Morgan Stanley

Pillar 3

Regulatory Disclosure (UK)

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1. Basel II Accord

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

The framework consists of three 'pillars':

- Pillar 1 – Minimum capital requirements: defines rules for the calculation of credit, market and operational risk;
- Pillar 2 – The Internal Capital Adequacy Assessment Process ("ICAAP") requires firms to self-assess the level of capital that adequately supports all relevant current and future risks in their business. The Prudential Regulation Authority ("PRA") undertakes a Supervisory Review and Evaluation Process ("SREP") to set Individual Capital Guidance and the Capital Planning Buffer; and
- Pillar 3 – Market discipline: requires expanded disclosures to allow investors and other market participants to understand capital adequacy, particular risk exposures and risk management processes of individual firms.

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

This disclosure is composed based on the rules in place at the time, i.e. Basel II. However, even though the Basel III rules make significant changes to the calculation of capital resources and requirements, the MSI Group and MSIP (Morgan Stanley & Co. International plc) remain well capitalised and above internal targets following the introduction of CRDIV on 1 January 2014.

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

2. Background to Pillar 3 Disclosures

This disclosure covers Morgan Stanley International Limited and its subsidiaries (the "MSI Group") as discussed further in Sections 3 and 4 below. The MSI Group's ultimate parent and controlling entity is Morgan Stanley, a Delaware corporation, which, together with its consolidated subsidiaries, form the Morgan Stanley Group ("Morgan Stanley Group"). Morgan Stanley is a "Financial Holding Company" as defined by the Bank Holding Company Act of 1956, as amended, and is subject to regulation by the Board of Governors of the Federal Reserve System (the "Federal Reserve").

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

Morgan Stanley is listed on the New York Stock Exchange and is required, by the U.S. Securities and Exchange Commission ("SEC"), to file public disclosures, including Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q and Current Reports on Form 8-K.

These disclosures can be found at http://www.morganstanley.com/about/ir/sec_filings.html.

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

The majority of the numerical disclosures in this document are calculated by reference to PRA / FCA's methodology and are not necessarily the primary exposure measures used by internal management. The calculation of exposure in this document is based on the calculation methodology for regulatory risk exposure prescribed by the PRA / FCA. These exposures include intra group exposures that form a sizeable proportion of the total exposure.

This document does not constitute a set of financial statements. The MSI Group 2013 audited financial statements are prepared in accordance with applicable United Kingdom ("UK") company law and accounting standards ("UK GAAP"). Information disclosed in the MSI Group 2013 audited financial statements will not necessarily be consistent with information disclosed in this document. Trading Book and Non-Trading Book definitions used in this document refer to the regulatory view and may differ from the accounting definitions.

3. Application of the Pillar 3 Framework

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

The basis of consolidation for prudential purposes is materially the same as consolidation for accounting purposes. The MSI Group completes its prudential consolidation in compliance with BIPRU, Section 8. The principal subsidiary undertakings of the MSI Group are listed in the MSI Group 2013 audited financial statements, Company disclosures note 3. The most significant of these subsidiaries is Morgan Stanley & Co. International plc ("MSIP"), the results of which are material to the MSI Group. The risk profile of MSIP is materially the same as the MSI Group and risk management policies and procedures are applied consistently.

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

4. Morgan Stanley International Limited

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

The principal activity of the MSI Group is the provision of financial services to corporations, governments and financial institutions. There have not been any significant changes in the MSI Group's principal activity in the period under review and no other significant changes in the MSI Group's principal activity is expected.

As at 31 December 2013, the following entities within the MSI Group were authorised by the PRA and regulated by the PRA and FCA:

- Morgan Stanley & Co. International plc
- Morgan Stanley Bank International Limited
- Morgan Stanley Securities Limited

The following entities within the MSI Group were authorised and regulated by the FCA:

- Morgan Stanley & Co. Limited
- Morgan Stanley Investment Management Limited
- Morgan Stanley Investment Management (ACD) Limited

Morgan Stanley is required to meet the requirements of the PRA Handbook (in particular BIPRU and GENPRU), including Pillar 3 disclosures, on a consolidated basis at the level of the MSI Group.

The MSI Group includes all the entities that form part of the accounting consolidation group.

As at 31 December 2013, there were no entities which were deducted from the MSI Group's capital resources.

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

5. Capital Resources

Under PRA supervision, the MSI Group is required to maintain a minimum ratio of total capital resources to capital requirements. As at 31 December 2013, the MSI Group was in compliance with the PRA capital requirements as defined by BIPRU. The PRA handbook can be found at http://fshandbook.info/FS/html/PRA/BIPRU. All capital resources included in Tiers 1, 2 or 3 are of standard form and the main terms and conditions of the capital instruments are disclosed in the MSI Group 2013 audited financial statements, see note 19 for subordinated debt disclosures and note 23, 24 and 34 for share capital disclosures.

The table below shows the financial resources of the MSI Group as at 31 December 2013 based upon the MSI Group 2013 audited financial statements:

Table 1: Capital Resources

AS AT END OF DECEMBER	MSI 2013 $MILLIONS	MSI 2012 $MILLIONS
Permanent Share Capital	1,614	1,614
Profit and loss account and other reserves	17,113	16,919
Less: Intangible assets	0	(48)
Less: Net losses on equities held in the available-for-sale financial assets category	0	0
Tier 1 capital resources	**18,727**	**18,485**
Tier 2 capital resources	**9,401**	**9,263**
Less: Expected losses and other negative amounts	(237)	(682)
Tier 1 plus tier 2 capital after deductions	**27,892**	**27,066**
Tier 3 capital resources	**1,423**	**1,352**
Less: Deductions from total capital	(92)	(70)
Total Capital Resources, Net of Deductions	**29,223**	**28,349**

Note: MSIP's Tier 1 common capital and total capital as at end of December 2013 were $15,348 million and $23,012 million, respectively ($12,159 million and $20,768 million, respectively for December 2012).

Permanent share capital and subordinated loans included in financial resources are consistent with MSI Group 2013 audited financial statements. The General Prudential sourcebook ("GENPRU") sections 1 and 2 define the items that are included or deducted from the profit and loss account and other reserves to arrive at total financial resources. As a result, the profit and loss account and other reserves balance noted above will differ to the MSI Group 2013 audited financial statements.

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

Management reviews capital levels on an ongoing basis in light of changing risk appetite, business needs and the external environment. The level of capital as at 31 December 2013 was 3% higher than 2012 principally as a result of anticipating capital requirements from forthcoming regulatory changes, in particular Basel III implementation.

Management ensures that appropriate levels of capital are maintained to support business needs whilst remaining in compliance with the target operating range established by the relevant MSI Group governing bodies and applicable regulatory requirements.

6. Regulatory Capital Requirements

The MSI Group calculates Pillar 1 capital requirements in accordance with the regulatory capital requirements of the PRA. As at 31 December 2013 and 31 December 2012, the MSI Group had the following capital requirements:

Table 2: Regulatory Capital Requirements

AS AT END OF DECEMBER	2013 $MILLIONS	2012 $MILLIONS
Credit risk capital component	784	794
Counterparty risk capital component	2,632	3,022
Market risk capital component	3,528	3,837
Concentration risk capital component	24	459
Operational risk — Basic Indicator Approach	816	830
Total Capital Requirements	**7,783**	**8,942**

Note: MSIP's capital requirement as at end of December 2013 was $6,117 million ($7,282 million at December 2012).

Credit and counterparty risk is the risk of loss arising from a borrower or counterparty failing to meet its financial obligations. Credit and counterparty capital requirements are devised from risk weighted exposures, determined using approved internal modelling approaches — the Foundation Internal Ratings Based Approach ("IRB") for credit risk and the Internal Model Method ("IMM") for counterparty risk — as well as standardised approaches. For a further discussion see section 11 Credit Risk.

Market risk is the risk of loss resulting from adverse changes in market prices and other factors. The market risk capital of the MSI Group comprises capital associated with the PRA's approved internal modelling approaches and that associated with the standardised approach. For a further discussion see section 12 Market Risk.

Operational Risk is defined as the risk of loss, or damage to Morgan Stanley's reputation, resulting from inadequate or failed processes, people and systems or from external events. This definition includes legal risk, but excludes strategic risk. Capital requirements for operational risk are currently calculated under the Basic Indicator Approach. For a further discussion see section 10 Operational Risk.

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

7. Application of the Pillar 2 Framework

The MSI Group prepares an ICAAP document in order to meet its obligations under BIPRU 2.2 "Internal Capital Adequacy Standards." The MSI Group's Required Capital Framework captures risks not adequately covered under Pillar 1 and calculates an additional capital buffer required to absorb stress losses. The framework is based on management's own risk assessment and is broadly consistent with the Morgan Stanley Group's Required Capital framework. It is used to ensure that the MSI Group carries, or has access to, sufficient capital to support all material risks residing within the MSI Group.

The MSI Group ICAAP:

- Identifies and measures material risks;
- Sets and assesses internal capital adequacy operating targets and limits that relate directly to risk through the Required Capital framework and the risk appetite defined by MSI Group Governing Bodies;
- Assesses current and future capital adequacy under normal and stressed operating environments over the capital planning horizon.

Through its Supervisory Review Process ("SREP") the PRA sets an Individual Capital Guidance ("ICG") which sets the minimum level of regulatory capital for the MSI Group. In addition, the PRA sets a capital planning buffer which is available to support the MSI Group in a stressed market environment.

8. Risk Management Objectives and Policies

Risk is an inherent part of the MSI Group's business activity. The MSI Group seeks to identify, assess, monitor and manage each of the various types of risk involved in its business activities in accordance with defined policies and procedures. The MSI Group has developed its own risk management policy framework, which leverages the policies and procedures of the Morgan Stanley Group, which includes escalation to the Group's Board of Directors and to appropriate senior management personnel of the MSI Group, as well as oversight through the MSI Group's Board of Directors and through a dedicated Risk Committee that reports to the Board. For more detail on the MSI Group's approach to risk management, see note 28 of the MSI Group 2013 audited financial statements.

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

9. Valuation and Accounting Policies

The MSI Group 2013 audited financial statements are prepared in accordance with UK GAAP. The MSI Group relies on its policies, procedures and systems to determine adequacy of valuation and compliance to accounting standards and GENPRU 1.3. To comply with the requirements of GENPRU 1.3, additional valuation adjustments are applied to capital over and above those that are taken in order to comply with UK GAAP. Further information regarding the accounting policies of the MSI Group, including measurement considerations, can be found in note 1 of the MSI Group 2013 audited financial statements.

10. Operational Risk

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

Operational risk management policies and procedures for the MSI Group are consistent with those of the Morgan Stanley Group and include escalation to the MSI Group's Board of Directors and appropriate senior management personnel.

Operational risk may be incurred across the MSI Group's full scope of business activities, including revenue-generating activities (e.g., sales and trading) and support functions (e.g., IT and facilities management). The operational risk management framework operates to identify, measure, monitor and control risk, in the context of an approved risk tolerance appetite, set by the Board of Directors.

During 2013, and on an ongoing basis, the MSI Group continued to enhance its operational risk management framework and its operational risk capital models.

11. Credit Risk

11.1 CREDIT EXPOSURE

Credit risk exposure is managed by Credit Risk Management ("CRM") under limits delegated by the MSI Board of Directors. The MSI Group Credit Limits Framework is one of the primary tools used to evaluate and manage credit risk levels. The Credit Limits Framework includes single name limits and portfolio concentration limits by country, industry and product type. CRM is responsible for ensuring transparency of material credit risks, ensuring compliance with established limits, approving material extensions of credit, and escalating risk concentrations to appropriate senior management.

The CRM policies and procedures of the MSI Group include ensuring transparency of material credit risks, ensuring compliance with established limits, approving material extensions of credit and escalating risk concentrations to appropriate senior management. CRM policies and procedures for the MSI Group are consistent with those of the Morgan Stanley Group and include escalation to appropriate key management personnel of the MSI Group.

The MSI Group is exposed primarily to single-name credit risk, requiring credit analysis of specific counterparties, both initially and on an ongoing basis. CRM takes place at the transaction, counterparty and portfolio levels. In order to help protect the MSI Group from losses resulting from its business activities, the MSI Group analyses material lending and derivative transactions and ensures that the creditworthiness of the MSI Group's counterparties and borrowers is reviewed regularly and that credit exposure is actively monitored and managed. For lending transactions, the MSI Group evaluates the relative position of its particular exposure in the borrower's capital structure and relative recovery prospects. The MSI Group also considers collateral arrangements and other structural elements of the particular transaction. The MSI Group has credit limits that restrict potential credit exposure to any one borrower or counterparty and to groups of connected borrowers or counterparties; these limits are monitored and credit exposures relative to these limits are reported to key MSI Group management.

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

The credit risk capital component reflects capital requirements attributable to the risk of loss arising from a borrower or counterparty failing to meet its obligations. Risk weighted exposures are determined using either an IRB Approach, which reflects the MSI Group's internal estimate of a borrower or counterparty's creditworthiness, or the standardised approach.

The MSI Group uses IMM for calculating its Counterparty Risk exposure, in accordance with BIPRU 13.6. The majority of over-the-counter ("OTC") derivatives within the MSI Group are in scope of the IMM waiver.

The IMM approach uses a Monte Carlo simulation technique to measure and monitor potential future exposures of derivative portfolios. The models used simulate risk factors and replicate the risk mitigation techniques such as netting and collateral. The most material risk factors are calibrated daily to market implied data, while other risk factors are calibrated based on three years or more of historical data.

The table below shows the counterparty and credit risk capital component ("CRCC") for the MSI Group as at 31 December 2013, for each exposure class, as per the classifications set out in BIPRU:

Table 3: CRCC

AS AT 31/12/2013	IRB APPROACH $MILLIONS	STANDARDISED APPROACH $MILLIONS	TOTAL CRCC $MILLIONS
Central Governments or Central Banks	99	15	114
Institutions	979	29	1,008
Corporates	1,807	187	1,994
Other	212	88	300
Total	**3,096**	**320**	**3,416**

11.3 INTERNAL RATINGS BASED APPROACH

The MSI Group has permission to use the Foundation Internal Rating Based ("FIRB") approach for the calculation of counterparty credit risk capital requirements. The permission covers all material portfolios and is applicable to all exposures to central governments, central banks, institutions and corporates.

The MSI Group leverages the IRB process for internal risk management processes.

Rating Process

Morgan Stanley's CRM expresses the creditworthiness of each counterparty by assigning it a rating; on a scale from AAA to D. Counterparty ratings establish the probability of default ("PD") "through the cycle." Each rating is linked to an exposure limit. To monitor the credit risk of the portfolio, the MSI Group uses quantitative models to estimate various risk parameters related to each counterparty and/or facility. CRM rates counterparties based on analysis of qualitative and quantitative factors relevant to credit standing in that industry or sector. The rating process typically includes analysis of the counterparty's financial statements, evaluation of its market position, strategy, management, legal and environmental issues, and consideration of industry dynamics affecting its performance. Credit professionals also consider security prices and other financial data reflecting a market view of the counterparty, and carry out due diligence with the counterparty's management, as needed.

CRM assigns counterparty ratings at the highest level in the counterparty's corporate structure. A subsidiary's rating may vary based on a variety of factors considered and documented during the rating process.

Where a parent guarantee has been received for a counterparty and the guarantee meets Morgan Stanley's internal requirements for PD substitution, then the rating of the guarantor is assigned to the counterparty.

Ratings for Special Purpose Vehicles ("SPVs") reflect CRM's assessment of the risk that the SPV will default. The rating therefore incorporates the Morgan Stanley Group's relative position in the counterparty's payment structure as well as the default risk associated with the underlying assets. Ratings are often 'tranche specific' (e.g., the AAA rated senior tranche or the BBB subordinated tranche).

Control Mechanisms for the Rating System

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

Morgan Stanley's internal rating process and philosophy are very similar to Standard and Poor's ("S&P"). For credit risk capital and risk management purposes, CRM maps PDs to S&P PDs and makes minor adjustments, such as preserving the monotonic relationship among rating grade PDs and maintaining the Basel II regulatory floor of 0.03%.

The present method of using S&P's extensive default history reflects a long-run view. The 2013 PDs are long-run averages of one-year default rates and are grounded on historical experience and empirical evidence. They are based on S&P's annual default rates from 1981 to 2012. This historical period covers at least three major credit downturn periods (1990-91, 2001-02 and 2007-09).

The Morgan Stanley Group confirms through an internal validation process that the PD values it uses are prudent when compared to actual Morgan Stanley Group default experience.

The table below shows a breakdown of the IRB related exposure amounts for the MSI Group as at 31 December 2013, for each credit quality step ("CQS") as defined in BIPRU 3:

Table 4: IRB EAD

CQS PD BAND AS AT 31/12/2013	TOTAL GROSS EXPOSURE $MILLIONS	EXPOSURE VALUE AFTER CREDIT RISK MITIGATION $MILLIONS	OUTSTANDING LOANS $MILLIONS	EXPOSURE VALUE OF UNDRAWN COMMITMENTS $MILLIONS	EXPOSURE WEIGHTED AVERAGE RISK WEIGHT
Central Governments or Central Banks					
1 0.00%–0.08%	18,449	4,900	85	114	0.11
2 0.09%–0.17%	1,062	890	0	0	0.18
3 0.21%–0.40%	907	889	0	0	0.42
4 0.51%–1.65%	1,794	229	0	0	0.53
5 1.92%–100%	14	14	0	0	2.75
Institutions					
1 0.00%–0.08%	49,994	12,833	176	234	0.13
2 0.09%–0.17%	145,893	27,081	53	71	0.22
3 0.21%–0.40%	6,042	2,366	0	0	0.52
4 0.51%–1.65%	20,997	1,877	114	0	1.07
5 1.92%–100%	15,123	1,667	17	0	1.68
Corporates					
1 0.00%–0.08%	24,881	9,963	1,205	1,588	0.25
2 0.09%–0.17%	48,094	23,228	633	750	0.27
3 0.21%–0.40%	9,727	5,526	1,020	1,127	0.53
4 0.51%–1.65%	60,823	4,432	545	647	0.71
5 1.92%–100%	35,760	4,078	480	247	2.19
Other	875	875	0	0	3.06
Total	**440,435**	**100,847**	**4,328**	**4,779**	

Equity Exposure Outside the Trading Book
The approach assigned for equity exposures falling outside of the trading book is as defined in the IRB section of BIPRU. For the purposes of risk weighting these equity exposures, the MSI Group applies the simple risk weight approach.

Non-trading book exposure in equities excludes any investments MSI Group holds in other Morgan Stanley Group undertakings. Total non-trading book equity exposure is immaterial (0.61% of total Exposure at Default ("EAD")).

Retail Exposures
The MSI Group does not have IRB exposure to retail clients.

11.4 STANDARDISED APPROACH

A standardised approach is used for certain asset categories, including receivables (e.g., fees and interest), unsettled trades and other assets.

The table below shows the exposures for the MSI Group as at 31 December 2013, calculated using the standardised approach for each exposure class as per the classifications set out in BIPRU:

Table 5: Standardised Approach EAD

AS AT 31/12/2013	TOTAL GROSS EXPOSURE $MILLIONS	EXPOSURE VALUE AFTER CREDIT RISK MITIGATION $MILLIONS
Central Governments or Central Banks	193	193
Institutions	491	491
Corporates	2,307	2,307
Other	1,102	1,102
Total	**4,092**	**4,092**

11.5 CREDIT EXPOSURE BREAKDOWN TABLES

The table below shows the gross and net credit exposures for the MSI Group as at 31 December 2013:

Table 6: Credit EAD

AS AT 31/12/2013	GROSS CREDIT EXPOSURE PRIOR TO CREDIT MITIGATION $MILLIONS	TOTAL EXPOSURE VALUE COVERED BY ELIGIBLE FINANCIAL COLLATERAL $MILLIONS	TOTAL EXPOSURE VALUE COVERED BY GUARANTEES $MILLIONS	NET CREDIT EXPOSURE $MILLIONS
Central Governments or Central Banks	22,419	16,247		7,115
Institutions	238,539	172,461	1,609	46,314
Corporates	181,592	105,437	1,827	49,533
Other	1,977	0	0	1,977
Total	**444,528**	**294,145**	**3,436**	**104,939**

"Exposure value covered by eligible financial collateral," represents the positive market value against which collateral has been received and for which an enforceable legal netting agreement exists in order to enable collateral to be applied. Net credit exposure is the EAD calculated under the rules prescribed in BIPRU upon which regulatory capital charges are calculated.

The table below shows the EAD by industry type for the MSI Group as at 31 December 2013:

Table 7: EAD broken down by Industry Type

AS AT 31/12/2013	EAD $MILLIONS
Banks and Securities Firms	54,098
Energy and Utilities	3,483
Exchanges and Clearing houses	2,199
Insurance	3,317
Leverage and Other Funds	7,329
Mutual and Pension Funds	14,226
Other Corporates	12,406
Real Estate	712
Sovereign	7,170
Total	**104,939**

In addition to assessing and monitoring its credit exposure and risk at the individual counterparty level, the MSI Group also reviews its credit exposure and risk to geographic regions. The table below shows the geographical distribution of credit exposures for the MSI Group as at 31 December 2013:

Table 8: Geographical Breakdown of EAD

AS AT 31/12/2013	AMERICAS $MILLIONS	EMEA $MILLIONS	ASIA $MILLIONS	TOTAL $MILLIONS
Central Governments or Central Banks	687	4,958	1,470	7,115
Institutions	15,994	20,308	10,012	46,314
Corporates	14,240	32,784	2,509	49,533
Other	0	1,977	0	1,977
Total	**30,921**	**60,027**	**13,990**	**104,939**

*EMEA – Europe, Middle East and Africa

As at 31 December 2013, credit exposure was concentrated in North America and Western Europe. The MSI Group pays particular attention to smaller exposures in emerging markets given their higher risk profile. Country ceiling ratings are derived using methodologies generally consistent with those employed by external rating agencies. The material credit exposure was to corporate entities and institutions.

11.6 CREDIT RISK MITIGATION

The MSI Group applies a number of credit risk mitigation techniques, including netting and collateral. Management of MSI Group's credit portfolio is centralised through a global risk management function.

Netting

The MSI Group has policies and procedures in place for recording netting agreements with clients, including the review of the legal enforceability of these agreements. In instances where the legal enforceability of an agreement cannot be confirmed, the benefit of netting is not applied. See Table 4: IRB EAD and Table 6: Credit EAD for the impact of netting and collateral.

Collateral

The amount and type of collateral required by the MSI Group depends on an assessment of the credit risk of the counterparty. Collateral held is managed, in accordance with MSI Group's guidelines and the relevant underlying agreements.

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

For specific transactions or counterparties, the MSI Group will accept letters of credit and guarantees following an appropriate level of due diligence. In such instances, the exposure is assumed to be to the provider of the letter of credit or guarantee.

The table below shows residual maturity breakdown of net credit exposures by exposure class for the MSI Group as at 31 December 2013:

Table 9: Residual Maturity Breakdown of EAD

AS AT 31/12/2013	LESS THAN 1 YR (INCL. 1 YR) $MILLIONS	OVER 1 YR TO LESS THAN 5 YRS $MILLIONS	5 YRS AND ABOVE $MILLIONS	NO MATURITY $MILLIONS	TOTAL $MILLIONS
Central Governments or Central Banks	4,653	1,424	847	192	7,115
Institutions	35,973	8,499	1,841	0	46,314
Corporates	31,859	10,680	6,693	301	49,533
Other	514	0	0	1,463	1,977
Total	**72,998**	**20,603**	**9,381**	**1,956**	**104,939**

Derivative credit exposure
The table below shows the trading book gross positive fair value of derivative contracts, netting benefits, netted current credit exposure and collateral held as at 31 December 2013 for the MSI Group:

Table 10: Derivative Credit Exposures

AS AT 31/12/2013	MARKET VALUE $MILLIONS
Gross positive fair value of contracts	281,074
Netting benefits	229,229
Gross positive fair value after netting	51,845
Collateral held	57,862
Net derivatives credit exposure (after netting and collateral)	12,112

Gross positive fair value represents any long market value on derivative transactions before netting benefits are applied but after any regulatory eliminations and exemptions are applied.

Collateral held represents the market value of collateral received, irrespective of enforceability or utilisation after regulatory eliminations and exemptions are applied.

Net derivatives credit exposure represents the net exposure after collateral, that meets regulatory and legal requirements, has been applied.

The table below shows the Derivative Contracts EAD by calculation method and exposure class for the MSI Group as at 31 December 2013:

Table 11: Derivative Contracts EAD by Calculation Method

AS AT 31/12/2013	IMM $MILLIONS	MTM(1) $MILLIONS	TOTAL $MILLIONS
Central Governments or Central Banks	2,280	312	2,592
Institutions	5,665	11,896	17,561
Corporates	14,406	10,951	25,357
Total	**22,351**	**23,159**	**45,510**

(1) Mark to market method.

11.7 COLLATERAL IMPACT OF A DOWNGRADE
The level of incremental collateral which would be required by derivative counterparties in the event of a Morgan Stanley ratings downgrade is monitored daily. Collateral triggers are maintained by the collateral management department and vary by counterparty.

The additional collateral or termination payments that may be called in the event of a future credit rating downgrade vary by contract and can be based on ratings by either or both of Moody's and S&P. At December 31, 2013, the future potential collateral amounts and termination payments that could be called or required from the MSI Group by counterparties or exchanges and clearing organisations in the event of one-notch or two-notch downgrade scenarios based on the relevant contractual downgrade triggers were $1,097 million and an incremental $1,691 million, respectively. See pages 22, 100 and 229 of the 2013 Form 10-K for details of Morgan Stanley Group collateral downgrade information.

11.8 WRONG WAY RISK
Specific wrong way risk arises when a transaction is structured in such a way that the exposure to the counterparty is positively correlated with the probability of default ("PD") of the counterparty. For example, a counterparty writing put options on its own stock or a counterparty collateralised by its own or related party stocks. The MSI Group considers these matters when approving transactions. General wrong way risk arises when the counterparty PD is correlated, for non-specific reasons, with the market or macroeconomic factors that affect the value of the counterparty's trades. The credit assessment process looks to identify these correlations and monitor accordingly.

12. Market Risk

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

Sound market risk management is an integral part of the Group's culture. The various business units and trading desks are responsible for ensuring that market risk exposures are well managed and in accordance with the firm's risk appetite. The control groups help ensure that these risks are measured and closely monitored and are made transparent to senior management. The Market Risk Department is responsible for ensuring transparency of material market risks, monitoring compliance with established limits, and escalating risk concentrations to appropriate senior management. To execute these responsibilities, the Market Risk Department monitors the MSI Group's risk against limits on aggregate risk exposures, performs a variety of risk analyses, routinely reports risk summaries, and maintains the MSI Group's VaR and scenario analysis systems. These limits are designed to control price and market liquidity risk. Market risk is also monitored through various measures: statistically (using VaR and related analytical measures); by measures of position sensitivity; and through routine stress testing, which measures the impact on the value of existing portfolios of specified changes in market factors, and scenario analyses conducted by the Market Risk Department in collaboration with the business units. The material risks identified by these processes are summarised in reports produced by the Market Risk Department that are circulated to and discussed with senior management.

12.1 VALUE-AT-RISK (VAR)

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

VaR Methodology, Assumptions and Limitations

The MSI 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 model uses four years of historical data with a volatility adjustment to reflect current market conditions. The MSI Group's 99%/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 1%, or once every 100 trading days, if the portfolio were held constant for one day.

The MSI 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 as well as linear exposures to implied volatility risks. 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).

The MSI Group uses VaR as one of a range of risk management tools. 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 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 MSI Group is aware of these and other limitations and, therefore, uses VaR as only one component in its risk management oversight process. This process also incorporates stress testing and scenario analyses and extensive risk monitoring, analysis, and control at the trading desk, division and MSI Group levels.

The MSI 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 MSI 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.

Since the VaR statistics reported in table 12 are estimates based on historical position and market data, VaR should not be viewed as predictive of the MSI Group's future revenues or financial performance or of its ability to monitor and manage risk. There can be no assurance that the MSI 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 once in 100 trading days. VaR does not predict the magnitude of losses which, should they occur, may be significantly greater than the VaR amount.

The methodology, assumptions and limitations of the MSI Group's VaR model are consistent with those of the Morgan Stanley Group. For a further discussion see pages 114 to 121 of the 2013 Form 10-K.

12.2 MARKET RISK CAPITAL COMPONENT

The market risk capital component of the MSI Group comprises capital associated with the VaR methodology in accordance with PRA's approved models and that associated with the standardised approach. The VaR-based capital and the Stressed VaR based capital are determined by the higher of the average of the 60 day 10-day VaR and 10-day Stressed VaR numbers multiplied by the multiplication factor, and the 10-day VaR and 10-day Stressed VaR for the relevant day. The Incremental Risk Charge (IRC) and All Price Risk (APR) charges are determined by the higher of the average of the 12 weeks IRC/APR and the IRC/APR charge for the relevant day.

The table below shows the maximum, minimum and average VaR and Stressed VaR, as well as the Incremental Risk Charge and All Price Risk measures for the year ending 31 December 2013 and as at 31 December 2013 for the MSI Group:

Table 12: Market Risk Component calculated in accordance with the PRA's approved models used for the Capital charge

FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2013	VAR[1] $MILLIONS	STRESSED VAR[1] $MILLIONS	IRC $MILLIONS	APR $MILLIONS
Average	104	167	477	8
Minimum	82	87	359	6
Maximum	186	278	622	12
Period End	108	210	471	11

[1] VaR and Stressed VaR are at a 99% confidence interval, 10 day holding period.

The MSI Group performs daily backtesting analysis at a granular level as part of a range of tools used to validate the accuracy of its VaR models. The MSI Group's regulatory VaR models meet the PRA's 'Green Zone' standards for model accuracy based on backtesting exceptions.

The table below shows the market risk capital charge for the MSI Group as at 31 December 2013, calculated in accordance with the standardised approach and categorised by component type:

Table 13: Market Risk Capital Component calculated in accordance with the Standardised Approach

AS AT 31/12/2013	$MILLIONS
Interest Rate PRR[1]	997
Equity PRR	1
Commodity PRR	2
Foreign Currency PRR	377
Total	**1,377**

[1] Of which: Specific Interest Rate Risk of Securitisation Positions $427m.

Regulatory changes to the market risk capital requirements were introduced from 31 December 2011 under CRDIII and include Stressed VaR, Incremental Risk Charge and the All Price Risk measure.

12.3 STRESSED VAR

Stressed VaR uses the same underlying models as VaR to produce a 1-day 99% VaR constructed over a 1 year period of continuous stress. The data set Stressed VaR uses is based on historical and non volatility adjusted simulations for the general market risk factors and Monte Carlo simulation for name specific risk in corporate shares, bonds, loans and related derivatives. The 1 year stressed window is chosen for each of the UK Regulated legal entities which have VaR model approval. The Stressed VaR model is agreed and approved by the MSI Group's regulator for use in regulatory calculations. Stressed 10-day VaR is constructed by scaling the Stressed 1-day VaR. The Stressed 10-day VaR as of period end was $210 million. The MSI Group's Stressed VaR capital charge was $601 million as at 31 December 2013, based upon the higher of the average of the 60 day Stressed 10-day VaR number multiplied by the multiplication factor, and the Stressed 10-day VaR for the relevant day.

12.4 INCREMENTAL RISK CHARGE

The Incremental Risk Charge ("IRC") measures the migration and default risk of traded instruments by issuers in a single integrated framework. The model assumes a constant level of risk and is calculated over a one year horizon at a confidence level of 99.9% using Monte Carlo simulations. The chief risk factors modelled are defaults, credit migrations, recovery risk and liquidity risk. The model differentiates the underlying traded instruments by liquidity horizon, with the minimum liquidity horizon set at three months. Concentrated positions are assigned higher liquidity horizons. The weighted liquidity horizon for IRC is 4.55 months. The MSI Group's charge relating to IRC was $471 million as at 31 December 2013.

12.5 ALL PRICE RISK

The All Price Risk ("APR") is a measure used to calculate all risks within designated credit correlation trading portfolios, as preapproved by the PRA. Calculated as the 99.9% percentile simulated loss, the APR covers the major risk types associated within the credit correlation trading portfolio, including credit migrations, defaults, recoveries, credit spread and correlation movements and liquidity risk. APR is calculated over a one year horizon assuming a constant level of risk. The constant liquidity horizon for APR is six months. The overall APR is floored at 8% of the corresponding standardised rules for the same portfolio. The MSI Group's charge relating to APR was $11 million as at 31 December 2013.

12.6 STRESS TESTING

During 2013, the MSI Group continued to use stress testing as a key risk management tool to address the severe stresses observed in global markets during an economic downturn.

The MSI Group uses "S-VaR" as a key metric in setting the Group's risk appetite, with limits to tail loss set by the MSI Board and considered for capital adequacy. In addition, a suite of macroeconomic severe but plausible stress scenarios are used to provide complementary tail loss estimates for risk management. S-VaR is a proprietary forward looking methodology that comprehensively measures the Morgan Stanley Group's market and credit risks. S-VaR simulates many stress scenarios based on more than 25 years of historical data and differentiates liquidities of various types of general and specific risks. Additionally, S-VaR captures event and default risks that are particularly relevant for credit portfolios.

12.7 INTEREST RATE RISK IN THE BANKING BOOK

Interest rate risk refers to the risk of losses arising from an adverse change in the interest rates curve within the defined Banking book population.

The interest rate risk in the Banking book is primarily from Corporate Treasury activities, with subordinated debt liabilities and Treasury's Liquidity Reserve investments the material contributors. The risk is typically short dated or has a frequent resetting feature which lowers the quantum of outright risk.

The MSI Group is exposed to interest rate risk primarily through the Trading book, which is captured within VaR.

The interest rate risk in the Banking book is not material in the context of the MSI Group. The amount is +$130K per basis point as at 30 December 2013 and the MSI Group risk is exposed to the yield curve lowering.

The table below shows the impact of a 1 basis point ("1bp") parallel shift in interest rates on the value of interest rate positions in the non-trading book for the MSI Group as at 31 December 2013:

Table 14: Interest Rate Risk in Non-Trading Book

AS AT 31/12/2013	PROFIT OR LOSS OF A +1BP PARALLEL SHIFT IN INTEREST RATES $MILLIONS	PROFIT OR LOSS OF A +1BP PARALLEL SHIFT IN INTEREST RATES $MILLIONS
USD	(0.55)	0.55
EUR	0.60	(0.60)
GBP	0.08	(0.08)
JPY	0.01	(0.01)
Other	0.00	0.00
Total	**0.13**	**(0.13)**

13. Securitisation

13.1 SECURITISATION ACTIVITIES

The MSI Group acts, or has historically acted, as originator, sponsor, liquidity provider, servicer and derivative counterparty to its own originated and sponsored securitisations, as well as those of third party securitisations. The majority of the securitisation exposures are trading book as at 31 December 2013.

The MSI Group's strategy has been to use securitisations for customer facilitation. The MSI Group has engaged in securitisation activities related to commercial and residential mortgage loans, corporate bonds and loans, and other types of financial instruments. The derivatives are generally interest rate swaps and usually with senior payment priority.

The MSI Group participated as a bookrunner or lead manager in a number of new securitisations during 2013. The MSI Group did not originate or sponsor any new securitisations in 2013.

13.2 REGULATORY CAPITAL TREATMENT

The MSI Group employs the FIRB approach and the Standardised Approach to calculate the capital on its securitisation positions. The FIRB and standardised approaches use rating agency credit ratings to determine risk weights. The MSI Group uses ratings from three External Credit Assessment Institutions, Moody's, S&P and Fitch. Retail exposures are treated under the Standardised Approach, whilst non-retail exposures are captured under the FIRB approach.

13.3 SECURITISATION EXPOSURES

The table below shows the capital requirements of securitisation positions within the MSI Group as at 31 December 2013:

Table 15: Securitisation Capital Requirement

AS AT 31/12/2013	MARKET RISK $MILLIONS	CREDIT RISK $MILLIONS
Capital Requirement	776	223

The table below shows securitisation positions broken down by Credit Quality Steps ("CQS") within the MSI Group as at 31 December 2013:

Table 16: Securitisation Exposures by Risk Weightings

AS AT 31/12/2013	MARKET RISK $MILLIONS	CREDIT RISK $MILLIONS
CQS 1–3	282	252
CQS 4–6	204	451
CQS 7–11	398	395
CQS unrated–1250%	875	164
Total	**1,759**	**1,262**
Of which: Resecuritisation	79	130

13.4 ACCOUNTING

Transfers of financial assets in securitisation transactions are generally accounted for as sales when the MSI Group has relinquished control over the transferred assets and met BIPRU 9 requirements for significant risk transfer. The gain or loss on sale of such financial assets depends, in part, on the previous carrying amount of the assets involved in the transfer (generally at fair value) and the sum of the proceeds and the fair value of the retained interests at the date of sale. Transfers that are not accounted for as sales are treated as secured financings. More details of the accounting policy for the MSI Group under UK GAAP can be found in Note 1g of the MSI Group audited financial statements.

13.5 VALUATION

The MSI Group may retain interests in the securitised financial assets of one or more tranches of the securitisation. These retained interests are included in the consolidated statements of the MSI Group at fair value. Any changes in the fair value of such retained interests are recognised through profit and loss in the MSI Group 2013 audited financial statements.

For further information on the MSI Group's valuation techniques related to securitisation, please refer to Notes 1f and 32 in the MSI Group 2013 audited financial statements, and pages 145 to 149 of the 2013 Form 10-K.

13.6 RISK MONITORING

The credit risk of the MSI Group's securitisations and resecuritisations is controlled by actively monitoring and managing the associated credit exposures. The MSI Group evaluates collateral quality, credit subordination levels and structural characteristics of securitisation and resecuritisation transactions at inception and on an ongoing basis, and manages exposures against internal limits.

The MSI Group follows a set of rigorous procedures for managing market risk on securitised products, evolving them with changes in market conditions:

- The MSI Group conducts an assessment of risk limits at least once a year, and more often if required. Risk appetite, collateral quality, liquidity and downside risk are important factors for setting market risk limits.
- The MSI Group measures downside risk using various metrics such as VaR, S-VaR and Scenarios, differentiating products based on collateral, seniority and liquidity.

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