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**MORGAN STANLEY & CO. INTERNATIONAL plc**

**Half-yearly financial report**

**30 June 2016**

# **MORGAN STANLEY & CO. INTERNATIONAL plc**

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# **MORGAN STANLEY & CO. INTERNATIONAL plc**

## **INTERIM MANAGEMENT REPORT**

The Directors present their interim management report and the condensed consolidated financial statements (“Interim Financial Statements”) of Morgan Stanley & Co. International plc (the “Company”) and all of its subsidiary undertakings (together the “Group”), for the six month period ended 30 June 2016. This interim management report has been prepared for the Group as a whole and therefore gives greater emphasis to those matters which are significant to the Company and its subsidiary undertakings when viewed as a whole.

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

## **RESULTS AND DIVIDENDS**

The Group made a profit after tax in the six month period to 30 June 2016 of \$293 million (30 June 2015: \$548 million). No interim dividends or payments of coupon interest on the additional Tier 1 capital instruments were paid or declared (30 June 2015: \$15 million of pre-tax coupon interest on the additional Tier 1 capital instruments was paid on 30 January 2015).

## **PRINCIPAL ACTIVITY**

The principal activity of the Group is the provision of financial services to corporations, governments and financial institutions.

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

There have not been any changes in the Group’s principal activity during the period and no significant change in the Group’s principal activity is expected.

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

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

## **REGULATION**

The Company is authorised by the Prudential Regulation Authority (“PRA”) and regulated by the PRA and the Financial Conduct Authority (“FCA”). In addition, the company is a registered swap dealer and is regulated by the US Commodity Futures Trading Commission.

# **MORGAN STANLEY & CO. INTERNATIONAL plc**

## **INTERIM MANAGEMENT REPORT**

### **BUSINESS REVIEW**

#### **UK Referendum**

On 23 June 2016, the UK electorate voted to leave the European Union (the “EU”). It is difficult to predict the future of the UK’s relationship with the EU, which uncertainty may increase the volatility in the global financial markets in the short- and medium-term. There are several alternative models of relationship that the UK might seek to negotiate with the EU, the timeframe for which is uncertain but could take two years or more. The regulatory framework applicable to financial institutions with significant operations in Europe, such as the Group and Morgan Stanley, is expected to evolve and specific and meaningful information regarding the long-term consequences of the vote is expected to become clearer over time. The Group and Morgan Stanley will continue to evaluate various courses of action in the context of the development of the UK’s withdrawal from the EU and the referendum’s potential impact on our operations.

#### **Overview of 2016 Financial Results**

The condensed consolidated income statement for the six month period to 30 June 2016 is set out on page 14. The Group reported a profit after tax for the six month period to 30 June 2016 of \$293 million compared to a profit after tax of \$548 million for the six month period to 30 June 2015 as a result of decreased revenues, partially offset by lower expenses.

The Group’s revenues are best reviewed across the aggregate of ‘Net gains on financial instruments classified as held for trading’, ‘Net gains on financial instruments designated at fair value through profit or loss’, ‘Interest income’, ‘Interest expense’ and ‘Other income’ (“aggregate revenues”). Aggregate revenues for the six month period ended 30 June 2016 decreased by 20% to \$2,177 million compared to \$2,717 million for the six month period ended 30 June 2015.

The decrease in aggregate revenues was primarily driven by decreased sales and trading revenues in both the Fixed Income and Commodities and the Investment Banking divisions.

The decrease in Fixed Income and Commodities sales and trading revenues was driven by market uncertainty, including the slowdown in China’s growth, continuing low oil prices and the UK referendum. In addition the Fixed Income revenues for the period ended 30 June 2015 benefited from increased client activity and volatility following the quantitative easing measures announced by the ECB in January 2015. Commodities revenues for the period ended 30 June 2015 also included revenues from the Oil and Merchanting business which was sold on 1 November 2015.

The decrease in Investment Banking revenues was due to reduced advisory revenues as a result of market uncertainty.

Equities sales and trading revenues were in line with the six month period ended 30 June 2015. Prime Brokerage revenues increased as a result of increased client activity and balances, offset by a decrease in Cash Equities and Derivatives revenues as a result of challenging market conditions.

Other expenses decreased from \$1,886 million for the six months ended 30 June 2015 to \$1,712 million for the six month period ended 30 June 2016. The decrease in expenses is due to a reduction in staff related costs, largely offset by an increase in non-staff related costs principally ‘management charges from other Morgan Stanley Group undertakings related to other services’.

Staff related costs decreased by 28% from \$1,057 million for the six month period ended 30 June 2015 to \$757 million for the six months ended 30 June 2016. This decrease was primarily driven by reduced salary costs and lower discretionary compensation. Salary costs were lower due to reduced head count and the weakening of the British Pound against the US dollar. Discretionary compensation reduced as a result of the reduction in revenues.

Non-staff related costs increased by 15% from \$829 million for the period ended 30 June 2015 to \$955 million for the period ended 30 June 2016. Included within ‘management charges from other Morgan Stanley Group undertakings related to other services’ for the period ended 30 June 2015 is a reimbursement of \$213 million of net costs, previously recharged from certain UK incorporated Morgan Stanley Group undertakings following the implementation of the new UK accounting framework.

# MORGAN STANLEY & CO. INTERNATIONAL plc

## INTERIM MANAGEMENT REPORT

### BUSINESS REVIEW (CONTINUED)

#### Overview of 2016 Financial Results (continued)

The Group's tax expense for the six month period ended 30 June 2016 was \$172 million compared to \$283 million for the six month period ended 30 June 2015. This represents an effective tax rate of 37% (30 June 2015: 34.1%) which is higher than the average standard rate of UK corporation tax (inclusive of the UK Banking surcharge) of 28% (30 June 2015: 20.25%). See note 3 for further details.

The condensed consolidated statement of financial position presented on page 17 reflects increases in the Group's total assets and total liabilities of \$76,857 million and \$76,551 million respectively, representing increases of 20% for each as at 30 June 2016 when compared to 31 December 2015. The increase in total assets is driven by increases of \$52,059 million in financial assets classified as held for trading and in securities purchased under agreement to resell of \$17,680 million. The increase in total liabilities is driven by increases in financial liabilities classified as held for trading of \$49,931 million, increase in securities sold under agreement to repurchase of \$6,518 million and an increase in trade payables of \$16,732 million.

The increase in both financial assets and liabilities classified as held for trading is driven by an increase in derivative assets and liabilities, mainly interest rate contracts, driven by fair value movements as interest rate yields were lower over the period and fair value changes in foreign exchange rate derivative contracts due to market volatility. The increase in both 'securities purchased under agreement to resell' and 'securities sold under agreement to repurchase' was driven by increased client financing activity. The increase in 'trade payables' was due to an increase in cash collateral received as a result of the increase in derivative balances.

The condensed consolidated statement of cash flows presented on page 18 shows an increase in cash and cash equivalents of \$2,365 million during the six month period to 30 June 2016 (six month period to 30 June 2015: net increase of \$860 million). Net cash flows from operating activities were \$2,452 million (six month period to 30 June 2015: \$939 million). This has been partially offset by net cash outflows from financing activity due to payment of interest on subordinated loan liabilities of \$84 million (six month period to 30 June 2015: \$68 million).

#### Key performance indicators

The Board of directors monitors the results of the Group by reference to a range of performance and risk based metrics, including, but not limited to the following:

##### *Profitability metrics*

*Operating margin:* The Group's operating margin (defined as net profit/ loss before tax as a percentage of aggregate revenues) was 21.4% for the six month period ended 30 June 2016 (30 June 2015: 30.6%)

*Return on equity:* The Group's return on equity (profit/ loss for the period as a percentage of total equity at the beginning of the year) was 1.7% for the six month period ended 30 June 2016 (six month period ended 30 June 2015: 3.3%).

*Return on assets:* The Group's return on assets (profit/ loss for the period as a percentage of total assets at the beginning of the year) was 0.1% for the six month period ended 30 June 2016 (six month period ended 30 June 2015: 0.1%).

##### *Balance sheet assets*

*Total assets:* Total assets of the Group continue to be closely monitored. The Group's total assets, as disclosed on page 17, increased by 20% from \$394,084 million at 31 December 2015 to \$470,941 million at 30 June 2016.

##### *Capital*

The Group monitors its, and the Company's capital position against a range of key metrics including the following:

*Tier 1 regulatory capital:* The Company's Tier 1 capital as calculated in accordance with PRA rules which are based on the fourth European Union ("EU") Capital Requirements Directive and EU Capital Requirements Regulation ("CRR"), collectively known as "CRD IV", was \$15,237 million

# **MORGAN STANLEY & CO. INTERNATIONAL plc**

## **INTERIM MANAGEMENT REPORT**

### **BUSINESS REVIEW (CONTINUED)**

#### **Key performance indicators (continued)**

##### *Capital (continued)*

as at 30 June 2016 (31 December 2015: \$15,255 million) and its Tier 1 capital ratio was 15.4% as at 30 June 2016 (31 December 2015: 15.5%), which is in excess of the required minimum regulatory ratio. Tier 1 capital ratio is defined as Tier 1 capital divided by risk-weighted assets ("RWAs").

*Leverage ratio:* CRD IV, introduced a new minimum leverage ratio, which compares Tier 1 capital to a measure of leverage exposure. As at 30 June 2016, the Company had a leverage ratio of 3.9% (31 December 2015: 4.3%), which is above the proposed required regulatory ratio of 3%, refer to page 10 for further details.

### **RISK MANAGEMENT**

The Morgan Stanley Group manages its risk on a global basis but in consideration of the individual legal entities. The Directors do not consider that the Group is materially exposed to any principal risks or uncertainties arising from financial instruments.

Risk is an inherent part of the Group's business activity. The Group seeks to identify, assess, monitor and manage each of the various types of risk involved in its business activities, in accordance with defined policies and procedures. The Group has developed its own risk management policy framework, which leverages the risk management policies and procedures of the Morgan Stanley Group and which includes escalation to the Group's Board of Directors and to appropriate senior management personnel of the Group as well as oversight through the Group's Board of Directors and through a dedicated Risk Committee of non-executive Directors that reports to the Board of Morgan Stanley International Limited ("MSI"), the Company's ultimate UK parent undertaking.

Note 8 to the condensed consolidated financial statements provides more detailed quantitative disclosures and note 28 to the consolidated financial statements for the year ended 31 December 2015 provides more detailed qualitative disclosures on the Group's exposure to financial risks.

Set out below is an overview of the Group's policies for the management of financial risk and other significant business risks.

#### **Market risk**

Market risk refers to the risk of losses for a position or portfolio due to changes in rates, foreign exchange, equities, implied volatilities, correlations or other market factors.

The Group manages the market risk associated with its trading activities at both a trading division and an individual product level, and includes consideration of market risk at the legal entity level.

The Group uses the statistical technique known as VaR as one of the tools used to measure, monitor and review the market risk exposures of its trading portfolios. The Market Risk Department calculates and distributes daily VaR-based risk measures to various levels of management. The table on the following page shows the Group's VaR for primary risk categories and total Management VaR for the six month period ended 30 June 2016 and for the year ended 31 December 2015.

# MORGAN STANLEY & CO. INTERNATIONAL plc

## INTERIM MANAGEMENT REPORT

### RISK MANAGEMENT (CONTINUED)

#### Market risk (continued)

	95% / one-day VaR for the six months ended 30 June 2016		95% / one-day VaR for the year ended 31 December 2015	
	Period		Period	
	End	Average	End	Average
	\$millions	\$millions	\$millions	\$millions
Primary Risk Categories	18	19	18	22
Credit Portfolio <sup>(1)</sup>	8	8	6	6
Less: Diversification benefit <sup>(2)</sup>	(7)	(5)	(4)	(5)
<b>Total Management VaR</b>	<b>19</b>	<b>22</b>	<b>20</b>	<b>23</b>

(1) The Credit Portfolio VaR is disclosed as a separate category from the Primary Risk Categories and includes loans that are carried at fair value and associated hedges as well as counterparty credit valuation adjustments and related hedges.

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

The Group's average Management VaR for Primary Risk Categories for the six month period ended 30 June 2016, was \$19 million compared to \$22 million for the year ended 31 December 2015. The decrease in average Management VaR for Primary Risk Categories is primarily due to decreased exposure to equity price and foreign exchange risk.

The Group's average Credit Portfolio VaR for the six months ended 30 June 2016 was \$8 million, compared to \$6 million for the year ended 31 December 2015. This was mainly due to an increase in credit risk exposure in high rated corporates.

#### Credit risk

Credit risk refers to the risk of loss arising when a borrower, counterparty or issuer does not meet its financial obligations to the Group. Credit risk includes country risk, which is further described below. The Group primarily incurs credit risk exposure to institutions and sophisticated investors mainly through its Institutional Securities business segment.

Credit risk exposure is managed on a global basis and in consideration of each significant legal entity within the Morgan Stanley Group. The credit risk management policies and procedures 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.

The table on the following page shows the Group's maximum exposure to credit risk and credit exposure, based on the carry amounts of certain financial assets the Group believes are subject to credit risk. Where the Group enters into credit enhancements, including receiving cash and security as collateral and master netting agreements, to manage the credit exposure on these financial instruments the financial effect of the credit enhancements is also disclosed in the table. The net credit exposure represents the credit exposure remaining after the effect of the credit enhancements. Exposure to other Morgan Stanley Group undertakings is included in this table.

# MORGAN STANLEY & CO. INTERNATIONAL plc

## INTERIM MANAGEMENT REPORT

### RISK MANAGEMENT (CONTINUED)

#### Credit risk (continued)

##### *Exposure to credit risk*

Class	30 June 2016			31 December 2015		
	Gross credit exposure <sup>(1)</sup>	Credit enhancements	Net credit exposure <sup>(2)</sup>	Gross credit exposure <sup>(1)</sup>	Credit enhancements	Net credit exposure <sup>(2)</sup>
	\$millions	\$millions	\$millions	\$millions	\$millions	\$millions
Cash collateral on securities borrowed	21,276	(20,495)	781	22,433	(21,116)	1,317
Securities purchased under agreement to resell	76,324	(74,987)	1,337	58,644	(57,951)	693
Financial assets classified as held for trading – derivatives	234,856	(223,728)	11,128	187,111	(178,730)	8,381
Financial assets designated at fair value through profit or loss	3,466	(2,977)	489	1,636	(958)	678
	<u>335,922</u>	<u>(322,187)</u>	<u>13,735</u>	<u>269,824</u>	<u>(258,755)</u>	<u>11,069</u>

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

(2) Of the residual net credit exposure, intercompany cross product netting arrangements are in place which would allow for an additional \$4,647 million (2015: \$2,716 million) to be offset in the event of default by certain Morgan Stanley counterparties.



# MORGAN STANLEY & CO. INTERNATIONAL plc

## INTERIM MANAGEMENT REPORT

### RISK MANAGEMENT (CONTINUED)

#### Credit risk (continued)

##### Country risk exposure

Country risk exposure is the risk that events in, or affecting, a foreign country might adversely affect the Group. “Foreign country” means any country other than the UK. Sovereign Risk, by contrast, is the risk that a government will be unwilling or unable to meet its debt obligations, or renege on the debt it guarantees. Sovereign risk is single-name risk for a sovereign government, its agencies and guaranteed entities. For further information on how the Group identifies, monitors and manages country risk exposure refer to page 5 of the consolidated financial statements for the year ended 31 December 2015.

The table below shows the Group’s five largest non-UK country net exposures. The Group’s sovereign exposures consist of financial instruments entered into with sovereign and local governments. Its non-sovereign exposures consist primarily of exposures to corporations and financial institutions. Exposure to other Morgan Stanley Group undertakings has been excluded from this table.

Country	Net Inventory <sup>(1)</sup> \$millions	Net Counterparty Exposure <sup>(2)</sup> \$millions	Funded lending \$millions	Unfunded Commitments \$millions	Exposure Before Hedges \$millions	Hedges <sup>(3)</sup> \$millions	Net Exposure <sup>(4)</sup> \$millions
Germany:							
Sovereigns	1,210	718	-	-	1,928	(433)	1,495
Non-sovereigns	(49)	1,807	-	120	1,878	(669)	1,209
Total Germany	1,161	2,525	-	120	3,806	(1,102)	2,704
Italy:							
Sovereigns	1,482	19	-	-	1,501	(16)	1,485
Non-sovereigns	152	569	-	442	1,163	(220)	943
Total Italy	1,634	588	-	442	2,664	(236)	2,428
United States:							
Sovereigns	(1,240)	51	-	-	(1,189)	-	(1,189)
Non-sovereigns	1,196	1,963	25	-	3,184	(11)	3,173
Total United States	(44)	2,014	25	-	1,995	(11)	1,984
United Arab Emirates:							
Sovereigns	(16)	768	-	-	752	(5)	747
Non-sovereigns	(38)	148	-	-	110	(10)	100
Total United Arab Emirates	(54)	916	-	-	862	(15)	847
South Korea:							
Sovereigns	62	64	-	-	126	-	126
Non-sovereigns	94	428	-	-	522	(15)	507
Total South Korea	156	492	-	-	648	(15)	633

(1) Net inventory represents exposure to both long and short single name and index positions (i.e. bonds and equities at fair value and CDS based on notional amount assuming zero recovery adjusted for any fair value receivable or payable). As a market maker, the Group transacts in these CDS positions to facilitate client trading.

(2) Net counterparty exposure (i.e. repurchase transactions, securities lending and over-the-counter (“OTC”) derivatives) taking into consideration legally enforceable master netting agreements and collateral.

(3) Represents CDS hedges (purchased and sold) on net counterparty exposure and funded lending executed by trading desks responsible for hedging counterparty and lending credit risk exposures for the Group. Amounts are based on the CDS notional amount assuming zero recovery adjusted for any fair value receivable or payable.

(4) In addition, as at 30 June 2016, the Group had exposure to these countries for overnight deposits with banks of approximately \$400 million.

# MORGAN STANLEY & CO. INTERNATIONAL plc

## INTERIM MANAGEMENT REPORT

### RISK MANAGEMENT (CONTINUED)

#### Liquidity and funding risk

Liquidity and funding risk refers to the risk that the Group 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 Group's ability to meet its financial obligations without experiencing significant business disruption or reputational damage that may threaten its viability as a going concern.

For a further discussion on the Group's liquidity and funding risk refer to page 7 of the strategic report in the consolidated financial statements for the year ended 31 December 2015.

#### *Secured funding*

The table below presents the Group's secured funding split between short term secured funding (with a maturity of less than one year remaining from 30 June 2016 and 31 December 2015) and long term secured funding (with a maturity of more than one year from 30 June 2016 and 31 December 2015) consisting of securities sold under agreements to repurchase and cash collateral on securities loaned.

For further information on how the Group's utilises secured funding refer to page 7 of the strategic report in the consolidated financial statements for the year ended 31 December 2015.

	30 June 2016 \$millions	31 December 2015 \$millions
<i>Short term secured funding:</i>		
Cash collateral on securities loaned	17,572	14,875
Securities sold under agreements to repurchase	41,747	34,558
Total short term secured funding	59,319	49,433
<i>Long term secured funding:</i>		
Cash collateral on securities loaned	55	1,393
Securities sold under agreements to repurchase	2,782	3,453
Total long term secured funding	2,837	4,846
<b>Total secured funding</b>	<b>62,156</b>	<b>54,279</b>

#### *Credit ratings*

The Company relies on external sources to finance a significant portion of its day-to-day operations. The cost and availability of financing generally are impacted by, among other variables, the Company's credit ratings. In addition, the Company's credit ratings can have an impact on certain trading revenues, particularly in those businesses where longer-term counterparty performance is a key consideration, such as OTC derivative transactions, including credit derivatives and interest rate swaps. Ratings agencies consider company-specific factors; other industry factors such as regulatory or legislative changes; the macroeconomic environment; and perceived levels of government support, among other things.

Some rating agencies have stated that they currently incorporate various degrees of credit rating uplift from non-governmental third party sources of potential support.

At 30 June 2016, the Company's senior unsecured ratings were as follows:

	Short- Term Debt	Long- Term Debt	Rating Outlook
Moody's Investors Service, Inc ("Moody's")	P-1	A1	Stable
Standard & Poor's Rating Service ("S&P")	A-1	A	Credit Watch Positive

**INTERIM MANAGEMENT REPORT**

**RISK MANAGEMENT (CONTINUED)**

**Liquidity and funding risk (continued)**

*Collateral impact of a downgrade*

In connection with certain OTC trading agreements and certain other agreements where the Company is a liquidity provider to certain financing vehicles, the Company may be required to provide additional collateral, immediately settle any outstanding liability balances with certain counterparties or pledge additional collateral to certain exchanges and clearing organisations in the event of a future credit rating downgrade, irrespective of whether the Company is in a net asset or net liability position.

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. As at 30 June 2016, the future potential collateral amounts and termination payments that could be called or required by counterparties or exchanges and clearing organisations, in the event of one-notch or two-notch downgrade scenarios, from the lower of Moody's or S&P ratings, based on the relevant contractual downgrade triggers, were \$545 million and an incremental \$621 million, respectively.

While certain aspects of a credit rating downgrade are quantifiable pursuant to contractual provisions, the impact it would have on the Company's business and results of operations in future periods is inherently uncertain and would depend on a number of interrelated factors, including, among others, the magnitude of the downgrade, the rating relative to peers, the rating assigned by the relevant agency pre-downgrade, individual client behaviour and future mitigating actions the Company might take. The liquidity impact of additional collateral requirements is included in the Group's Liquidity Stress Tests.

**Operational risk**

Operational risk refers to the risk of loss, or of damage to the Group's reputation, resulting from inadequate or failed processes, people and systems or from external events (e.g. fraud, theft, legal and compliance risks or damage to physical assets). Operational risk relates to the following risk event categories as defined by Basel Capital Standards: internal fraud; external fraud; employment practices and workplace safety; clients, products and business practices; business disruption and system failure; damage to physical assets; and execution, delivery and process management. The Group may incur operational risk across the full range of its business activities, including revenue-generating activities (e.g. sales and trading) and support and control groups (e.g., information technology and trade processing).

For further information on the Group's operational risk, refer to the pages 9 and 10 of the strategic report in the consolidated financial statements for the year ended 31 December 2015.

**Conduct risk**

Conduct risk refers to the risk that the Group's actions or behaviours do not adequately consider the impact on its clients, expected market users or the markets. Conduct risk is managed within the framework set out by MSI and all of its subsidiary undertakings (together "the MSI Group") and is managed and owned across business and control functions through policies, processes and controls within a designed framework.

**Legal, regulatory and compliance risk**

Legal, regulatory and compliance risk includes the risk of legal or regulatory sanctions, material financial loss; including fines, penalties, judgements, damages and/ or settlements or loss to reputation the Group may suffer as a result of a failure to comply with laws, regulations, rules, related self-regulatory organisation standards and codes of conduct applicable to our business activities. This risk also includes contractual and commercial risk, such as the risk that a counterparty's performance obligations will be unenforceable. It also includes compliance with Anti-Money Laundering and terrorist financing rules and regulations. The Group is generally subject to extensive regulation in the different jurisdictions in which it conducts its business.

For further information on the Group's legal, regulatory and compliance risk, refer to the pages 10 and 11 of the strategic report in the consolidated financial statements for the year ended 31 December 2015.

# MORGAN STANLEY & CO. INTERNATIONAL plc

## INTERIM MANAGEMENT REPORT

### CAPITAL MANAGEMENT

The Group views capital as an important source of financial strength. It actively manages and monitors its capital in line with established policies and procedures and in compliance with local regulatory requirements.

There have been no significant changes to the Group's capital management policies since 31 December 2015. For further information on the Group's capital management policies, refer to the pages 11 and 12 of the strategic report in the consolidated financial statements for the year ended 31 December 2015.

#### *Leverage ratio*

CRD IV, introduced a new minimum leverage ratio, which compares Tier 1 capital to a measure of leverage exposure. Leverage exposure is defined as the sum of adjusted assets less Tier 1 capital deductions plus off-balance sheet exposures. The minimum leverage ratio is expected to become effective for the Company on 1 January 2018, although public disclosure requirements are effective for reporting periods from 1 January 2015. The table below shows the leverage ratio calculation as at 30 June 2016 and 31 December 2015 for the Company. At both 30 June 2016 and 31 December 2015, the Company had a leverage ratio above the proposed required regulatory ratio of 3%. During the period the leverage ratio has moved from 4.3% as at 31 December 2015 to 3.9% as of 30 June 2016. The change in leverage ratio was due to an increase in total assets, mainly derivative assets. Refer to the 'overview of 2016 financial results' on page 3 for further details.

	30 June 2016	31 December 2015
	\$millions	\$millions
Total assets	469,778	392,721
Regulatory adjustments	(83,288)	(41,706)
Total leverage ratio exposure	386,490	351,015
Tier 1 capital	15,237	15,253
Leverage ratio	3.9%	4.3%

### REGULATORY REQUIREMENTS

#### **Capital resources**

The Group continues to actively manage its capital and liquidity position to ensure adequate resources are available to support its activities, to enable it to withstand market stresses, and to meet regulatory stress testing requirements proposed by its regulators globally.

The Company is regulated by the FCA and the PRA and as such is subject to minimum capital requirements. The Company's capital is monitored on an ongoing basis to ensure compliance with these requirements. At a minimum, the Company must ensure that capital resources described in accordance with the CRR as Own Funds, are greater than the capital resource requirement covering credit, market and operational risk.

The Company complied with all of its regulatory capital requirements during the period.

The table on the following page sets out the Company's capital resources as at 30 June 2016 and 31 December 2015.

# MORGAN STANLEY & CO. INTERNATIONAL plc

## INTERIM MANAGEMENT REPORT

### REGULATORY REQUIREMENTS (CONTINUED)

#### Capital resources (continued)

	30 June 2016 \$millions	31 December 2015 \$millions
Capital instruments and the related share premium accounts eligible as Common Equity Tier 1 capital ("CET 1")	11,978	11,978
Retained earnings	1,919	1,871
Other reserves	1,285	1,286
CET 1 capital before regulatory adjustments	15,182	15,135
Total regulatory adjustments to CET 1	(1,245)	(1,180)
<b>CET1 capital</b>	13,937	13,955
Additional Tier 1 capital	1,300	1,300
<b>Tier 1 capital</b>	15,237	15,255
Tier 2 capital instruments (long-term subordinated loans)	7,906	7,906
<b>Own Funds</b>	23,143	23,161

Movement in Own Funds of the Company was as follows:

	30 June 2016 \$millions	31 December 2015 \$millions
Opening Own Funds	23,161	22,701
Change in Tier 1 capital:		
CET 1 capital before regulatory adjustments	47	318
Regulatory adjustments to CET 1	(65)	142
<b>Closing Own Funds</b>	23,143	23,161

#### GOING CONCERN

Business risks associated with the uncertain market, economic and political conditions are being actively monitored and managed by the Group. Retaining sufficient liquidity and capital to withstand these market pressures remains central to the Group's strategy. In particular, the Group's capital and liquidity is deemed sufficient to exceed regulatory minimums under both a normal and in a stressed market environment for the foreseeable future. Additionally, the Group has access to further Morgan Stanley Group capital and liquidity as required.

Taking all of these factors into consideration, the Directors believe it is reasonable to assume that the Group will have access to adequate resources to continue in operational existence for the foreseeable future. Accordingly they continue to adopt the going concern basis in preparing the interim management reports and Interim Financial Statements.

Approved by the Board and signed on its behalf by

C Castello

Director

22 September 2016

# **MORGAN STANLEY & CO. INTERNATIONAL plc**

## **DIRECTORS' RESPONSIBILITY STATEMENT**

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

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

By order of the Board on 22 September 2016



C Castello

Director

Board of Directors:

D O Cannon

C Castello

T Duhon

L Guy

J Horder

A Kohli

M C Phibbs

I Plenderleith (Chairman)

R P Rooney

D A Russell

# **INDEPENDENT REVIEW REPORT TO MORGAN STANLEY & CO. INTERNATIONAL plc**

We have been engaged by the Company to review the condensed set of financial statements in the half-yearly financial report for the six month period ended 30 June 2016 which comprises the condensed consolidated income statement, the condensed consolidated statement of comprehensive income, the condensed consolidated statement of changes in equity, the condensed consolidated statement of financial position, the condensed consolidated statement of cash flows and related notes 1 to 14. We have read the other information contained in the half-yearly financial report and considered whether it contains any apparent misstatements or material inconsistencies with the information in the condensed set of financial statements.

This report is made solely to the Company in accordance with International Standard on Review Engagements (UK and Ireland) 2410, "*Review of Interim Financial Information Performed by the Independent Auditor of the Entity*" issued by the Auditing Practices Board. Our work has been undertaken so that we might state to the Company those matters we are required to state to them in an independent review report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company, for our review work, for this report, or for the conclusions we have formed.

## **Directors' responsibilities**

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

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

## **Our responsibility**

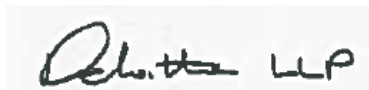
Our responsibility is to express to the Company a conclusion on the condensed set of interim financial statements in the half-yearly financial report based on our review.

## **Scope of review**

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

## **Conclusion**

Based on our review, nothing has come to our attention that causes us to believe that the condensed set of interim financial statements in the half-yearly financial report for the six month period ended 30 June 2016 is not prepared, in all material aspects, in accordance with International Accounting Standard 34 as adopted by the European Union and the Disclosure and Transparency Rules of the United Kingdom's Financial Conduct Authority.



Deloitte LLP  
Chartered Accountants and Statutory Auditor  
London  
22 September 2016

**MORGAN STANLEY & CO. INTERNATIONAL plc**

**CONDENSED CONSOLIDATED INCOME STATEMENT**

**Six months ended 30 June 2016**

		<b>Six months ended 30 June 2016 \$millions (unaudited)</b>	<b>Restated Six months ended 30 June 2015 \$millions (unaudited)</b>
	<b>Note</b>		
Net gains on financial instruments classified as held for trading		1,911	2,258
Net (losses)/gains on financial instruments designated at fair value through profit or loss		(20)	81
Interest income		52	105
Interest expense		(344)	(383)
Other income		578	656
Other expense	2	(1,712)	(1,886)
<b>PROFIT BEFORE TAX</b>		<u>465</u>	<u>831</u>
Income tax expense	3	(172)	(283)
<b>PROFIT FOR THE PERIOD</b>		<u><u>293</u></u>	<u><u>548</u></u>
Attributable to:			
Owners of the parent		293	548
<b>PROFIT FOR THE PERIOD</b>		<u><u>293</u></u>	<u><u>548</u></u>

All operations were continuing in the current and prior periods.

The notes on pages 19 to 51 form an integral part of the Interim Financial Statements.

Details of the restatement are provided in note 1.



**MORGAN STANLEY & CO. INTERNATIONAL plc****CONDENSED CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME****Six months ended 30 June 2016**

	<b>Six months ended 30 June 2016 \$millions (unaudited)</b>	<b>Six months ended 30 June 2015 \$millions (unaudited)</b>
<b>PROFIT FOR THE PERIOD</b>	<u>293</u>	<u>548</u>
<b>OTHER COMPREHENSIVE INCOME, NET OF TAX</b>		
<b>Items that will not be reclassified subsequently to profit or loss:</b>		
Actuarial losses on defined benefit plans	-	(1)
<b>Items that may be reclassified subsequently to profit or loss:</b>		
Currency translation reserve:		
Foreign currency translation differences arising on foreign operations during the period	19	(27)
Available-for-sale reserve:		
Net change in fair value of available-for-sale financial assets	(6)	(2)
<b>OTHER COMPREHENSIVE INCOME/(LOSS) AFTER INCOME TAX</b>	<u>13</u>	<u>(30)</u>
<b>TOTAL COMPREHENSIVE INCOME</b>	<u>306</u>	<u>518</u>
Attributable to:		
Owners of the parent	305	523
Non-controlling interests	1	(5)
<b>TOTAL COMPREHENSIVE INCOME</b>	<u>306</u>	<u>518</u>

The notes on pages 19 to 51 form an integral part of the Interim Financial Statements.

# MORGAN STANLEY & CO. INTERNATIONAL plc

## CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

### Six months ended 30 June 2016

	Equity instrument	Share premium account	Currency translation reserve	Available - for-sale reserve	Capital contribution reserve	Capital redemption reserve	Pension reserve	Retained earnings	Attributable to owners of the parent	Non-controlling interest	Total equity
	\$millions	\$millions	\$millions	\$millions	\$millions	\$millions	\$millions	\$millions	\$millions	\$millions	\$millions
<b>Balance at 1 January 2016</b>	12,765	513	(12)	3	3	1,400	-	1,790	16,462	65	16,527
Profit for the period	-	-	-	-	-	-	-	293	293	-	293
Other comprehensive income	-	-	18	(6)	-	-	-	-	12	1	13
<b>Total comprehensive income</b>	-	-	18	(6)	-	-	-	293	305	1	306
<b>Balance at 30 June 2016 (unaudited)</b>	12,765	513	6	(3)	3	1,400	-	2,083	16,767	66	16,833

	Equity instruments	Share premium account	Currency translation reserve	Available - for-sale reserve	Capital contribution reserve	Capital redemption reserve	Pension reserve	Retained earnings	Attributable to owners of the parent	Non-controlling interest	Total equity
	\$millions	\$millions	\$millions	\$millions	\$millions	\$millions	\$millions	\$millions	\$millions	\$millions	\$millions
<b>Balance at 1 January 2015</b>	12,764	513	27	6	3	1,400	2	1,402	16,117	71	16,188
Profit for the period	-	-	-	-	-	-	-	548	548	-	548
Other comprehensive income	-	-	(22)	(2)	-	-	(1)	-	(25)	(5)	(30)
<b>Total comprehensive income</b>	-	-	(22)	(2)	-	-	(1)	548	523	(5)	518
<b>Transactions with owners:</b>											
Issue of ordinary share capital	1	-	-	-	-	-	-	-	1	-	1
Coupon interest on Additional Tier 1 capital	-	-	-	-	-	-	-	(12)	(12)	-	(12)
<b>Balance at 30 June 2015 (unaudited)</b>	12,765	513	5	4	3	1,400	1	1,938	16,629	66	16,695

The notes on pages 19 to 51 form an integral part of the Interim Financial Statements.

**CONDENSED CONSOLIDATED STATEMENT OF FINANCIAL POSITION**  
**As at 30 June 2016**

		<b>30 June 2016</b>	<b>31 December 2015</b>
		<b>\$millions</b>	<b>\$millions</b>
<b>ASSETS</b>	<b>Note</b>	<b>(unaudited)</b>	
Loans and receivables:			
Cash and short term deposits		14,281	11,882
Cash collateral on securities borrowed		21,276	22,433
Securities purchased under agreements to resell		76,324	58,644
Trade receivables		55,307	50,940
Other receivables		1,655	1,891
		<u>168,843</u>	<u>145,790</u>
Financial assets classified as held for trading (of which approximately \$47,132 million (2015: \$39,718 million) were pledged to various parties)	4	298,332	246,273
Financial assets designated at fair value through profit or loss		3,466	1,636
Available-for-sale financial assets		32	39
Current tax assets		112	185
Deferred tax assets		115	120
Prepayments and accrued income		35	38
Property, plant and equipment		6	3
<b>TOTAL ASSETS</b>		<u><b>470,941</b></u>	<u><b>394,084</b></u>
<b>LIABILITIES AND EQUITY</b>			
Financial liabilities at amortised cost:			
Bank loans and overdrafts		11	-
Cash collateral on securities loaned		17,627	16,268
Securities sold under agreements to repurchase		44,529	38,011
Trade payables		98,797	82,065
Subordinated loans		7,906	7,906
Other payables		13,627	11,588
		<u>182,497</u>	<u>155,838</u>
Financial liabilities classified as held for trading	4	266,437	216,506
Financial liabilities designated at fair value through profit or loss		4,860	4,865
Provisions		22	21
Current tax liabilities		84	101
Deferred tax liabilities		19	23
Accruals and deferred income		184	197
Post employment benefit obligations		5	6
<b>TOTAL LIABILITIES</b>		<u><b>454,108</b></u>	<u><b>377,557</b></u>
<b>EQUITY</b>			
Equity instruments		12,765	12,765
Share premium account		513	513
Currency translation reserve		6	(12)
Available-for-sale-reserve		(3)	3
Capital contribution reserve		3	3
Capital redemption reserve		1,400	1,400
Retained earnings		2,083	1,790
<b>Equity attributable to owners of the parent</b>		<u><b>16,767</b></u>	<u><b>16,462</b></u>
<b>Non-controlling interest</b>		<u><b>66</b></u>	<u><b>65</b></u>
<b>TOTAL EQUITY</b>		<u><b>16,833</b></u>	<u><b>16,527</b></u>
<b>TOTAL LIABILITIES AND EQUITY</b>		<u><b>470,941</b></u>	<u><b>394,084</b></u>

The notes on pages 19 to 51 form an integral part of the Interim Financial Statements.

**MORGAN STANLEY & CO. INTERNATIONAL plc**

**CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS**

**As at 30 June 2016**

		Six months ended 30 June 2016 \$millions (unaudited)	Six months ended 30 June 2015 \$millions (unaudited)
	Note		
<b>NET CASH FLOWS FROM OPERATING ACTIVITIES</b>	6	2,452	939
<b>INVESTING ACTIVITIES</b>			
Purchase of property, plant and equipment		(3)	-
Purchase of available-for-sale financial assets		-	(1)
Proceeds from sale of available-for-sale financial assets		-	1
<b>NET CASH FLOWS USED IN INVESTING ACTIVITIES</b>		<u>(3)</u>	<u>-</u>
<b>FINANCING ACTIVITIES</b>			
Issue of equity instruments		-	1
Dividends paid		-	(12)
Interest on subordinated loan liabilities		(84)	(68)
<b>NET CASH FLOWS USED IN FINANCING ACTIVITIES</b>		<u>(84)</u>	<u>(79)</u>
<b>NET INCREASE IN CASH AND CASH EQUIVALENTS</b>		2,365	860
Currency translation differences on foreign currency cash balances		23	(209)
<b>CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE PERIOD</b>		<u>11,882</u>	<u>11,656</u>
<b>CASH AND CASH EQUIVALENTS AT THE END OF THE PERIOD</b>		<u>14,270</u>	<u>12,307</u>

The notes on pages 19 to 51 form an integral part of the Interim Financial Statements.

**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**Six months ended 30 June 2016**

**1. BASIS OF PREPARATION**

**a. General information**

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

The comparative information for the year ended 31 December 2015 does not constitute statutory accounts as defined in section 434 of the Companies Act. A copy of the statutory accounts for that year has been delivered to the Registrar of Companies. The auditor's report on those accounts was not qualified, did not include a reference to any matters to which the auditors drew attention by way of emphasis without qualifying the report and did not contain statements under section 498(2) or (3) of the Companies Act.

**b. Accounting policies**

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

In preparing these Interim Financial Statements the Group has applied consistently the accounting policies and methods of computation used in the Group's annual consolidated financial statements for the year ended 31 December 2015, except where noted below.

**New standards and interpretations adopted during the period**

The following amendments to standards relevant to the Group's operations were adopted during the period. These amendments to standards did not have a material impact on the Group's condensed consolidated financial statements.

An amendment to IAS 1 '*Presentation of financial statements*' was issued by the IASB in December 2014, as part of the Disclosure Initiative project. The amendment is applicable in annual periods beginning on or after 1 January 2016. The amendment was endorsed by the EU in December 2015.

Amendments to IAS 16 and IAS 38 '*Acceptable Methods of Depreciation and Amortisation*' were issued by the IASB in May 2014, for prospective application in annual periods beginning on or after 1 January 2016. The amendments were endorsed by the EU in December 2015.

As part of the 2012 – 2014 Annual Improvements Cycle published in September 2014, the IASB made amendments to the following standards that are relevant to the Group's operations: IFRS 7 '*Financial instruments: Disclosures*', IAS 19 '*Employee benefits*' and IAS 34 '*Interim financial reporting*', for application in accounting periods beginning on or after 1 January 2016. The improvements were endorsed by the EU in December 2015.

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

**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**Six months ended 30 June 2016**

**1. BASIS OF PREPARATION (CONTINUED)**

**New standards and interpretations not yet adopted**

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

An amendment to IAS 7 'Statement of Cash Flows' was issued by the IASB in January 2016, as part of the Disclosure Initiative project. The amendment is applicable in annual periods beginning on or after 1 January 2017. Early application is permitted.

An amendment to IAS 12 'Income Taxes' was issued by the IASB in January 2016, for application in annual periods beginning on or after 1 January 2017. Early application is permitted.

An amendment to IFRS 2 'Share based payments' was issued by the IASB in June 2016, for application in annual periods beginning on or after 1 January 2018. Early application is permitted.

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. IFRS 9 is applicable retrospectively, except where otherwise prescribed by transitional provisions of the standard, and is effective for annual periods beginning on or after 1 January 2018. Early application, either in full or relating to own credit in isolation, is permitted. The Group is currently assessing the impact of IFRS 9 on its consolidated financial statements.

IFRS 15 'Revenue from Contracts with Customers' ("IFRS 15") was issued by the IASB in May 2014 for retrospective application in annual periods beginning on or after 1 January 2018. In addition, amendments to IFRS 15 were issued by the IASB in April 2016 requiring application in annual periods beginning on or after 1 January 2018. Early application of IFRS 15 and the amendments is permitted. The Group is currently assessing the impact of IFRS 15 on its consolidated financial statements.

IFRS 16 'Leases' ("IFRS 16") was issued by the IASB in January 2016, for retrospective application in annual periods beginning on or after 1 January 2019. Early application is permitted. The Group is currently assessing the impact of IFRS 16 on its consolidated financial statements.

**c. Restatement of comparative amounts**

The condensed consolidated income statement includes a prior year adjustment to increase both 'interest income' and 'interest expense' by \$69 million. This relates to interest income and expense that was incorrectly presented net. This error had no impact on the Group's profit within the Group's condensed consolidated income statement or the condensed consolidated statement of financial position for the period. Note 6 has also been revised as a result of the restatement.

**d. Use of estimates and sources of uncertainty**

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

For judgements used in determining whether the Group should consolidate a structured entity and in determining fair value of certain assets and liabilities see note 10 and note 11 respectively.

# MORGAN STANLEY & CO. INTERNATIONAL plc

## NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Six months ended 30 June 2016

### 2. OTHER EXPENSE

	30 June 2016 \$millions	30 June 2015 \$millions
Direct staff costs	80	80
Management charges from other Morgan Stanley Group undertakings relating to staff costs <sup>(1)</sup>	677	977
Management charges from other Morgan Stanley Group undertakings relating to other services <sup>(2)</sup>	315	98
Brokerage fees	265	283
Administration and corporate services	105	171
Professional services	149	173
Other	121	104
	<u>1,712</u>	<u>1,886</u>

(1) 'Management charges from other Morgan Stanley Group undertakings relating to staff costs' decreased from \$977 million for the six month period ended 30 June 2015 to \$677 million for the six months ended 30 June 2016. This decrease was primarily driven by reduced salary costs and lower discretionary compensation. Salary costs were lower due to reduced head count and the weakening of the British Pound against the US dollar. Discretionary compensation reduced as a result of the reduction in revenues.

(2) 'Management charges from other Morgan Stanley Group undertakings relating to other services' increased from \$98 million for the period ended 30 June 2015 to \$315 million for the period ended 30 June 2016. Included within 'management charges from other Morgan Stanley Group undertakings related to other services' for the period ended 30 June 2015 is a reimbursement of \$213 million of net costs, previously recharged from certain UK incorporated Morgan Stanley Group undertakings following the implementation of the new UK accounting framework.

### 3. INCOME TAX EXPENSE

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

The Group's effective tax rate for the six month period ended 30 June 2016 is 37% (30 June 2015: 34.1%), which is higher than the standard rate of corporation tax (inclusive of the UK Banking Surcharge) in the UK of 28% (30 June 2015: 20.25%). The main reasons for the higher effective tax rate for the period ended 30 June 2016 are non-creditable withholding tax and non-deductible expenditure. The higher effective tax rate for the period ended 30 June 2015 was due to the recognition of a provision against certain withholding tax reclaim balances recognised in prior periods.

# MORGAN STANLEY & CO. INTERNATIONAL plc

## NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Six months ended 30 June 2016

### 4. FINANCIAL ASSETS AND FINANCIAL LIABILITIES CLASSIFIED AS HELD FOR TRADING

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

	30 June 2016	30 June 2016	31 December 2015	31 December 2015
	Assets	Liabilities	Assets	Liabilities
	\$millions	\$millions	\$millions	\$millions
Government debt securities	13,400	15,154	11,365	10,747
Corporate and other debt	8,211	2,128	6,969	1,284
Corporate equities	41,865	24,461	40,828	23,424
Derivatives (see note 5)	234,856	224,694	187,111	181,051
	<u>298,332</u>	<u>266,437</u>	<u>246,273</u>	<u>216,506</u>

There are no terms and conditions of any financial asset or liability classified as held for trading that may individually significantly affect the amount, timing and certainty of future cash flows for the Group.

### 5. DERIVATIVES CLASSIFIED AS HELD FOR TRADING

	30 June 2016			
	Bilateral OTC	Cleared OTC	Listed derivative contracts	Total
	\$millions	\$millions	\$millions	\$millions
Derivative assets:				
Interest rate contracts	112,199	3,607	8	115,814
Credit contracts	10,003	11	-	10,014
Foreign exchange and gold contracts	74,171	385	-	74,556
Equity contracts	26,880	-	5,820	32,700
Commodity contracts	1,720	-	52	1,772
	<u>224,973</u>	<u>4,003</u>	<u>5,880</u>	<u>234,856</u>
Derivative liabilities:				
Interest rate contracts	103,128	3,239	8	106,375
Credit contracts	9,945	8	-	9,953
Foreign exchange and gold contracts	72,859	436	-	73,295
Equity contracts	26,970	-	6,008	32,978
Commodity contracts	2,061	-	32	2,093
	<u>214,963</u>	<u>3,683</u>	<u>6,048</u>	<u>224,694</u>



**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**Six months ended 30 June 2016**

**5. DERIVATIVES CLASSIFIED AS HELD FOR TRADING (CONTINUED)**

	<b>31 December 2015</b>			
	<b>Bilateral OTC \$millions</b>	<b>Cleared OTC \$millions</b>	<b>Listed derivative contracts \$millions</b>	<b>Total \$millions</b>
Derivative assets:				
Interest rate contracts	77,298	2,761	1	80,060
Credit contracts	10,154	4	-	10,158
Foreign exchange and gold contracts	62,171	295	-	62,466
Equity contracts	24,665	-	5,253	29,918
Commodity contracts	4,438	-	71	4,509
	<u>178,726</u>	<u>3,060</u>	<u>5,325</u>	<u>187,111</u>
Derivative liabilities:				
Interest rate contracts	71,645	2,854	2	74,501
Credit contracts	10,391	7	-	10,398
Foreign exchange and gold contracts	61,021	238	-	61,259
Equity contracts	26,458	-	5,241	31,699
Commodity contracts	2,811	-	383	3,194
	<u>172,326</u>	<u>3,099</u>	<u>5,626</u>	<u>181,051</u>

# MORGAN STANLEY & CO. INTERNATIONAL plc

## NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Six months ended 30 June 2016

### 6. ADDITIONAL CASH FLOW INFORMATION

	Six months ended 30 June 2016 \$millions	Six months ended 30 June 2015 \$millions
Profit for the period	293	548
Adjustments for:		
Depreciation on property, plant and equipment	1	1
Movement in impairment losses for loans and receivables	6	6
Interest income (restated) <sup>(1)</sup>	(52)	(105)
Interest expense (restated) <sup>(1)</sup>	344	383
Income tax expense	172	283
Operating cash flows before changes in operating assets and liabilities	764	1,116
Change in operating assets		
Increase in loans and receivables, excluding cash and short term deposits	(20,756)	(2,437)
(Increase)/decrease in financial assets classified as held for trading	(52,059)	22,278
Increase in financial assets designated at fair value through profit or loss	(1,830)	(2,206)
	(74,645)	17,635
Change in operating liabilities		
Increase/ (decrease) in financial liabilities at amortised cost, excluding bank loans and overdrafts	26,621	(709)
Increase/ (decrease) in financial liabilities classified as held for trading	49,931	(19,668)
(Decrease)/ increase in financial liabilities designated at fair value through profit or loss	(5)	2,585
Increase in provisions	1	2
	76,548	(17,790)
Interest received (restated) <sup>(1)</sup>	103	109
Interest paid (restated) <sup>(1)</sup>	(267)	(280)
Income taxes paid	(46)	(33)
Effect of foreign exchange movements	(5)	182
<b>Net cash flows used in operating activities</b>	<b>2,452</b>	<b>939</b>

(1) Details of the restatement are provided in note 1.

# MORGAN STANLEY & CO. INTERNATIONAL plc

## NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Six months ended 30 June 2016

### 7. SEGMENT REPORTING

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

#### Business segments

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

Consistent with the period ended 30 June 2015, the Group has one reportable business segment for the period ended 30 June 2016, Institutional Securities, which includes the provision of financial advisory and capital raising services; corporate lending; sales, trading, financing and market-making activities in equity and fixed income securities and related products, including foreign exchange and commodities; and investment activities.

#### Geographical segments

The Group operates in three geographic regions being EMEA, the Americas and Asia.

	EMEA		Americas		Asia		Total	
	30 June 2016 \$millions	30 June 2015 \$millions	30 June 2016 \$millions	30 June 2015 \$millions	30 June 2016 \$millions	30 June 2015 \$millions	30 June 2016 \$millions	30 June 2015 \$millions
External revenues net of interest	2,129	2,626	8	29	40	62	2,177	2,717
Profit before income tax	458	801	2	1	5	29	465	831
	30 June 2016 \$millions	31 Dec 2015 \$millions	30 June 2016 \$millions	31 Dec 2015 \$millions	30 June 2016 \$millions	31 Dec 2015 \$millions	30 June 2016 \$millions	31 Dec 2015 \$millions
Total assets	350,163	284,119	63,770	59,102	57,008	50,863	470,941	394,084

### 8. FINANCIAL RISK MANAGEMENT

#### Risk management procedures

The Group's risk management procedures are consistent with those disclosed in the Group's consolidated financial statements for the year ended 31 December 2015. The disclosure presented below is limited to quantitative data for each risk category and should be read in conjunction with the risk management procedures detailed in note 28 of the consolidated financial statements for the year ended 31 December 2015.

# MORGAN STANLEY & CO. INTERNATIONAL plc

## NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Six months ended 30 June 2016

### 8. FINANCIAL RISK MANAGEMENT (CONTINUED)

#### Credit risk

##### *Exposure to credit risk*

The maximum exposure to credit risk ("gross credit exposure") of the Group as at 30 June 2016 is disclosed below, based on the carrying amounts of the financial assets the Group believes are subject to credit risk.

##### *Exposure to credit risk by class*

Class	30 June 2016			31 December 2015		
	Gross credit exposure <sup>(1)</sup> \$millions	Credit enhancements \$millions	Net credit exposure <sup>(2)</sup> \$millions	Gross credit exposure <sup>(1)</sup> \$millions	Credit enhancements \$millions	Net credit exposure <sup>(2)</sup> \$millions
Loans and receivables:						
Cash and short term deposits	14,281	-	14,281	11,882	-	11,882
Cash collateral on securities borrowed	21,276	(20,495)	781	22,433	(21,116)	1,317
Securities purchased under agreements to resell	76,324	(74,987)	1,337	58,644	(57,951)	693
Trade receivables <sup>(3)</sup>	55,307	-	55,307	50,940	-	50,940
Other receivables	833	-	833	1,209	-	1,209
Financial assets classified as held for trading:						
Derivatives	234,856	(223,728)	11,128	187,111	(178,730)	8,381
Financial assets designated at fair value through profit or loss	3,466	(2,977)	489	1,636	(958)	678
	406,343	(322,187)	84,156	333,855	(258,755)	75,100
<b>Unrecognised financial instruments</b>						
Guarantees	1,220	-	1,220	982	-	982
Letters of credit	1	-	1	1	-	1
Loan commitments	1,950	-	1,950	1,983	-	1,983
Underwriting commitments	25	-	25	-	-	-
Unsettled securities purchased under agreements to resell <sup>(4)</sup>	39,958	-	39,958	18,391	-	18,391
	449,497	(322,187)	127,310	355,212	(258,755)	96,457

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

(2) Of the residual net credit exposure, intercompany cross product netting arrangements are in place which would allow for an additional \$4,647 million (2015: \$2,716 million) to be offset in the event of default by certain Morgan Stanley counterparties.

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

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

The impact of master netting arrangements and similar agreements on the Group's ability to offset financial assets and financial liabilities is disclosed in note 9.

# MORGAN STANLEY & CO. INTERNATIONAL plc

## NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Six months ended 30 June 2016

### 8. FINANCIAL RISK MANAGEMENT (CONTINUED)

#### Credit risk (continued)

*Maximum exposure to credit risk by credit rating (1)*

Credit rating	Gross credit exposure	
	30 June 2016 \$millions	31 December 2015 \$millions
AAA	12,237	12,013
AA	88,424	62,608
A	245,990	203,875
BBB	76,440	52,808
BB	16,014	13,923
B	4,991	5,164
CCC	2,495	2,448
D	14	12
Unrated	2,892	2,361
<b>Total</b>	<b>449,497</b>	<b>355,212</b>

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

#### *Financial assets past due but not impaired*

At 30 June 2016, \$3,130 million of financial assets included in loans and receivables in the condensed consolidated statement of financial position were past due but not impaired (31 December 2015: \$1,180 million).

#### *Financial assets individually impaired*

Class	30 June 2016 \$millions	31 December 2015 \$millions
Loans and receivables:		
Trade receivables	33	28
<b>Total</b>	<b>33</b>	<b>28</b>

# MORGAN STANLEY & CO. INTERNATIONAL plc

## NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Six months ended 30 June 2016

### 8. FINANCIAL RISK MANAGEMENT (CONTINUED)

#### Liquidity and funding risk

##### *Maturity analysis*

	On demand	Less than 1 month	Equal to or more than 1 month but less than 3 months	Equal to or more than 3 months but less than 1 year	Equal to or more than 1 year but less than 5 years	Equal to or more than 5 years	Total
30 June 2016	\$millions	\$millions	\$millions	\$millions	\$millions	\$millions	\$millions
<b>Financial liabilities</b>							
Financial liabilities at amortised cost:							
Bank loans and overdrafts	11	-	-	-	-	-	11
Cash collateral on securities loaned	17,108	25	239	200	55	-	17,627
Securities sold under agreements to repurchase	18,889	12,438	4,941	5,479	2,782	-	44,529
Trade payables	98,797	-	1	1	-	-	98,799
Other payables	3,505	6	31	332	7,597	2,778	14,249
Subordinated loans	-	-	-	61	747	9,007	9,815
Financial liabilities classified as held for trading:							
Derivatives	224,694	-	-	-	-	-	224,694
Other	41,743	-	-	-	-	-	41,743
Financial liabilities designated at fair value through profit or loss	2,158	42	44	481	790	1,345	4,860
<b>Total financial liabilities</b>	<b>406,905</b>	<b>12,511</b>	<b>5,256</b>	<b>6,554</b>	<b>11,971</b>	<b>13,130</b>	<b>456,327</b>
<b>Unrecognised financial instruments</b>							
Guarantees	1,220	-	-	-	-	-	1,220
Letters of credit	-	-	-	-	1	-	1
Loan commitments	1,950	-	-	-	-	-	1,950
Lease commitments	-	1	2	4	13	3	23
Underwriting commitments	-	25	-	-	-	-	25
Unsettled securities purchased under agreements to resell <sup>(1)</sup>	39,245	490	223	-	-	-	39,958
<b>Total unrecognised financial instruments</b>	<b>42,415</b>	<b>516</b>	<b>225</b>	<b>4</b>	<b>14</b>	<b>3</b>	<b>43,177</b>

(1) The Group enters into forward starting reverse repurchase agreements (agreements which have a trade date at or prior to 30 June 2016 and settle subsequent to period end). These agreements primarily settle within three business days and of the total amount at 30 June 2016, \$39,245 million settled within three business days.

# MORGAN STANLEY & CO. INTERNATIONAL plc

## NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Six months ended 30 June 2016

### 8. FINANCIAL RISK MANAGEMENT (CONTINUED)

#### Liquidity and funding risk (continued)

##### Maturity analysis (continued)

			Equal to or more than 1 month but less than 3 months	Equal to or more than 3 months but less than 1 year	Equal to or more than 1 year but less than 5 years	Equal to or more than 5 years	Total
31 December 2015	On demand \$millions	Less than 1 month \$millions	\$millions	\$millions	\$millions	\$millions	\$millions
<b>Financial liabilities</b>							
Financial liabilities at amortised cost:							
Cash collateral on securities loaned	12,571	216	706	1,382	1,393	-	16,268
Securities sold under agreements to repurchase	20,642	5,739	2,614	5,581	3,474	-	38,050
Trade payables	82,065	-	1	8	31	-	82,105
Subordinated loans	-	-	-	178	1,016	9,357	10,551
Other payables	4,426	14	29	244	4,976	2,760	12,449
Financial liabilities classified as held for trading:							-
Derivatives	181,051	-	-	-	-	-	181,051
Other	35,455	-	-	-	-	-	35,455
Financial liabilities designated at fair value through profit or loss	2,571	148	86	571	561	928	4,865
<b>Total financial liabilities</b>	<b>338,781</b>	<b>6,117</b>	<b>3,436</b>	<b>7,964</b>	<b>11,451</b>	<b>13,045</b>	<b>380,794</b>
<b>Unrecognised financial instruments</b>							
Guarantees	982	-	-	-	-	-	982
Letters of credit	-	-	-	-	-	1	1
Loan commitments	1,983	-	-	-	-	-	1,983
Lease commitments	-	1	2	4	23	4	34
Unsettled securities purchased under agreements to resell <sup>(1)</sup>	18,228	163	-	-	-	-	18,391
<b>Total unrecognised financial instruments</b>	<b>21,193</b>	<b>164</b>	<b>2</b>	<b>4</b>	<b>23</b>	<b>5</b>	<b>21,391</b>

(1) The Group enters into forward starting reverse repurchase agreements (agreements which have a trade date at or prior to 31 December 2015 and settle subsequent to period end). These agreements primarily settle within three business days and of the total amount at 31 December 2015, \$18,228 million settled within three business days.

# MORGAN STANLEY & CO. INTERNATIONAL plc

## NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Six months ended 30 June 2016

### 8. FINANCIAL RISK MANAGEMENT (CONTINUED)

#### Market risk

##### *Sensitivity analysis*

##### *VaR for the six month period ended 30 June 2016*

The table below presents the Management VaR for the Group's Trading portfolio, on a period-end, six month average basis as well as the high and low values for the six months ended 30 June 2016 and the year ended 31 December 2015.

	95% / one-day VaR for the six months ended 30 June 2016				95% / one-day VaR for the year ended 31 December 2015			
	Period				Period			
	End	Average	High	Low	End	Average	High	Low
	\$millions	\$millions	\$millions	\$millions	\$millions	\$millions	\$millions	\$millions
<i>Market Risk Category:</i>								
Interest rate and credit spread	12	14	20	9	10	14	20	10
Equity price	13	11	13	9	12	14	38	10
Foreign exchange rate	4	3	5	2	2	6	12	2
Commodity price	1	2	3	-	2	2	3	-
Less: Diversification benefit <sup>(1)(2)</sup>	(12)	(11)	N/A	N/A	(8)	(14)	N/A	N/A
Primary Risk Categories	18	19	24	14	18	22	42	16
Credit Portfolio <sup>(3)</sup>	8	8	10	6	6	6	8	5
Less: Diversification benefit <sup>(1)(2)</sup>	(7)	(5)	N/A	N/A	(4)	(5)	N/A	N/A
<b>Total Management VaR</b>	<b>19</b>	<b>22</b>	<b>27</b>	<b>15</b>	<b>20</b>	<b>23</b>	<b>43</b>	<b>17</b>

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

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

(3) The Credit Portfolio VaR is disclosed as a separate category from the Primary Risk Categories and includes loans that are carried at fair value and associated hedges as well as counterparty credit valuation adjustments and related hedges.

The Group's average Management VaR for its Primary Risk Categories for the six month period to 30 June 2016 was \$19 million compared with \$22 million for the year to 31 December 2015. The decrease in the average VaR for Primary Risk Categories is primarily due to decreased exposure to equity price and foreign exchange risk.

The average Credit Portfolio VaR for the six month period to 30 June 2016 was \$8 million compared with \$6 million for the year to 31 December 2015. This was mainly due to an increase in credit risk exposure in high rated corporates.

The average total Management VaR for the six month period to 30 June 2016 was \$22 million compared with \$23 million for the year to 31 December 2015.

##### *Non-trading risks for the six month period ended 30 June 2016*

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



# MORGAN STANLEY & CO. INTERNATIONAL plc

## NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Six months ended 30 June 2016

### 8. FINANCIAL RISK MANAGEMENT (CONTINUED)

#### Market risk (continued)

##### *Interest rate risk*

The Group's VaR excludes certain funding liabilities and money market transactions. The application of a parallel shift in interest rates of 50 basis points increase or decrease to these positions would result in a net gain or loss of approximately \$0.3 million as at 30 June 2016, compared to a net gain or loss of \$1.8 million as at 31 December 2015.

##### *Funding liabilities*

The credit spread risk sensitivity of the Group's mark-to-market funding liabilities corresponds to an increase in value of approximately \$0.1 million and \$0.3 million for each 1 basis point widening in the Group's credit spread level for both 30 June 2016 and 31 December 2015, respectively.

##### *Equity investments price risk*

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

	30 June 2016 10% sensitivity \$millions	31 December 2015 10% sensitivity \$millions
Available-for-sale financial assets	3	4

##### *Currency risk*

The analysis below details the foreign currency exposure for the Group, by foreign currency, relating to the retranslation of its non-US dollar denominated branches and subsidiaries. The analysis calculates the impact on total comprehensive income of a reasonably possible parallel shift of the foreign currency in relation to the US dollar, with all other variables held constant. This analysis does not take into account the effect of the foreign currency hedges held by other members of the Morgan Stanley Group.

	30 June 2016			31 December 2015		
	Sensitivity to applied percentage change in currency (+/-)			Sensitivity to applied percentage change in currency (+/-)		
	Foreign currency exposure \$millions	Percentage change applied %	Other comprehensive income \$millions	Foreign currency exposure \$millions	Percentage change applied %	Other comprehensive income \$millions
Australian Dollar	-	14%	-	(35)	14%	(5)
British Pound	-	10%	-	(85)	6%	(5)
Euro	257	12%	31	248	12%	30
Taiwan Dollar	72	6%	4	68	6%	4
Polish Zloty	2	17%	-	2	17%	-
South Korean Won	176	8%	14	191	8%	15
Swedish Krona	13	21%	3	13	21%	3
Swiss Franc	12	12%	1	11	12%	1
	532		53	413		43

**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**Six months ended 30 June 2016**

**9. FINANCIAL ASSETS AND FINANCIAL LIABILITIES SUBJECT TO OFFSETTING**

In the condensed consolidated statement of financial position, financial assets and financial liabilities are only offset and presented on a net basis where there is a current legally enforceable right to set off the recognised amounts and an intention to either settle on a net basis or to realise the assets and the liability simultaneously. In the absence of such conditions, financial assets and financial liabilities are presented on a gross basis.

The following tables present information about the offsetting of financial instruments and related collateral amounts. The tables do not include information about financial instruments that are subject only to a collateral agreement. The effect of a master netting arrangements, collateral agreements and other credit enhancements, on the Group's exposure to credit risk is disclosed in note 8. The information below is limited to quantitative information and should be read in conjunction with note 31 of the consolidated financial statements for the year ended 31 December 2015.

# MORGAN STANLEY & CO. INTERNATIONAL plc

## NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Six months ended 30 June 2016

### 9. FINANCIAL ASSETS AND FINANCIAL LIABILITIES SUBJECT TO OFFSETTING (CONTINUED)

	Gross amounts <sup>(1)</sup> \$millions	Amounts offset in the condensed consolidated statement of financial position <sup>(2) (3)</sup> \$millions	Net amounts presented in the condensed consolidated statement of financial position \$millions	Amounts not offset in the condensed consolidated statement of financial position <sup>(4) (5)</sup> Financial instruments \$millions	Cash collateral \$millions	Net exposure <sup>(6)</sup> \$millions
<b>30 June 2016</b>						
<b>Assets</b>						
Loans and receivables:						
Cash collateral on securities borrowed	43,128	(21,852)	21,276	(20,495)	-	781
Securities purchased under agreement to resell	102,692	(26,368)	76,324	(74,987)	-	1,337
Financial assets classified as held for trading:						
Derivatives	303,264	(68,408)	234,856	(189,756)	(33,972)	11,128
<b>TOTAL</b>	<b>449,084</b>	<b>(116,628)</b>	<b>332,456</b>	<b>(285,238)</b>	<b>(33,972)</b>	<b>13,246</b>
<b>Liabilities</b>						
Financial liabilities at amortised cost:						
Cash collateral on securities loaned	39,479	(21,852)	17,627	(17,365)	-	262
Securities sold under agreement to repurchase	70,897	(26,368)	44,529	(42,300)	-	2,229
Financial liabilities classified as held for trading:						
Derivatives	288,009	(63,315)	224,694	(188,268)	(25,079)	11,347
<b>TOTAL</b>	<b>398,385</b>	<b>(111,535)</b>	<b>286,850</b>	<b>(247,933)</b>	<b>(25,079)</b>	<b>13,838</b>

- (1) Amounts include \$412 million of cash collateral on securities borrowed, \$922 million of securities purchased under agreements to resell, \$4,327 million of financial assets classified as held for trading - derivatives, \$214 million of cash collateral on securities loaned, \$2,001 million of securities sold under agreements to repurchase and \$5,133 million of financial liabilities classified as held for trading - derivatives which are either not subject to master netting agreements or collateral agreements or are subject to such agreements but the Group has not determined the agreements to be legally enforceable.
- (2) Amounts are reported on a net basis in the condensed consolidated statements of financial position when there is a legally enforceable master netting arrangement that provides for a current right of offset and there is an intention to either settle on a net basis or to realise the asset and liability simultaneously.
- (3) Amounts include \$9,385 million of cash collateral related to financial assets classified as held for trading - derivatives and \$4,292 million of cash collateral related to financial liabilities classified as held for trading - derivatives, recognised in amounts offset in the consolidated statement of financial position for assets and liabilities respectively.
- (4) Amounts relate to master netting arrangements and collateral arrangements which have been determined by the Group to be legally enforceable but do not meet all criteria required for net presentation within the condensed consolidated statement of financial position.
- (5) The cash collateral not offset is recognised in the condensed consolidated statement of financial position within trade receivables and payables respectively.
- (6) Intercompany cross-product legally enforceable netting arrangements are in place which would allow for an additional \$4,647 million of the total consolidated statement of financial position to be offset in the ordinary course of business and/ or in the event of default. The additional amounts for offset would include a portion of the residual net exposure.

# MORGAN STANLEY & CO. INTERNATIONAL plc

## NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Six months ended 30 June 2016

### 9. FINANCIAL ASSETS AND FINANCIAL LIABILITIES SUBJECT TO OFFSETTING (CONTINUED)

	Gross amounts <sup>(1)</sup> \$millions	Amounts offset in the condensed consolidated statement of financial position <sup>(2) (3)</sup> \$millions	Net amounts presented in the condensed consolidated statement of financial position \$millions	Amounts not offset in the condensed consolidated statement of financial position <sup>(4) (5)</sup> Financial instruments \$millions	Cash collateral \$millions	Net exposure <sup>(6)</sup> \$millions
<b>31 December 2015</b>						
<b>Assets</b>						
Loans and receivables:						
Cash collateral on securities borrowed	37,141	(14,708)	22,433	(21,116)	-	1,317
Securities purchased under agreement to resell	78,218	(19,574)	58,644	(57,951)	-	693
Financial assets classified as held for trading:						
Derivatives	232,096	(44,985)	187,111	(151,591)	(27,139)	8,381
<b>TOTAL</b>	<b>347,455</b>	<b>(79,267)</b>	<b>268,188</b>	<b>(230,658)</b>	<b>(27,139)</b>	<b>10,391</b>
<b>Liabilities</b>						
Financial liabilities at amortised cost:						
Cash collateral on securities loaned	30,976	(14,708)	16,268	(16,234)	-	34
Securities sold under agreement to repurchase	57,585	(19,574)	38,011	(35,808)	-	2,203
Financial liabilities classified as held for trading:						
Derivatives	223,016	(41,965)	181,051	(147,725)	(23,139)	10,187
<b>TOTAL</b>	<b>311,577</b>	<b>(76,247)</b>	<b>235,330</b>	<b>(199,767)</b>	<b>(23,139)</b>	<b>12,424</b>

- (1) Amounts include \$773 million of cash collateral on securities borrowed, \$450 million of securities purchased under agreements to resell, \$2,786 million of financial assets classified as held for trading - derivatives, \$10 million of cash collateral on securities loaned, \$2,038 million of securities sold under agreements to repurchase and \$2,908 million of financial liabilities classified as held for trading - derivatives which are either not subject to master netting agreements or collateral agreements or are subject to such agreements but the Group has not determined the agreements to be legally enforceable.
- (2) Amounts are reported on a net basis in the consolidated statements of financial position when there is a legally enforceable master netting arrangement that provides for a current right of offset and there is an intention to either settle on a net basis or to realise the asset and liability simultaneously.
- (3) Amounts include \$4,351 million of cash collateral related to financial assets classified as held for trading - derivatives and \$1,258 million of cash collateral related to financial liabilities classified as held for trading - derivatives, recognised in amounts offset in the consolidated statement of financial positions for assets and liabilities respectively.
- (4) Amounts relate to master netting arrangements and collateral arrangements which have been determined by the Group to be legally enforceable but do not meet all criteria required for net presentation within the consolidated statement of financial position.
- (5) The cash collateral not offset is recognised in the consolidated statement of financial position within trade receivables and payables respectively.
- (6) Of the residual net exposure, intercompany cross-product legally enforceable netting arrangements are in place which would allow for an additional \$2,716 million to be offset in the ordinary course of business and/ or in the event of default.

**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**Six months ended 30 June 2016**

**10. INTEREST IN STRUCTURED ENTITIES**

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

Information on certain types of structured entities is provided in the consolidated financial statements for the year ended 31 December 2015. The information below is limited to quantitative information and should be read in conjunction with note 16 of the consolidated financial statements for the year ended 31 December 2015.

**Consolidated structured entities**

As at 30 June 2016 the Group did not have any structured entities that it consolidated (31 December 2015: nil).

**Unconsolidated structured entities**

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

The table below shows certain non-consolidated structured entities in which the Group had an interest at 30 June 2016 and 31 December 2015. The tables include all structured entities in which the Group has determined that its maximum exposure to loss is greater than specific thresholds or meets certain other criteria. Most of the structured entities included in the tables below are sponsored by unrelated parties; the Group's involvement is generally the result of the Group's secondary market-making activities.

	<b>Mortgage and asset-backed securitisations \$millions</b>	<b>Collateralised debt obligation \$millions</b>	<b>Fund investments \$millions</b>	<b>Other \$millions</b>	<b>Total \$millions</b>
<b>30 June 2016</b>					
Structured entity assets that the Group does not consolidate (unpaid principal balance)	<u>3,596</u>	<u>1,951</u>	<u>2,947</u>	<u>14</u>	<u>8,508</u>
Maximum exposure to loss:					
Debt and equity interests	213	54	-	-	267
Derivative and other contracts	<u>-</u>	<u>-</u>	<u>2,947</u>	<u>15</u>	<u>2,962</u>
Total maximum exposure to loss	<u>213</u>	<u>54</u>	<u>2,947</u>	<u>15</u>	<u>3,229</u>
Carrying value of exposure to loss - assets <sup>(1)</sup> :					
Debt and equity interests	213	54	-	-	267
Derivative and other contracts	<u>-</u>	<u>-</u>	<u>20</u>	<u>5</u>	<u>25</u>
<b>Total carrying value of exposure to loss - assets</b>	<u>213</u>	<u>54</u>	<u>20</u>	<u>5</u>	<u>292</u>
Carrying value of exposure to loss - liabilities <sup>(1)</sup> :					
Derivatives and other contracts	<u>-</u>	<u>-</u>	<u>30</u>	<u>-</u>	<u>30</u>
<b>Total carrying value of exposure to loss - liabilities</b>	<u>-</u>	<u>-</u>	<u>30</u>	<u>-</u>	<u>30</u>

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

# MORGAN STANLEY & CO. INTERNATIONAL plc

## NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Six months ended 30 June 2016

### 10. INTEREST IN STRUCTURED ENTITIES (CONTINUED)

#### Unconsolidated structured entities (continued)

	Mortgage and asset-backed securitisations \$millions	Collateralised debt obligation \$millions	Fund investments \$millions	Other \$millions	Total \$millions
<b>31 December 2015</b>					
Structured entity assets that the Group does not consolidate (unpaid principal balance)	10,351	4,637	2,791	74	17,853
Maximum exposure to loss:					
Debt and equity interests	488	116	-	28	632
Derivative and other contracts	-	-	2,791	39	2,830
<b>Total maximum exposure to loss</b>	<b>488</b>	<b>116</b>	<b>2,791</b>	<b>67</b>	<b>3,462</b>
Carrying value of exposure to loss - assets <sup>(1)</sup> :					
Debt and equity interests <sup>(1)</sup>	488	116	-	28	632
Derivative and other contracts	-	-	8	5	13
<b>Total carrying value of exposure to loss - assets</b>	<b>488</b>	<b>116</b>	<b>8</b>	<b>33</b>	<b>645</b>
Carrying value of exposure to loss - liabilities <sup>(1)</sup> :					
Derivatives and other contracts	-	-	12	-	12
<b>Total carrying value of exposure to loss - liabilities</b>	<b>-</b>	<b>-</b>	<b>12</b>	<b>-</b>	<b>12</b>

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

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

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

# MORGAN STANLEY & CO. INTERNATIONAL plc

## NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Six months ended 30 June 2016

### 10. INTEREST IN STRUCTURED ENTITIES (CONTINUED)

#### Unconsolidated structured entities (continued)

Securitisation transactions generally involve structured entities. Primarily as a result of its secondary market-making activities, the Group owned additional securities issued by securitisation structured entities for which the maximum exposure to loss is less than specific thresholds. These additional securities totalled \$319 million at 30 June 2016 (31 December 2015: \$527 million). Details of the type of securities retained are shown in the table below.

	30 June 2016 \$millions	31 December 2015 \$millions
<i>Securities backed by:</i>		
Residential mortgage loans	136	275
Commercial mortgage loans	32	41
CDOs or other CLOs	116	142
Other consumer loans	35	69
	<u>319</u>	<u>527</u>

The Group's primary risk exposure is to the securities issued by the structured entity owned by the Group, with the risk highest on the most subordinate class of beneficial interests. These securities generally are included in Financial assets classified as held for trading – corporate and other debt. The Group does not provide additional support in these transactions through contractual facilities, such as liquidity facilities, guarantees or similar derivatives. The Group's maximum exposure to loss generally equals the fair value of the securities owned.

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

#### Sponsored unconsolidated structured entities

Details of when the Group considers itself the sponsor of certain non-consolidated structured entities is provided in note 16 of the consolidated financial statements for the year ended 31 December 2015.

In some sponsored entities, the Group has been involved with the structured entity through establishing the structured entity, marketing of products associated with the structured entity in its own name, and/ or through involvement in the design of the structured entity.

The loss related to sponsored entities issuing equity linked notes during the six month period to 30 June 2016 was \$0.2 million (31 December 2015: gain of \$2 million related to issuing equity linked notes). Gains or losses are reported under 'Net gains on financial instruments classified as held for trading' in the condensed consolidated income statement. No assets were transferred to sponsored structured entities during the six month period to 30 June 2016 (31 December 2015: \$nil).

# NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Six months ended 30 June 2016

## 11. FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE

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

The following tables present the carrying value of the Group's financial assets and financial liabilities recognised at fair value on a recurring basis, classified according to the fair value hierarchy. The information below is limited to quantitative information and should be read in conjunction with note 32 of the consolidated financial statements for the year ended 31 December 2015.

30 June 2016

	Quoted prices in active market (Level 1) \$millions	Valuation techniques using observable inputs (Level 2) \$millions	Valuation techniques with significant non- observable inputs (Level 3) \$millions	Total \$millions
Financial assets classified as held for trading:				
Government debt securities	10,658	2,741	1	13,400
Corporate and other debt	-	7,797	414	8,211
Corporate equities	41,390	321	154	41,865
Derivatives:				
Interest rate contracts	-	115,770	44	115,814
Credit contracts	-	9,818	196	10,014
Foreign exchange and gold contracts	-	74,388	168	74,556
Equity contracts	528	30,992	1,180	32,700
Commodity contracts	4	1,760	8	1,772
Total financial assets classified as held for trading	52,580	243,587	2,165	298,332
Financial assets designated at fair value through profit or loss	-	3,222	244	3,466
Available-for-sale financial assets:				
Corporate equities	1	16	15	32
<b>Total financial assets measured at fair value</b>	<b>52,581</b>	<b>246,825</b>	<b>2,424</b>	<b>301,830</b>
Financial liabilities classified as held for trading:				
Government debt securities	13,083	2,071	-	15,154
Corporate and other debt	-	2,123	5	2,128
Corporate equities	24,300	123	38	24,461
Derivatives:				
Interest rate contracts	-	105,454	921	106,375
Credit contracts	-	9,739	214	9,953
Foreign exchange and gold contracts	-	73,166	129	73,295
Equity contracts	446	30,672	1,860	32,978
Commodity contracts	-	2,081	12	2,093
Total financial liabilities classified as held for trading	37,829	225,429	3,179	266,437
Financial liabilities designated at fair value through profit or loss	-	4,602	258	4,860
<b>Total financial liabilities measured at fair value</b>	<b>37,829</b>	<b>230,031</b>	<b>3,437</b>	<b>271,297</b>



**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**Six months ended 30 June 2016**

**11. FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE (CONTINUED)**

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

**31 December 2015**

	Quoted prices in active market (Level 1) \$millions	Valuation techniques using observable inputs (Level 2) \$millions	Valuation techniques with significant unobservable inputs (Level 3) \$millions	Total \$millions
Financial assets classified as held for trading:				
Government debt securities	7,282	4,079	4	11,365
Corporate and other debt	-	6,393	576	6,969
Corporate equities	40,364	236	228	40,828
Derivatives:				
Interest rate contracts	-	79,813	247	80,060
Credit contracts	-	9,890	268	10,158
Foreign exchange and gold contracts	-	62,014	452	62,466
Equity contracts	566	27,450	1,902	29,918
Commodity contracts	8	4,495	6	4,509
Total financial assets classified as held for trading	48,220	194,370	3,683	246,273
Financial assets designated at fair value through profit or loss	-	1,255	381	1,636
Available-for-sale financial assets:				
Corporate equities	1	-	38	39
<b>Total financial assets measured at fair value</b>	<b>48,221</b>	<b>195,625</b>	<b>4,102</b>	<b>247,948</b>
Financial liabilities classified as held for trading:				
Government debt securities	8,451	2,296	-	10,747
Corporate and other debt	-	1,279	5	1,284
Corporate equities	23,372	37	15	23,424
Derivatives:				
Interest rate contracts	-	73,572	929	74,501
Credit contracts	-	10,119	279	10,398
Foreign exchange and gold contracts	-	61,047	212	61,259
Equity contracts	183	29,061	2,455	31,699
Commodity contracts	14	3,174	6	3,194
Total financial liabilities classified as held for trading	32,020	180,585	3,901	216,506
Financial liabilities designated at fair value through profit or loss	-	4,705	160	4,865
<b>Total financial liabilities measured at fair value</b>	<b>32,020</b>	<b>185,290</b>	<b>4,061</b>	<b>221,371</b>

**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**Six months ended 30 June 2016**

**11. FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE (CONTINUED)**

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

There were no material transfers between Level 1 and Level 2 of the fair value hierarchy during the six month period to 30 June 2016 and for the year to 31 December 2015.

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

The table on the following page presents the changes in the fair value of the Group's Level 3 financial assets and financial liabilities for the six months ended 30 June 2016. Level 3 instruments may be hedged with instruments classified in Level 1 and Level 2. As a result, the realised and unrealised gains/ (losses) for assets and liabilities within the Level 3 category presented in the tables below do not reflect the related realised and unrealised gains/ (losses) on hedging instruments that have been classified by the Group within the Level 1 and / or Level 2 categories.

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

The Morgan Stanley Group operates a number of intra-group policies to ensure that, where possible, revenues and related costs are matched. Where the trading positions included in the below table are risk managed using financial instruments held by other Morgan Stanley Group undertakings, these policies potentially result in the recognition of offsetting gains/ (losses) in the Group.

# MORGAN STANLEY & CO. INTERNATIONAL plc

## NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Six months ended 30 June 2016

### 11. FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE (CONTINUED)

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

30 June 2016

	Balance at 1 January 2016 \$million	Total gains or (losses) recognised in consolidated income statement \$million	Total gains or (losses) recognised in consolidated other comprehensive income \$million	Purchases \$million	Sales \$million	Issuances \$million	Settlements \$million	Net transfers in and / or out of Level 3 <sup>(1)</sup> \$million	Balance at 30 June 2016 \$million	Unrealised gains or (losses) for level 3 assets/ liabilities outstanding as at 30 June 2016 <sup>(2)</sup> \$million
Financial assets classified as held for trading:										
Government debt securities	4	-	-	-	(4)	-	-	1	1	-
Corporate and other debt	576	13	-	136	(266)	-	-	(45)	414	14
Corporate equities	228	(22)	-	83	(35)	-	-	(100)	154	(23)
Total financial assets classified as held for trading	808	(9)	-	219	(305)	-	-	(144)	569	(9)
Financial assets designated at fair value through profit or loss	381	(2)	-	83	(230)	-	-	12	244	(2)
Available-for-sale financial assets:										
Corporate equities	38	-	(1)	-	-	-	-	(22)	15	(1)
<b>Total financial assets measured at fair value</b>	<b>1,227</b>	<b>(11)</b>	<b>(1)</b>	<b>302</b>	<b>(535)</b>	<b>-</b>	<b>-</b>	<b>(154)</b>	<b>828</b>	<b>(12)</b>
Financial liabilities classified as held for trading:										
Corporate and other debt	5	-	-	-	-	-	-	-	5	-
Corporate equities	15	(4)	-	(9)	17	-	-	11	38	(4)
Net derivative contracts <sup>(3)</sup>	1,006	(155)	-	(392)	-	330	326	115	1,540	(222)
Total financial liabilities classified as held for trading	1,026	(159)	-	(401)	17	330	326	126	1,583	(226)
Financial liabilities designated at fair value through profit or loss	160	(1)	-	-	-	133	(97)	61	258	(1)
<b>Total financial liabilities measured at fair value</b>	<b>1,186</b>	<b>(160)</b>	<b>-</b>	<b>(401)</b>	<b>17</b>	<b>463</b>	<b>229</b>	<b>187</b>	<b>1,841</b>	<b>(227)</b>

- (1) For financial assets and financial liabilities that were transferred into and out of Level 3 during the period, gains or (losses) are presented as if the assets or liabilities had been transferred into or out of Level 3 as at the beginning of the period.
- (2) Amounts represent unrealised gains or (losses) for the period related to assets and liabilities still outstanding as at the end of the period. The unrealised gains or (losses) are recognised in the condensed consolidated income statement or condensed consolidated statement of comprehensive income. As detailed in the financial instruments accounting policy in the Group's annual financial statements for the year ended 31 December 2015.
- (3) Net derivative contracts represent Financial liabilities classified as held for trading – derivative contracts net of Financial assets classified as held for trading – derivative contracts.

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## NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Six months ended 30 June 2016

### 11. FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE (CONTINUED)

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

31 December 2015

	Balance at 1 January 2015 \$million	Total gains or (losses) recognised in condensed income statement \$million	Total gains or (losses) recognised in condensed consolidated other comprehensive income \$million	Purchases \$million	Sales \$million	Issuances \$million	Settlements \$million	Net transfers in and / or out of Level 3 <sup>(1)</sup> \$million	Balance at 31 December 2015 \$million	Unrealised gains or (losses) for level 3 assets/ liabilities outstanding as at 31 December 2015 <sup>(2)</sup> \$million
Financial assets classified as held for trading:										
Government debt securities	39	(1)	-	1	(30)	-	-	(5)	4	-
Corporate and other debt	496	16	-	376	(303)	-	(2)	(7)	576	5
Corporate equities	119	12	-	128	(193)	-	-	162	228	20
Total financial assets classified as held for trading	654	27	-	505	(526)	-	(2)	150	808	25
Financial assets designated at fair value through profit or loss	1,316	(14)	-	93	(737)	-	(263)	(14)	381	(14)
Available-for-sale financial assets:										
Corporate equities	40	-	(3)	1	-	-	-	-	38	-
<b>Total financial assets measured at fair value</b>	<b>2,010</b>	<b>13</b>	<b>(3)</b>	<b>599</b>	<b>(1,263)</b>	<b>-</b>	<b>(265)</b>	<b>136</b>	<b>1,227</b>	<b>11</b>
Financial liabilities classified as held for trading:										
Corporate and other debt	6	2	-	(6)	7	-	-	-	5	-
Corporate equities	3	79	-	(145)	103	-	-	133	15	79
Net derivative contracts <sup>(3)</sup>	834	250	-	(2,534)	-	2,667	(83)	372	1,006	101
Total financial liabilities classified as held for trading	843	331	-	(2,685)	110	2,667	(83)	505	1,026	180
Financial liabilities designated at fair value through profit or loss	69	2	-	-	-	141	(43)	(5)	160	2
<b>Total financial liabilities measured at fair value</b>	<b>912</b>	<b>333</b>	<b>-</b>	<b>(2,685)</b>	<b>110</b>	<b>2,808</b>	<b>(126)</b>	<b>500</b>	<b>1,186</b>	<b>182</b>

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

(2) Amounts represent unrealised gains or (losses) for the period related to assets and liabilities still outstanding as at the end of the period. The unrealised gains or (losses) are recognised in the condensed consolidated income statement or condensed consolidated statement of total recognised gains and losses. As detailed in the financial instruments accounting policy in the Group's annual financial statements for the year ended 31 December 2015.

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

During the period, there were no material transfers from Level 2 to Level 3 or Level 3 to Level 2 of the fair value hierarchy (2015: \$nil).

# NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Six months ended 30 June 2016

## 11. FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE (CONTINUED)

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

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

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

The table below provides information on the valuation techniques, significant unobservable inputs and their ranges and averages for each major sub category of assets and liabilities measured at fair value on a recurring basis with a significant Level 3 balance.

The level of aggregation and breadth of products cause the range of inputs to be wide and not evenly distributed across the inventory. Further, the range of unobservable inputs may differ across firms in the financial services industry because of diversity in the types of products included in each firm's inventory. The following disclosures also include qualitative information on the sensitivity of the fair value measurements to changes in the significant unobservable inputs.

30 June 2016	Fair value \$millions	Valuation technique	Significant unobservable input(s) / sensitivity of the fair value to changes in the unobservable inputs	Range <sup>(2)</sup>	Averages <sup>(3) (5)</sup>
<b>ASSETS</b>					
<b>Financial assets classified as held for trading:</b>					
- Corporate equities	154	Comparable pricing	Comparable equity price / (A)	100%	100%
- Corporate and other debt:					
- Residential mortgage backed securities	58	Comparable pricing	Comparable bond price / (A)	4 to 95 points	35 points
- Commercial mortgage backed securities	51	Comparable pricing	Comparable bond price / (A)	3 to 11 points	7 points
- Asset backed securities	76	Comparable pricing	Comparable bond price / (A)	8 to 100 points	59 points
- Corporate bonds	176	Comparable pricing	Comparable bond price / (A)	4 to 102 points	87 points
		Option Model	At the money volatility / (C) / (D)	6% to 38%	26%
			Volatility skew / (A) / (D)	-1% to 0%	-1%
- Collateralised debt obligations	23	Comparable pricing	Comparable loan price / (A)	22 to 100 points	74 points
<b>Financial assets designated at fair value through profit or loss:</b>					
- Prepaid OTC Contracts	65	Option Model	At the money volatility / (C) / (D)	22% to 23%	23%
			Volatility skew / (A) / (D)	-3% to -2%	-2%
		Comparable pricing	Comparable bond price / (C)	15%	15%
- Customer Loans	179	Margin Loan Model	Discount rate / (C)	10%	10%
			Volatility skew / (C)	28%	28%
		Option Model	Volatility skew / (C)	-1%	-1%
<b>LIABILITIES</b>					
<b>Financial liabilities classified as held for trading:</b>					
- Corporate equities	(38)	Comparable pricing	Comparable equity price / (A)	100%	100%
- Net derivatives contracts: (1)(4)(6)					
- Credit	(18)	Correlation Model	Credit Correlation / (B)	29% to 92%	49%
		Comparable pricing	Comparable bond price / (C)	3 to 101 points	41 points
- Equity	(681)	Option Model	At the money volatility / (A) / (D)	6% to 77%	32%
			Volatility skew / (A) / (D)	-4% to 0%	-1%
			Equity-equity correlation / (A) / (D)	40% to 98%	75%
			Equity-FX correlation / (C) / (D)	-70% to -21%	-42%

# MORGAN STANLEY & CO. INTERNATIONAL plc

## NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Six months ended 30 June 2016

### 11. FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE (CONTINUED)

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

#### i. Quantitative information about and qualitative sensitivity of significant unobservable inputs (continued)

30 June 2016	Fair value \$millions	Valuation technique	Significant unobservable input(s) / sensitivity of the fair value to changes in the unobservable inputs <sup>(5)</sup>	Range <sup>(2)</sup>	Averages <sup>(3) (5)</sup>
<b>LIABILITIES (CONTINUED)</b>					
<b>Financial liabilities classified as held for trading (continued):</b>					
- Net derivatives contracts (continued):(1)(4)(6)					
- Interest rate	(876)	Option Model	Inflation volatility / (A) /(D)	0% to 1%	1%, 1%
			Interest rate Curve / (A) /(D)	0%	0%, 0%
			Interest rate - Foreign exchange correlation / (C) /(D)	32% to 53%	43%, 43%
			Interest rate - Inflation correlation / (A) /(D)	-44% to -24%	-34%, -33%
			Interest rate curve correlation / (C) /(D)	36% to 98%	72%, 76%
			Interest rate quanto correlation / (A) /(D)	-8% to 35%	2%, -8%
			Interest rate volatility skew / (A) /(D)	39% to 166%	74%, 70%
- Foreign exchange	38	Option Model	Interest rate curve / (A) /(D)	0%	0%, 0%
			Interest rate - Foreign exchange correlation / (C) /(D)	32% to 53%	43%, 43%
			Interest rate volatility skew / (A) /(D)	43% to 179%	72%, 77%
			Interest rate curve correlation / (C) /(D)	0%	0%, 0%
<b>Financial liabilities designated at fair value through profit or loss</b>					
- Prepaid OTC contracts	(82)	Option Model	At the money volatility / (A) /(D)	19% to 35%	25%
			Volatility skew / (C) /(D)	-1% to 0%	-1%
		Comparable pricing	Comparable bond price / (C)	15%	15%
- Issued structured notes	(176)	Option Model	At the money volatility / (C) /(D)	6% to 33%	27%
			Volatility skew / (C) /(D)	-1% to 0%	-1%
			Equity-equity correlation / (A) /(D)	50% to 90%	73%
			Equity-FX correlation / (C) /(D)	-55% to -6%	-42%
			Equity-Interest rate correlation / (A) /(D)	7% to 44%	26%

(1) Net derivative contracts represent financial liabilities classified as held for trading – derivative contracts net of financial assets classified as held for trading – derivative contracts. In addition, there are other derivative contracts with a fair value of \$nil (31 December 2015: \$nil) not included within one of the major derivative categories.

(2) The ranges of significant unobservable inputs are represented in points, percentages or basis points. Points are a percentage of par; for example, 100 points would be 100% of par. A basis point (bps) equals 1/100<sup>th</sup> of 1%; for example, 353 basis points would equal 3.53%.

(3) Amounts represent weighted averages except where simple averages and the median of the inputs are provided (see footnote 5 below). Weighted averages are calculated by weighting each input by the fair value of the respective financial instruments except for derivative instruments where inputs are weighted by risk.

(4) CVA and FVA are included in the fair value, but excluded from the valuation techniques and significant unobservable inputs in the table above. CVA is deemed to be a Level 3 input when the underlying counterparty credit curve is unobservable. FVA is deemed to be a Level 3 input in its entirety given the lack of observability of funding spreads in the principal market.

(5) The data structure of the significant unobservable inputs used in valuing interest rate contract, foreign exchange contracts and certain equity contracts may be in a multi-dimensional form, such as a curve or surface, with risk distributed across the structure. Therefore, a simple average and median, together with the range of data inputs, may be more appropriate measurements than a single point weighted average.

(6) Includes derivative contracts with multiple risks (i.e. hybrid products)

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

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

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## NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Six months ended 30 June 2016

### 11. FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE (CONTINUED)

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

#### i. Quantitative information about and qualitative sensitivity of significant unobservable inputs (continued)

31 December 2015	Fair value \$millions	Valuation technique	Significant unobservable input(s) / sensitivity of the fair value to changes in the unobservable inputs <sup>(5)</sup>	Range <sup>(2)</sup>	Averages <sup>(3) (5)</sup>
<b>ASSETS</b>					
<b>Financial assets classified as held for trading:</b>					
- Corporate equities	228	Comparable pricing	Comparable equity price / (A)	100%	100%
		Market Approach	EBITDA Multiple / (A)	9 times	9 times
- Corporate and other debt:					
- Residential mortgage backed securities	76	Comparable pricing	Comparable bond price / (A)	4 to 85 points	32 points
- Commercial mortgage backed securities	58	Comparable pricing	Comparable bond price / (A)	3 to 90 points	9 points
- Asset backed securities	96	Comparable pricing	Comparable bond price / (A)	9 to 100 points	65 points
- Corporate bonds	176	Comparable pricing	Comparable bond price / (A)	3 to 100 points	83 points
		Option Model	At the money volatility / (C) / (D)	6% to 38%	25%
			Volatility skew / (C) / (D)	-1% to 0%	0%
- Collateralised debt obligations	154	Comparable pricing	Comparable loan price / (A)	67 to 102 points	87 points
<b>Financial assets designated at fair value through profit or loss:</b>					
- Prepaid OTC Contracts	93	Option Model	At the money volatility / (C) / (D)	21% to 36%	29%
			Volatility skew / (C) / (D)	0%	0%
- Customer Loans	288	Margin Loan Model	Credit spread / (C)	499 bps	499 bps
			Volatility skew / (C)	13% to 29%	20%
		Option Model	Volatility skew / (C)	-1%	-1%
<b>Available-for-sale financial assets:</b>					
- Corporate equities	38	Comparable pricing	Comparable equity price / (A)	100%	100%
<b>LIABILITIES</b>					
<b>Financial liabilities classified as held for trading:</b>					
- Net derivatives contracts: (1)(4)(6)					
- Credit	(11)	Correlation Model	Credit Correlation / (B)	39% to 87%	57%
		Comparable pricing	Comparable bond price / (C)	3 to 100 points	37 points
- Equity	(553)	Option Model	At the money volatility / (A) / (D)	18% to 65%	36%
			Volatility skew / (A) / (D)	-3% to 0%	0%
			Equity correlation / (A) / (D)	40% to 99%	69%
			Equity foreign exchange correlation / (C) / (D)	-60% to -10%	-39%
- Interest rate	(682)	Option Model	Inflation volatility / (C) / (D)	58%	58%, 58%
			Interest rate Curve / (A) / (D)	0%	0%, 0%
			Interest rate - Foreign exchange correlation / (A) / (D)	25% to 62%	43%, 43%
			Interest rate - Inflation correlation / (A) / (D)	-41% to -39%	-41%, -41%
			Interest rate curve correlation / (C) / (D)	24% to 95%	60%, 69%
			Interest rate quanto correlation / (A) / (D)	-8% to 36%	5%, -6%
			Interest rate volatility skew / (A) / (D)	29% to 82%	43%, 40%
- Foreign exchange	240	Option Model	Interest rate curve / (A) / (D)	0%	0%, 0%
			Interest rate - Foreign exchange correlation / (A) / (D)	25% to 62%	43%, 43%
			Interest rate volatility skew / (A) / (D)	29% to 82%	43%, 40%
<b>Financial liabilities designated at fair value through profit or loss</b>					
- Issued structured notes	(147)	Option Model	At the money volatility / (C) / (D)	26% to 38%	31%
			Volatility skew / (C) / (D)	-1% to 0%	0%
			Equity correlation / (C) / (D)	42% to 97%	67%
			Equity FX correlation / (A) / (D)	-54% to -6%	-44%

**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**Six months ended 30 June 2016**

**11. FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE (CONTINUED)**

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

**i. Quantitative information about and qualitative sensitivity of significant unobservable inputs (continued)**

- (1) Net derivative contracts represent financial assets classified as held for trading – derivative contracts net of financial liabilities classified as held for trading – derivative contracts. In addition, there are other derivative contracts with a fair value of \$nil (31 December 2015: \$nil) not included within one of the major derivative categories.
- (2) The ranges of significant unobservable inputs are represented in points, percentages or basis points. Points are a percentage of par; for example, 100 points would be 100% of par. A basis point (bps) equals 1/100<sup>th</sup> of 1%; for example, 353 basis points would equal 3.53%.
- (3) Amounts represent weighted averages except where simple averages and the median of the inputs are provided (see footnote 5 below). Weighted averages are calculated by weighting each input by the fair value of the respective financial instruments except for derivative instruments where inputs are weighted by risk.
- (4) CVA and FVA are included in the fair value, but excluded from the valuation techniques and significant unobservable inputs in the table above. CVA is deemed to be a Level 3 input when the underlying counterparty credit curve is unobservable. FVA is deemed to be a Level 3 input in its entirety given the lack of observability of funding spreads in the principal market.
- (5) The data structure of the significant unobservable inputs used in valuing interest rate contract, foreign exchange contracts and certain equity contracts may be in a multi-dimensional form, such as a curve or surface, with risk distributed across the structure. Therefore, a simple average and median, together with the range of data inputs, may be more appropriate measurements than a single point weighted average.
- (6) Includes derivative contracts with multiple risks (i.e. hybrid products)

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

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

A description of significant unobservable inputs included in the table above for all major categories of assets and liabilities is included within note 32 of the consolidated financial statements for the year ended 31 December 2015.

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

The following tables present the sensitivity of the fair value of Level 3 financial assets and financial liabilities to reasonably possible alternative assumptions, providing quantitative information on the potential variability of the fair value measurement. The information below is limited to quantitative information and should be read in conjunction with note 32 of the consolidated financial statements for the year ended 31 December 2015.



# MORGAN STANLEY & CO. INTERNATIONAL plc

## NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Six months ended 30 June 2016

### 11. FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE (CONTINUED)

- d. Valuation of Level 3 financial assets and liabilities recognised at fair value on a recurring basis (continued)
- ii. Sensitivity of fair values to changing significant assumptions to reasonably possible alternatives (continued)

30 June 2016

	Fair value \$millions	Effect of reasonably possible alternative assumptions	
		Increase in fair value \$millions	Decrease in fair value \$millions
Financial assets classified as held for trading:			
Government debt securities	1	-	-
Corporate and other debt	414	14	(14)
Corporate equities	154	1	(25)
Financial assets designated at fair value through profit or loss:			
Prepaid OTC contracts	65	1	(2)
Customer loans	179	-	-
Available-for-sale financial assets:			
Corporate equities	15	-	-
Financial liabilities classified as held for trading:			
Corporate and other debt	5	-	-
Corporate equities	38	-	(7)
Net derivatives contracts <sup>(1)(2)</sup>	1,540	49	(44)
Financial liabilities designated at fair value through profit or loss:			
Prepaid OTC contracts	82	2	(2)
Issued structured notes	176	2	(3)

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

(2) CVA and FVA are included in the fair value, but excluded from the effect of reasonably possible alternative assumptions in the table above. CVA is deemed to be a Level 3 input when the underlying counterparty credit curve is unobservable. FVA is deemed to be a Level 3 input in its entirety given the lack of observability of funding spreads in the principal market.

**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**Six months ended 30 June 2016**

**11. FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE (CONTINUED)**

- d. Valuation of Level 3 financial assets and liabilities recognised at fair value on a recurring basis (continued)
- ii. Sensitivity of fair values to changing significant assumptions to reasonably possible alternatives (continued)

**31 December 2015**

		Effect of reasonably possible alternative assumptions	
	Fair value \$millions	Increase in fair value \$millions	Decrease in fair value \$millions
Financial assets classified as held for trading:			
Government debt securities	4	-	-
Corporate and other debt	576	19	(35)
Corporate equities	228	2	(41)
Financial assets designated at fair value through profit or loss:			
Prepaid OTC contracts	93	3	(3)
Customer loans	288	1	-
Available-for-sale financial assets:			
Corporate equities	38	9	(2)
Financial liabilities classified as held for trading:			
Corporate and other debt	5	-	-
Corporate equities	15	-	-
Net derivatives contracts <sup>(1)(2)</sup>	1,006	37	(52)
Financial liabilities designated at fair value through profit or loss:			
Prepaid OTC contracts	13	-	-
Issued structured notes	147	2	(2)

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

(2) CVA and FVA are included in the fair value, but excluded from the effect of reasonably possible alternative assumptions in the table above. CVA is deemed to be a Level 3 input when the underlying counterparty credit curve is unobservable. FVA is deemed to be a Level 3 input in its entirety given the lack of observability of funding spreads in the principal market.

**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**Six months ended 30 June 2016**

**11. FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE (CONTINUED)**

**e. Financial instruments valued using unobservable market data**

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

	<b>30 June 2016</b>	<b>31 December 2015</b>
	<b>\$millions</b>	<b>\$millions</b>
At 1 January	216	234
New transactions in the period	10	43
Amounts recognised in the condensed consolidated income statement during the period	(30)	(61)
<b>At 30 June / 31 December</b>	<b>196</b>	<b>216</b>

The condensed consolidated statement of financial position categories 'Financial assets and financial liabilities classified as held for trading', 'Financial assets and financial liabilities designated at fair value through profit or loss', and 'Available-for-sale financial assets' include financial instruments whose fair value is based on valuation techniques using unobservable market data. The balance above predominantly relates to derivative contracts.

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

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

# MORGAN STANLEY & CO. INTERNATIONAL plc

## NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Six months ended 30 June 2016

### 12. ASSETS AND LIABILITIES NOT MEASURED AT FAIR VALUE

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

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

		Fair value measurement using:		
		Quoted prices in active market (Level 1)	Valuation techniques using observable inputs (Level 2)	Valuation techniques with significant unobservable inputs (Level 3)
Carrying value	Fair value			
\$millions	\$millions	\$millions	\$millions	\$millions
<b>30 June 2016</b>				
<b>Financial liabilities</b>				
Other payables	9,692	9,578	-	9,578
<b>31 December 2015</b>				
<b>Financial liabilities</b>				
Other payables	6,814	6,566	-	6,566

Also included in the condensed consolidated statement of financial position is \$3,935 million (31 December 2015: \$4,774 million) of other payables where the carrying value is a reasonable approximation of fair value. The fair value of other payables is determined based on current interest rates and credit spreads for debt instruments with similar terms and maturity.

### 13. RELATED PARTY DISCLOSURES

The management and execution of business strategies on a global basis results in many Morgan Stanley transactions impacting a number of Morgan Stanley Group entities. The Morgan Stanley Group operates a number of intra-group policies to ensure that, where possible, revenues and related costs are matched. For the six month period ended 30 June 2016, \$640 million was transferred to other Morgan Stanley Group undertakings relating to such policies and recognised in the condensed consolidated income statement (six month period to 30 June 2015: \$998 million).

The Group receives and incurs management charges to and from other Morgan Stanley Group undertakings for infrastructure services, including the provision of staff and office facilities. For the six month period ended 30 June 2016 'management charges from other Morgan Stanley Group undertakings relating to staff costs' were \$677 million (30 June 2015: \$977 million) and 'management charges from other Morgan Stanley Group undertakings relating to other services' were \$315 million (30 June 2015: \$98 million). See note 2 for further details.

### 14. LITIGATION

In addition to the matters described below, in the normal course of business, the Group has been named, from time to time, as a defendant in various legal actions, including arbitrations, class actions and other litigation, arising in connection with its activities as a global diversified financial services institution. Certain of the actual or threatened legal actions include claims for substantial compensatory and/or punitive damages or claims for indeterminate amounts of damages. In some cases, the entities that would otherwise be the primary defendants in such cases are bankrupt or in financial distress.

**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**Six months ended 30 June 2016**

**14. LITIGATION (CONTINUED)**

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

The Group contests liability and/or the amount of damages as appropriate in each pending matter. Where available information indicates that it is probable a liability had been incurred at the date of the consolidated financial statements and the Group can reasonably estimate the amount of that loss, the Group accrues the estimated loss by a charge to income. The Group's future legal expenses may fluctuate from period to period, given the current environment regarding government investigations and private litigation affecting global financial services firms, including the Group.

In many proceedings and investigations, however, it is inherently difficult to determine whether any loss is probable or even possible, or to estimate the amount of any loss. The Group cannot predict with certainty if, how or when such proceedings or investigations will be resolved or what the eventual settlement, fine, penalty or other relief, if any, may be, particularly for proceedings and investigations where the factual record is being developed or contested or where plaintiffs or government entities seek substantial or indeterminate damages, restitution, disgorgement or penalties. Numerous issues may need to be resolved, including through potentially lengthy discovery and determination of important factual matters, determination of issues related to class certification and the calculation of damages or other relief, and by addressing novel or unsettled legal questions relevant to the proceedings or investigations in question, before a loss or additional loss or range of loss or additional loss can be reasonably estimated for a proceeding or investigation. Subject to the foregoing, the Group believes, based on current knowledge and after consultation with counsel, that the outcome of such proceedings and investigations will not have a material adverse effect on the consolidated financial condition of the Group, although the outcome of such proceedings or investigations could be material to the Group's operating results and cash flows for a particular period depending on, among other things, the level of the Group's revenues or income for such period.

Over the last several years, the level of litigation and investigatory activity (both formal and informal) by government and self-regulatory agencies has increased materially in the financial services industry. As a result, the Group expects that it may become the subject of increased claims for damages and other relief and, while the Group has identified below certain proceedings that the Group believes to be material, individually or collectively, there can be no assurance that additional material losses will not be incurred from claims that have not yet been asserted or are not yet determined to be material.

On 1 April 2016, the California Attorney General's Office filed an action against certain Morgan Stanley Group affiliates in California state court styled *California v. Morgan Stanley, et al.*, on behalf of California investors, including the California Public Employees' Retirement System and the California Teachers' Retirement System. The complaint alleges that the Morgan Stanley Group affiliates made misrepresentations and omissions regarding residential mortgage-backed securities and notes issued by the Cheyne SIV, and asserts violations of the California False Claims Act and other state laws and seeks treble damages, civil penalties, disgorgement, and injunctive relief. On 20 July 2016, the Morgan Stanley Group affiliates filed a demurrer.

On 11 July 2016, the Group received an invitation to respond to a proposed claim ("Proposed Claim") by the public prosecutor for Court of Accounts for the Republic of Italy. The Proposed Claim relates to certain derivative transactions between the Republic of Italy and the Group and another Morgan Stanley Group affiliate. The transactions were originally entered into between 1999 and 2005, and were terminated in December 2011 and January 2012. The Proposed Claim alleges, inter alia, that the Group was acting as an agent of the Republic of Italy, that some or all of the derivative transactions were improper and that the termination of the transactions was also improper. The Proposed Claim indicates that, if a proceeding is initiated against the Group, the public prosecutor would be asserting administrative claims against the Group for €2.879 billion. The Group does not agree with the Proposed Claim and intends to present its defences to the public prosecutor.