for a 95% / one-day VaR. VaR does not predict the magnitude of losses which, should they occur, may be significantly greater than the VaR amount.

Sensitivity analysis

VaR for the six month period ended 30 June 2013

The table below presents VaR for the Group's Trading portfolio, on a period-end, period average and period high and low basis for 30 June 2013 and 31 December 2012.

The Credit Portfolio VaR is disclosed as a separate category from the Primary Risk Categories. The Credit Portfolio VaR includes the mark-to-market relationship lending exposures and associated hedges as well as counterparty credit valuation adjustments and related hedges.

MORGAN STANLEY & CO. INTERNATIONAL plc

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Six months ended 30 June 2013

6. FINANCIAL RISK MANAGEMENT (CONTINUED)

Market risk (continued)

Sensitivity analysis (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% VaR	95% / one-day VaR for the six months ended 30 June 2013				95% / one-day VaR for the nine months ended 31 December 2012 ⁽³⁾			
	Period		High \$million	Low \$million	Period		High \$million	Low \$million
Market Risk Category	End \$million	Average \$million			End \$million	Average \$million		
Interest rate and credit spread	15	15	24	12	17	18	28	14
Equity price	14	14	32	11	13	16	29	12
Foreign exchange rate	4	3	9	2	3	3	8	2
Commodity price	1	1	2	1	1	2	4	1
Less: Diversification benefit ⁽¹⁾⁽²⁾	(14)	(12)	N/A	N/A	(13)	(15)	N/A	N/A
Primary Risk Categories VaR	20	21	37	17	21	24	42	19
Credit Portfolio VaR	9	10	13	8	13	14	17	12
Less: Diversification benefit ⁽¹⁾⁽²⁾	(5)	(6)	N/A	N/A	(7)	(8)	N/A	N/A
Total trading VaR	24	25	41	21	27	30	51	22

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

(2) N/A - Not Applicable. The minimum and maximum VaR values for the total VaR and each of the component VaRs might have occurred on different days during the period and therefore the diversification benefit is not an applicable measure.

(3) The new VaR model is effective from 1 April 2012 therefore comparative VaR is shown for the nine months ending 31 December 2012.

The Group's average VaR for the Primary Risk Categories for the six month period to 30 June 2013 was \$21 million compared with \$24 million for the nine months to 31 December 2012. Reduced risk taking in fixed income products was the primary driver of the decrease.

The average Credit Portfolio VaR for the six month period to 30 June 2013 was \$10 million compared with \$14 million for the nine months to 31 December 2012. The decrease in the average VaR over period was from reduced counterparty exposure, resulting in a lower Credit Portfolio VaR for the six month period to 30 June 2013.

The average Total Trading VaR for the six month period to 30 June 2013 was \$25 million compared with \$30 million for the nine months to 31 December 2012.

MORGAN STANLEY & CO. INTERNATIONAL plc

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Six months ended 30 June 2013

6. FINANCIAL RISK MANAGEMENT (CONTINUED)

Market risk (continued)

Non-trading risks for the six month period ended 30 June 2013

The Group believes that sensitivity analysis is an appropriate representation of the Group's non-trading risks. Reflected below is this analysis, which covers substantially all of the non-trading risk in the Group's portfolio.

Interest rate risk

The Group's VaR excludes certain funding liabilities and money market transactions. The application of a parallel shift in interest rates of 50 basis points increase or decrease to these positions would result in a net gain or loss of approximately \$2.6 million as at 30 June 2013, compared to a net gain or loss of \$2.5 million as at 31 December 2012.

Counterparty exposure related to the Group's own spreads

The credit spread risk relating to the Group's own mark-to-market derivative counterparty exposure corresponds to an increase in value of approximately \$2.6 million for each 1 basis point widening in the Group's credit spread level at 30 June 2013, compared to \$3 million at 31 December 2012.

Structured notes

The credit spread risk sensitivity of the Group's mark-to-market structured notes corresponded to an increase in value of approximately \$0.7 million for each 1 basis point widening in the Group's credit spread level at both 30 June 2013 and 31 December 2012.

Equity investments price risk

The Group is exposed to equity price risk as a result of changes in the fair value of its investments in both exchange traded equity securities and private equities classified as available-for-sale financial assets. These investments are predominantly equity positions with long investment horizons, the majority of which are for business facilitation purposes. The market risk related to these investments is measured by estimating the potential reduction in net revenues associated with a 10% decline in investment values.

	30 June 2013	31 December 2012
	10% sensitivity	10% sensitivity
	\$millions	\$millions
Available-for-sale financial assets	4	4
	4	4

MORGAN STANLEY & CO. INTERNATIONAL plc

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Six months ended 30 June 2013

6. FINANCIAL RISK MANAGEMENT (CONTINUED)

Market risk (continued)

Currency risk

The Group has foreign currency exposure arising from foreign operations. The majority of this foreign currency risk has been hedged by other members of the Morgan Stanley Group, primarily Morgan Stanley, by utilising forward foreign currency exchange contracts.

The analysis below details this foreign currency exposure for the Group, 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 the any foreign currency hedges held by the Group or by other members of the Morgan Stanley Group.

	30 June 2013			31 December 2012		
	Sensitivity to applied percentage change in currency (+/-)			Sensitivity to applied percentage change in currency (+/-)		
	Foreign currency exposure \$millions	Percentage change applied %	Other comprehensive income \$millions	Foreign currency exposure \$millions	Percentage change applied %	Other comprehensive income \$millions
Australian Dollar	(51)	27%	(14)	(16)	27%	(4)
Euro	450	7%	31	450	7%	31
British Pound	52	29%	15	55	29%	16
New Taiwan Dollar	63	8%	5	62	8%	5
New Zealand Dollar	2	24%	-	2	24%	-
Polish Zloty	3	16%	-	2	16%	-
Singapore Dollar	-	9%	-	-	9%	-
South Korean Won	208	42%	88	206	42%	87
Swedish Krona	16	23%	4	16	23%	4
Swiss Franc	11	10%	1	10	10%	1
	<u>754</u>		<u>130</u>	<u>787</u>		<u>140</u>

The reasonably possible percentage change in the currency rate against US dollars has been calculated based on the greatest annual percentage change over a period from 1 December 2007 to 30 June 2013. Thus the percentage change applied may not be the same percentage as the actual change in the currency rate for the six month period to 30 June 2013, or for the year ended 31 December 2012.

The Group also has foreign currency exposure arising from its trading activities and assets and liabilities in currencies other than US dollars, which it actively manages by hedging with other Morgan Stanley Group undertakings. The residual currency risk for the Group from this activity is not material.

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
Six months ended 30 June 2013

7. FINANCIAL ASSETS AND FINANCIAL LIABILITIES SUBJECT TO OFFSETTING

In order to manage credit exposure arising from its business activities, the Group applies various credit risk management policies and procedures (see Note 6 for further details). Such procedures include, in appropriate circumstances, entering into master netting arrangements and collateral arrangements with its counterparties. These agreements provide the Group with the right, in the ordinary course of business and / or in the event of a counterparty default (such as bankruptcy or a counterparty's failure to pay or perform), to net a counterparty's rights and obligations under such agreement and, in the event of counterparty default, set off collateral against the net amount owed by the counterparty. However, in certain circumstances, the Group may not have such an agreement in place; the relevant insolvency regime (which is based on type of counterparty entity and the jurisdiction of organisation of the counterparty) may not support the enforceability of the agreement; or the Group may not have sought legal advice to support the enforceability of the agreement. In cases where the Group has not determined an agreement to be enforceable, the related amounts are not offset in the tabular disclosures. The Group's policy is generally to take possession of securities purchased under agreements to resell and securities borrowed, and to receive securities and cash posted as collateral (with rights of rehypothecation), although in certain cases the Group may agree for such collateral to be posted to a third party custodian under a tri-party arrangement that enables the Group to take control of such collateral in the event of a counterparty default. The enforceability of the master netting agreement is taken into account in the Group's risk management practices and application of counterparty credit limits. The Group also monitors the fair value of the underlying securities as compared with the related receivable or payable, including accrued interest, and, as necessary, requests additional collateral as provided under the applicable agreement to ensure such transactions are adequately collateralised. In the condensed consolidated statement of financial position, financial assets and financial liabilities are only offset and presented on a net basis where there is a current legally enforceable right to set off the recognised amounts and an intention to either settle on a net basis or to realise the asset and the liability simultaneously. In the absence of such conditions, financial assets and financial liabilities are presented on a gross basis.

The following tables present information about the offsetting of financial instruments and related collateral amounts. It does not include information about financial instruments that are subject only to a collateral agreement. The effect of master netting arrangements, collateral agreements and other credit enhancements, on the Group's exposure to credit risk is disclosed in Note 6.

MORGAN STANLEY & CO. INTERNATIONAL plc

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Six months ended 30 June 2013

7. FINANCIAL ASSETS AND FINANCIAL LIABILITIES SUBJECT TO OFFSETTING (CONTINUED)

	Gross amounts ⁽¹⁾	Amounts offset in the condensed consolidated statement of financial position ⁽²⁾	Net amounts presented in the condensed consolidated statement of financial position	Amounts not offset in the condensed consolidated statement of financial position ^{(3) (4) (5)}		Net exposure ⁽⁶⁾
	\$millions	\$millions	\$millions	Financial instruments \$millions	Cash collateral \$millions	\$millions
30 June 2013						
Assets						
Loans and receivables:						
Cash collateral on securities borrowed	39,240	(8,890)	30,350	(29,316)	-	1,034
Securities purchased under agreement to resell	141,642	(33,553)	108,089	(103,989)	-	4,100
Financial assets classified as held for trading:						
Derivatives	289,848	(1,092)	288,756	(243,689)	(26,949)	18,118
TOTAL	470,730	(43,535)	427,195	(376,994)	(26,949)	23,252
Liabilities						
Financial liabilities at amortised cost:						
Cash collateral on securities loaned	39,271	(8,890)	30,381	(29,804)	-	577
Securities sold under agreement to repurchase	118,203	(33,553)	84,650	(78,915)	-	5,735
Financial liabilities classified as held for trading:						
Derivatives	284,577	(1,092)	283,485	(243,439)	(20,879)	19,167
TOTAL	442,051	(43,535)	398,516	(352,158)	(20,879)	25,479

(1) Amounts include \$316 million of cash collateral on securities borrowed, \$3,253 million of securities purchased under agreements to resell, \$3,139 million of financial assets classified as held for trading – derivatives, \$26 million of cash collateral on securities loaned, \$4,705 million of securities sold under agreements to resell and \$2,044 million of financial liabilities classified as held for trading – derivatives which are either not subject to master netting agreements or collateral agreements or are subject to such agreements but the Group has not determined the agreements to be legally enforceable.

(2) Amounts are reported on a net basis in the condensed consolidated statements of financial position when there is a legally enforceable master netting arrangement that provides for a current right of offset and there is an intention to either settle on a net basis or to realise the asset and liability simultaneously.

(3) Amounts relate to master netting arrangements and collateral arrangements which have been determined by the Group to be legally enforceable but do not meet all criteria required for net presentation within the condensed consolidated statement of financial position.

(4) The cash collateral is recognised in the condensed consolidated statement of financial position within trade receivables and payables respectively.

(5) Certain other trade receivables and payables that are not presented net within the condensed consolidated statement of financial position have legally enforceable master netting agreements or similar arrangements in place which would allow for an additional \$12,613 million to be offset in the event of default.

(6) Of the residual net exposure, intercompany cross-product legally enforceable netting arrangements are in place which would allow for an additional \$2,986 million to be offset in the ordinary course of business and / or in the event of default.

MORGAN STANLEY & CO. INTERNATIONAL plc

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Six months ended 30 June 2013

7. FINANCIAL ASSETS AND FINANCIAL LIABILITIES SUBJECT TO OFFSETTING (CONTINUED)

	Gross amounts ⁽¹⁾ \$millions	Amounts offset in the consolidated statement of financial position ⁽²⁾ \$millions	Net amounts presented in the consolidated statement of financial position \$millions	Amounts not offset in the consolidated statement of financial position ^{(3) (4) (5)}		Net exposure ⁽⁶⁾ \$millions
				Financial instruments \$millions	Cash collateral \$millions	
31 December 2012						
Assets						
Loans and receivables:						
Cash collateral on securities borrowed	31,303	-	31,303	(30,687)	-	616
Securities purchased under agreement to resell	120,487	(20,705)	99,782	(95,398)	-	4,384
Financial assets classified as held for trading:						
Derivatives	283,782	(1,122)	282,660	(240,556)	(29,464)	12,640
TOTAL	435,572	(21,827)	413,745	(366,641)	(29,464)	17,640
Liabilities						
Financial liabilities at amortised cost:						
Cash collateral on securities loaned	29,336	-	29,336	(28,985)	-	351
Securities sold under agreement to repurchase	106,399	(20,705)	85,694	(81,642)	-	4,052
Financial liabilities classified as held for trading:						
Derivatives	279,392	(1,122)	278,270	(243,597)	(22,330)	12,343
TOTAL	415,127	(21,827)	393,300	(354,224)	(22,330)	16,746

(1) Amounts include \$196 million of cash collateral on securities borrowed, \$4,125 million of securities purchased under agreements to resell, \$1,473 million of financial assets classified as held for trading - derivatives, \$9 million of cash collateral on securities loaned, \$3,760 million of securities sold under agreements to resell and \$1,373 million of financial liabilities classified as held for trading - derivatives which are either not subject to master netting agreements or collateral agreements or are subject to such agreements but the Group has not determined the agreements to be legally enforceable.

(2) Amounts are reported on a net basis in the condensed consolidated statements of financial position when there is a legally enforceable master netting arrangement that provides for a current right of offset and there is an intention to either settle on a net basis or to realise the asset and liability simultaneously.

(3) Amounts relate to master netting arrangements and collateral arrangements which have been determined by the Group to be legally enforceable but do not meet all criteria required for net presentation within the condensed consolidated statement of financial position.

(4) The cash collateral is recognised in the condensed consolidated statement of financial position within trade receivables and payables respectively.

(5) Certain other trade receivables and payables that are not presented net within the condensed consolidated statement of financial position have legally enforceable master netting agreements or similar arrangements in place which would allow for an additional \$4,559 million to be offset in the event of default.

(6) Of the residual net exposure, intercompany cross-product legally enforceable netting arrangements are in place which would allow for an additional \$2,749 million to be offset in the ordinary course of business and / or in the event of default.

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
Six months ended 30 June 2013

8. INTEREST IN STRUCTURED ENTITIES

The Group is involved with various special purpose entities (“SPE”) in the normal course of business. In most cases, these entities are deemed to be structured entities.

A structured entity is an entity in which equity investors do not typically have the characteristics of a controlling financial interest. The party that consolidates the structured entity is the investor that controls the structured entity. An investor controls a structured entity when it is exposed, or has the rights, to variable returns from its involvement with the structured entity and has the ability to affect those returns through its power over the structured entity. The Group consolidates structured entities it controls.

The Group’s interests in structured entities include certain debt and equity interests, commitments, guarantees, derivative instruments and certain fees. The Group’s involvement with structured entities arises primarily from:

- Loans made to and investments in structured entities that hold debt, equity, real estate or other assets.
- Interests purchased in connection with market-making activities and retained interests held as a result of securitisation activities.
- Structuring of asset-repackaged notes designed to meet the investment objectives of clients.
- Certain derivatives entered into with structured entities.

Consolidated structured entities

The Group determines whether it controls, and therefore should consolidate, a structured entity upon its initial involvement with the structured entity and reassesses whether it should continue to consolidate on an ongoing basis as long as it has any continuing involvement with the structured entity. This determination is based upon an analysis of the design of the structured entity, including the structured entity’s structure and activities; assessment of the significance of the powers to make economic decisions which are held by the Group and its related parties and whether such powers may be used to affect its investor returns; and consideration of the significance of direct and indirect interests in the structured entity which are held by the Group and its related parties.

The power to make the most significant economic decisions may take a number of different forms. The Group considers servicing or collateral management decisions as generally representing the power to make the most significant economic decisions in transactions such as securitisations or collateralised debt obligations (“CDOs”). As a result, the Group does not consolidate securitisations or CDOs for which it does not act as the servicer or collateral manager unless it holds certain other rights to replace the servicer or collateral manager or to require the liquidation of the entity. In fund structures, the power to appoint or direct the fund manager is generally the most significant power.

For certain structured entities, such as entities which issued Credit Linked Notes (‘CLNs’) and other asset-repackaged notes, there are no significant economic decisions made on an ongoing basis. In these cases, the Group focuses its analysis on decision making powers relating to liquidation of the entity or unwinding or termination of the transaction structure. Based upon factors, which include an analysis of the nature of the assets, including whether the assets were issued in a transaction sponsored by the Group and the extent of the information available to the Group and to investors, the number, nature and involvement of investors, other rights held by the Group and investors, the standardisation of the legal documentation and the level of the continuing involvement by the Group, including the amount and type of interests owned by the Group and by other investors, the Group concluded in some of these transactions that decisions made prior to the initial closing were shared between the Group and the initial investors. The Group focused its control decision on any right held by the Group or investors related to the termination of the structured entity. Many CLNs and other asset repackaged notes have no such termination rights.

MORGAN STANLEY & CO. INTERNATIONAL plc

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Six months ended 30 June 2013

8. INTEREST IN STRUCTURED ENTITIES (CONTINUED)

Consolidated structured entities (continued)

The assets owned by many consolidated structured entities cannot be removed unilaterally by the Group and are not generally available to the Group. The related liabilities issued by many consolidated structured entities are non-recourse to the Group. In certain other consolidated structured entities, the Group has the unilateral right to remove assets or provide additional recourse through derivatives such as total return swaps, guarantees or other forms of involvement.

The Group accounts for the assets held by structured entities primarily in Financial assets classified as held for trading – corporate and other debt and the liabilities of the structured entities as Financial liabilities designated at fair value in the condensed consolidated statement of financial position.

The table below shows information about the structured entities the Group consolidates. Consolidated structured entity assets and liabilities are presented after intercompany eliminations and include assets financed on a non-recourse basis:

	Mortgage and asset-backed securitisations	Credit linked notes	Other	Total
	\$millions	\$millions	\$millions	\$millions
30 June 2013				
Structured entity assets	83	163	-	246
Structured entity liabilities	83	162	-	245
31 December 2012				
Structured entity assets	233	271	2	506
Structured entity liabilities	192	252	-	444

In general, the Group's exposure to loss in consolidated structured entities is limited to losses that would be absorbed by the structured entity's assets recognised in its financial statements, net of losses absorbed by third-party holders of the structured entity's liabilities. The Group also had additional maximum exposure to losses of approximately \$nil and \$2 million at 30 June 2013 and 31 December 2012, respectively. This additional exposure related primarily to certain derivatives (e.g., instead of purchasing senior securities, the Group has sold credit protection to synthetic CDOs through credit derivatives that are typically related to the most senior tranche of the CDO) and commitments, guarantees and other forms of involvement.

The Group has not provided financial support or otherwise agreed to be responsible for supporting any consolidated structured entity financially.

Unconsolidated structured entities

The Group has interests in structured entities that the Group does not control and are therefore not consolidated.

The Group's transactions with unconsolidated structured entities primarily include securitisations, credit protection purchased through CLNs, other structured financings and collateralised loan and debt obligations. The Group's interests in structured entities that it does not consolidate can include ownership of retained interests in Group-sponsored transactions, interests purchased in the secondary market (both for Group-sponsored transactions and transactions sponsored by third parties), and certain derivatives with securitisation structured entities. The risks associated with derivatives entered into with structured entities are essentially the same as similar derivatives with non structured entity counterparties and are managed as part of the Group's overall exposure. The usage of structured entities is further described below.

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
Six months ended 30 June 2013

8. INTEREST IN STRUCTURED ENTITIES (CONTINUED)

Unconsolidated structured entities (continued)

Securitisation Activities. In a securitisation transaction, the Group transfers assets (generally commercial or residential mortgage loans) to a structured entity, sells to investors most of the beneficial interests, such as notes or certificates, issued by the structured entity, and in many cases, retains other beneficial interests. The purchase of the transferred assets by the structured entity is financed through the same of these interests. In many securitisations, particularly those involving residential mortgage loans, the Group also enters into derivative transactions, primarily interest rate swaps or interest rate caps with a senior payment priority, with the structured entity.

Credit Protection Purchased through CLNs. In a CLN transaction, the Group transfers reference assets (generally high-quality securities or money market investments) to an structured entity, enters into a derivative transaction in which the structured entity writes protection on an unrelated reference asset or group of assets, through a credit default swap, a total return swap or similar instrument, and sells to investors the securities issued by the structured entity. In some transactions, the Group may also enter into interest rate or currency swaps with the structured entity. The purchase of the transferred assets by the structured entity is financed through the sale of the securities issued. Upon the occurrence of a credit event related to the reference asset, the structured entity will deliver collateral securities as the payment to the Group. The Group is generally exposed to price changes on the collateral securities in the event of a credit event and subsequent sale. These transactions are designed to provide investors with exposure to certain credit risk on the reference asset. The structure of the transaction determines the accounting treatment. In some transactions, the assets and liabilities of the structured entity are recognised in the Group's consolidated financial statements. In other transactions, the transfer of the collateral securities is accounted for as a sale of assets, and the structured entity is not consolidated. CLNs are included in Other in the tables below.

Collateralised Loan and Debt Obligations. A collateralised loan obligation or a CDO is a structured entity that purchases a pool of assets, consisting of corporate loans, corporate bonds, asset-backed securities or synthetic exposures on similar assets through derivatives, and issues multiple tranches of debt and equity securities to investors. The purchase of the assets by the structured entity is financed through the issuance of the tranches of securities.

Equity-Linked Notes. In an equity-linked note transaction the Group typically transfers to a structured entity either a note issued by the Group, the payments on which are linked to the performance of a specific equity security, equity index or other index, or debt securities issued by other companies and a derivative contract, the terms of which will relate to the performance of a specific equity security, equity index or other index. These transactions are designed to provide investors with exposure to certain risks related to the specific equity security, equity index or other index. The purchase of the transferred note or debt securities by the structured entity is financed through the sale of equity interests to investors. Equity-linked notes are included in Other in the tables below.

Fund Investments. In a fund investment structure the Group provides clients with indirect access to specified underlying investments through total return swaps. The investments are purchased and held by a structured entity in which the Group holds an interest. The structured entity is financed through the sale of notes to investors.

MORGAN STANLEY & CO. INTERNATIONAL plc

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Six months ended 30 June 2013

8. INTEREST IN STRUCTURED ENTITIES (CONTINUED)

Unconsolidated structured entities (continued)

The table below shows certain non-consolidated structured entities in which the Group had an interest at 30 June 2013. The tables include all structured entities in which the Group has determined that its maximum exposure to loss is greater than specific thresholds or meets certain other criteria. Most of the structured entities included in the tables below are sponsored by unrelated parties; the Group's involvement generally is the result of the Company's secondary market-making activities.

	Mortgage and asset-backed securitisations \$millions	Collateralised debt obligation \$millions	Fund investments \$millions	Other \$millions	Total \$millions
30 June 2013					
Structured entity assets that the Group does not consolidate (unpaid principal balance)	9,484	-	1,671	182	11,337
Maximum exposure to loss:					
Debt and equity interests	496	-	-	24	520
Derivative and other contracts	-	-	1,671	41	1,712
Total maximum exposure to loss	496	-	1,671	65	2,232
Carrying value of exposure to loss - assets:					
Debt and equity interests ⁽¹⁾	496	-	-	24	520
Derivative and other contracts	-	-	3	1	4
Total carrying value of exposure to loss - assets	496	-	3	25	524
Carrying value of exposure to loss - liabilities:					
Derivatives and other contracts ⁽¹⁾	-	-	3	1	4
Total carrying value of exposure to loss - liabilities	-	-	3	1	4

(1) Amounts are recognised in the condensed consolidated statement of financial position in financial assets or liabilities classified as held for trading – derivatives or financial assets or liabilities held for trading – corporate and other debt.

MORGAN STANLEY & CO. INTERNATIONAL plc

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
Six months ended 30 June 2013

8. INTEREST IN STRUCTURED ENTITIES (CONTINUED)

Unconsolidated structured entities (continued)

	Mortgage and asset-backed securitisations \$millions	Collateralised debt obligation \$millions	Fund investments \$millions	Other \$millions	Total \$millions
31 December 2012					
Structured entity assets that the Group does not consolidate (unpaid principal balance)	8,197	899	1,559	217	10,872
Maximum exposure to loss:					
Debt and equity interests	488	49	-	39	576
Derivative and other contracts	-	-	1,559	87	1,646
Total maximum exposure to loss	488	49	1,559	126	2,222
Carrying value of exposure to loss - assets:					
Debt and equity interests ⁽¹⁾	488	49	-	33	570
Derivative and other contracts	-	-	3	2	5
Total carrying value of exposure to loss - assets	488	49	3	35	575
Carrying value of exposure to loss - liabilities:					
Derivatives and other contracts ⁽¹⁾	-	-	-	-	-
Total carrying value of exposure to loss - liabilities	-	-	-	-	-

(1) Amounts are recognised in the condensed consolidated statement of financial position in financial assets or liabilities classified as held for trading – derivatives or financial assets or liabilities held for trading – corporate and other debt.

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
Six months ended 30 June 2013

8. INTEREST IN STRUCTURED ENTITIES (CONTINUED)

Unconsolidated structured entities (continued)

The Group's maximum exposure to loss often differs from the carrying value of the interests held by the Group. The maximum exposure to loss is dependent on the nature of the Group's interest in the structured entities and is limited to the notional amounts of certain liquidity facilities, other credit support, total return swaps, written put options, and the fair value of certain other derivatives and investments the Group has made in the structured entities. Liabilities issued by structured entities generally are non-recourse to the Group. Where notional amounts are utilised in quantifying maximum exposure related to derivatives, such amounts do not reflect fair value write downs already recorded by the Group.

The Group's maximum exposure to loss does not include the offsetting benefit of any financial instruments that the Group may utilise to hedge these risks associated with the Group's interests. In addition, the Group's maximum exposure to loss is not reduced by the amount of collateral held as part of a transaction with the structured entity or any party to the structured entity directly against a specific exposure to loss.

Securitisation transactions generally involve structured entities. Primarily as a result of its secondary market-making activities, the Group owned additional securities issued by securitisation structured entities for which the maximum exposure to loss is less than specific thresholds. These additional securities totalled \$543 million at 30 June 2013 (31 December 2012: \$409 million). These securities were retained in connection with transfers of assets by the Group. Securities issued by securitisation structured entities consist of \$219 million of securities backed primarily by residential mortgage loans (31 December 2012: \$210 million), \$132 million of securities backed by commercial mortgage loans (31 December 2012: \$55 million), \$183 million of securities backed by collateralised debt obligations or collateralised loan obligations (31 December 2012: \$125 million) and \$10 million backed by other consumer loans (31 December 2012: \$19 million). The Group's primary risk exposure is to the securities issued by the structured entity owned by the Group, with the risk highest on the most subordinate class of beneficial interests. These securities generally are included in Financial assets classified as held for trading – corporate and other debt. The Group does not provide additional support in these transactions through contractual facilities, such as liquidity facilities, guarantees or similar derivatives. The Group's maximum exposure to loss generally equals the fair value of the securities owned.

The Group has not provided, or otherwise agreed to be responsible for, supporting any unconsolidated structured entity financially.

MORGAN STANLEY & CO. INTERNATIONAL plc

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Six months ended 30 June 2013

9. ASSETS AND LIABILITIES MEASURED AT FAIR VALUE

a. Financial assets and liabilities recognised at fair value on a recurring basis

The following tables present the carrying value of the Group's financial assets and financial liabilities recognised at fair value on a recurring basis, classified according to the fair value hierarchy.

30 June 2013

	Quoted prices in active market (Level 1) \$millions	Valuation techniques using observable inputs (Level 2) \$millions	Valuation techniques with significant non- observable inputs (Level 3) \$millions	Total \$millions
Financial assets classified as held for trading:				
- Government debt securities	12,279	2,862	4	15,145
- Corporate equities	28,452	1,599	87	30,138
- Corporate and other debt	1	9,485	745	10,231
- Derivatives	635	285,235	2,886	288,756
Total financial assets classified as held for trading	41,367	299,181	3,722	344,270
Financial assets designated at fair value through profit or loss				
	-	6,860	889	7,749
Available-for-sale financial assets:				
- Corporate equities	1	-	40	41
Total financial assets measured at fair value	41,368	306,041	4,651	352,060
Financial liabilities classified as held for trading:				
- Government debt securities	12,151	2,148	-	14,299
- Corporate equities	18,449	1,856	1	20,306
- Corporate and other debt	18	3,196	3	3,217
- Derivatives	377	279,203	3,905	283,485
Total financial liabilities classified as held for trading	30,995	286,403	3,909	321,307
Financial liabilities designated at fair value through profit or loss				
	-	12,591	206	12,797
Total financial liabilities measured at fair value	30,995	298,994	4,115	334,104

MORGAN STANLEY & CO. INTERNATIONAL plc

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
Six months ended 30 June 2013

9. ASSETS AND LIABILITIES MEASURED AT FAIR VALUE (CONTINUED)

a. Financial assets and liabilities recognised at fair value on a recurring basis (continued)

31 December 2012

	Quoted prices in active market (Level 1) \$millions	Valuation techniques using observable inputs (Level 2) \$millions	Valuation techniques with significant non- observable inputs (Level 3) \$millions	Total \$millions
Financial assets classified as held for trading:				
- Government debt securities	14,783	3,368	2	18,153
- Corporate equities	29,624	768	113	30,505
- Corporate and other debt	1	9,412	963	10,376
- Derivatives	470	279,179	3,011	282,660
Total financial assets classified as held for trading	44,878	292,727	4,089	341,694
Financial assets designated at fair value through profit or loss	-	7,014	577	7,591
Available-for-sale financial assets:				
- Corporate equities	2	-	38	40
Total financial assets measured at fair value	44,880	299,741	4,704	349,325
Financial liabilities classified as held for trading:				
- Government debt securities	14,638	2,371	-	17,009
- Corporate equities	16,240	430	3	16,673
- Corporate and other debt	4	2,057	35	2,096
- Derivatives	426	273,601	4,243	278,270
Total financial liabilities classified as held for trading	31,308	278,459	4,281	314,048
Financial liabilities designated at fair value through profit or loss	-	12,252	308	12,560
Total financial liabilities measured at fair value	31,308	290,711	4,589	326,608

MORGAN STANLEY & CO. INTERNATIONAL plc

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Six months ended 30 June 2013

9. ASSETS AND LIABILITIES MEASURED AT FAIR VALUE (CONTINUED)

a. Financial assets and liabilities recognised at fair value on a recurring basis (continued)

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

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

Government debt securities

Sovereign government obligations are valued using quoted prices in active markets when available. These bonds are generally categorised in Level 1 of the fair value hierarchy. If the market is less active or prices are dispersed, these bonds are categorised in Level 2 of the fair value hierarchy.

Corporate equities

Exchange-Traded Equity Securities. Exchange traded equity securities are generally valued based on quoted prices from the exchange. To the extent these securities are actively traded, valuation adjustments are not applied and they are categorised in Level 1 of the fair value hierarchy; otherwise, they are categorised in Level 2 or Level 3 of the fair value hierarchy.

Investments. The Group's investments include direct investments in equity securities as well as investments in private equity funds, real estate funds and hedge funds, which include investments made in connection with certain employee deferred compensation plans. 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 generally considers the net asset value of the fund provided by the fund manager to be the best estimate of fair value. For non-exchange-traded investments either held directly or held 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. Exchange-traded direct equity investments are generally valued based on quoted prices from the exchange.

Exchange-traded direct equity investments that are actively traded are categorised in Level 1 of the fair value hierarchy. Non-exchange-traded direct equity investments and investments in private equity and real estate funds are generally categorised in Level 3 of the fair value hierarchy. Investments in hedge funds that are redeemable at the measurement date or in the near future, are categorised in Level 2 of the fair value hierarchy; otherwise they are categorised in level 3 of the fair value hierarchy

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 price or spread data obtained from observed transactions or independent external parties such as vendors or brokers. When position-specific external price data are not observable, the fair value determination may require benchmarking to similar instruments and/or analysing expected credit losses, default and recover rates. In evaluating the fair value of each security, the Group considers security collateral-specific attributes, including payment priority, credit enhancement levels, type of collateral, delinquency rates and loss severity. In addition, for RMBS borrowers, Fair Issac Corporation ("FICO") scores and the level of documentation for the loan are also considered. Market standard models, such as Intex, Trepp or others, may be deployed to model the specific collateral composition and cash flow structure of each transaction. Key inputs to these models are market spreads, forecasted credit losses, default and prepayment rates for each asset category. Valuation levels of RMBS and CMBS indices are used as an additional data point for benchmarking purposes or to price outright index positions.

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
Six months ended 30 June 2013

9. ASSETS AND LIABILITIES MEASURED AT FAIR VALUE (CONTINUED)

a. Financial assets and liabilities recognised at fair value on a recurring basis (continued)

RMBS, CMBS and other ABS are generally categorised in Level 2 of the fair value hierarchy. 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, then RMBS, CMBS and ABS are categorised in Level 3 of the fair value hierarchy.

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 obtained from independent external parties such as vendors and brokers adjusted for any basis difference between cash and derivative instruments. The spread data used are for the same maturity as the bond. If the spread data does not reference the issuer, then data that reference a comparable issuer are used. When position-specific external price data is not observable, fair value is determined based on either benchmarking to similar instruments or cash flow models with yield curves, bond or single name credit default swap spreads and recovery rates as significant inputs. Corporate bonds are generally categorised in Level 2 of the fair value hierarchy; in instances where prices, spreads or any other of the aforementioned key inputs are unobservable, they are categorised in Level 3 of the fair value hierarchy.

Collateralised Debt Obligations (“CDOs”). The Group holds cash CDOs that typically reference a tranche of an underlying synthetic portfolio of single name credit default swaps collateralised by corporate bonds (“credit-linked notes”) or cash portfolio of asset-backed securities (“asset-backed CDOs”). Credit correlation, a primary input used to determine the fair value of credit-linked notes, is usually unobservable and derived using a benchmarking technique. The other credit-linked note model inputs such as credit spreads, including collateral spreads, and interest rates are typically observable. Asset-backed CDOs are valued based on an evaluation of the market and model input parameters sourced from similar positions as indicated by primary and secondary market activity. Each asset-backed CDO position is evaluated independently taking into consideration available comparable market levels, underlying collateral performance and pricing, deal structures, as well as liquidity. Cash CDOs are categorised in Level 2 of the fair value hierarchy when either the credit correlation input is insignificant or comparable market transactions are observable. In instances where the credit correlation input is deemed to be significant or comparable market transactions are unobservable, cash CDOs are categorized in Level 3 of the fair value hierarchy.

Derivatives

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

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

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

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
Six months ended 30 June 2013

9. ASSETS AND LIABILITIES MEASURED AT FAIR VALUE (CONTINUED)

a. Financial assets and liabilities recognised at fair value on a recurring basis (continued)

Derivatives (continued)

Other derivative products, including complex products that have become illiquid, require more judgement in the implementation of the valuation technique applied due to the complexity of the valuation assumptions and the reduced observability of inputs. This includes certain types of interest rate derivatives with both volatility and correlation exposure and credit derivatives including mortgage-related CDO securities, certain types of ABS 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 credit default swaps on certain mortgage-backed or asset-backed securities, for which observability of external price data is limited, are valued based on an evaluation of the market and model input parameters sourced from similar positions as indicated by primary and secondary market activity. Each position is evaluated independently taking into consideration available comparable market levels as well as cash-synthetic basis, or the underlying collateral performance and pricing, behaviour of the tranche under various cumulative loss and prepayment scenarios, deal structures (e.g. non-amortising reference obligations, call features) and liquidity. While these factors may be supported by historical and actual external observations, the determination of their value as it relates to specific positions nevertheless requires significant judgement.

For basket credit default swaps and CDO-squared positions, the correlation input between reference credits is unobservable for each specific swap or position and is benchmarked to standardised proxy baskets for which correlation data are available. The other model inputs such as credit spread, interest rates and recovery rates are observable. In instances where the correlation input is deemed to be significant, these instruments are categorised in Level 3 of the fair value hierarchy; otherwise, these instruments are categorised in Level 2 of the fair value hierarchy.

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

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

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

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

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
Six months ended 30 June 2013

9. ASSETS AND LIABILITIES MEASURED AT FAIR VALUE (CONTINUED)

a. Financial assets and liabilities recognised at fair value on a recurring basis (continued)

Corporate loans

Corporate loans and lending commitments. The fair value of corporate loans is estimated using recently executed transactions, market price quotations (where observable), implied yields from comparable debt and market observable credit default swap spread levels obtained from independent external parties such as vendors or brokers 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 lending commitments is determined by using executed transactions on comparable loans and the anticipated market price based on pricing indications from syndicate banks and customers. The valuation of loans and lending commitments also takes into account fee income that is considered an attribute of the contract. Corporate loans and lending commitments are generally categorised in Level 2 of the fair value hierarchy except in instances where prices or significant spread inputs are unobservable, in which case they are categorised in Level 3 of the fair value hierarchy.

b. Transfers between Level 1 and Level 2 of the fair value hierarchy for financial assets and liabilities recognised at fair value on a recurring basis

There were no material transfers between Level 1 and Level 2 of the fair value hierarchy during the six month period to 30 June 2013.

During 2012, the Group reclassified approximately \$2,700 million of derivative assets and approximately \$1,981 million of derivative liabilities from Level 2 to Level 1 as these listed derivatives became actively traded and were valued based on quoted prices from the exchange. Also during the year, the Group reclassified approximately \$302 million of listed derivative assets from Level 1 to Level 2 as transactions in these contracts did not occur with sufficient frequency and volume to constitute an active market.

c. Changes in Level 3 financial assets and liabilities recognised at fair value on a recurring basis

The following table presents the changes in the fair value of the Group's Level 3 financial assets and financial liabilities for the six months ended 30 June 2013. Level 3 instruments may be hedged with instruments classified in Level 1 and Level 2. As a result, the realised and unrealised gains (losses) for assets and liabilities within the Level 3 category presented in the tables below do not reflect the related realised and unrealised gains (losses) on hedging instruments that have been classified by the Group within the Level 1 and / or Level 2 categories.

Additionally, both observable and unobservable inputs may be used to determine the fair value of positions that the Group has classified within the Level 3 category. As a result, the unrealised gains (losses) during the period for assets and liabilities within the Level 3 category presented in the tables below may include changes in fair value during the period that were attributable to both observable (e.g., changes in market interest rates) and unobservable (e.g., changes in unobservable long-dated volatilities) inputs.

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 below table are risk managed using financial instruments held by other Morgan Stanley Group undertakings, these policies potentially result in the recognition of offsetting gains or losses in the Group.

MORGAN STANLEY & CO. INTERNATIONAL plc

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Six months ended 30 June 2013

9. ASSETS AND LIABILITIES MEASURED AT FAIR VALUE (CONTINUED)

c. Changes in Level 3 assets and liabilities measured at fair value on a recurring basis (continued)

30 June 2013

	Balance at 1 January 2013	Total gains or (losses) recognised in condensed consolidated income statement ⁽¹⁾	Total gains or (losses) recognised in condensed consolidated other comprehensive income ⁽¹⁾	Purchases	Sales	Issuances	Settlements	Net transfers in and/or out of Level 3 ⁽²⁾	Balance at 30 June 2013	Unrealised gains or (losses) for level 3 assets/liabilities outstanding as at 30 June 2013 ⁽³⁾
	\$million	\$million	\$million	\$million	\$million	\$million	\$million	\$million	\$million	\$million
Financial assets classified as held for trading:										
- Government debt securities	2	-	-	3	-	-	-	(1)	4	-
- Corporate equities	113	(10)	-	-	(18)	-	-	2	87	(12)
- Corporate and other debt	963	103	-	181	(235)	-	(233)	(34)	745	17
Total financial assets classified as held for trading	1,078	93	-	184	(253)	-	(233)	(33)	836	5
Financial assets designated at fair value through profit or loss	577	(7)	-	332	(13)	-	-	-	889	(3)
Available-for-sale financial assets:										
- Corporate equities	38	-	2	6	(6)	-	-	-	40	-
Total financial assets measured at fair value	1,693	86	2	522	(272)	-	(233)	(33)	1,765	2
Financial liabilities classified as held for trading:										
- Corporate equities	3	(4)	-	2	-	-	-	-	1	(5)
- Corporate and other debt	35	(4)	-	-	(3)	-	-	(25)	3	-
- Net derivative contracts ⁽⁴⁾	1,232	67	-	(183)	-	249	(155)	(191)	1,019	34
Total financial liabilities classified as held for trading	1,270	59	-	(181)	(3)	249	(155)	(216)	1,023	29
Financial liabilities designated at fair value through profit or loss	308	(1)	-	12	(114)	59	(58)	-	206	(1)
Total financial liabilities measured at fair value	1,578	58	-	(169)	(117)	308	(213)	(216)	1,229	28

- (1) The total gains or (losses) are recognised in the condensed consolidated income statement and the condensed consolidated statement of comprehensive income, as detailed in the financial instruments accounting policy in the Group's annual financial statements for the year ended 31 December 2012.
- (2) For financial assets and financial liabilities that were transferred into and out of Level 3 during the period, 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 period.
- (3) Amounts represent unrealised gains or (losses) for the period related to assets and liabilities still outstanding as at the end of the period. The unrealised gains or (losses) are recognised in the condensed consolidated income statement or condensed consolidated statement of total recognised gains and losses, as detailed in the financial instruments accounting policy in the Group's annual financial statements for the year ended 31 December 2012.
- (4) Net derivative contracts represent Financial assets classified as held for trading – derivative contracts net of Financial liabilities classified as held for trading – derivative contracts.

MORGAN STANLEY & CO. INTERNATIONAL plc

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Six months ended 30 June 2013

9. ASSETS AND LIABILITIES MEASURED AT FAIR VALUE (CONTINUED)

c. Changes in Level 3 assets and liabilities measured at fair value on a recurring basis (continued)

31 December 2012

	Balance at 1 January 2012	Total gains or (losses) recognised in condensed consolidated income statement ⁽¹⁾	Total gains or (losses) recognised in condensed consolidated other comprehensive income ⁽¹⁾	Purchases	Sales	Issuances	Settlements	Net transfers in and / or out of Level 3 ⁽²⁾	Balance at 31 December 2012	Unrealised gains or (losses) for level 3 assets/liabilities outstanding as at 31 December 2012 ⁽³⁾
	\$million	\$million	\$million	\$million	\$million	\$million	\$million	\$million	\$million	\$million
Financial assets classified as held for trading:										
- Government debt securities	1	-	-	-	-	-	-	1	2	-
- Corporate equities	162	3	-	45	(32)	-	-	(65)	113	6
- Corporate and other debt	2,235	(41)	-	352	(394)	-	(1,043)	(146)	963	(33)
Total financial assets classified as held for trading	2,398	(38)	-	397	(426)	-	(1,043)	(210)	1,078	(27)
Financial assets designated at fair value through profit or loss	-	-	-	266	-	-	-	311	577	-
Available-for-sale financial assets:										
- Corporate equities	65	46	(16)	2	-	-	(59)	-	38	-
Total financial assets measured at fair value	2,463	8	(16)	665	(426)	-	(1,102)	101	1,693	(27)
Financial liabilities classified as held for trading:										
- Corporate equities	1	(2)	-	(1)	2	-	-	3	3	1
- Corporate and other debt	70	-	-	(44)	29	-	-	(20)	35	(13)
- Net derivative contracts ⁽⁴⁾	1,632	342	-	(375)	5	135	41	(548)	1,232	175
Total financial liabilities classified as held for trading	1,703	340	-	(420)	36	135	41	(565)	1,270	163
Financial liabilities designated at fair value through profit or loss	381	(55)	-	-	-	-	(18)	-	308	(55)
Total financial liabilities measured at fair value	2,084	285	-	(420)	36	135	23	(565)	1,578	108

(1) The total gains or (losses) are recognised in the condensed consolidated income statement and the condensed consolidated statement of comprehensive income, as detailed in the financial instruments accounting policy in the Group's annual financial statements for the year ended 31 December 2012.

(2) For financial assets and financial liabilities that were transferred into and out of Level 3 during the period, 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 period.

(3) Amounts represent unrealised gains or (losses) for the period related to assets and liabilities still outstanding as at the end of the period. The unrealised gains or (losses) are recognised in the condensed consolidated income statement or condensed consolidated statement of total recognised gains and losses, as detailed in the financial instruments accounting policy in the Group's annual financial statements for the year ended 31 December 2012.

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

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
Six months ended 30 June 2013

9. ASSETS AND LIABILITIES MEASURED AT FAIR VALUE (CONTINUED)

c. Changes in Level 3 assets and liabilities measured at fair value on a recurring basis (continued)

During the period, there were no material transfers from Level 3 to Level 2 of the fair value hierarchy (2012: \$1,604 million of derivative assets and \$2,152 million of derivative liabilities).

There were no material transfers from Level 2 to Level 3 during the period (2012: \$nil).

d. Valuation of Level 3 financial assets and liabilities recognised at fair value on a recurring basis

The disclosures below provide information on the sensitivity of fair value measurements to key inputs and assumptions.

i. Quantitative information about and qualitative sensitivity of significant unobservable inputs

The table below provides information on the valuation techniques, significant unobservable inputs and their ranges for each major category of assets and liabilities measured at fair value on a recurring basis with a significant Level 3 balance. The table also provides information on the directional effect of a change in a significant unobservable input on the fair value measurement.

The level of aggregation and breadth of products cause the range of inputs to be wide and not evenly distributed across the inventory. Further, the range on unobservable inputs may differ across firms in the financial services industry because of diversity in the types of products included in each firm's inventory.

MORGAN STANLEY & CO. INTERNATIONAL plc

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Six months ended 30 June 2013

9. ASSETS AND LIABILITIES MEASURED AT FAIR VALUE (CONTINUED)

d. Valuation of Level 3 financial assets and liabilities recognised at fair value on a recurring basis (continued)

30 June 2013

ASSETS	Fair value \$millions	Valuation technique	Significant unobservable input(s) / Sensitivity of the fair value to changes in the unobservable inputs	Range ⁽²⁾
Financial assets classified as held for trading:				
- Corporate equities	87	Net Asset Value	Discount to net asset value / (C)	0% to 38%
- Corporate and other debt:				
- Asset backed securities	31	Correlation model	Credit Correlation / (B)	39 to 45%
		Comparable pricing	Comparable bond price / (A)	100 points
- Corporate bonds	190	Comparable pricing	Comparable bond price / (A)	2 to 147 points
- Collateralised debt obligations	130	Comparable pricing	Comparable loan price / (A)	40 to 96 points
		Correlation Model	Credit Correlation / (B)	41 - 45%
- Loans and lending commitments	157	Comparable pricing	Comparable loan price / (A)	0 to 100 points
- Other debt	237	Comparable pricing	Comparable bond price / (A)	96 to 100 points
Financial assets designated at fair value through profit or loss:	889	Margin Loan Model	Credit spread / (C)(D)	30 to 306 bps
			Volatility skew / (C)(D)	-2% to 0%
		Option Model	At the money volatility / (A)	31% to 42%
LIABILITIES				
- Net derivatives contracts: ⁽¹⁾				
- Credit	16	Correlation Model	Credit Correlation / (B)	38 to 87%
		Comparable pricing	Comparable bond price / (C)(D)	8 to 95 points
			Credit Spread / (C)(D)	55 to 3,543 bps
- Equity ⁽³⁾	1,215	Option Model	At the money volatility / (C)(D)	18% to 38%
			Volatility skew / (C)(D)	-1% to 0%
			Equity correlation / (A)(D)	40% to 99%
			Equity Foreign exchange correlation / (A)(D)	-50% to -12%
- Interest rate	(152)	Option Model	Interest rate - Foreign exchange correlation / (A)	2% to 63%
- Foreign exchange	(31)	Option Model	Interest rate - Foreign exchange correlation / (A)	2% to 63%
Financial liabilities designated at fair value through profit or loss:				
- Other	206	Comparable pricing	Comparable bond price / (A)	96 to 100 points

(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. In addition, there are other derivative contracts with a fair value of \$29 million not included within one of the major derivative categories.

(2) The ranges of significant unobservable inputs are represented in points, percentages or basis points. Points are a percentage of par; for example, 100 points would be 100% of par. A basis point equals 1/100th of 1%; for example, 306 basis points would equal 3.06%.

(3) Includes derivative contracts with multiple risks (ie. hybrid products)

Sensitivity of the fair value to changes in the unobservable inputs:

- (A) Significant increase/ (decrease) in the unobservable input in isolation would result in a significantly higher/ (lower) fair value measurement.
- (B) Significant changes in credit correlation may result in a significantly higher or lower fair value measurement. Increasing/ (decreasing) correlation drives a redistribution of risk within the capital structure such that junior tranches become less/ (more) risky and senior tranches become more/ (less) risky.
- (C) Significant increase/ (decreases) in the unobservable input in isolation would result in a significantly lower/ (higher) fair value measurement.
- (D) There are no predictable relationships between the significant unobservable inputs.

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
Six months ended 30 June 2013

9. ASSETS AND LIABILITIES MEASURED AT FAIR VALUE (CONTINUED)

d. Valuation of Level 3 financial assets and liabilities recognised at fair value on a recurring basis (continued)

The following provides a description of significant unobservable inputs included in the table above for all major categories of assets and liabilities:

- *Comparable bond price* – a pricing input used when prices for the identical instrument are not available. Significant subjectivity may be involved when fair value is determined using pricing data available for comparable instruments. Valuation using comparable instruments can be done by calculating an implied yield (or spread over a liquid benchmark) from the price of a comparable bond, then adjusting that yield (or spread) to derive a value for the bond. The adjustment to yield (or spread) should account for relevant differences in the bonds such as maturity or credit quality. Alternatively, a price-to-price basis can be assumed between the comparable instrument and bond being valued in order to establish the value of the bond. Additionally, as the probability of default increases for a given bond (i.e., as the bond becomes more distressed), the valuation of that bond will increasingly reflect its expected recovery level assuming default. The decision to use price-to-price or yield/spread comparisons largely reflects trading market convention for the financial instruments in question. Price-to-price comparisons are primarily employed for CMBS, CDO, mortgage loans and distressed corporate bonds. Implied yield (or spread over a liquid benchmark) is utilised predominately for non-distressed corporate bonds, loans and credit contracts.
- *Correlation* – a pricing input where the payoff is driven by more than one underlying risk. Correlation is a measure of the relationship between the movements of two variables (i.e., how the change in one variable influences a change in the other variable). Credit correlation, for example, is the factor that describes the relationship between the probability of individual entities to default on obligations and the joint probability of multiple entities to default on obligations. The correlation ranges may be wide since any two underlying inputs may be highly correlated (either positively or negatively) or weakly correlated.
- *Credit spread* – the difference in yield between different securities due to differences in credit quality. The credit spread reflects the additional net yield an investor can earn from a security with more credit risk relative to one with less credit risk. The credit spread of a particular security is often quoted in relation to the yield on a credit risk-free benchmark security or reference rate, typically either US Treasury or LIBOR.
- *Volatility* – the measure of the variability in possible returns for an instrument given how much that instrument changes in value over time. Volatility is a pricing input for options and, generally, the lower the volatility, the less risky the option. The level of volatility used in the valuation of a particular option depends on a number of factors, including the nature of the risk underlying that option (e.g., the volatility of a particular underlying equity security may be significantly different from that of a particular underlying commodity index), the tenor and the strike price of the option.
- *Volatility skew* – the measure of the difference in implied volatility for options with identical underliers and expiry dates but with different strikes. The implied volatility for an option with a strike price that is above or below the current price of an underlying asset will typically deviate from the implied volatility for an option with a strike price equal to the current price of that same underlying asset.

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
Six months ended 30 June 2013

9. ASSETS AND LIABILITIES MEASURED AT FAIR VALUE (CONTINUED)

d. Valuation of Level 3 financial assets and liabilities recognised at fair value on a recurring basis (continued)

ii. 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. 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, to provide information about the variability of the fair value measurement, the unobservable parameters were varied to the extremes of the ranges of reasonably possible alternatives using statistical techniques, such as dispersion in comparable observable external inputs for similar asset classes, historic data or judgement if a statistical technique is not appropriate. Where a financial instrument has more than one unobservable parameter, the sensitivity analysis reflects the greatest reasonably possible increase or decrease to fair value by varying the assumptions individually. It is unlikely that all unobservable parameters would be concurrently 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.

The following tables present the sensitivity of the fair value of Level 3 financial assets and financial liabilities to reasonably possible alternative assumptions, providing quantitative information on the potential variability of the fair value measurement.

MORGAN STANLEY & CO. INTERNATIONAL plc

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
Six months ended 30 June 2013

9. ASSETS AND LIABILITIES MEASURED AT FAIR VALUE (CONTINUED)

d. Valuation of Level 3 financial assets and liabilities recognised at fair value on a recurring basis (continued)

30 June 2013

	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	4	-	-
- Corporate equities	87	2	(2)
- Corporate and other debt	745	24	(25)
Financial assets designated at fair value through profit or loss:			
- Prepaid OTC contracts	2	-	-
- Customer loans	887	2	(1)
- Other	-	-	-
Available-for-sale financial assets:			
- Corporate equities	40	-	-
Financial liabilities classified as held for trading:			
- Corporate equities	1	-	-
- Corporate and other debt	3	-	-
- Net derivatives contracts ⁽¹⁾	1,019	160	(202)
Financial liabilities designated at fair value through profit or loss:			
- Prepaid OTC contracts	21	1	(1)
- Structured notes	-	-	-
- Other	185	-	-

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

MORGAN STANLEY & CO. INTERNATIONAL plc

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
Six months ended 30 June 2013

9. ASSETS AND LIABILITIES MEASURED AT FAIR VALUE (CONTINUED)

d. Valuation of Level 3 financial assets and liabilities recognised at fair value on a recurring basis (continued)

31 December 2012

	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	963	45	(33)
- Corporate and other debt	113	4	(4)
Financial assets designated at fair value through profit or loss:			
- Prepaid OTC contracts	14	-	(13)
- Other	563	-	-
Available-for-sale financial assets:			
- Corporate equities	38	1	(13)
Financial liabilities classified as held for trading:			
- Corporate equities	3	-	-
- Corporate and other debt	35	-	-
- Net derivatives contracts ⁽¹⁾	1,232	132	(111)
Financial liabilities designated at fair value through profit or loss:			
- Prepaid OTC contracts	134	2	(2)
- Structured notes	1	-	-
- Other	173	-	-

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

MORGAN STANLEY & CO. INTERNATIONAL plc

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Six months ended 30 June 2013

9. ASSETS AND LIABILITIES MEASURED AT FAIR VALUE (CONTINUED)

e. Financial instruments valued using unobservable market data

The amounts not recognised in the condensed consolidated income statement 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:

	30 June 2013 \$millions	31 December 2012 \$millions
At 1 January	559	536
New transactions	21	141
Amounts recognised in the condensed consolidated income statement during the period	(33)	(118)
At 30 June / 31 December	547	559

The condensed consolidated statement of financial position categories 'Financial assets and financial liabilities classified as held for trading', 'Financial assets and financial liabilities designated at fair value through profit or loss', and 'Available-for-sale financial assets' include financial instruments whose fair value is based on valuation techniques using unobservable market data. The amounts not recognised in the condensed consolidated income statement during the period predominantly relates to derivatives.

f. Assets and liabilities measured at fair value on a non-recurring basis

Non-recurring fair value measurements of assets or liabilities are those which are required or permitted in the condensed consolidated statement of financial position in particular circumstances. There were no assets or liabilities measured at fair value on a non-recurring basis during the current or prior period.

MORGAN STANLEY & CO. INTERNATIONAL plc

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Six months ended 30 June 2013

10. ASSETS AND LIABILITIES NOT MEASURED AT FAIR VALUE

The table below presents the carrying value, fair value and fair value hierarchy category of certain financial assets and financial liabilities that are not measured at fair value in the condensed consolidated statement of financial position.

Financial assets and financial liabilities not measured at fair value for which the carrying value is considered a reasonable approximation of fair value are excluded from the table below.

30 June 2013

	Carrying value \$millions	Fair value \$millions	Fair value measurement using:		
			Quoted prices in active market (Level 1) \$millions	Valuation techniques using observable inputs (Level 2) \$millions	Valuation techniques with significant unobservable inputs (Level 3) \$millions
Financial liabilities					
Subordinated loans ⁽¹⁾	7,906	6,266	-	6,266	-
Other payables ⁽²⁾	2,166	1,990	-	1,990	-

(1) The carrying value as at 31 December 2012 was \$7,906 million and fair value was \$6,663 million.

(2) Also included in the condensed consolidated statement of financial position is \$18,014 million of Other payables where the carrying value is a reasonable approximation of fair value.

The fair value of 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 PRA and FCA.

The fair value of other payables is determined based on current interest rates and credit spreads for debt instruments with similar terms and maturity.

MORGAN STANLEY & CO. INTERNATIONAL plc

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Six months ended 30 June 2013

11. DISPOSAL OF SUBSIDIARIES

In January 2013 the Group restructured a subsidiary company, Morgan Stanley Derivative Products (Luxembourg) S.à r.l. (“MSDP”) and disposed of MSDP together with five other wholly owned subsidiaries to another Morgan Stanley Group undertaking outside of the Group. The subsidiaries that were disposed of were non-US dollar functional currency entities. The subsidiaries were sold for consideration equal to their net book value, however, as a consequence of the sale, accumulated foreign currency translation losses amounting to \$151 million were reclassified from the “Currency translation reserve” to the condensed consolidated income statement within “Net currency translation loss on disposal of subsidiaries”. This reclassification did not have an impact on the net assets of the Group.

The carrying value of the net assets of these subsidiaries at the date of disposal was as follows:

	At disposal \$millions
ASSETS	
Trade receivables	1,899
Financial assets classified as held for trading	1,840
TOTAL ASSETS	<u>3,739</u>
LIABILITIES	
Other payables	1,901
Financial liabilities classified as held for trading	3
TOTAL LIABILITIES	<u>1,904</u>
NET ASSETS	<u>1,835</u>
Total consideration received	1,835
Reclassification of net cumulative translation losses	151
Loss on disposal	<u>151</u>

12. RELATED PARTY DISCLOSURES

The management and execution of business strategies on a global basis results in many Morgan Stanley transactions impacting a number of Morgan Stanley Group entities. The Morgan Stanley Group operates a number of intra-group policies to ensure that, where possible, revenues and related costs are matched. For the six month period ended 30 June 2013, \$461 million was transferred to other Morgan Stanley Group undertakings relating to such policies and recognised in the condensed consolidated income statement (six month period to 30 June 2012: \$346 million).

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
Six months ended 30 June 2013

13. LITIGATION

In the normal course of business, the Group has been named, from time to time, as a defendant in various legal actions, including arbitrations, class actions and other litigation, arising in connection with its activities as a global diversified financial services institution. Certain of the actual or threatened legal actions include claims for substantial compensatory and/or punitive damages or claims for indeterminate amounts of damages. In some cases, the entities that would otherwise be the primary defendants in such cases are bankrupt or are in financial distress. These actions have included, but are not limited to, residential mortgage and credit crisis related matters. Over the last several years, the level of litigation and investigatory activity focused on residential mortgage and credit crisis related matters has increased materially in the financial services industry. As a result, the Group expects that it may become the subject of increased claims for damages and other relief regarding residential mortgages and related securities in the future. While the Group has identified below any new actions or developments which have occurred with respect to certain litigation matters previously reported in the Group's annual financial statements for the year ended 31 December 2012, there can be no assurance that material losses will not be incurred from claims that have not yet been notified to the Group or are not yet determined to be probable or possible and reasonably estimable losses.

The Group is also involved, from time to time, in other reviews, investigations and proceedings (both formal and informal) by governmental and self-regulatory agencies regarding the Group's business and involving, among other matters, accounting and operational matters, certain of which may result in adverse judgments, settlements, fines, penalties, injunctions or other relief.

The Group contests liability and/or the amount of damages as appropriate in each pending matter. Where available information indicates that it is probable a liability had been incurred at the date of the condensed consolidated financial statements and the Group can reasonably estimate the amount of that loss, the Group accrues the estimated loss by a charge to income. In many proceedings, however, it is inherently difficult to determine whether any loss is probable or even possible or to estimate the amount of any loss. In addition, even where loss is possible or an exposure to loss exists in excess of the liability already accrued with respect to a previously recognized loss contingency, it is not always possible to reasonably estimate the size of the possible loss or range of loss.

For certain legal proceedings, the Group cannot reasonably estimate such losses, particularly for proceedings that are in their early stages of development or where plaintiffs seek substantial or indeterminate damages. Numerous issues may need to be resolved, including through potentially lengthy discovery and determination of important factual matters, determination of issues related to class certification and the calculation of damages, and by addressing novel or unsettled legal questions relevant to the proceedings in question, before a loss or additional loss or range of loss or additional loss can be reasonably estimated for any proceeding.

For certain other legal proceedings, the Group can estimate reasonably possible losses, additional losses, ranges of loss or ranges of additional loss in excess of amounts accrued, but does not believe, based on current knowledge and after consultation with counsel, that such losses will have a material adverse effect on the Group's condensed consolidated financial statements as a whole, other than the matter referred to below.

On 23 May 2013, certain parties in *Abu Dhabi Commercial Bank, et al. v. Morgan Stanley & Co. Inc., et al.* filed a notice of appeal as to certain claims dismissed from the matter prior to the settlement by the remaining parties.

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
Six months ended 30 June 2013

13. LITIGATION (CONTINUED)

On 1 July 2013, the European Commission (“EC”) issued a Statement of Objections (“SO”) addressed to twelve financial firms (including the Group), the International Swaps and Derivatives Association, Inc. (“ISDA”) and Markit Group Limited (“Markit”) and various affiliates alleging that, between 2006 and 2009, the recipients breached EU competition law by taking and refusing to take certain actions in an effort to prevent the development of exchange traded CDS products. The SO indicates that the EC plans to impose remedial measures and fines on the recipients. The Group and the other recipients have been given an opportunity to respond to the SO. An affiliate of the Group and others have also responded to an ongoing investigation by the Antitrust Division of the United States Department of Justice related to the CDS market.