Registered number: 35857

Registered office:
22 Grenville Street
St Helier
Jersey
JE4 8PX

MORGAN STANLEY (JERSEY) LIMITED

Report and financial statements

31 December 2012

MORGAN STANLEY (JERSEY) LIMITED

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MORGAN STANLEY (JERSEY) LIMITED

DIRECTORS' REPORT

The Directors present their report and financial statements (which comprise the statement of comprehensive income, statement of changes in equity, statement of financial position, statement of cash flows and the related notes, 1 to 16) for Morgan Stanley (Jersey) Limited (the "Company") for the year ended 31 December 2012.

RESULTS AND DIVIDENDS

The result for the year, after tax, was $nil (2011: $nil result after tax).

During the year, no dividends were paid or proposed (2011: $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 year under review and no significant change in the Company's principal activity is expected.

BUSINESS REVIEW

During 2012, global market and economic conditions have remained challenging with continuing concerns about the European sovereign debt crisis, lack of robust economic recovery in the United States ("US") and other developed markets and slowing economic growth in emerging markets. These on-going conditions present difficulties and uncertainty for the business outlook that may adversely impact the financial performance of the Company in the future.

The statement of comprehensive income is set out on page 9. The result for the year is $nil which is consistent with the Company's function and the prior year. Interest expense and interest income for the prior year include interest on redeemable preference shares and the related hedging instrument respectively. The decrease in interest expense and interest income of $1,661,000 is primarily due to the redemption of the preference shares in the year ended 31 December 2011.

The statement of financial position is set out on page 11. Total assets and total liabilities at the end of the year were $614,097,000 and $613,641,000 respectively, both of which have decreased by $90,629,000 or 13% from the prior year. The value of financial instruments in issue decreased from 31 December 2011, resulting in a corresponding decrease in the related hedging instruments. This is primarily as a result of a decrease in the level of issuances together with financial instruments reaching contractual maturity and fair value movements. At 31 December 2012, cash and short-term deposits and trade payables have increased to $12,025,000 and $11,368,000 respectively, primarily due to cash collateral received from another Morgan Stanley Group undertaking, against the receivable on certain prepaid equity securities contracts held.

The performance of the Company is included in the results of the Morgan Stanley Group which are disclosed in the Morgan Stanley Group's Annual Report on Form 10-K to the United States Securities and Exchange Commission. The Morgan Stanley Group manages its key performance indicators on a global basis but in consideration of individual legal entities. For this reason, the Company's Directors believe that providing further performance indicators for the Company itself would not enhance an understanding of the development, performance or position of the business of the Company.

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.

DIRECTORS' REPORT

BUSINESS REVIEW (CONTINUED)

Risk management

Risk is an inherent part of 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.

Morgan Stanley has taken transformative steps during this extremely difficult environment, including the de-risking of the statement of financial position and those related to capital and liquidity outlined below.

Note 12 to the financial statements provides qualitative and quantitative disclosures about the Company's management and exposure to 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.

The Morgan Stanley Group manages credit risk exposure on a global consolidated basis as well as giving consideration to individual legal entities. It does this by ensuring transparency of material credit risks, ensuring compliance with established limits, approving material extensions of credit, escalating risk concentrations to appropriate senior management and mitigating credit risk through the use of collateral and other arrangements.

Liquidity and capital resources

Liquidity and funding risk refers to the risk that the Company will be unable to meet its funding obligations in a timely manner. Liquidity risk stems from the potential risk that the Company will be unable to obtain necessary funding through borrowing money at favourable interest rates or maturity terms, or selling assets in a timely manner and at a reasonable price.

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 Company to fulfil its financial obligations and support the execution of the Company's business strategies. The Company's capital management framework is further discussed in note 15.

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. The Morgan Stanley Group uses Liquidity Stress Tests to model liquidity outflows across multiple scenarios over a range of time horizons. These scenarios contain various combinations of idiosyncratic and systemic stress events.

DIRECTORS' REPORT

BUSINESS REVIEW (CONTINUED)

Risk management

On 21 June 2012, Moody's Investor Services announced the conclusion of an industry-wide reassessment and revised ratings for 15 global capital markets banks. The Morgan Stanley Group's long- and short- term debt ratings were lowered two notches to Baa1/P-2 from A2/P-1, and a negative outlook was assigned.

While certain aspects of a credit ratings downgrade are quantifiable pursuant to contractual provisions, the impact it will have on the Morgan Stanley Group's business and results of operation in future periods is inherently uncertain and will depend on a number of inter-related factors, including among others, the magnitude of the downgrade, individual client behaviour and future mitigating actions the Morgan Stanley Group may take. The liquidity impact of additional collateral requirements is included in the Morgan Stanley Group's Liquidity Stress Tests.

Operational risk

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

The 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 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.

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

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

DIRECTORS' REPORT

BUSINESS REVIEW (CONTINUED)

Risk management (continued)

Legal, regulatory and compliance 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 taxation of financial transactions, liabilities and employee compensation as well as 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.

Many of these reforms, if enacted, may materially affect the Company's and the Morgan Stanley Group's business, financial condition, results of operations and cash flows in the future.

MORGAN STANLEY (JERSEY) LIMITED

DIRECTORS' REPORT

DIRECTORS

The following Directors held office throughout the year and to the date of approval of this report (except where otherwise shown):

E Alby	Director	(resigned 5 March 2013)
H Herrmann	Director	
C Schmuck	Director	(appointed 18 March 2013)
F Chesnay	Alternate Director	
G Essex-Cater	Alternate Director	
D Godwin	Alternate Director	(resigned 19 July 2012)
H Grant	Alternate Director	
C Ruark	Alternate Director	(resigned 27 July 2012)
S Vardon	Alternate Director	
State Street Secretaries (Jersey) Limited	Company Secretary	

EVENTS AFTER THE REPORTING DATE

There have been no significant events since the reporting date.

AUDITOR

The Directors have dispensed with the requirement to hold annual general meetings. As such, under Companies (Jersey) Law 1991, Deloitte LLP will remain in office until formally removed.

Approved by the Board and signed on its behalf ~~by~~

GARETH ESSEX-CATER

Alternate Director

25 April 2013

MORGAN STANLEY (JERSEY) LIMITED

DIRECTORS' RESPONSIBILITY STATEMENT

The Directors are responsible for preparing their report and the financial statements in accordance with applicable law and regulations.

Companies (Jersey) Law 1991 requires the Directors to prepare financial statements for each financial year. Under that law the Directors have prepared the financial statements in accordance with International Financial Reporting Standards ("IFRSs") as adopted by the European Union ("EU"). Under company law the Directors must not approve the accounts unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit and loss of the Company for that period.

In preparing these financial statements, the Directors are required by International Accounting Standard ("IAS") 1 *'Presentation of financial statements'* ("IAS 1") to:

(a) properly select and apply accounting policies;
(b) present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
(c) provide additional disclosures when compliance with the specific requirements in IFRSs is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance; and
(d) make an assessment of the Company's ability to continue as a going concern.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with Companies (Jersey) Law 1991. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Each of the Directors who held office at the date of approval of the Directors' report, confirm to the best of their knowledge:

- in accordance with rule 4.1.12(3)(a) of the Financial Services Authority's Disclosure and Transparency Rules, the financial statements, which have been prepared in accordance with IFRSs as issued by the International Accounting Standards Board ("IASB") and as endorsed by the EU, have been prepared in accordance with the applicable set of accounting standards and give a true and fair view of the assets, liabilities, financial position and result of the Company; and

- the management report represented by the Directors' report has been prepared in accordance with rule 4.1.12(3)(b) of the Disclosure and Transparency Rules, and includes a fair review of the development and performance of the business and the position of the Company together with a description of the principal risks and uncertainties that the Company faces.

Approved by the Board and signed on its behalf by

GARETH ESSEX-CATER
Alternate Director

25 April 2013

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF MORGAN STANLEY (JERSEY) LIMITED

We have audited the financial statements of Morgan Stanley (Jersey) Limited for the year ended 31 December 2012 which comprise of the statement of comprehensive income, the statement of changes in equity, the statement of financial position, the statement of cash flows and the related notes 1 to 16. The financial reporting framework that has been applied in their preparation is applicable law and IFRSs as adopted by the EU.

This report is made solely to the Company's members, as a body, in accordance with Article 113A of the Companies (Jersey) Law 1991. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's 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 and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of Directors and auditor

As explained more fully in the Directors' responsibilities statement, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view of the state of the Company's affairs as at 31 December 2012 and of its result for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the EU; and
- have been prepared in accordance with the requirements of the Companies (Jersey) Law 1991.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF MORGAN STANLEY (JERSEY) LIMITED

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies (Jersey) Law 1991 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or
- we have not received all the information and explanations we require for our audit.

Ana Kekovska ACA, CA (Aust.)
for and on behalf of Deloitte LLP
Chartered Accountants
St Helier, Jersey

25 April 2013

MORGAN STANLEY (JERSEY) LIMITED

STATEMENT OF COMPREHENSIVE INCOME
Year ended 31 December 2012

	Note	2012 $'000	2011 $'000
Net gains on financial instruments designated at fair value through profit or loss		-	-
Interest income	4	91	1,752
Interest expense	4	(91)	(1,752)
RESULT BEFORE INCOME TAX		-	-
Income tax expense	6	-	-
RESULT AND TOTAL COMPREHENSIVE INCOME FOR THE YEAR		-	-

All operations were continuing in the current and prior year.

The notes on pages 13 to 39 form an integral part of the financial statements.

MORGAN STANLEY (JERSEY) LIMITED

STATEMENT OF CHANGES IN EQUITY
Year ended 31 December 2012

	Stated capital $'000	Retained earnings $'000	Total equity $'000
Balance at 1 January 2011	14	442	456
Result and total comprehensive income for the year	-	-	-
Balance at 31 December 2011	14	442	456
Result and total comprehensive income for the year	-	-	-
Balance at 31 December 2012	14	442	456

The notes on pages 13 to 39 form an integral part of the financial statements.

MORGAN STANLEY (JERSEY) LIMITED

Registered number: 35857

STATEMENT OF FINANCIAL POSITION
As at 31 December 2012

	Note	2012 $'000	2011 $'000
ASSETS			
Loans and receivables:			
Cash and short-term deposits		12,025	138
Trade receivables		884	-
Other receivables	16	2,912	7,171
		15,821	7,309
Financial assets designated at fair value through profit or loss	7	598,276	697,417
TOTAL ASSETS		614,097	704,726
LIABILITIES AND EQUITY			
Financial liabilities at amortised cost:			
Trade payables		11,368	75
Other payables	16	3,997	6,778
		15,365	6,853
Financial liabilities designated at fair value through profit or loss	7	598,276	697,417
TOTAL LIABILITIES		613,641	704,270
EQUITY			
Stated capital	9	14	14
Retained earnings		442	442
Equity attributable to the owners of the Company		456	456
TOTAL EQUITY		456	456
TOTAL LIABILITIES AND EQUITY		614,097	704,726

These financial statements were approved by the Board and authorised for issue on 25 April 2013:

Signed on behalf of the Board

GARETH ESSEX-CATER

Alternate Director

The notes on pages 13 to 39 form an integral part of the financial statements.

MORGAN STANLEY (JERSEY) LIMITED

STATEMENT OF CASH FLOWS
Year ended 31 December 2012

	2012 $'000	2011 $'000
OPERATING ACTIVITIES		
Result for the year	-	-
Adjustments for:		
Interest income	(91)	(1,752)
Interest expense	91	1,752
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	3,466	72,334
Decrease in financial assets designated at fair value through profit or loss	99,141	278,393
	102,607	350,727
Changes in operating liabilities		
Increase/(decrease) in financial liabilities at amortised cost	8,421	(72,334)
Decrease in financial liabilities designated at fair value through profit or loss	(99,141)	(278,393)
	(90,720)	(350,727)
NET CASH FLOWS FROM OPERATING ACTIVITIES	11,887	-
NET INCREASE IN CASH AND CASH EQUIVALENTS	11,887	-
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE YEAR	138	138
CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR	12,025	138

The notes on pages 13 to 39 form an integral part of the financial statements.

MORGAN STANLEY (JERSEY) LIMITED

NOTES TO THE FINANCIAL STATEMENTS
Year ended 31 December 2012

1. CORPORATE INFORMATION

The Company is incorporated and domiciled in Jersey, at the following address:

22 Grenville Street, St Helier, Jersey, JE4 8PX.

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

The Company's immediate and 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. Morgan Stanley is incorporated in the state of Delaware, the United States of America.

2. BASIS OF PREPARATION

Statement of compliance

The Company has prepared its annual financial statements in accordance with IFRSs issued by the IASB as adopted by the EU, Interpretations issued by the IFRS Interpretations Committee and Companies (Jersey) Law 1991.

New standards and interpretations adopted during the year

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

New standards and interpretations not yet adopted

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

An amendment to IAS 1 was issued by the IASB in June 2011 for application in annual periods beginning on or after 1 July 2012. The revised standard was endorsed by the EU in June 2012.

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

An amendment to IFRS 7 *'Financial instruments: Disclosures – offsetting financial assets and financial liabilities'* was issued by the IASB in December 2011 for retrospective application in annual periods beginning on or after 1 January 2013 and interim periods within those annual periods. The amendment was endorsed by the EU in December 2012.

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

IFRS 13 *'Fair value measurement'* was issued by the IASB in May 2011 for prospective application in annual periods beginning on or after 1 January 2013 and was endorsed by the EU in December 2012.

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

Basis of measurement

The financial statements of the Company are prepared under the historical cost convention except for certain financial instruments that have been measured at fair value as explained in the accounting policies below.

2. BASIS OF PREPARATION (CONTINUED)

Use of estimates and sources of uncertainty

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

The going concern assumption

The Company's business activities, together with the factors likely to affect its future development, performance and position, are reflected in the Business Review section of the Directors' report on pages 1 to 4. In addition, the notes to the financial statements include the Company's objectives, policies and processes for managing its capital; its financial risk management objectives; details of its financial instruments; and its exposures to credit risk and liquidity risk.

As set out in the Directors' report, retaining sufficient liquidity and capital to withstand market pressures remains central to the Morgan Stanley Group's and the Company's strategy.

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 annual report and financial statements.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

a. Functional currency

Items included in the financial statements are measured and presented in US dollars, the currency of the primary economic environment in which the Company operates.

All currency amounts in the financial statements and Directors' report are rounded to the nearest thousand US dollars.

b. Foreign currencies

All monetary assets and liabilities denominated in currencies other than US dollars are translated into US dollars at the rates ruling at the reporting date. Transactions in currencies other than US dollars are recorded at the rates prevailing at the dates of the transactions. All translation differences are taken through the statement of comprehensive income. Exchange differences recognised in the statement of comprehensive income are presented in 'Other income' or 'Other expense', except where noted in 3(c) below.

c. Financial instruments

The Company classifies its financial assets into the following categories on initial recognition: financial assets designated at fair value through profit or loss and loans and receivables.

The Company classifies its financial liabilities into the following categories on initial recognition: financial liabilities designated at fair value through profit or loss and financial liabilities at amortised cost.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

c. Financial instruments (continued)

More information regarding these classifications is included below:

i) Financial instruments designated at fair value through profit or loss

The Company has designated certain financial assets and financial liabilities at fair value through profit or loss when the financial assets or financial liabilities are managed, evaluated and reported internally on a fair value basis.

From the date the transaction in a financial instrument designated at fair value is entered into (trade date) until settlement date, the Company recognises any unrealised fair value changes in the contract as financial instruments designated at fair value through profit or loss. On settlement date, the fair value of consideration given or received is recognised as a financial instrument designated at fair value through profit or loss (see note 3(d) below). All subsequent changes in fair value, foreign exchange differences, interest and dividends, are reflected in the statement of comprehensive income in 'Net gains on financial instruments designated at fair value through profit or loss'.

Transaction costs are excluded from the initial fair value measurement of the financial instrument. These costs are recognised in the statement of comprehensive income in 'Other expense'.

ii) Loans and receivables and financial liabilities at amortised cost

Financial assets classified as loans and receivables are initially recognised on settlement date at fair value (see note 3(d) below) and subsequently measured at amortised cost less allowance for impairment. Interest is recognised in the statement of comprehensive income in 'Interest income', using the effective interest rate method as described below. Transaction costs that are directly attributable to the acquisition of the financial asset are added to or deducted from the fair value on initial recognition. Impairment losses and reversals of impairment losses on financial assets classified as loans and receivables are recognised in the statement of comprehensive income in 'Other expense'.

Financial liabilities held at amortised cost are initially recognised on settlement date at fair value (see note 3(d) below) and subsequently measured at amortised cost. Interest is recognised in the statement of comprehensive income in 'Interest expense' using the effective interest rate method as described below. Transaction costs that are directly attributable to the issue of the financial liability are added to or deducted from the fair value on initial recognition.

The effective interest rate method is a method of calculating the amortised cost of a financial asset or financial liability (or a group of financial assets or financial liabilities) and of allocating the interest income or interest expense over the expected life of the financial asset or financial liability. The effective interest rate is the rate that exactly discounts the estimated future cash payments and receipts through the expected life of the financial asset or financial liability (or, where appropriate a shorter period) to the carrying amount of the financial asset or financial liability. The effective interest rate is established on initial recognition of the financial asset and financial liability. The calculation of the effective interest rate includes all fees and commissions paid or received, transaction costs, and discounts or premiums that are an integral part of the effective interest rate. Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial asset or financial liability.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

d. Fair value of financial instruments

Fair value measurement

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (i.e. the "exit price") in an orderly transaction between market participants at the measurement date.

In determining fair value, the Company uses various valuation approaches and establishes a hierarchy for inputs used in measuring fair value that maximises the use of relevant observable inputs and minimises the use of unobservable inputs by requiring that the most observable inputs be used when available. Observable inputs are inputs that market participants would use in pricing the asset or liability developed based on market data obtained from sources independent of the Company. Unobservable inputs are inputs that reflect the Company's assumptions about the assumptions other market participants would use in pricing the asset or liability, developed based on the best information available in the circumstances.

The availability of observable inputs can vary from product to product and is affected by a wide variety of factors, including, for example, the type of product, whether the product is new and not yet established in the marketplace, the liquidity of markets and other characteristics particular to the product. To the extent that valuation is based on models or inputs that are less observable or unobservable in the market, the determination of fair value requires more judgement.

The Company considers prices and inputs that are current as of the measurement date, including during periods of market dislocation. In periods of market dislocation, the observability of prices and inputs may be reduced for many instruments.

Valuation techniques

Fair value for many cash and OTC contracts is derived using pricing models. Pricing models take into account the contract terms (including maturity), as well as multiple inputs including, where applicable, commodity prices, equity prices, interest rate yield curves, credit curves, correlation, creditworthiness of the counterparty, option volatility and currency rates. Where appropriate, valuation adjustments are made to account for various factors such as liquidity risk (bid-ask adjustments), credit quality, model uncertainty and concentration risk.

Adjustments for liquidity risk adjust model-derived valuations of financial instruments for the bid-mid or mid-ask spread required to properly reflect the exit price of a risk position. Bid-mid and mid-ask spreads are marked to levels observed in trader activity, broker quotes or other external third-party data. Where these spreads are unobservable for the particular position in question, spreads are derived from observable levels of similar positions.

Credit valuation adjustments are applied to both cash instruments and OTC derivatives. For cash instruments, the impact of changes in its own credit spreads is considered when measuring the fair value of liabilities and the impact of changes in the counterparty's credit spreads is considered when measuring the fair value of assets. For OTC derivatives, the impact of changes in both the Company's and the counterparty's credit standing is considered when measuring fair value. In determining the expected exposure the Company simulates the distribution of the future exposure to a counterparty, then applies market-based default probabilities to the future exposure, leveraging external third-party credit default swap ("CDS") spread data. Where CDS spread data are unavailable for a specific counterparty, bond market spreads, CDS spread data based on the counterparty's credit rating or CDS spread data that reference a comparable counterparty may be utilised. The Company also considers collateral held and legally enforceable master netting agreements that mitigate the Company's exposure to each counterparty.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

d. Fair value of financial instruments (continued)

Adjustments for model uncertainty are taken for positions where underlying models are reliant on significant inputs that are neither directly nor indirectly observable, hence requiring reliance on established theoretical concepts in their derivation. These adjustments are derived by making assessments of the possible degree of variability using statistical approaches and market-based information where possible. The Company generally subjects all valuations and models to a review process initially and on a periodic basis thereafter.

The Company may apply a concentration adjustment to certain of its OTC derivatives portfolios to reflect the additional cost of closing out a particularly large risk exposure. Where possible, these adjustments are based on observable market information but in many instances significant judgement is required to estimate the costs of closing out concentrated risk exposures due to the lack of liquidity in the marketplace.

Fair value is a market-based measure considered from the perspective of a market participant rather than an entity-specific measure. Therefore, even when market assumptions are not readily available, the Company's own assumptions are set to reflect those that the Company believes market participants would use in pricing the asset or liability at the measurement date.

Valuation process
The Valuation Review Group ("VRG") within the Financial Control Group is responsible for the Company's fair value valuation policies, processes and procedures. VRG is independent of the business units and reports to the Chief Financial Officer ("CFO"), who has final authority over the valuation of the Company's financial instruments. VRG implements valuation control processes to validate the fair value of the Company's financial instruments measured at fair value including those derived from pricing models. These control processes are designed to ensure that the values used for financial reporting are based on observable inputs wherever possible. In the event that observable inputs are not available, the control processes are designed to ensure that the valuation approach utilised is appropriate and consistently applied and that the assumptions are reasonable.

The Company's control processes apply to all financial instruments, unless otherwise noted. These control processes include:

Model Review. VRG, in conjunction with the Market Risk Department and, where appropriate, the Credit Risk Management Department, both of which report to the Chief Risk Officer, independently review valuation models' theoretical soundness, the appropriateness of the valuation methodology and calibration techniques developed by the business units using observable inputs. Where inputs are not observable, VRG reviews the appropriateness of the proposed valuation methodology to ensure it is consistent with how a market participant would arrive at the unobservable input. The valuation methodologies utilised in the absence of observable inputs may include extrapolation techniques and the use of comparable observable inputs. As part of the review, VRG develops a methodology to independently verify the fair value generated by the business unit's valuation model. Before trades are executed using new valuation models, those models are required to be independently reviewed. All of the Company's valuation models are subject to an independent annual VRG review.

Independent Price Verification. The business units are responsible for determining the fair value of financial instruments using approved valuation models and valuation methodologies. Generally on a monthly basis, VRG independently validates the fair values of financial instruments determined using valuation models by determining the appropriateness of the inputs used by the business units and by testing compliance with the documented valuation methodologies approved in the model review process described above.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

d. Fair value of financial instruments (continued)

VRG uses recently executed transactions, other observable market data such as exchange data, broker/ dealer quotes, third-party pricing vendors and aggregation services for validating the fair values of financial instruments generated using valuation models. VRG assesses the external sources and their valuation methodologies to determine if the external providers meet the minimum standards expected of a third-party pricing source. Pricing data provided by approved external sources are evaluated using a number of approaches; for example, by corroborating the external sources' prices to executed trades, by analysing the methodology and assumptions used by the external source to generate a price and/ or by evaluating how active the third-party pricing source (or originating sources used by the third-party pricing source) is in the market. Based on this analysis, VRG generates a ranking of the observable market data to ensure that the highest-ranked market data source is used to validate the business unit's fair value of financial instruments.

For financial instruments where the fair value is based on unobservable inputs, VRG reviews the business unit's valuation techniques to ensure these are consistent with market participant assumptions.

The results of this independent price verification and any adjustments made by VRG to the fair value generated by the business units are presented to management of the Morgan Stanley Group's three business segments (*i.e.* Institutional Securities, Global Wealth Management Group and Asset Management), the CFO and the Chief Risk Officer on a regular basis.

Review of Transactions where the valuation is based on unobservable inputs. VRG reviews the models and valuation methodology used to price all new material Level 3 transactions and both the Financial Control Group and Market Risk Department management must approve the fair value of the trade that is initially recognised.

Gains and losses on inception

In the normal course of business, the fair value of a financial instrument on initial recognition is the transaction price (i.e. the fair value of the consideration given or received). In certain circumstances, however, the fair value will be based on other observable current market transactions in the same instrument, without modification or repackaging, or on a valuation technique whose variables include only data from observable markets. When such evidence exists, the Company recognises a gain or loss on inception of the transaction.

When unobservable market data has a significant impact on determining fair value at the inception of the transaction, the entire initial gain or loss indicated by the valuation technique as at the transaction date is not recognised immediately in the statement of comprehensive income and is recognised instead when the market data becomes observable.

e. Derecognition of financial assets and liabilities

The Company derecognises a financial asset only when the contractual rights to the cash flows from the asset expire, or when it transfers the financial asset and substantially all the risk and rewards of ownership of the asset.

The Company derecognises financial liabilities when the Company's obligations are discharged, cancelled or they expire.

f. Impairment of financial assets

At each reporting date, an assessment is made as to whether there is any objective evidence of impairment in the value of a financial asset classified as loans and receivables. Impairment losses are recognised if an event has occurred which will have an adverse impact on the expected future cash flows of an asset and the expected impact can be reliably estimated.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

f. Impairment of financial assets (continued)

Impairment losses on loans and receivables carried at amortised cost are measured as the difference between the carrying amount of the financial asset and the present value of estimated cash flows discounted at the asset's original effective interest rate. Such impairment losses are recognised in the statement of comprehensive income within 'Other expense' and are recognised against the carrying amount of the impaired asset on the statement of financial position. Interest on the impaired asset continues to be accrued on the reduced carrying amount based on the original effective interest rate of the asset.

If in a subsequent period, the amount of the estimated impairment loss decreases because of an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed as detailed by financial asset in note 3(c)(ii). Any reversal is limited to the extent that the value of the asset may not exceed the original amortised cost of the asset had no impairment occurred.

g. Cash and cash equivalents

For the purposes of the statement of cash flows, cash and cash equivalents comprise cash with banks, along with highly liquid investments, with original maturities of three months or less, that are readily convertible to known amounts of cash and subject to insignificant risk of change in value.

h. Offsetting of financial assets and financial liabilities

The Company is party to the Morgan Stanley master netting agreement which allows for the offset of certain intercompany balances between the Company and other Morgan Stanley subsidiary undertakings and the Company intends to settle all such intercompany balances on a net basis. Accordingly, certain intercompany balances with other Morgan Stanley group undertakings are presented on a net basis in the statement of financial position.

4. INTEREST INCOME AND INTEREST EXPENSE

'Interest income' and 'Interest expense' represent total interest income and total interest expense for financial assets and financial liabilities that are not carried at fair value.

No other gains or losses have been recognised in respect of loans and receivables other than as disclosed as 'Interest income' within the statement of comprehensive income.

No other gains or losses have been recognised in respect of financial liabilities measured at amortised cost other than as disclosed as 'Interest expense' within the statement of comprehensive income.

5. AUDIT FEES

Audit fees of $81,000 (2011: $101,000) have been borne by another Morgan Stanley Group undertaking in both the current and prior year.

6. INCOME TAX EXPENSE

The Company is subject to Jersey income tax at the rate of 0% (2011: 0%).

7. 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 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.

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 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.

	2012		2011	
	Assets $'000	Liabilities $'000	Assets $'000	Liabilities $'000
Issued structured notes	-	598,276	-	697,417
Prepaid equity securities contracts	598,276	-	697,417	-
	598,276	598,276	697,417	697,417

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

	Gain or (loss) recognised in the statement of comprehensive income		Cumulative gain or (loss) recognised in the statement of comprehensive income	
	Year ended 31 December 2012 $'000	Year ended 31 December 2011 $'000	2012 $'000	2011 $'000
Issued structured notes	(81,901)	71,470	20,803	102,704
Prepaid equity securities contracts	81,901	(71,470)	(20,803)	(102,704)
	-	-	-	-

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

The changes in fair value attributable to own credit risk for issued structured notes are 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 $17,280,000 higher than the contractual amount due at maturity (2011: $59,916,000 lower).

8. PREFERENCE SHARES

	Preference shares of no par value: $'000
Issued and fully paid	
At 1 January 2011	68,566
Interest	1,681
Foreign exchange	3,246
Redeemed in the year	(73,493)
At 31 December 2011 and 31 December 2012	-

At 1 January 2011 the Company's issued share capital included 4,445 mandatory redeemable preference shares at an issue price of £9,364 each, classified as financial liabilities at amortised cost. During the year ended 31 December 2011 the preference shares were redeemed for $73,493,000.

At 31 December 2012 the Company had warrants in issue with a carrying value of $275,825,000 (31 December 2011: $390,354,000) recognised as issued structured notes within financial liabilities designated at fair value, which are exercisable for redeemable preference shares on the warrant expiration date.

The preference shares carry no rights to receive dividends or to receive notice of, or attend, or vote at any general meeting of the Company. On winding up or other return of capital, they have the right to repayment in priority to any payment to the holders of ordinary shares and nominal shares, to the relevant redemption amount, in accordance with the terms.

Refer to note 9 for details of authorised preference shares.

9. EQUITY

Stated capital

	Ordinary shares of no par value: $'000
Issued and fully paid	
At 1 January 2011, 31 December 2011 and 31 December 2012	14

At 31 December 2012, the total issued stated capital equated to $14,000 (2011: $14,000) comprising of 10,000 British pound denominated ordinary shares of no par value. All ordinary shares are recorded at the rates of exchange ruling at the date the shares were paid up. The terms of other shares classified as financial liabilities are detailed in note 8.

The Company is authorised to issue an unlimited number of shares designated as ordinary shares of no par value, an unlimited number of shares designated as nominal shares of no par value and an unlimited number of shares designated as unclassified shares of no par value available for issue as separate classes of preference shares of no par value.

10. EXPECTED MATURITY OF ASSETS AND LIABILITIES

The table below shows an analysis of assets and liabilities analysed according to when they are expected to be recovered, realised or settled.

At 31 December 2012	Less than twelve months $'000	Equal to or more than twelve months $'000	Total $'000
ASSETS			
Loans and receivables:			
Cash and short-term deposits	12,025	-	12,025
Trade receivables	884	-	884
Other receivables	2,912	-	2,912
	15,821	-	15,821
Financial assets designated at fair value through profit or loss	35,506	562,770	598,276
	51,327	562,770	614,097
LIABILITIES			
Financial liabilities at amortised cost:			
Trade payables	11,368	-	11,368
Other payables	3,997	-	3,997
	15,365	-	15,365
Financial liabilities designated at fair value through profit or loss	35,506	562,770	598,276
	50,871	562,770	613,641

10. EXPECTED MATURITY OF ASSETS AND LIABILITIES (CONTINUED)

At 31 December 2011	Less than twelve months $'000	Equal to or more than twelve months $'000	Total $'000
ASSETS			
Loans and receivables:			
Cash and short-term deposits	138	-	138
Other receivables	7,171	-	7,171
	7,309	-	7,309
Financial assets designated at fair value through profit or loss	57,664	639,753	697,417
	64,973	639,753	704,726
LIABILITIES			
Financial liabilities at amortised cost:			
Trade payables	75	-	75
Other payables	6,778	-	6,778
	6,853	-	6,853
Financial liabilities designated at fair value through profit or loss	57,664	639,753	697,417
	64,517	639,753	704,270

11. SEGMENT 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.

12. 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 financial obligations.

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

The Company enters into 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 ensures that the creditworthiness of the Company's counterparties is reviewed regularly and that credit exposure is actively monitored and managed. This includes an assessment of an obligor's probability of default and relative recovery prospects.

Collateral and other credit enhancements

As a result of certain changes in regulation in the US, which impacts 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 current year. This arrangement may provide the Company with the ability to offset the counterparty's rights and obligations, to request additional collateral when necessary and/or to liquidate the collateral in the event of counterparty default. 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 the reporting date is disclosed below, based on the 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.

12. FINANCIAL RISK MANAGEMENT (CONTINUED)

Credit risk (continued)

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

Exposure to credit risk by class

Class	2012			2011		
	Gross credit exposure (1) $'000	Credit enhancements $'000	Net credit exposure $'000	Gross credit exposure (1) $'000	Credit enhancements $'000	Net credit exposure $'000
Loans and receivables:						
Cash and short-term deposits	12,025	-	12,025	138	-	138
Trade receivables	884	-	884	-	-	-
Other receivables	2,912	-	2,912	7,171	-	7,171
Financial assets designated at fair value through profit or loss:						
Prepaid equity securities contracts	598,276	(10,913)	587,363	697,417	-	697,417
	614,097	(10,913)	603,184	704,726	-	704,726

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

Maximum exposure to credit risk by credit rating[1]

Credit rating	Gross credit exposure 2012 $'000	Gross credit exposure 2011 $'000
A	614,097	704,726

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

At 31 December 2012 there were no financial assets past due but not impaired or individually impaired (2011: none).

Liquidity risk

Liquidity risk is the risk that the entity may encounter difficulty in meeting obligations associated with financial liabilities that are settled by delivering cash or another financial asset.

12. FINANCIAL RISK MANAGEMENT (CONTINUED)

Liquidity 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 Morgan Stanley Group's liquidity and funding risk management policies are designed to mitigate the potential risk that entities within the Morgan Stanley Group, including the Company, may be unable to access adequate financing to service their financial liabilities when they become payable without material, adverse franchise or business impact. The key objective of the liquidity and funding risk management framework is to support the successful execution of both the Morgan Stanley Group's and the Company's business strategies while ensuring ongoing and sufficient liquidity through the business cycle and during periods of stressed market conditions.

The Company hedges 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 the 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 multi-notch credit rating downgrades; (vi) additional collateral that would be required due to collateral substitutions, collateral disputes and uncalled collateral; (vii) discretionary unsecured debt buybacks; (viii) drawdowns on unfunded commitments provided to third parties; (ix) client cash withdrawals and reduction in customer short positions that fund long positions; (x) limited access to the foreign exchange swap markets; (xi) return of securities borrowed on an uncollateralised basis; and (xii) maturity roll-off of outstanding letters of credit with no further issuance.

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

12. FINANCIAL RISK MANAGEMENT (CONTINUED)

Liquidity 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 on-going 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 and 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 (including US government securities, US agency securities, US agency mortgage-backed securities, Federal Deposit Insurance Corporation -guaranteed corporate debt, non-US government securities and other highly liquid investment grade securities).

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 programs for both standard and structured products, targeting global investors and currencies.

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 collateralised receivables arising from its Institutional Securities business segment's sales and trading activities. The liquid nature of these assets provides the Morgan Stanley Group and the Company with flexibility in funding and managing their business.

12. FINANCIAL RISK MANAGEMENT (CONTINUED)

Liquidity 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 31 December 2012. 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.

31 December 2012	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
Financial assets							
Loans and receivables:							
Cash and short-term deposits	12,025	-	-	-	-	-	12,025
Trade receivables	884	-	-	-	-	-	884
Other receivables	2,912	-	-	-	-	-	2,912
Financial assets designated at fair value through profit or loss:							
Prepaid equity securities contracts	-	-	14,240	21,266	562,770	-	598,276
Total financial assets	15,821	-	14,240	21,266	562,770	-	614,097
Financial liabilities							
Financial liabilities at amortised cost:							
Trade payables	11,368	-	-	-	-	-	11,368
Other payables	3,997	-	-	-	-	-	3,997
Financial liabilities designated at fair value through profit or loss:							
Issued structured notes	-	-	14,240	21,266	562,770	-	598,276
Total financial liabilities	15,365	-	14,240	21,266	562,770	-	613,641

12. FINANCIAL RISK MANAGEMENT (CONTINUED)

Liquidity risk (continued)

31 December 2011	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
Financial assets							
Loans and receivables:							
Cash and short-term deposits	138	-	-	-	-	-	138
Other receivables	7,171	-	-	-	-	-	7,171
Financial assets designated at fair value through profit or loss:							
Prepaid equity securities contracts	-	1,706	3,930	52,028	434,865	204,888	697,417
Total financial assets	7,309	1,706	3,930	52,028	434,865	204,888	704,726
Financial liabilities							
Financial liabilities at amortised cost:							
Trade payables	75	-	-	-	-	-	75
Other payables	6,778	-	-	-	-	-	6,778
Financial liabilities designated at fair value through profit or loss:							
Issued structured notes	-	1,706	3,930	52,028	434,865	204,888	697,417
Total financial liabilities	6,853	1,706	3,930	52,028	434,865	204,888	704,270

Market risk

Market risk is defined under 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.

12. 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.

13. FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE

a. Fair value hierarchy disclosure

Financial instruments recognised at fair value are broken down for disclosure purposes into a three level fair value hierarchy based on the observability of inputs as follows:

- Quoted prices (unadjusted) in an active market for identical assets or liabilities (Level 1) – Valuations based on quoted prices in active markets for identical assets or liabilities that the Morgan Stanley Group has the ability to access. Valuation adjustments and block discounts are not applied to Level 1 instruments. Since valuations are based on quoted prices that are readily and regularly available in an active market, valuation of these products does not entail a significant degree of judgement.
- Valuation techniques using observable inputs (Level 2) – Valuations based on one or more quoted prices in markets that are not active or for which all significant inputs are observable, either directly or indirectly.
- Valuation techniques with significant unobservable inputs (Level 3) – Valuations based on inputs that are unobservable and significant to the overall fair value measurement.

Fair value control processes

The Company employs control processes to validate the fair value of its financial instruments, including those derived from pricing models. These control processes are designed to assure that the values used for financial reporting are based on observable inputs wherever possible. In the event that observable inputs are not available, the control processes are designed to assure that the valuation approach utilised is appropriate and consistently applied and that the assumptions are reasonable. These control processes include reviews of the pricing model's theoretical soundness and appropriateness by Morgan Stanley Group personnel with relevant expertise who are independent from the trading desks.

Additionally, groups independent from the trading divisions within the financial control, market risk and credit risk management departments participate in the review and validation of the fair values generated from pricing models, as appropriate. Where a pricing model is used to determine fair value, recently executed comparable transactions and other observable market data are considered for purposes of validating assumptions underlying the model.

13. FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE (CONTINUED)

a. Fair value hierarchy disclosure (continued)

Financial assets and liabilities recognised at fair value

The following tables present the carrying value of the Company's financial assets and financial liabilities recognised at fair value, classified according to the fair value hierarchy described above:

31 December 2012	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	-	524,867	73,409	598,276
Total financial assets measured at fair value	-	524,867	73,409	598,276
Financial liabilities designated at fair value through profit or loss:				
Issued structured notes	-	524,867	73,409	598,276
Total financial liabilities measured at fair value	-	524,867	73,409	598,276

31 December 2011	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	-	622,113	75,304	697,417
Total financial assets measured at fair value	-	622,113	75,304	697,417
Financial liabilities designated at fair value through profit or loss:				
Issued structured notes	-	622,113	75,304	697,417
Total financial liabilities measured at fair value	-	622,113	75,304	697,417

13. FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE (CONTINUED)

a. Fair value hierarchy disclosure (continued)

The Company's valuation approach and fair value hierarchy categorisation for financial instruments recognised at fair value is as follows:

Issued structured notes and prepaid equity securities contracts

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, issued 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. Changes in Level 3 assets and liabilities measured at fair value

The following tables presents the changes in the fair value of the Company's Level 3 financial assets and financial liabilities.

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 or losses during the year for assets and liabilities within the Level 3 category presented in the tables below may include changes in fair value during the year that were attributable to both observable (e.g. changes in market interest rates) and unobservable (e.g. changes in unobservable long-dated volatilities) inputs.

As disclosed in note 16, 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 tables 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.

13. FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE (CONTINUED)

b. Changes in Level 3 assets and liabilities measured at fair value (continued)

31 December 2012

	Balance at 1 January 2012 $'000	Total gains or (losses) recognised in statement of comprehensive income $'000	Purchases $'000	Issuances $'000	Settlements $'000	Net transfers in and/or out of Level 3 (1) $'000	Balance at 31 December 2012 $'000	Unrealised gains / (losses) for Level 3 assets /liabilities outstanding as at 31 December 2012 (2) $'000
Financial assets designated at fair value through profit or loss:								
Prepaid equity securities contracts	75,304	3,234	6,903	-	(11,047)	(985)	73,409	6,821
Total financial assets measured at fair value	75,304	3,234	6,903	-	(11,047)	(985)	73,409	6,821
Financial liabilities designated at fair value through profit or loss:								
Issued structured notes	(75,304)	(3,234)	-	(6,903)	11,047	985	(73,409)	(6,821)
Total financial liabilities measured at fair value	(75,304)	(3,234)	-	(6,903)	11,047	985	(73,409)	(6,821)

(1) 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.

(2) Amounts represent unrealised gains or (losses) for the year ended 31 December 2012 related to assets and liabilities still outstanding at 31 December 2012. The unrealised gains or (losses) are recognised in the statement of comprehensive income as detailed in the financial instruments accounting policy (note 3c).

During the year, the Company reclassified approximately $4,475,000 of prepaid equity securities contracts and $4,475,000 of 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 year, the Company reclassified approximately $5,460,000 of prepaid equity securities contracts and $5,460,000 of 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.

13. FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE (CONTINUED)

b. Changes in Level 3 assets and liabilities measured at fair value (continued)

31 December 2011	Balance at 1 January 2011 $'000	Total gains or (losses) recognised in statement of comprehensive income $'000	Purchases $'000	Issuances $'000	Settlements $'000	Net transfers in and/or out of Level 3 (1) $'000	Balance at 31 December 2011 $'000	Unrealised gains / (losses) for Level 3 assets /liabilities outstanding as at 31 December 2011 (2) $'000
Financial assets designated at fair value through profit or loss:								
Prepaid equity securities contracts	167,315	(3,467)	29,044	-	(75,943)	(41,645)	75,304	(1,749)
Total financial assets measured at fair value	167,315	(3,467)	29,044	-	(75,943)	(41,645)	75,304	(1,749)
Financial liabilities designated at fair value through profit or loss:								
Issued structured notes	(167,315)	3,467	-	(29,044)	75,943	41,645	(75,304)	1,749
Total financial liabilities measured at fair value	(167,315)	3,467	-	(29,044)	75,943	41,645	(75,304)	1,749

(1) 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.

(2) Amounts represent unrealised gains or (losses) for the year ended 31 December 2011 related to assets and liabilities still outstanding at 31 December 2011. The unrealised gains or (losses) are recognised in the statement of comprehensive income as detailed in the financial instruments accounting policy (note 3c)

During 2011, the Company reclassified approximately $1,314,000 of prepaid equity securities contracts and $1,314,000 of 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 2011, the Company reclassified approximately $42,959,000 of prepaid equity securities contracts and $42,959,000 of 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 the fair value measurement.

c. Significant transfers between Level 1 and Level 2 of the fair value hierarchy

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

13. FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE (CONTINUED)

d. 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 disclosure above. 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, 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 as at 31 December 2012 to reasonably possible alternative assumptions.

31 December 2012		**Effect of reasonably possible alternative assumptions**	
	Fair value $'000	**Increase in fair value $'000**	**Decrease in fair value $'000**
Financial assets designated at fair value through profit or loss:			
Prepaid equity securities contracts	73,409	1,911	(1,797)
Financial liabilities designated at fair value through profit or loss:			
Issued structured notes	(73,409)	(1,911)	1,797

31 December 2011		**Effect of reasonably possible alternative assumptions**	
	Fair value $'000	**Increase in fair value $'000**	**Decrease in fair value $'000**
Financial assets designated at fair value through profit or loss:			
Prepaid equity securities contracts	75,304	1,876	(1,417)
Financial liabilities designated at fair value through profit or loss:			
Issued structured notes	(75,304)	(1,876)	1,417

14. FINANCIAL INSTRUMENTS NOT MEASURED AT FAIR VALUE

For all financial assets and financial liabilities 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 financial assets and financial liabilities.

15. CAPITAL MANAGEMENT

The Morgan Stanley Group manages its capital on a global basis with consideration for its legal entities. The capital managed by the Morgan Stanley Group broadly includes ordinary share capital, preference share capital, subordinated loans and reserves.

The Morgan Stanley Group's required capital estimation is based on the Required Capital Framework, an internal capital adequacy measure. The framework is a risk-based internal use of capital measure, which is compared with the Morgan Stanley Group's regulatory capital to help ensure the Morgan Stanley Group maintains an amount of risk-based going concern capital after absorbing potential losses from extreme stress events where applicable, at a point in time. The difference between the Morgan Stanley Group's regulatory capital and aggregate Required Capital is the Morgan Stanley Group's Parent capital.

The Required Capital Framework will evolve over time in response to changes in the business and regulatory environment and to incorporate enhancements in modelling techniques.

The Morgan Stanley Group actively manages its consolidated capital position based upon, among other things, business opportunities, risks, capital availability and rates of return together with internal capital policies, regulatory requirements and rating agency guidelines and, therefore, in the future may expand or contract its capital base to address the changing needs of its businesses.

The Morgan Stanley Group also aims to adequately capitalise at a legal entity level whilst safeguarding that entity's ability to continue as a going concern and ensuring that it meets all regulatory capital requirements, so that it can continue to provide returns for the Morgan Stanley Group.

In order to maintain or adjust the capital structure as described above, the Company may adjust the amount of dividends paid, return capital to shareholders, issue new shares, or sell assets to reduce debt.

The Company manages the following items as capital:

	2012 $'000	2011 $'000
Stated capital	14	14
Reserves	442	442
	456	456

16. RELATED PARTY DISCLOSURES

Parent and ultimate controlling entity

The Company's immediate and ultimate parent undertaking and controlling entity and the smallest and largest group of which the Company is a member and for which group financial statements are prepared is Morgan Stanley. Morgan Stanley is incorporated in the state of Delaware, the United States of America and copies of its financial statements can be obtained from www.morganstanley.com/investorrelations.

Key management compensation

Key management personnel are defined as those persons having authority and responsibility for planning, directing and controlling the activities of the Company. Key management personnel includes the Board of Directors of the Company.

16. RELATED PARTY DISCLOSURES (CONTINUED)

Key management compensation (continued)

Compensation paid to key management personnel in respect of their services rendered to the Company is:

	2012 $'000	2011 $'000
Short-term employee benefits	4	5
Other long-term employee benefits	1	1
	5	6

Key management personnel compensation is borne by other Morgan Stanley Group undertakings in both the current and prior years.

Alternate directors

Each of G.P. Essex-Cater, C. Ruark, H.C. Grant, D.M. Godwin, F.X.A. Chesnay and S.M. Vardon is or was an employee of a subsidiary of State Street Corporation ("SSC"). Affiliates of SSC provide administrative services to the Company at commercial rates.

During the year $70,000 (2011: $197,000) was payable in respect of administrative services of which no fees were outstanding at the year end. These amounts are borne by another Morgan Stanley Group undertaking in the current and prior year.

Transactions with related parties

The Morgan Stanley Group conducts business for clients globally through a combination of both functional and legal entity organisational structures. Accordingly, the Company is closely integrated with the operations of the Morgan Stanley Group and enters into transactions with other Morgan Stanley Group undertakings on an arm's length basis for the purposes of utilising financing, trading and risk management, and infrastructure services. The nature of these relationships along with information about the transactions and outstanding balances is given below. The Company has not recognised any expense and has made no provision for impairment relating to the amount of outstanding balances from related parties (2011: $nil).

Funding

The Company receives general funding from and provides general funding to other Morgan Stanley Group undertakings.

General funding is undated, unsecured, floating rate lending. Funding may be received or provided for specific transaction related funding requirements, or for general operational purposes. The interest rates are established by the Morgan Stanley Group Treasury function for all entities within the Morgan Stanley Group and approximate the market rate of interest that the Morgan Stanley Group incurs in funding its business.

16. RELATED PARTY DISCLOSURES (CONTINUED)

Transactions with related parties (continued)

Details of the outstanding balances on these funding arrangements and the related interest income or expense recognised in the statement of comprehensive income during the year are shown in the table below:

	2012 Interest $'000	2012 Balance $'000	2011 Interest $'000	2011 Balance $'000
Amounts due from the Company's direct parent undertakings	-	-	58	1
Amounts due from other Morgan Stanley Group undertakings	91	2,912	13	7,170
	91	2,912	71	7,171
Amounts due to the Company's direct parent undertakings	81	3,456	15	3,286
Amounts due to other Morgan Stanley Group undertakings	10	541	56	3,492
	91	3,997	71	6,778

Trading and risk management

On the issuance of financial instruments, the Company enters into hedges of the obligations by purchasing financial instruments from other Morgan Stanley Group undertakings. All such transactions are entered into on an arm's length basis. The total amounts receivable and payable on these financial instruments were as follows:

	2012 Interest $'000	2012 Balance $'000	2011 Interest $'000	2011 Balance $'000
Amounts due from other Morgan Stanley Group undertakings	-	599,160	1,681	697,417
Amounts due to other Morgan Stanley Group undertakings	-	559,653	1,681	628,397

Included in 'Amounts due to other Morgan Stanley Group undertakings' is an amount of $11,368,000 in relation to the cash collateral received from another Morgan Stanley Group undertaking, against the receivable on certain prepaid equity securities contracts held.

In addition, the management and execution of business strategies on a global basis results in many Morgan Stanley transactions impacting a number of Morgan Stanley Group undertakings. The Morgan Stanley Group operates a number of intra-group policies to ensure that, where possible, revenues and related costs are matched. For the year ended 31 December 2012, a loss of $418,000 was recognised in the statement of comprehensive income arising from such policies (2011: loss of $71,000).

16. RELATED PARTY DISCLOSURES (CONTINUED)

Transactions with related parties (continued)

Infrastructure services

In the current and prior year the Company uses infrastructure services, including the provision of office facilities, operated by other Morgan Stanley Group undertakings at no charge. In addition, as disclosed in note 5, the audit fees have been borne by another Morgan Stanley Group undertaking.