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MORGAN STANLEY (JERSEY) LIMITED

Interim financial report

30 June 2014

MORGAN STANLEY (JERSEY) LIMITED

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MORGAN STANLEY (JERSEY) LIMITED

INTERIM MANAGEMENT REPORT

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

RESULTS AND DIVIDENDS

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

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

PRINCIPAL ACTIVITY

The principal activity of the Company is the issuance of financial instruments and the hedging of the obligations arising pursuant to such issuances.

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

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

BUSINESS REVIEW

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

Major European equity market indices were generally higher at the end of the six month period ended 30 June 2014 compared with the start of the period with Euro-area gross domestic product continuing to grow modestly during 2014. To further stimulate economic activity, the European Central Bank lowered its benchmark interest rate from 0.25% to a record low 0.15% during the six month period ended 30 June 2014, despite persistently low inflation. The Euro-area unemployment rate decreased to 11.5% at 30 June 2014, from 11.8% at 31 December 2013. At 30 June 2014, the Bank of England's ("BOE") benchmark interest rate was 0.5%, which was unchanged from 31 December 2013. The BOE also remained committed to an asset purchase program of £375 billion, also unchanged from 31 December 2013.

MORGAN STANLEY (JERSEY) LIMITED

INTERIM MANAGEMENT REPORT

The condensed statement of comprehensive income is set out on page 8. The result for the six months ended 30 June 2014 is \$nil which is consistent with the Company's function and the six months ended 30 June 2013.

The condensed statement of financial position is set out on page 10. Total assets and total liabilities at 30 June 2014 were \$315,519,000 and \$315,063,000 respectively, both of which have decreased by \$105,595,000, or 25% from 31 December 2013. The decrease in total assets and total liabilities from 31 December 2013 is primarily due to a decrease in the value of issued structured notes, classified in financial liabilities designated at fair value through profit or loss, and the related hedging instruments, classified in financial assets designated at fair value through profit or loss. This is primarily as a result of issued structured notes reaching contractual maturity and fair value movements.

The Risk Management section below sets out the Company's and the Morgan Stanley Group's policies for the management of liquidity and cash flow risk and other significant business risks.

Risk management

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

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

Market risk

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

The Morgan Stanley Group manages the market risk associated with its trading activities on a global basis, at both a trading division and an individual product level, which includes consideration of market risk for each individual legal entity.

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

Credit risk

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

The Morgan Stanley Group manages credit risk exposure on a global consolidated basis and in consideration of individual legal entities. The credit risk management policies and procedures of the Morgan Stanley Group establish the framework for identifying, measuring, monitoring and controlling credit risk whilst ensuring transparency of material credit risks, ensuring compliance with established limits and escalating risk concentrations to appropriate senior management. Credit risk management policies and procedures for the Company are consistent with those of the Morgan Stanley Group and include escalation to appropriate key management personnel of the Company.

Liquidity and funding risk

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

MORGAN STANLEY (JERSEY) LIMITED

INTERIM MANAGEMENT REPORT

BUSINESS REVIEW (CONTINUED)

Risk management (continued)

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

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

Operational risk

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

The Company's business is highly dependent on the ability to process, on a daily basis, a large number of transactions across numerous and diverse markets in many currencies. In addition, we may introduce new products or services or change processes, resulting in new operational risk that we may not fully appreciate or identify. In general, the transactions processed are increasingly complex. The Company relies on the ability of the Morgan Stanley Group's employees, its internal systems, and systems at technology centres operated by unaffiliated third parties to process a high volume of transactions.

The Company also faces the risk of operational failure or termination of any of the clearing agents, exchanges, clearing houses or other financial intermediaries it uses to facilitate securities transactions. In the event of a breakdown or improper operation of the Company's or a third party's systems or improper or unauthorised action by third parties or the Morgan Stanley Group's employees, the Company could suffer financial loss, an impairment to its liquidity, a disruption of its businesses, regulatory sanctions or damage to its reputation. In addition, the interconnectivity of multiple financial institutions with central agencies, exchanges and clearing house, and the increased importance of these entities, increases the risk that an operational failure at one institution or entity may cause an industry-wide operational failure that could materially impact the Company's ability to conduct business.

The Company's operations rely on the secure processing, storage and transmission of confidential and other information in its computer systems and the systems of third parties with which we do business or that facilitate our business activities, such as vendors. Like other financial services firms, the Company and its third party providers have been and continue to be subject to unauthorised access, mishandling or misuse, computer viruses or malware cyber-attacks, denial of service attacks and other events. Events such as these could have a security impact on the Company's systems and jeopardise the Company's or the Company's clients' or counterparties' personal, confidential, proprietary or other information processed and stored in, and transmitted through, the Company's and our third party providers' computer systems. Furthermore, such events could cause interruptions or malfunctions in the Company's, the Company's clients', the Company's counterparties' or third parties' operations, which could result in reputational damage, client dissatisfaction, litigation or regulatory fines or penalties not covered by insurance maintained by the Company, and adversely affect the business, financial condition or results of operations.

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

MORGAN STANLEY (JERSEY) LIMITED

INTERIM MANAGEMENT REPORT

BUSINESS REVIEW (CONTINUED)

Risk management (continued)

Legal and regulatory risk

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

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

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

Going concern

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

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

MORGAN STANLEY (JERSEY) LIMITED

INTERIM MANAGEMENT REPORT

DIRECTORS

The following Directors held office throughout the period and to the date of approval of this report:

H Herrmann	Director
C Schmuck	Director
G Essex-Cater	Alternate Director
H Grant	Alternate Director
S Hopkins	Alternate Director
C Ruark	Alternate Director

EVENTS AFTER THE REPORTING DATE

There have been no significant events since the reporting date.

Approved by the Board and signed on its behalf by

A handwritten signature in dark ink, appearing to read 'Gordon Brown', with a long, sweeping horizontal flourish extending to the right.

Alternate Director

MORGAN STANLEY (JERSEY) LIMITED

DIRECTORS' RESPONSIBILITY STATEMENT

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

- (a) the condensed financial statements, which have been prepared in accordance with International Accounting Standard ("IAS") 34 '*Interim financial reporting*' ("IAS 34") as adopted by the European Union ("EU"), give a true and fair view of the assets, liabilities, financial position and result of the Company; and
- (b) the interim management report includes a fair review of the information required by rule 4.2.7R of the Disclosure and Transparency Rules, being an indication of the important events that have occurred during the six months ended 30 June 2014 and their impact on the condensed financial statements, and a description of the principal risks and uncertainties for the remaining six months of the financial year.

Approved by the Board and signed on its behalf by



Alternate Director
Board of Directors

H Herrmann
C Schmuck
G Essex-Cater
H Grant
S Hopkins
C Ruark

Director
Director
Alternate Director
Alternate Director
Alternate Director
Alternate Director

INDEPENDENT REVIEW REPORT TO MORGAN STANLEY (JERSEY) LIMITED

We have been engaged by the Company to review the condensed set of financial statements in the interim financial report for the six months ended 30 June 2014 which comprise the condensed statement of comprehensive income, the condensed statement of changes in equity, the condensed statement of financial position, the condensed statement of cash flows and the related notes 1 to 7. We have read the other information contained in the interim management report and considered whether it contains any apparent misstatements or material inconsistencies with the information in the condensed set of financial statements.

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 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

This interim financial report is the responsibility of, and has been approved by, the Directors. The Directors are responsible for preparing the interim 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 Company are prepared in accordance with International Financial Reporting Standards as adopted by the EU. The condensed set of financial statements included in this interim financial report has been prepared in accordance with IAS 34 "*Interim Financial Reporting*" ("IAS 34"), as adopted by the EU.

Our responsibility


Our responsibility is to express to the Company a conclusion on the condensed set of financial statements in the interim 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 any audit opinion.

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the condensed set of financial statements in the interim financial report for the six months ended 30 June 2014 is not prepared, in all material aspects, in accordance with IAS 34 as adopted by the EU and the Disclosure and Transparency Rules of the United Kingdom's Financial Conduct Authority.


Deloitte LLP
Chartered Accountants
St Helier, Jersey

28 August 2014

MORGAN STANLEY (JERSEY) LIMITED

CONDENSED STATEMENT OF COMPREHENSIVE INCOME Six months ended 30 June 2014

	Six months ended 30 June 2014 \$'000 (unaudited)	Six months ended 30 June 2013 \$'000 (unaudited)
Net gains on financial instruments designated at fair value through profit or loss	-	-
Interest income	40	41
Interest expense	(40)	(41)
RESULT BEFORE INCOME TAX	<hr/> -	<hr/> -
Income tax expense	-	-
RESULT AND TOTAL COMPREHENSIVE INCOME FOR THE PERIOD	<hr/> <hr/> -	<hr/> <hr/> -

All operations were continuing in the current and prior period.

The notes on pages 12 to 29 form an integral part of the condensed financial statements.

MORGAN STANLEY (JERSEY) LIMITED

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

	Stated capital \$'000	Retained earnings \$'000	Total equity \$'000
Balance at 1 January 2013 (audited)	14	442	456
Result and total comprehensive income for the period	-	-	-
Balance at 30 June 2013 (unaudited)	<u>14</u>	<u>442</u>	<u>456</u>
Balance at 1 January 2014 (audited)	14	442	456
Result and total comprehensive income for the period	-	-	-
Balance at 30 June 2014 (unaudited)	<u>14</u>	<u>442</u>	<u>456</u>

The notes on pages 12 to 29 form an integral part of the condensed financial statements.

MORGAN STANLEY (JERSEY) LIMITED

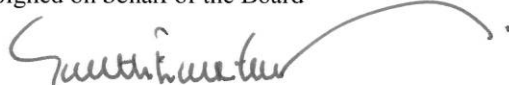
Registered number: 35857

CONDENSED STATEMENT OF FINANCIAL POSITION**As at 30 June 2014**

		30 June 2014 \$'000 (unaudited)	31 December 2013 \$'000 (audited)
	Note		
ASSETS			
Loans and receivables:			
Cash and short-term deposits		7,212	10,558
Trade receivables		435	441
Other receivables		3,236	3,762
		<u>10,883</u>	<u>14,761</u>
Financial assets designated at fair value through profit or loss	2	<u>304,636</u>	<u>406,353</u>
TOTAL ASSETS		<u><u>315,519</u></u>	<u><u>421,114</u></u>
LIABILITIES AND EQUITY			
Financial liabilities at amortised cost:			
Trade payables		5,159	9,913
Other payables		5,268	4,392
		<u>10,427</u>	<u>14,305</u>
Financial liabilities designated at fair value through profit or loss	2	<u>304,636</u>	<u>406,353</u>
TOTAL LIABILITIES		<u>315,063</u>	<u>420,658</u>
EQUITY			
Stated capital		14	14
Retained earnings		<u>442</u>	<u>442</u>
Equity attributable to owners of the Company		<u>456</u>	<u>456</u>
TOTAL EQUITY		<u>456</u>	<u>456</u>
TOTAL LIABILITIES AND EQUITY		<u><u>315,519</u></u>	<u><u>421,114</u></u>

These condensed financial statements were approved by the Board and authorised for issue on **28.8.2014**

Signed on behalf of the Board



Alternate Director

The notes on pages 12 to 29 form an integral part of the condensed financial statements.

MORGAN STANLEY (JERSEY) LIMITED

CONDENSED STATEMENT OF CASH FLOWS Six months ended 30 June 2014

	Six months ended 30 June 2014 \$'000 (unaudited)	Six months ended 30 June 2013 \$'000 (unaudited)
OPERATING ACTIVITIES		
Result for the period	-	-
<i>Adjustments for:</i>		
Interest income	(40)	(41)
Interest expense	40	41
Operating cash flows before changes in operating assets and liabilities	-	-
Changes in operating assets		
Decrease in loans and receivables, excluding cash and short-term deposits	572	2,640
Decrease in financial assets designated at fair value through profit or loss	101,717	173,895
	102,289	176,535
Changes in operating liabilities		
Decrease in financial liabilities at amortised cost	(3,918)	(2,585)
Decrease in financial liabilities designated at fair value through profit or loss	(101,717)	(173,895)
	(105,635)	(176,480)
NET CASH FLOWS (USED IN)/FROM OPERATING ACTIVITIES	(3,346)	55
NET (DECREASE)/INCREASE IN CASH AND CASH EQUIVALENTS	(3,346)	55
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE PERIOD	10,558	12,025
CASH AND CASH EQUIVALENTS AT THE END OF THE PERIOD	7,212	12,080

The notes on pages 12 to 29 form an integral part of the condensed financial statements.

MORGAN STANLEY (JERSEY) LIMITED

NOTES TO THE CONDENSED FINANCIAL STATEMENTS

Six months ended 30 June 2014

1. BASIS OF PREPARATION

Statement of compliance

The Company prepares its annual financial statements in accordance with International Financial Reporting Standards ("IFRSs") issued by the International Accounting Standards Board ("IASB") as adopted by the EU, Interpretations issued by the IFRS Interpretations Committee and Companies (Jersey) Law 1991. The condensed financial statements have been prepared in accordance with the Disclosure and Transparency Rules of the Financial Conduct Authority and in accordance with IAS 34 as adopted by the EU.

Accounting policies

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

New standards and interpretations adopted during the period

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

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

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

New standards and interpretations not yet adopted

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

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

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

Use of estimates and sources of uncertainty

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

For further details on the judgements used in determining fair value of certain assets and liabilities, see note 6.

MORGAN STANLEY (JERSEY) LIMITED

NOTES TO THE CONDENSED FINANCIAL STATEMENTS

Six months ended 30 June 2014

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

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

Issued structured notes: These relate to financial liabilities which arise from selling structured products generally in the form of notes or warrants. These instruments contain an embedded derivative which significantly modifies the cash flows of the issuance. The return on the instrument is linked to an underlying that is not clearly and closely related to the debt host including, but not limited to, equity, credit or commodity-linked notes. The structured notes are designated at fair value through profit or loss as the risks to which the Company is a contractual party are risk managed on a fair value basis as part of the Company's trading portfolio and the risk is reported to key management personnel on this basis.

At 30 June 2014 the Company had warrants in issue with a carrying value of \$107,846,000 (31 December 2013: \$140,259,000) recognised as issued structured notes within financial liabilities designated at fair value through profit or loss, which are exercisable for redeemable preference shares on the warrant expiration date.

Prepaid equity securities contracts: These contracts involve derivatives for which an initial payment is paid at inception. These financial instruments are part of the hedging strategy for the obligations arising pursuant to the issuance of the structured notes. The prepaid equity securities contracts are designated at fair value through profit or loss as the risks to which the Company is a contractual party are managed on a fair value basis as part of the Company's trading portfolio and the risk is reported to key management personnel on this basis.

	30 June 2014		31 December 2013	
	Assets	Liabilities	Assets	Liabilities
	\$'000	\$'000	\$'000	\$'000
Issued structured notes	-	304,636	-	406,353
Prepaid equity securities contracts	304,636	-	406,353	-
	<u>304,636</u>	<u>304,636</u>	<u>406,353</u>	<u>406,353</u>

The following table presents the change in fair value and the cumulative change recognised in the condensed statement of comprehensive income attributable to own credit risk for issued structured notes.

	Gain or (loss) recognised in the condensed statement of comprehensive income		Cumulative gain or (loss) recognised in the condensed statement of comprehensive income	
	Six months ended 30 June 2014	Six months ended 30 June 2013	30 June 2014	31 December 2013
	\$'000	\$'000	\$'000	\$'000
Issued structured notes	(2,227)	(9,553)	2,435	4,662
Prepaid equity securities contracts	2,227	9,553	(2,435)	(4,662)
	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>

MORGAN STANLEY (JERSEY) LIMITED

NOTES TO THE CONDENSED FINANCIAL STATEMENTS

Six months ended 30 June 2014

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

The change in fair value through the condensed statement of comprehensive income attributable to own credit risk for issued structured notes is determined as the amount of change in fair value that is not attributable to changes in market conditions that give rise to market risk.

The carrying amount of financial liabilities designated at fair value was \$92,253,000 higher than the contractual amount due at maturity (31 December 2013: \$931,000 higher).

3. SEGMENTAL REPORTING

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

Business segments

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

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

Geographical segments

The Company operates in one geographic region, Europe.

4. FINANCIAL RISK MANAGEMENT

Risk management procedures

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

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

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

Credit risk

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

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

MORGAN STANLEY (JERSEY) LIMITED

NOTES TO THE CONDENSED FINANCIAL STATEMENTS

Six months ended 30 June 2014

4. FINANCIAL RISK MANAGEMENT (CONTINUED)

Credit risk (continued)

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

In addition, the Company incurs credit risk exposure to financial institutions on its cash and short-term deposits. The Credit Risk Management Department evaluates the creditworthiness of the Company's obligors on a regular basis, and ensures that credit exposure is actively monitored and managed. The evaluation of obligors includes an assessment of the probability that an obligor will default on its financial obligations and any subsequent losses that may occur when an obligor defaults.

Collateral and other credit enhancements

Due to regulations in the US, which impact certain counterparties to the Company's prepaid equity securities contracts, the Company entered into a collateral arrangement with another Morgan Stanley Group undertaking. During the six months ended 30 June 2014, the prepaid equity securities contracts with these counterparties matured and the corresponding collateral held was returned by the Company. Collateral held is managed in accordance with the Morgan Stanley Group's guidelines and the relevant underlying agreements.

Exposure to credit risk

The maximum exposure to credit risk ("gross credit exposure") of the Company as at 30 June 2014 and 31 December 2013 is disclosed below, based on carrying amounts of the financial assets the Company believes are subject to credit risk. Where the Company enters into credit enhancements to manage the credit exposure on these financial instruments, the financial effect of the credit enhancement is also disclosed below. The net credit exposure represents the credit exposure remaining after the effect of the credit enhancements.

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

MORGAN STANLEY (JERSEY) LIMITED

NOTES TO THE CONDENSED FINANCIAL STATEMENTS Six months ended 30 June 2014

4. FINANCIAL RISK MANAGEMENT (CONTINUED)

Credit risk (continued)

Exposure to credit risk by class:

Class	30 June 2014			31 December 2013		
	Gross credit exposure	Credit enhancements	Net credit exposure	Gross credit exposure	Credit enhancements	Net credit exposure
	(1) \$'000	\$'000	(2) \$'000	(1) \$'000	\$'000	(2) \$'000
Loans and receivables:						
Cash and short-term deposits	7,212	-	7,212	10,558	-	10,558
Trade receivables	435	-	435	441	-	441
Other receivables	3,236	-	3,236	3,762	-	3,762
Financial assets designated at fair value through profit or loss:						
Prepaid equity securities contracts	304,636	-	304,636	406,353	(7,804)	398,549
	<u>315,519</u>	<u>-</u>	<u>315,519</u>	<u>421,114</u>	<u>(7,804)</u>	<u>413,310</u>

(1) The carrying amount recognised in the condensed statement of financial position best represents the Company'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 \$295,179,000 (31 December 2013: \$385,105,000) to be offset in the event of default by certain Morgan Stanley counterparties.

The impact of master netting arrangements and similar agreements on the Company's ability to offset financial assets and financial liabilities is disclosed in note 5.

Maximum exposure to credit risk by credit rating⁽¹⁾

Credit rating	Gross credit exposure	
	30 June 2014	31 December 2013
	\$'000	\$'000
A	<u>315,519</u>	<u>421,114</u>

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

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

Liquidity and funding risk

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

MORGAN STANLEY (JERSEY) LIMITED

NOTES TO THE CONDENSED FINANCIAL STATEMENTS

Six months ended 30 June 2014

4. FINANCIAL RISK MANAGEMENT (CONTINUED)

Liquidity and funding risk (continued)

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

The Company hedges all of its financial liabilities arising from the issuance of financial instruments with financial assets entered into with other Morgan Stanley Group undertakings, where both the Company and other Morgan Stanley Group undertakings are wholly-owned subsidiaries of the same group parent company, Morgan Stanley. Further, the maturity profile of the financial assets matches the maturity profile of the financial liabilities.

Liquidity management policies

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

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

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

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

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

MORGAN STANLEY (JERSEY) LIMITED

NOTES TO THE CONDENSED FINANCIAL STATEMENTS Six months ended 30 June 2014

4. FINANCIAL RISK MANAGEMENT (CONTINUED)

Liquidity and funding risk (continued)

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

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

Global Liquidity Reserve. The Morgan Stanley Group maintains sufficient liquidity reserves ("the Global Liquidity Reserve") to cover daily funding needs and meet strategic liquidity targets sized by the CFP and Liquidity Stress Tests. The size of the Global Liquidity Reserve is actively managed by the Morgan Stanley Group. The following components are considered in sizing the Global Liquidity Reserve: unsecured debt maturity profile, statement of financial position size and composition, funding needs in a stressed environment inclusive of contingent cash outflows and collateral requirements. Additionally, the Global Liquidity Reserve includes an additional reserve, which is primarily a discretionary surplus based on the Morgan Stanley Group's risk tolerance and is subject to change dependent on market and firm-specific events.

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

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

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

Funding management policies

The Morgan Stanley Group manages its funding in a manner that reduces the risk of disruption to the Morgan Stanley Group's and the Company's operations. The Morgan Stanley Group pursues a strategy of diversification of secured and unsecured funding sources (by product, by investor and by region) and attempts to ensure that the tenor of the Morgan Stanley Group's, and the Company's, liabilities equals or exceeds the expected holding period of the assets being financed.

The Morgan Stanley Group funds its statement of financial position on a global basis through diverse sources, which includes consideration of the funding risk of each legal entity. These sources may include the Morgan Stanley Group's equity capital, long-term debt, securities sold under agreements to repurchase, securities lending, deposits, commercial paper, letters of credit and lines of credit. The Morgan Stanley Group has active financing programmes for both standard and structured products targeting global investors and currencies.

Balance sheet management

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

MORGAN STANLEY (JERSEY) LIMITED

NOTES TO THE CONDENSED FINANCIAL STATEMENTS Six months ended 30 June 2014

4. FINANCIAL RISK MANAGEMENT (CONTINUED)

Liquidity and funding risk (continued)

Maturity analysis

In the following maturity analysis of financial assets and financial liabilities, financial assets designated at fair value through profit or loss and financial liabilities designated at fair value through profit or loss are disclosed according to their earliest contractual maturity; all such amounts are presented at their fair value, consistent with how these financial instruments are managed. All other amounts represent the undiscounted cash flows receivable and payable by the Company arising from its financial assets and financial liabilities to earliest contractual maturities as at 30 June 2014 and 31 December 2013. Receipt of financial assets and repayments of financial liabilities that are subject to immediate notice are treated as if notice were given immediately and are classified as on demand. This presentation is considered by the Company to appropriately reflect the liquidity risk arising from these financial assets and financial liabilities, presented in a way that is consistent with how the liquidity risk on these financial assets and financial liabilities is managed by the Company.

	On demand \$'000	Less than 1 month \$'000	Equal to or more than 1 month but less than 3 months \$'000	Equal to or more than 3 months but less than 1 year \$'000	Equal to or more than 1 year but less than 5 years \$'000	Equal to or more than 5 years \$'000	Total \$'000
30 June 2014							
Financial assets							
Loans and receivables:							
Cash and short-term deposits	7,212	-	-	-	-	-	7,212
Trade receivables	435	-	-	-	-	-	435
Other receivables	3,236	-	-	-	-	-	3,236
Financial assets designated at fair value through profit or loss:							
Prepaid equity securities contracts	-	10,812	27,398	61,683	204,743	-	304,636
Total financial assets	10,883	10,812	27,398	61,683	204,743	-	315,519
Financial liabilities							
Financial liabilities at amortised cost:							
Trade payables	5,159	-	-	-	-	-	5,159
Other payables	5,268	-	-	-	-	-	5,268
Financial liabilities designated at fair value through profit or loss:							
Issued structured notes	-	10,812	27,398	61,683	204,743	-	304,636
Total financial liabilities	10,427	10,812	27,398	61,683	204,743	-	315,063

MORGAN STANLEY (JERSEY) LIMITED

NOTES TO THE CONDENSED FINANCIAL STATEMENTS Six months ended 30 June 2014

4. FINANCIAL RISK MANAGEMENT (CONTINUED)

Liquidity and funding risk (continued)

	On demand \$'000	Less than 1 month \$'000	Equal to or more than 1 month but less than 3 months \$'000	Equal to or more than 3 months but less than 1 year \$'000	Equal to or more than 1 year but less than 5 years \$'000	Equal to or more than 5 years \$'000	Total \$'000
31 December 2013							
Financial assets							
Loans and receivables:							
Cash and short-term deposits	10,558	-	-	-	-	-	10,558
Trade receivables	441	-	-	-	-	-	441
Other receivables	3,762	-	-	-	-	-	3,762
Financial assets designated at fair value through profit or loss:							
Prepaid equity securities contracts	-	-	44,135	91,839	270,379	-	406,353
Total financial assets	14,761	-	44,135	91,839	270,379	-	421,114
Financial liabilities							
Financial liabilities at amortised cost:							
Trade payables	9,913	-	-	-	-	-	9,913
Other payables	4,392	-	-	-	-	-	4,392
Financial liabilities designated at fair value through profit or loss:							
Issued structured notes	-	-	44,135	91,839	270,379	-	406,353
Total financial liabilities	14,305	-	44,135	91,839	270,379	-	420,658

Market risk

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

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

To execute these responsibilities, the Morgan Stanley Group monitors the market risk of the firm against limits on aggregate risk exposures, performs a variety of risk analyses, routinely reports risk summaries and maintains the Value at Risk ("VaR") and scenario systems. The Company is managed within the Morgan Stanley Group's global framework. The market risk management policies and procedures of the Company include performing risk analyses and reporting any material risks identified to appropriate key management personnel of the Company.

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

MORGAN STANLEY (JERSEY) LIMITED

NOTES TO THE CONDENSED FINANCIAL STATEMENTS **Six months ended 30 June 2014**

4. FINANCIAL RISK MANAGEMENT (CONTINUED)

Market risk (continued)

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

5. FINANCIAL ASSETS AND FINANCIAL LIABILITIES SUBJECT TO OFFSETTING

In order to manage credit exposure arising from its business activities, the Company applies various credit risk management policies and procedures, see note 4 for further details. Primarily in connection with prepaid equity securities contracts, the Company enters into master netting arrangements and collateral arrangements with its counterparties. These agreements provide the Company with the right, in the ordinary course of business and/ or in the event of a counterparty default (such as bankruptcy or a counterparty's failure to pay or perform), to net a counterparty's rights and obligations under such agreement and, in the event of a counterparty default, set off collateral held by the Company against the net amount owed by the counterparty. In certain circumstances, the Company may not have such an agreement in place; the relevant insolvency regime (which is based on type of counterparty entity and the jurisdiction of organisation of the counterparty) may not support the enforceability of the agreement; or the Company may not have sought legal advice to support the enforceability of the agreement. In cases where the Company has not determined an agreement to be enforceable, the related amounts are not offset in the narrative disclosures. The Company's policy is generally to take possession of securities and to receive cash posted as collateral (with rights of rehypothecation). The enforceability of the master netting agreement is taken into account in the Company's risk management practices and application of counterparty credit limits. The Company also monitors the fair value of the underlying securities as compared with the related payable, and, as necessary, requests additional collateral as provided under the applicable agreement to ensure such transactions are adequately collateralised.

In the condensed statement of financial position, financial assets and financial liabilities are only offset and presented on a net basis where there is a current legally enforceable right to set off the recognised amounts and an intention to either settle on a net basis or to realise the asset and the liability simultaneously. Due to the absence of such conditions, financial assets and financial liabilities are presented on a gross basis in the condensed statement of financial position. In relation to financial assets and financial liabilities designated at fair value through profit or loss, collateral arrangements are in place which would allow for \$nil (31 December 2013: \$7,804,000) to be offset, and intercompany cross-product netting arrangements are in place which would allow for \$295,179,000 (31 December 2013: \$385,105,000) to be further offset.

MORGAN STANLEY (JERSEY) LIMITED

NOTES TO THE CONDENSED FINANCIAL STATEMENTS

Six months ended 30 June 2014

6. ASSETS AND LIABILITIES MEASURED AT FAIR VALUE

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

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

30 June 2014

	Quoted prices in active market (Level 1) \$'000	Valuation techniques using observable inputs (Level 2) \$'000	Valuation techniques with significant unobservable inputs (Level 3) \$'000	Total \$'000
Financial assets designated at fair value through profit or loss:				
Prepaid equity securities contracts	-	296,815	7,821	304,636
Total financial assets measured at fair value	-	296,815	7,821	304,636
Financial liabilities designated at fair value through profit or loss:				
Issued structured notes	-	296,815	7,821	304,636
Total financial liabilities measured at fair value	-	296,815	7,821	304,636

31 December 2013

	Quoted prices in active market (Level 1) \$'000	Valuation techniques using observable inputs (Level 2) \$'000	Valuation techniques with significant unobservable inputs (Level 3) \$'000	Total \$'000
Financial assets designated at fair value through profit or loss:				
Prepaid equity securities contracts	-	374,027	32,326	406,353
Total financial assets measured at fair value	-	374,027	32,326	406,353
Financial liabilities designated at fair value through profit or loss:				
Issued structured notes	-	374,027	32,326	406,353
Total financial liabilities measured at fair value	-	374,027	32,326	406,353

MORGAN STANLEY (JERSEY) LIMITED

NOTES TO THE CONDENSED FINANCIAL STATEMENTS Six months ended 30 June 2014

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

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

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

Issued structured notes and prepaid equity securities contracts designated at fair value through profit or loss

The Company issues structured notes and purchases prepaid equity securities contracts that have coupons or repayment terms linked to the performance of debt or equity securities, indices, currencies or commodities. The fair value of structured notes and prepaid equity securities contracts is determined using valuation models for the derivative and debt portions of the notes. These models incorporate observable inputs referencing identical or comparable securities, including prices to which the notes are linked, interest rate yield curves, option volatility and currency, commodity or equity prices. Independent, external and traded prices for the notes are also considered. The impact of own credit spreads is also included based on observed secondary bond market spreads. Generally, structured notes and prepaid equity securities contracts are categorised in Level 2 of the fair value hierarchy. In instances where significant inputs are unobservable, they are categorised in Level 3 of the fair value hierarchy.

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

There were no transfers between Level 1 and Level 2 of the fair value hierarchy during the current period and prior year.

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

The following tables present the changes in the fair value of the Company's Level 3 financial assets and financial liabilities for the period ended 30 June 2014 and year ended 31 December 2013.

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

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

MORGAN STANLEY (JERSEY) LIMITED

NOTES TO THE CONDENSED FINANCIAL STATEMENTS Six months ended 30 June 2014

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

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

30 June 2014

	Balance at 1 January 2014 \$'000	Total gains or (losses) recognised in condensed statement of comprehensive income ⁽¹⁾ \$'000	Purchases \$'000	Issuances \$'000	Settlements \$'000	Net transfers in and/or out of Level 3 ⁽²⁾ \$'000	Balance at 30 June 2014 \$'000	Unrealised gains / (losses) for level 3 assets /(liabilities) outstanding as at 30 June 2014 ⁽³⁾ \$'000
Financial assets designated at fair value through profit or loss:								
Prepaid equity securities contracts	32,326	119	-	-	(2,113)	(22,511)	7,821	374
Total financial assets measured at fair value	32,326	119	-	-	(2,113)	(22,511)	7,821	374
Financial liabilities designated at fair value through profit or loss:								
Issued structured notes	(32,326)	(119)	-	-	2,113	22,511	(7,821)	(374)
Total financial liabilities measured at fair value	(32,326)	(119)	-	-	2,113	22,511	(7,821)	(374)

(1) The total gains or (losses) are recognised in the condensed statement of comprehensive income as detailed in the financial instruments accounting policy in the Company's annual financial statements for the period ended 30 June 2014.

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

(3) Amounts represent unrealised gains or (losses) for the period ended 30 June 2014 related to assets and liabilities still outstanding at 30 June 2014. The unrealised gains or (losses) are recognised in the condensed statement of comprehensive income as detailed in the financial instruments accounting policy in the Company's annual financial statements for the year ended 31 December 2013.

During the period ended 30 June 2014, the Company reclassified approximately \$2,779,000 of prepaid equity securities contracts and issued structured notes from Level 2 to Level 3. The reclassifications were due to a reduction in the volume of recently executed transactions and market price quotations for these instruments, or lack of available broker quotes, such that certain significant inputs for the fair value measurement became unobservable.

During the period ended 30 June 2014, the Company reclassified approximately \$25,290,000 of prepaid equity securities contracts and issued structured notes from Level 3 to Level 2. The reclassifications were due to an increase in market price quotations for these or comparable instruments or available broker quotes, such that observable inputs were utilised for fair value measurement.

MORGAN STANLEY (JERSEY) LIMITED

NOTES TO THE CONDENSED FINANCIAL STATEMENTS Six months ended 30 June 2014

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

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

31 December 2013

	Balance at 1 January 2013 \$'000	Total gains or (losses) recognised in condensed statement of comprehensive income ⁽¹⁾ \$'000	Purchases \$'000	Issuances \$'000	Settlements \$'000	Net transfers in and/or out of Level 3 ⁽²⁾ \$'000	Balance at 31 December 2013 \$'000	Unrealised gains / (losses) for level 3 assets /(liabilities) outstanding as at 31 December 2013 ⁽³⁾ \$'000
Financial assets designated at fair value through profit or loss:								
Prepaid equity securities contracts	73,409	975	-	-	(8,715)	(33,343)	32,326	4,659
Total financial assets measured at fair value	73,409	975	-	-	(8,715)	(33,343)	32,326	4,659
Financial liabilities designated at fair value through profit or loss:								
Issued structured notes	(73,409)	(975)	-	-	8,715	33,343	(32,326)	(4,659)
Total financial liabilities measured at fair value	(73,409)	(975)	-	-	8,715	33,343	(32,326)	(4,659)

(1) The total gains or (losses) are recognised in the condensed statement of comprehensive income as detailed in the financial instruments accounting policy in the Company's annual financial statements for the year ended 31 December 2013.

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

(3) Amounts represent unrealised gains or (losses) for the year ended 31 December 2013 related to assets and liabilities still outstanding at 31 December 2013. The unrealised gains or (losses) are recognised in the condensed statement of comprehensive income as detailed in the financial instruments accounting policy in the Company's annual financial statements for the year ended 31 December 2013.

During the prior year, the Company reclassified approximately \$17,782,000 of prepaid equity securities contracts and issued structured notes from Level 2 to Level 3. The reclassifications were due to a reduction in the volume of recently executed transactions and market price quotations for these instruments, or lack of available broker quotes, such that certain significant inputs for the fair value measurement became unobservable.

During the prior year, the Company reclassified approximately \$51,125,000 of prepaid equity securities contracts and issued structured notes from Level 3 to Level 2. The reclassifications were due to an increase in market price quotations for these or comparable instruments or available broker quotes, such that observable inputs were utilised for fair value measurement.

MORGAN STANLEY (JERSEY) LIMITED

NOTES TO THE CONDENSED FINANCIAL STATEMENTS Six months ended 30 June 2014

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

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

31 December 2013

	Fair value \$'000	Valuation technique	Significant unobservable input(s)/ sensitivity of the fair value to changes in the unobservable inputs	Range	Averages ⁽¹⁾
ASSETS					
Financial assets designated at fair value through profit or loss:					
Prepaid equity securities contracts	32,326	Option model	At the money volatility / (B) Volatility skew / (B) Equity - Equity correlation / (A) Equity - Foreign exchange correlation / (B)	4% to 22% -3% to 0% 45% to 89% -28% to -25%	13% -1% 72% -28%
LIABILITIES					
Financial liabilities designated at fair value through profit or loss:					
Issued structured notes	(32,326)	Option model	At the money volatility / (A) Volatility skew / (A) Equity - Equity correlation / (B) Equity - Foreign exchange correlation / (A)	4% to 22% -3% to 0% 45% to 89% -28% to -25%	13% -1% 72% -28%

(1) Amounts represent weighted averages which are calculated by weighting each input by the fair value of the respective financial instruments.

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 increase/ (decrease) in the unobservable input in isolation would result in a significantly lower/ (higher) fair value measurement.

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

- *Correlation* – a pricing input where the payoff is driven by more than one underlying risk. Correlation is a measure of the relationship between the movements of two variables (i.e. how the change in one variable influences a change in the other variable). The correlation ranges may be wide since any two underlying inputs may be highly correlated (either positively or negatively) or weakly correlated.
- *Volatility* – the measure of the variability in possible returns for an instrument given how much that instrument changes in value over time. Volatility is a pricing input for options and, generally, the lower the volatility, the less risky the option. The level of volatility used in the valuation of a particular option depends on a number of factors, including the nature of the risk underlying that option (e.g. the volatility of a particular underlying equity security may be significantly different from that of a particular underlying commodity index), the tenor and the strike price of the option.
- *Volatility skew* – the measure of the difference in implied volatility for options with identical underliers and expiry dates but with different strikes. The implied volatility for an option with a strike price that is above or below the current price of an underlying asset will typically deviate from the implied volatility for an option with a strike price equal to the current price of that same underlying asset.

MORGAN STANLEY (JERSEY) LIMITED

NOTES TO THE CONDENSED FINANCIAL STATEMENTS

Six months ended 30 June 2014

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

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

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

All financial instruments are valued in accordance with the techniques outlined in the fair value hierarchy. Some of these techniques, including those used to value instruments categorised in Level 3 of the fair value hierarchy, are dependent on unobservable parameters and the fair value for these financial instruments has been determined using parameters appropriate for the valuation methodology based on prevailing market evidence. It is recognised that the unobservable parameters could have a range of reasonably possible alternative values.

In estimating the change in fair value, to provide information about the variability of the fair value measurement, the unobservable parameters were varied to the extremes of the ranges of reasonably possible alternatives using statistical techniques, such as dispersion in comparable observable external inputs for similar asset classes, historic data or judgement if a statistical technique is not appropriate. Where a financial instrument has more than one unobservable parameter, the sensitivity analysis reflects the greatest reasonably possible increase or decrease to fair value by varying the assumptions individually. It is unlikely that all unobservable parameters would be concurrently at the extreme range of possible alternative assumptions and therefore the sensitivity shown below is likely to be greater than the actual uncertainty relating to the financial instruments.

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

30 June 2014	Fair value \$'000	Effect of reasonably possible alternative assumptions	
		Increase in fair value \$'000	Decrease in fair value \$'000
Financial assets designated at fair value through profit or loss:			
Prepaid equity securities contracts	7,821	196	(196)
Financial liabilities designated at fair value through profit or loss:			
Issued structured notes	(7,821)	(196)	196

MORGAN STANLEY (JERSEY) LIMITED

NOTES TO THE CONDENSED FINANCIAL STATEMENTS **Six months ended 30 June 2014**

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

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

31 December 2013	Fair value \$'000	Effect of reasonably possible alternative assumptions	
		Increase in fair value \$'000	Decrease in fair value \$'000
Financial assets designated at fair value through profit or loss:			
Prepaid equity securities contracts	32,326	645	(638)
Financial liabilities designated at fair value through profit or loss:			
Issued structured notes	(32,326)	(645)	638

e. 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 statement of financial position in particular circumstances. There were no assets or liabilities measured at fair value on a non-recurring basis during the current period or prior year.

7. ASSETS AND LIABILITIES NOT MEASURED AT FAIR VALUE

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