Registered number: 43542

Registered office:
c/o Maples Corporate Services Limited
PO Box 309
Ugland House
Grand Cayman
KY1-1104
Cayman Islands

MORGAN STANLEY CAPITAL (CAYMAN ISLANDS) LIMITED

Interim financial report

30 June 2014

MORGAN STANLEY CAPITAL (CAYMAN ISLANDS) LIMITED

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INTERIM MANAGEMENT REPORT

The Directors present their interim management report, Directors' responsibility statement and condensed financial statements of Morgan Stanley Capital (Cayman Islands) Limited (the "Company") for the six months ended 30 June 2014.

RESULTS AND DIVIDENDS

The result for the six months ended 30 June 2014, after tax, was $nil (30 June 2013: $nil result after tax).

During the six months ended 30 June 2014, no dividends were paid or proposed (30 June 2013: $nil).

PRINCIPAL ACTIVITY

The Company is an exempt company incorporated under the laws of the Cayman Islands.

The principal activity of the Company is the issuance of Optimised Portfolios as Listed Securities ("OPALS") and the hedging of the obligations arising pursuant to such issuances with Equity Linked Obligations ("ELOs").

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

There have not been any significant changes in the Company's principal activity in the period under review and no significant change in the Company's principal activity is expected.

BUSINESS REVIEW

During the six month period ended 30 June 2014, global market and economic conditions remained on an overall upward trend since the end of 2013. The United States ("US") economy continued to show signs of growth during the six month period ended 30 June 2014, despite a decline in real gross domestic product in the first quarter of the year. The U.S. employment situation continued to improve as evidenced by the decline in the unemployment rate. Inflation remained at historically low levels. The Eurozone economy continued its moderate recovery from a deep recession, but monetary and credit growth remained subdued. By contrast, the United Kingdom ("UK") had a stronger-than-expected recovery and the second quarter of 2014 marked its strongest calendar quarter in four years. Japan experienced stronger growth despite a drop in consumer spending resulting from a rise in the sales tax. In China, the government continued reforms to change the structure of the Chinese economy with the objective to maintain its current high growth rate. Elsewhere, emerging markets have experienced considerable volatility resulting in part from the Federal Reserve's reduction of quantitative easing.

The condensed statement of comprehensive income is set out on page 8. The result for the six months ended 30 June 2014 is $nil which is consistent with the Company's function and the six months ended 30 June 2013. Interest income and interest expense decreased by $27,000 compared to the six months ended 30 June 2013 due to a reduction in interest rates applied to outstanding balances with other Morgan Stanley Group undertakings.

The condensed statement of financial position is set out on page 10. The value of financial assets and financial liabilities, designated at fair value through profit or loss, which are represented by ELOs and OPALS respectively, have increased by $114,820,000 to $2,034,291,000 compared with 31 December 2013 due to fair value movements in the period.

INTERIM MANAGEMENT REPORT

BUSINESS REVIEW (CONTINUED)

The risk management section below sets out the Company'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 Company’s business activity and is managed 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 Company’s own risk management policies and procedures are consistent with those of the Morgan Stanley Group.

Note 4 to the condensed financial statements provides qualitative and quantitative disclosures about the Company’s management of and exposure to financial risks, including liquidity risk.

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.

It is the policy and objective of the Company not to be exposed to market risk.

Credit risk

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

The Morgan Stanley Group manages credit risk exposure on a global consolidated basis as well as giving consideration to individual legal entities. The credit risk management policies and procedures of the Morgan Stanley Group establish the framework for identifying, measuring, monitoring and controlling credit risk whilst 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 Company are consistent with those of the Morgan Stanley Group and include escalation to appropriate key management personnel of the Company.

Liquidity and funding risk

Liquidity and funding risk refers to the risk that the Company will be unable to finance its operations due to a loss of access to the capital markets or difficulty in liquidating its assets. Liquidity and funding risk also encompasses the Company’s ability to meet its financial obligations without experiencing significant business disruption or reputational damage that may threaten its viability as a going concern.

The primary goal of the Morgan Stanley Group’s liquidity risk management framework is to ensure that the Morgan Stanley Group, including the Company, have access to adequate funding across a wide range of market conditions. The framework is designed to enable the Morgan Stanley Group to fulfil its financial obligations and support the execution of the Company’s business strategies.

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

INTERIM MANAGEMENT REPORT

BUSINESS REVIEW (CONTINUED)

Risk management (continued)

Operational risk

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

The Company'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 addition, we may introduce new products or services or change processes resulting in new operational risk that we may not fully appreciate or identify. In general, the transactions processed are increasingly complex. The Company 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 Company 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 Company's or a third party's systems or improper or unauthorised action by third parties or the Morgan Stanley Group's employees, the Company could suffer financial loss, an impairment to its liquidity, a disruption of its businesses, regulatory sanctions or damage to its reputation. In addition, the interconnectivity of multiple financial institutions with central agencies, exchanges and clearing houses, and the increased importance of these entities, increase the risk that an operational failure at one institution or entity may cause an industry-wide operational failure that could materially impact the Company's ability to conduct business.

The Company's operations rely on the secure processing, storage and transmission of confidential and other information in its computer systems and systems of third parties with which we do business or that facilitate our business activities, such as vendors. Like other financial services firms, the Company and its third party providers have been and continue to be subject to unauthorised access, mishandling or misuse, computer viruses or malware cyber attacks and other events. Events such as these could have a security impact on the Company's systems and jeopardise the Company's or the Company's clients' or counterparties' personal, confidential, proprietary or other information processed and stored in, and transmitted through, the Company's and our third party providers' computer systems. Furthermore, such events could cause interruptions or malfunctions in the Company's, the Company's clients', the Company'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 Company, 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.

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.

INTERIM MANAGEMENT REPORT

BUSINESS REVIEW (CONTINUED)

Risk management (continued)

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 United Kingdom ("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 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.

Going concern

Business risks associated with the uncertain market and economic conditions are being monitored and managed by the Morgan Stanley Group and the Company. Retaining sufficient liquidity and capital to withstand these market pressures remains central to the Morgan Stanley Group's and the Company'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 it has sufficient resources at its disposal to absorb losses associated with certain stressed scenarios.

Taking all these factors into consideration, the Directors believe it is reasonable to assume that the Company will have access to adequate resources to continue in operational existence for the foreseeable future. Accordingly they continue to adopt the going concern basis in preparing the condensed financial statements.

DIRECTORS

The following Directors held office throughout the six month period ended 30 June 2014 and to the date of approval of this interim financial report:

H. Nakajima
M. Stern

INTERIM MANAGEMENT REPORT

EVENTS AFTER THE REPORTING DATE

There have been no significant events since the reporting date.

Approved by the Board and signed on its behalf by

Director

DIRECTORS' RESPONSIBILITY STATEMENT

In accordance with Article 4(2)(c) of the Luxembourg Law of 11 January 2008 there are certain transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market (the "Transparency Law").

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

(a) the condensed financial statements, which has been prepared in accordance with International Accounting Standard ("IAS") 34 '*Interim financial reporting*' ("IAS 34") as adopted by the European Union ("EU"), gives a true and fair view of the assets, liabilities, financial position and result of the Company; and

(b) the interim management report includes a fair review of the information required by Article 4(4) of the Transparency Law, being an indication of the important events that have occurred during the six months ended 30 June 2014 and their impact on the condensed financial statements, and a description of the principal risks and uncertainties for the remaining six months of the financial year.

Approved by the Board and signed on its behalf by

Director

Board of Directors

H. Nakajima
M. Stern

INDEPENDENT REVIEW REPORT
TO MORGAN STANLEY CAPITAL (CAYMAN ISLANDS) LIMITED

To the Board of Directors of
Morgan Stanley Capital (Cayman Islands) Limited
Cayman Islands

Report on the condensed set of financial statements

We have reviewed the accompanying condensed set of financial statements of Morgan Stanley Capital (Cayman Islands) Limited which comprises the condensed statement of financial position as at 30 June 2014, the condensed statement of comprehensive income, the condensed statement of changes in equity, the condensed statement of cash flows for the six months ended 30 June 2014 and a summary of significant accounting policies and other explanatory information. We have read the other information contained in the interim management report and considered whether it contains any apparent misstatements or material inconsistencies with the information in the condensed set of financial statements. Our responsibility is to express a conclusion on the condensed set of financial statements based on our review.

Scope of review

We conducted our review in accordance with International Standard on Review Engagements 2410, *"Review of Interim Financial Information Performed by the Independent Auditor of the Entity"*. A review of interim financial information consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing 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 any audit opinion.

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the condensed statement of financial position of Morgan Stanley Capital (Cayman Islands) Limited as at 30 June 2014, and the related condensed statement of comprehensive income, the condensed statement of changes in equity and the condensed statement of cash flows for the six month period then ended is not prepared, in all material aspects, in accordance with IAS 34 *"Interim Financial Reporting"* ("IAS 34") as adopted by the European Union ("EU")

Report on other legal and regulatory requirements

Nothing has come to our attention that causes us to believe that the interim management report, which is the responsibility of the Board of Directors, contains any apparent misstatements or material inconsistencies with the information in the condensed set of financial statements.

For Deloitte Audit, *Cabinet de révision agréé*

Martin Flaunet, *Réviseur d'entreprises agréé*

Partner

Luxembourg, 28 August 2014

MORGAN STANLEY CAPITAL (CAYMAN ISLANDS) LIMITED

CONDENSED STATEMENT OF COMPREHENSIVE INCOME
Six months ended 30 June 2014

	Six months ended 30 June 2014 $'000 (unaudited)	Six months ended 30 June 2013 $'000 (unaudited)
Net gains on financial instruments designated at fair value through profit or loss	-	-
Interest income	2,166	2,193
Interest expense	(2,166)	(2,193)
RESULT BEFORE INCOME TAX	-	-
Income tax expense	-	-
RESULT AND TOTAL COMPREHENSIVE INCOME FOR THE PERIOD	-	-

All operations were continuing in the current and prior period.

The notes on pages 12 to 21 form an integral part of the condensed financial statements.

CONDENSED STATEMENT OF CHANGES IN EQUITY
Six months ended 30 June 2014

	Share capital $'000	Retained earnings $'000	Total equity $'000
Balance at 1 January 2013 (audited)	1	-	1
Result and total comprehensive income for the period	-	-	-
Balance at 30 June 2013 (unaudited)	1	-	1
Balance at 1 January 2014 (audited)	1	-	1
Result and total comprehensive income for the period	-	-	-
Balance at 30 June 2014 (unaudited)	1	-	1

The notes on pages 12 to 21 form an integral part of the condensed financial statements.

MORGAN STANLEY CAPITAL (CAYMAN ISLANDS) LIMITED
Registered number: 43542

CONDENSED STATEMENT OF FINANCIAL POSITION
As at 30 June 2014

	Note	30 June 2014 $'000 (unaudited)	31 December 2013 $'000 (audited)
ASSETS			
Loans and receivables:			
Other receivables		190,227	188,061
Financial assets designated at fair value through profit or loss	2,4,5	2,034,291	1,919,471
TOTAL ASSETS		2,224,518	2,107,532
LIABILITIES AND EQUITY			
Financial liabilities at amortised cost:			
Bank loans and overdrafts		2	-
Other payables		190,224	188,060
		190,226	188,060
Financial liabilities designated at fair value through profit or loss	2,4,5	2,034,291	1,919,471
TOTAL LIABILITIES		2,224,517	2,107,531
EQUITY			
Share capital		1	1
Retained earnings		-	-
Equity attributable to owners of the Company		1	1
TOTAL EQUITY		1	1
TOTAL LIABILITIES AND EQUITY		2,224,518	2,107,532

This condensed financial statements were approved by the Board and authorised for issue on

Signed on behalf of the Board

Director

The notes on pages 12 to 21 form an integral part of the condensed financial statements.

MORGAN STANLEY CAPITAL (CAYMAN ISLANDS) LIMITED

CONDENSED STATEMENT OF CASH FLOWS
Six months ended 30 June 2014

	Six months ended 30 June 2014 $'000 (unaudited)	Six months ended 30 June 2013 $'000 (unaudited)
OPERATING ACTIVITIES		
Result for the period	-	-
Adjustment for:		
Interest income	(2,166)	(2,193)
Interest expense	2,166	2,193
Operating cash flows before changes in operating assets and liabilities	-	-
Changes in operating assets		
Increase in loans and receivables	-	(1)
Increase in financial assets designated at fair value through profit or loss	(114,820)	(199,274)
	(114,820)	(199,275)
Changes in operating liabilities		
(Decrease)/ Increase in financial liabilities at amortised cost, excluding bank loans and overdrafts	(1)	1
Increase in financial liabilities designated at fair value through profit or loss	114,820	199,274
	114,819	199,275
Interest paid	(1)	-
NET CASH FLOWS USED IN OPERATING ACTIVITIES	(2)	-
NET DECREASE IN CASH AND CASH EQUIVALENTS	(2)	-
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE PERIOD	-	-
CASH AND CASH EQUIVALENTS AT THE END OF THE PERIOD	(2)	-

The notes on pages 12 to 21 form an integral part of the condensed financial statements.

1. BASIS OF PREPARATION

General information

The information in this interim financial report does not constitute statutory accounts within the meaning of Section 435 of the UK Companies Act 2006 (the "Companies Act").

The information for the year ended 31 December 2013 does not constitute statutory accounts as defined in Section 434 of the Companies Act. The report of the Réviseur d'enterprises agréé on those accounts was not qualified and did not include a reference to any matters which the auditors drew attention by way of emphasis without qualifying the report.

Statement of compliance

The Company prepares its annual financial statements in accordance with International Financial Reporting Standards ("IFRS") issued by the International Accounting Standards Board ("IASB") as adopted by the EU and Interpretations issued by the IFRS Interpretations Committee. The condensed financial statements has been prepared in accordance with IAS 34 as adopted by the EU.

Accounting policies

In preparing this condensed financial statements, the Company has applied consistently the accounting policies and methods of computation used in the Company's annual financial statements for the year ended 31 December 2013.

New standards and interpretations adopted during the period

The following amendment to a standard relevant to the Company's operations was adopted during the period. This amendment did not have a material impact on the Company's condensed 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.

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

New standards and interpretations not yet adopted

At the date of authorisation of these condensed financial statements, the following standard and amendments to standards relevant to the Company's operations were issued by the IASB but not yet mandatory. Except where otherwise stated, the Company does not expect that the adoption of the following standard and amendment to standards will have a material impact on the Company's condensed financial statements.

IFRS 9 '*Financial instruments*' ("IFRS 9") was issued by the IASB in November 2009, amended in November 2013, and revised and reissued by the IASB in July 2014. Retrospective application is required by IFRS 9, which is effective for annual periods beginning on or after 1 January 2018. Early adoption, either in full or relating to own credit in isolation, is permitted. Although there are expected to be significant changes to the presentation of financial instruments by the Company/Group, there is not expected to be a significant impact on net assets.

As part of the December 2013 Improvement to IFRSs, the IASB made amendments to the following standards that are relevant to the Company's operations: IFRS 2 '*Share-based payment*', IFRS 8 '*Operating segments*', IFRS 13 '*Fair value measurement*' and IAS 24 '*Related party disclosure*' (for application in accounting periods beginning on or after 1 July 2014).

1. BASIS OF PREPARATION (CONTINUED)

Use of estimates and sources of uncertainty

The preparation of the Company's condensed financial statements requires management to make judgements, estimates and assumptions regarding the valuation of certain financial instruments, impairment of assets, and other matters that affect the condensed financial statements and related disclosures. The Company believes that the estimates utilised in preparing the condensed financial statements are reasonable, relevant and reliable. Actual results could differ from these estimates.

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

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

OPALS – These instruments are securities whose investment performance corresponds generally to that of a benchmark index by an indirect investment in a basket of shares. All dividends and certain other amounts associated with these baskets, net of certain expenses, are received by the Company to enable it to fulfil its obligations to holders of OPALS. These instruments contain an embedded derivative which significantly modifies the cash flows of the issuance. The return on the instrument is linked to an underlying that is not clearly and closely related to the debt host including, but not limited to, equity, credit or commodity- linked notes. Using the fair value option, the entire instrument is measured at fair value through profit or loss.

ELOs – The Company is a party to a Master Equity Linked Obligation Agreement and to a Master Equity Linked Counterparty Agreement with other Morgan Stanley Group undertakings. ELOs are purchased to hedge the issuance of OPALS and track the value of a basket of equities. These instruments contain an embedded derivative that significantly modifies the cash flows that would otherwise be required under the contract. Using the fair value option, the entire instrument is measured at fair value through profit or loss.

	30 June 2014		31 December 2013	
	Assets $'000	**Liabilities $'000**	**Assets $'000**	**Liabilities $'000**
OPALS	-	2,034,291	-	1,919,471
ELOs	2,034,291	-	1,919,471	-
	2,034,291	2,034,291	1,919,471	1,919,471

There were no significant gains or losses attributable to changes in own credit risk for financial liabilities designated at fair value for six months ended 30 June 2014 (31 December 2013: $nil).

The carrying amount of financial liabilities designated at fair value at 30 June 2014 and 31 December 2013 is considered to be a reasonable approximation of the contractual value at maturity.

3. SEGMENT REPORTING

Segment information is present in respect of the Company's business segments. The business segments are based on the Company's management and internal reporting structure.

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 Company's own business segments are consistent with those of Morgan Stanley.

3. SEGMENT REPORTING (CONTINUED)

The Company has one reportable business segment, Institutional Securities, which provides financial services to financial institutions. The Company's business includes the issuance of financial instruments and the hedging of the obligations arising pursuant to such issuances.

4. FINANCIAL RISK MANAGEMENT

Risk management procedures

Risk is an inherent part of both Morgan Stanley's and the Company's business activity and is managed by the Company 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 Company's own risk management policies and procedures are consistent with those of the Morgan Stanley Group.

The principal activity of the Company is the issuance of OPALS and the hedging of the obligations arising pursuant to such issuances. It is the policy and objective of the Company not to be exposed to market risk. On issuance of each financial instrument, the Company enters into economics hedges of its obligations by purchasing financial instruments from another Morgan Stanley Group undertaking.

Significant risks faced by the Company resulting from its trading activities are set out below.

Credit risk

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

The Morgan Stanley Group manages credit risk exposure on a global consolidated basis and in consideration of individual legal entities. The credit risk management policies and procedures of the Morgan Stanley Group establish the framework for identifying, measuring, monitoring and controlling credit risk while 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 Company are consistent with those of the Morgan Stanley Group and include escalation to appropriate key management personnel of the Company.

The Company enters into all of its financial asset transactions with other Morgan Stanley Group undertakings, and both the Company and the other Morgan Stanley Group undertakings are wholly-owned subsidiaries of the same ultimate parent entity, Morgan Stanley. As a result of the implicit support that would be provided by Morgan Stanley, the Company is considered exposed to the credit risk of Morgan Stanley, except where the Company transacts with other Morgan Stanley Group undertakings that have a higher credit rating to that of Morgan Stanley.

The maximum exposure to credit risk of the Company at the reporting date is the carrying amount of the financial assets held in the condensed statement of financial position. The Company has not entered into any credit enhancements to manage its exposure to credit risk.

The Company does not have any significant exposure arising from items not recognised on its condensed statement of financial position.

4. FINANCIAL RISK MANAGEMENT (CONTINUED)

Credit risk (continued)

Maximum exposure to credit risk by credit rating[(1)]

Credit rating	Gross credit exposure 30 June 2014 $'000	Gross credit exposure 31 December 2013 $'000
A	2,224,518	2,107,532

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

At 30 June 2014 there were no financial assets past due but not impaired or individually impaired (31 December 2013: $none).

Liquidity and funding risk

Liquidity and funding risk refers to the risk that the Company will be unable to finance its operations due to a loss of access to the capital markets or difficulty in liquidating its assets. Liquidity and funding risk also encompasses the Company's ability to meet its financial obligations without experiencing significant business disruption or reputational damage that may threaten its viability as a going concern. Liquidity risk is the risk that the Company's financial condition or overall safety and soundness is adversely affected by an inability (or perceived inability) to meet its obligations.

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 Company are consistent with those of the Morgan Stanley Group. The primary goal of the Morgan Stanley Group's liquidity risk management framework is to ensure the Morgan Stanley Group, including the Company, have access to adequate funding across a wide range of market conditions. The framework is designed to enable the Company to fulfil its financing obligations and support the execution of the Company's business strategies.

The Company hedges all of its financial liabilities with financial assets entered into with another Morgan Stanley Group undertaking, that is a wholly-owned subsidiary of the parent, Morgan Stanley. Further, the maturity profile of the financial assets matches the maturity profile of the financial liabilities.

Liquidity management policies

The core components of the Morgan Stanley Group's liquidity management framework, which includes consideration of the liquidity risk for each individual legal entity, are the Contingency Funding Plan ("CFP"), Liquidity Stress Tests and the Global Liquidity Reserve, which support the Morgan Stanley 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 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.

4. FINANCIAL RISK MANAGEMENT (CONTINUED)

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

Since the Company hedges the liquidity risk of its financial liabilities with financial assets that match the maturity profile of the financial liabilities, the Company is not considered a major operating subsidiary for the purposes of liquidity risk. However, the Company would have access to the cash or liquidity reserves held by Morgan Stanley in the unlikely event that it was unable to access adequate financing to service its financial liabilities when they become payable.

The CFP and Liquidity Stress Tests are evaluated on an ongoing basis and reported to the Firm Risk Committee, Asset/Liability Management Committee, and other appropriate risk committees.

Global Liquidity Reserve. The Morgan Stanley Group maintains 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. The size of the Global Liquidity Reserve is actively managed by the Morgan Stanley Group. The following components are considered in sizing the Global Liquidity Reserve: unsecured debt maturity profile, statement of financial position size and composition, funding needs in a stressed environment inclusive of contingent cash outflows and collateral requirements. Additionally, the Global Liquidity Reserve includes an additional reserve, which is primarily a discretionary surplus based on the Morgan Stanley Group’s risk tolerance and is subject to change dependent on market and firm-specific events.

The Global Liquidity Reserve, to which the Company has access, is held within Morgan Stanley and the Morgan Stanley Group’s major operating subsidiaries and is composed of diversified cash and cash equivalents and highly liquid unencumbered securities.

Eligible unencumbered securities include US government securities, US agency securities, US agency mortgage-backed securities, non-US government securities and other highly liquid investment grade securities.

The ability to monetise assets during a liquidity crisis is critical. The Morgan Stanley Group believes that the assets held in the Global Liquidity Reserve can be monetised within five business days in a stressed environment given the highly liquid and diversified nature of the reserves.

4. FINANCIAL RISK MANAGEMENT (CONTINUED)

Liquidity and funding risk (continued)

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 Company'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 Company's, liabilities equals or exceeds the expected holding period of the assets being financed.

The Morgan Stanley Group funds its 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 programmes for both standard and structured products targeting global investors and currencies.

Balance sheet management

In managing both the Morgan Stanley Group's and the Company's funding risk the composition and size of the entire 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 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 Company with flexibility in managing the size of its statement of financial position.

Maturity analysis

In the following maturity analysis of financial assets and financial liabilities, financial assets designated at fair value through profit or loss and financial liabilities designated at fair value through profit or loss are disclosed according to their earliest contractual maturity; all such amounts are presented at their fair value, consistent with how these financial instruments are managed. All other amounts represent the undiscounted cash flows receivable and payable by the Company arising from its financial assets and financial liabilities to earliest contractual maturities as at 30 June 2014. Receipt of financial assets and 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 Company to appropriately reflect the liquidity risk arising from these financial assets and financial liabilities, presented in a way that is consistent with how the liquidity risk on these financial assets and financial liabilities is managed by the Company.

4. FINANCIAL RISK MANAGEMENT (CONTINUED)

Liquidity and funding risk (continued)

30 June 2014	On demand $'000
Financial assets	
Loans and receivables:	
Other receivables	190,227
Financial assets designated at fair value through profit or loss	
ELOs	2,034,291
Total financial assets	2,224,518
Financial liabilities	
Financial liabilities at amortised cost:	
Bank loans and overdrafts	2
Other payables	190,224
Financial liabilities designated at fair value through profit or loss	
OPALS	2,034,291
Total financial liabilities	2,224,517

31 December 2013	On demand $'000
Financial assets	
Loans and receivables:	
Other receivables	188,061
Financial assets designated at fair value through profit or loss	
ELOs	1,919,471
Total financial assets	2,107,532
Financial liabilities	
Financial liabilities at amortised cost:	
Other payables	188,060
Financial liabilities designated at fair value through profit or loss	
OPALS	1,919,471
Total financial liabilities	2,107,531

4. FINANCIAL RISK MANAGEMENT (CONTINUED)

Market risk

Market risk is defined by IFRS 7 *'Financial instruments: Disclosures'* as the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices.

Sound market risk management is an integral part of the Company's and the Morgan Stanley Group's culture. The Company 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 Value at Risk ("VaR") and scenario systems. The Company is managed within the Morgan Stanley Group's global framework. The market risk management policies and procedures of the Company include performing risk analyses and reporting any material risks identified to appropriate key management personnel of the Company.

The Company enters into all of its financial asset transactions with other Morgan Stanley Group undertakings, where both the Company and the other Morgan Stanley Group undertakings are wholly-owned subsidiaries of the same group parent entity, Morgan Stanley.

The issued OPALS expose the Company to the risk of changes in market prices of the underlying securities, interest rate risk and, where denominated in currencies other than US dollar, the risk of changes in rates of exchange between the US dollar and the other relevant currencies. The Company uses the risk mirroring contracts, in the form of ELOs, which it purchases from another Morgan Stanley Group undertaking, to match the price, interest rate and foreign currency risks associated with the issuance of the OPALS, consistent with the Company's risk management strategy. As such, the Company is not exposed to any market risk on these financial instruments.

5. 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 Company's financial assets and financial liabilities recognised at fair value on a recurring basis, classified according to the fair value hierarchy.

30 June 2014	**Quoted prices in active market (Level 1) $'000**	**Valuation techniques using observable inputs (Level 2) $'000**	**Valuation techniques with significant unobservable inputs (Level 3) $'000**	**Total $'000**
Financial assets designated at fair value through profit or loss:				
ELOs	-	2,034,291	-	2,034,291
Total financial assets measured at fair value	-	2,034,291	-	2,034,291
Financial liabilities designated at fair value through profit or loss:				
OPALS	-	2,034,291	-	2,034,291
Total financial liabilities measured at fair value	-	2,034,291	-	2,034,291

31 December 2013	**Quoted prices in active market (Level 1) $'000**	**Valuation techniques using observable inputs (Level 2) $'000**	**Valuation techniques with significant unobservable inputs (Level 3) $'000**	**Total $'000**
Financial assets designated at fair value through profit or loss:				
ELOs	-	1,919,471	-	1,919,471
Total financial assets measured at fair value	-	1,919,471	-	1,919,471
Financial liabilities designated at fair value through profit or loss:				
OPALS	-	1,919,471	-	1,919,471
Total financial liabilities measured at fair value	-	1,919,471	-	1,919,471

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

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

The Company'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:

OPALS

The Company issues OPALS, which are securities whose investment performance corresponds generally to that of a benchmark index by an indirect investment in a basket of shares. The fair value of OPALS is determined using valuation models, incorporating observable inputs referencing identical or comparable securities to the underlying shares. The impact of own credit spreads is also considered and included as appropriate. OPALS are categorised in Level 2 of the fair value hierarchy.

ELOs

ELOs are purchased to hedge the issuance of OPALS as the investment performance of the ELOs corresponds generally to that of the same benchmark index by an indirect investment in a basket of shares, as that of the OPALS they were purchased to hedge. The fair value of the ELOs is determined using valuation models, incorporating observable inputs referencing identical or comparable securities to the underlying shares. The impact of own credit spreads is also considered and included as appropriate. ELOs are categorised in Level 2 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 transfers into or out of Level 2 of the fair value hierarchy during the current period and prior year.

c. 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 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 period or prior year.

6. ASSETS AND LIABILITIES NOT MEASURED AT FAIR VALUE

For all financial instruments not measured at fair value, the carrying amount is considered to be a reasonable approximation of fair value due to the short term nature of these assets and liabilities.