

**Registered Number: 2164628**

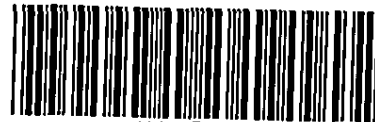
Registered Office  
25 Cabot Square  
Canary Wharf  
London E14 4QA

**MORGAN STANLEY & CO. LIMITED**

**Report and financial statements**

**31 December 2009**

THURSDAY



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# **MORGAN STANLEY & CO. LIMITED**

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# **MORGAN STANLEY & CO. LIMITED**

## **DIRECTORS' REPORT**

The Directors present their report and financial statements (which comprise the profit and loss account, the statement of total recognised gains and losses, the balance sheet, and the related notes, 1 to 22) for Morgan Stanley & Co Limited (the "Company") for the year ended 31 December 2009. The prior accounting period is a thirteen month period to 31 December 2008 due to a change in the accounting reference date in the prior period.

## **RESULTS AND DIVIDENDS**

The profit for the year, after tax, was \$181,233,000 (2008: \$212,738,000 profit after tax).

During the year no dividends were paid or proposed (2008: \$17,093,000).

## **PRINCIPAL ACTIVITY**

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".

The principal activity of the Company is the provision of financial services to corporations and financial institutions.

The Company is authorised and regulated by the Financial Services Authority ("FSA").

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**

The profit and loss account for the year is set out on page 7. The Company made a profit on ordinary activities before tax of \$181,164,000, a decrease of \$34,805,000 or 16% compared to the 13 months to 31 December 2008. The reduction of \$430,000,000 of non-cumulative preference share capital, which was funded by the repayment to the Company of a long-term loan, led to net interest income falling between the two periods. There were no net gains on Available-for-sale Financial Assets in 2009 as the related asset was sold in 2008, and there was a fall of \$13,454,000 in the level of other income in 2009 compared to 2008, due mainly to a reduction in Fee and commission income.

The balance sheet is set out on page 9 of the financial statements. Shareholders' funds at the end of the year were \$817,598,000, a decrease of \$248,767,000 or 23% over the prior period. The fall in shareholders' funds was driven by the \$430,000,000 reduction in non-cumulative preference share capital, offset by profit for the year, after tax, of \$181,233,000.

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 performance indicators for the Company itself would not enhance an understanding of the development, performance or position of the business of the Company.

### **Current market conditions**

During the second half of 2009, global market and economic conditions improved and global capital markets began to recover from the severe downturn that occurred at the end of 2008. Economic conditions however continue to be challenging. These conditions present difficulties and uncertainty for the business outlook which may adversely impact the financial performance of the Company in the future.

During the year ending 31 December 2008, the Morgan Stanley Group took certain steps to respond to the stresses experienced in the global financial markets at the end of 2008 and to strengthen the Morgan Stanley Group's overall capital and liquidity position, including participation in the US Government's Troubled Asset Relief Program ("TARP"). In mid 2009, as a result of its strong capital position, Morgan Stanley received approval from the US Treasury to repay the \$10 billion TARP investment received in 2008. 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 its subsidiary entities. 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.

# MORGAN STANLEY & CO. LIMITED

## DIRECTORS' REPORT (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.

#### *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 in consideration of each individual legal entity, but on a global basis, at both a trading division and an individual product level.

#### *Credit risk*

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

The Morgan Stanley Group manages credit risk exposure on a global basis as well as giving consideration to each individual legal entity. 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 risk*

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 Morgan Stanley Group's senior management establishes the overall liquidity and capital policies of the Morgan Stanley Group. The Morgan Stanley Group's liquidity and funding risk management policies are designed to mitigate the potential risk that the Morgan Stanley Group and the Company may be unable to access adequate financing to service its financial obligations without material franchise or business impact. The key objectives of the liquidity and funding risk management framework are to support the successful execution of the Morgan Stanley Group's and the Company's business strategies while ensuring sufficient liquidity through the business cycle and during periods of stressed market conditions. The Morgan Stanley Group has established regional committees to oversee the activities of its subsidiaries from a regional perspective.

#### *Basel II Pillar 3 disclosures*

The disclosures made in order to comply with the Financial Services Authority's rules, which implement in the UK the EU Directives underlying the revised capital adequacy framework, are available on the Morgan Stanley website.

## DIRECTORS

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

|               |                             |
|---------------|-----------------------------|
| M Colicci     | (appointed 21 October 2009) |
| F R Petugas   |                             |
| S C T Robey   |                             |
| R S Rosenthal |                             |
| D G Turowski  | (appointed 21 May 2009)     |

## DIRECTORS' LIABILITY INSURANCE

Qualifying indemnity provisions (as defined in section 234 of the Companies Act 2006) were in force during the year and at the date of the Directors' report for the benefit of all the Directors of the Company under a Directors' and Officers' Liability Insurance policy taken out by Morgan Stanley, the Company's ultimate parent company.

# **MORGAN STANLEY & CO. LIMITED**

## **DIRECTORS' REPORT (CONTINUED)**

### **POST BALANCE SHEET EVENTS**

On 9 December 2009 the UK government announced proposed legislation in its Pre-Budget Report imposing a Bank Payroll Tax. The legislation was enacted on 8 April 2010 as part of the Finance Act. The tax applies to discretionary bonuses over a certain amount awarded to certain employees within scope ("Banking Employees") in the period from 9 December 2009 to 5 April 2010. The liability for the tax will be that of the entity that benefits from the services of the Banking Employees, rather than the employing entity. The Company is still evaluating the impact of this legislation and has recognised a charge of \$24,821,000 in 2010, when the legislation was enacted, based on the minimum amount currently estimated will be payable by the Company in August 2010. Due to the ongoing uncertainties regarding the application, scope and implementation of the legislation, the final payment amount may differ from this estimated financial effect.

### **AUDITORS**

Deloitte LLP have expressed their willingness to continue in office as auditors of the Company and, under Sections 485 to 488 of the Companies Act 2006, will be deemed to be re-appointed.

#### **Statement as to disclosure of information to auditors**

Each of the persons who are Directors of the Company at the date when this report is approved confirms that

- so far as each of the Directors is aware, there is no relevant audit information (being information needed by the Company's auditors in connection with preparing their report) of which the Company's auditors are unaware, and
- each of the Directors has taken all the steps that he/she ought to have taken as a Director to make himself/herself aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of s418 of the Companies Act 2006.

### **STATEMENT OF DIRECTORS' RESPONSIBILITIES**

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

Company law requires the Directors to prepare financial statements for each financial year. Under that law the Directors have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom accounting standards and applicable law). Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing these financial statements, the Directors are required to

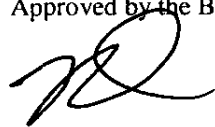
- select suitable accounting policies and then apply them consistently,
- make judgements and accounting estimates that are reasonable and prudent,
- state whether applicable UK accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements, and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

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 the Companies Act 2006. 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.

**MORGAN STANLEY & CO. LIMITED**

**DIRECTORS' REPORT (CONTINUED)**

Approved by the Board and signed on its behalf by **RICHARD ROSENTHAL**

A handwritten signature in black ink, appearing to be 'RR' or a stylized 'R' followed by a '2'.

Director

23 April 2010

## **INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF MORGAN STANLEY & CO. LIMITED**

We have audited the financial statements of Morgan Stanley & Co Limited for the year ended 31 December 2009 which comprise the Profit and Loss Account, the Balance Sheet, the Statement of Total Recognised Gains and Losses and the related notes 1 to 22. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. 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 auditors' 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 auditors**

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 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 (APB'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.

### **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 2009 and of its profit for the year then ended,
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice, and
- have been prepared in accordance with the requirements of the Companies Act 2006.

### **Opinion on other matter prescribed by the Companies Act 2006**

In our opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

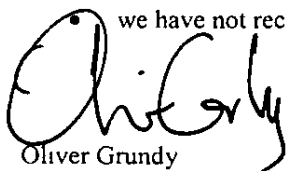
## **INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF MORGAN STANLEY & CO. LIMITED (CONTINUED)**

### **Matters on which we are required to report by exception**

We have nothing to report in respect of the following matters where the Companies Act 2006 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
- certain disclosures of directors' remuneration specified by law are not made, or

- we have not received all the information and explanations we require for our audit



Oliver Grundy

(Senior Statutory Auditor)

for and on behalf of Deloitte LLP

Chartered Accountants and Statutory Auditors

London, England

23, April 2010



# MORGAN STANLEY & CO. LIMITED

## PROFIT AND LOSS ACCOUNT Year ended 31 December 2009

|  | Note | Year ended<br>31 December<br>2009<br>\$'000 | 1 December<br>2007 to 31<br>December<br>2008<br>\$'000 |
|--|------|---|--|
| Net gains on fixed asset investments                     |      |   |  |
| - Available-for-sale financial assets                    | 2    | -   | 6,386  |
| Interest income  | 3    | 25,122                                      | 55,971   |
| Interest expense   | 4    | (5,665)                                     | (20,111)   |
| Other income   | 5    | 588,870                                     | 602,324  |
| Other expense  | 6    | (427,163)                                   | (428,601)  |
| <b>PROFIT ON ORDINARY ACTIVITIES<br/>BEFORE TAXATION</b> |      | <b>181,164</b>                              | <b>215,969</b>   |
| Tax credit/(charge) on profit on ordinary activities     | 9    | 69  | (3,231)  |
| <b>PROFIT FOR THE FINANCIAL PERIOD</b>                   |      | <b>181,233</b>                              | <b>212,738</b>   |

All operations were continuing in the current year and prior period

A reconciliation of the movement in shareholders' funds is disclosed in note 18 to the financial statements

The notes on pages 10 to 22 form an integral part of the financial statements

# MORGAN STANLEY & CO. LIMITED

## STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES Year ended 31 December 2009

|  | Note | Year ended<br>31 December<br>2009<br>\$'000 | 1 December<br>2007 to 31<br>December<br>2008<br>\$'000 |
|--|------|---|--|
| <b>PROFIT FOR THE FINANCIAL PERIOD</b>   |      | 181,233                                     | 212,738  |
| Fair value reserve   |      |   |  |
| Net change in fair value of available-for-sale financial<br>assets recognised directly in equity |      | -   | 6,386  |
| Net amount transferred to profit and loss account  |      | -   | (6,386)  |
| <b>TOTAL RECOGNISED GAINS AND LOSSES<br/>RELATING TO THE PERIOD</b>                              | 18   | <u>181,233</u>                              | <u>212,738</u>   |

**MORGAN STANLEY & CO. LIMITED**

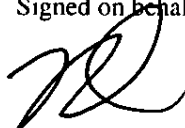
Registered Number 2164628

**BALANCE SHEET****As at 31 December 2009**

|   | Note | 2009<br>\$'000 | 2008<br>\$'000   |
|---|------|----------------|------------------|
| <b>FIXED ASSETS</b>                                       |      |                |                  |
| Investments   |      |                |                  |
| - Subsidiary and associated undertakings                  | 10   | -              | -                |
|   |      | <u>-</u>       | <u>-</u>         |
| <b>CURRENT ASSETS</b>                                     |      |                |                  |
| Loans and receivables                                     |      |                |                  |
| - Debtors   | 11   | 947,315        | 1,223,626        |
| - Cash at bank  |      | -              | 906              |
| Other assets  | 12   | 1,252          | 2,808            |
|   |      | <u>948,567</u> | <u>1,227,340</u> |
| <b>CREDITORS: AMOUNTS FALLING DUE<br/>WITHIN ONE YEAR</b> |      |                |                  |
| Financial liabilities at amortised cost                   | 14   | (113,342)      | (145,688)        |
| Other creditors   | 15   | (17,240)       | (14,844)         |
|   |      | <u>-</u>       | <u>-</u>         |
| <b>NET CURRENT ASSETS</b>                                 |      | <u>817,985</u> | <u>1,066,808</u> |
| <b>PROVISIONS FOR LIABILITIES AND CHARGES</b>             | 16   | (387)          | (443)            |
|   |      | <u>-</u>       | <u>-</u>         |
| <b>NET ASSETS</b>   |      | <u>817,598</u> | <u>1,066,365</u> |
| <b>CAPITAL AND RESERVES</b>                               |      |                |                  |
| Called up share capital                                   | 17   | 11,001         | 441,001          |
| Profit and loss account                                   | 18   | 806,597        | 625,364          |
|   |      | <u>-</u>       | <u>-</u>         |
| <b>SHAREHOLDERS' FUNDS</b>                                |      | <u>817,598</u> | <u>1,066,365</u> |

These financial statements were approved by the Board and authorised for issue on 23 April 2010

Signed on behalf of the Board


Director **RICHARD ROSENTHAL****23 APRIL 2010**

The notes on pages 10 to 22 form an integral part of the financial statements

**NOTES TO THE FINANCIAL STATEMENTS**  
**Year ended 31 December 2009**

**1. ACCOUNTING POLICIES**

The Company's principal accounting policies are summarised below and have been applied consistently throughout the year and preceding period

**a) Basis of preparation**

The financial statements are prepared under the historical cost convention, modified by the inclusion of financial instruments at fair value as described in note 1(f) below, and in accordance with applicable United Kingdom company law and accounting standards

Certain limited format changes have been made to prior year amounts to conform to the current year presentation

The Company is not required to prepare consolidated financial statements by virtue of the exemption under Section 400 of the Companies Act 2006. The results of the Company are included within the financial statements of Morgan Stanley International Limited, a company registered in England and Wales, which will prepare consolidated financial statements for the year to 31 December 2009. The financial statements therefore present information about the Company as an individual entity and not about its group

The Company's ultimate UK parent undertaking, Morgan Stanley International Limited, presents information in accordance with FRS 29 *Financial Instruments Disclosures*. Accordingly, the Company is exempt from the disclosure requirements of FRS 29

In the prior period the Company changed its accounting reference date from 30 November to 31 December to align with the changed year end of its ultimate parent undertaking, Morgan Stanley. The change resulted in the Company reporting a period of thirteen months to 31 December 2008. The comparative figures reflected in these financial statements are for the thirteen month period to 31 December 2008 as previously reported and therefore are not entirely comparable with amounts shown for the current year

**b) The going concern assumption**

The Company's business activities, together with the factors likely to affect its future development, performance and position are set out in the Business Review section of the Directors' report on pages 1 to 3

As set out in the Directors' report, the Company operates within the global liquidity management framework of the Morgan Stanley Group. Throughout the difficult market conditions, this framework has continued to provide sufficient liquidity to the Group and to the Company, and the Company's capital and liquidity position is satisfactory

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

**c) 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 Directors' report and the financial statements are rounded to the nearest thousand US dollars

**NOTES TO THE FINANCIAL STATEMENTS**  
**Year ended 31 December 2009**

**1. ACCOUNTING POLICIES (CONTINUED)**

**d) 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 balance sheet date. Transactions in currencies other than US dollars are recorded at the rates prevailing at the dates of the transactions. Foreign exchange differences on financial investments classified as available-for-sale are recorded in the 'Fair value reserve' in equity, with the exception of translation differences on the amortised cost of the monetary available-for-sale assets, which are recognised through the profit and loss account. All other translation differences are taken through the profit and loss account. Exchange differences recognised in the profit and loss account are presented in 'Other income' or 'Other expense', except where noted in 1(e) below.

**e) Financial instruments**

The Company classifies its financial assets into the following categories on initial recognition: financial assets classified as held for trading, available-for-sale fixed asset investments, other fixed asset investments and loans and receivables.

The Company classifies its financial liabilities into the following categories on initial recognition: financial liabilities classified as held for trading, and financial liabilities at amortised cost.

More information regarding these classifications is included below.

**i) Financial instruments classified as held for trading**

Financial instruments classified as held for trading, including all derivatives, are initially recorded on trade date at fair value (see note 1(f) below). All subsequent related gains and losses, including foreign exchange differences, interest and dividends, are reflected in the profit and loss account in 'Net gains/ (losses) on financial instruments classified as held for trading'. Transaction costs are excluded from the initial and subsequent fair value measurement of the financial instrument. These costs are recognised in the profit and loss account in 'Other expense'.

**ii) Available-for-sale fixed asset investments**

Fixed asset investments categorised as available-for-sale are recorded on trade date and are initially recognised and subsequently measured at fair value (see note 1(f) below).

For equity instruments, dividend income and impairment losses are recorded in the profit and loss account in 'Net gains/ (losses) on fixed asset investments in available-for-sale financial assets'. All other gains and losses on debt and equity instruments classified as available-for-sale are recognised in the 'Fair value reserve' in equity.

Transaction costs that are directly attributable to the acquisition of the available-for-sale fixed asset investment are added to the fair value on initial recognition.

On disposal or impairment of an available-for-sale fixed asset investment, the cumulative gain or loss in the 'Fair value reserve' is transferred to and recognised in the profit and loss account and reported in 'Net gains/ (losses) on fixed asset investments in available-for-sale financial assets'.

## NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2009

### 1. ACCOUNTING POLICIES (CONTINUED)

#### iii) Investments in subsidiary and associated undertakings

Investments in subsidiary and associated undertakings outside the scope of FRS 26 *Financial instruments recognition and measurement* ("FRS 26"), are recorded within 'Investments in subsidiary and associated undertakings' and are stated at cost, less provision for any impairment. Interest (recognised on an accruals basis), dividend income (recognised when the Company's right to receive payment is established), impairment losses, reversals of impairment losses, and foreign exchange differences on monetary investments are all reported in the profit and loss account in 'Net gains/ (losses) on fixed asset investments in subsidiary and associated undertakings'.

All other investments in Morgan Stanley Group undertakings are classified as available-for-sale fixed asset investments and accounted for as described in note 1(e)(ii).

#### iv) Loans and receivables and financial liabilities at amortised cost

Financial assets categorised as loans and receivables are initially recognised on settlement date at fair value (see note 1(f) below) and subsequently measured at amortised cost less allowance for impairment. Interest is recognised in the profit and loss account in 'Interest income', using the effective interest rate method. Transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability are added to or deducted from the fair value on initial recognition.

The effective interest method is a method of calculating the amortised cost of a financial asset or financial liability (or 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 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 liability.

Impairment losses, reversals of impairment losses and foreign exchange differences on financial assets classified as loans and receivables are recognised in the profit and loss account in either 'Other expense' or 'Other income' as appropriate.

Financial liabilities held at amortised cost are initially recognised on settlement date at fair value (see note 1(f) below) and subsequently measured at amortised cost. Interest is recognised in the profit and loss account in 'Interest expense' using the effective interest rate method as described above. Foreign exchange differences on financial liabilities held at amortised cost are recognised in the profit and loss account in 'Other income' or 'Other expense' as appropriate.

In the course of financing its business and as part of its trading activities, the Company enters into arrangements which involve the sale of securities with agreements to repurchase, the purchase of securities with resale agreements, the lending of securities with collateral received and the borrowing of securities with collateral given. Cash collateral balances repayable and accrued interest arising under repurchase agreements and securities lending arrangements are classified as 'Financial liabilities at amortised cost' and the related securities, where owned by the Company, are included in 'Financial assets classified as held for trading'. Cash collateral balances receivable and accrued interest arising under resale agreements and securities borrowing arrangements are classified as debtors within 'Loans and receivables'. Securities received by the Company under resale arrangements and securities borrowing arrangements are generally not recognised on the balance sheet.

#### f) 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.

**NOTES TO THE FINANCIAL STATEMENTS**

**Year ended 31 December 2009**

**1. ACCOUNTING POLICIES (CONTINUED)**

In determining fair value, the Company uses various valuation approaches. A hierarchy of inputs is used in measuring fair value that maximises the use of 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 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 the markets and other characteristics particular to the transaction. 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 uses 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 financial instruments, including over-the-counter ("OTC") financial instruments, is derived using pricing models. Pricing models take into account the contract terms (including the maturity), as well as multiple inputs including, where applicable, equity prices, interest rate yield curves, credit curves, correlation, creditworthiness of the counterparty, option volatility and currency rates. The impact of the Company's own credit spreads is also considered when measuring the fair value of liabilities, including OTC derivative contracts. Where appropriate, valuation adjustments are made to account for various factors such as liquidity risk (bid-ask adjustments), credit quality and model uncertainty. These adjustments are subject to judgement, are applied on a consistent basis and are based upon observable inputs where available. The Company generally subjects all valuations and models to a review process initially and on a periodic basis thereafter.

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.

Depending on the product and the terms of the transaction, the fair value of OTC financial instruments can be modelled using a series of techniques, including closed-form analytic formulae such as the Black-Scholes option pricing model, simulation models or a combination thereof. Many pricing models do not entail material subjectivity because the methodologies employed do not necessitate significant judgement, and the pricing inputs are observed from actively quoted markets. In the case of more established derivative products, the pricing models used by the Company are widely accepted by the financial services industry.

*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 change in fair value indicated by the valuation technique as at the transaction date is not recognised immediately in the profit and loss account and is recognised instead when the market data becomes observable.

**NOTES TO THE FINANCIAL STATEMENTS**

**Year ended 31 December 2009**

**1. ACCOUNTING POLICIES (CONTINUED)**

**g) Impairment of financial assets**

At each balance sheet date, an assessment is made as to whether there is any objective evidence of impairment in the value of financial assets classified as available-for-sale fixed asset investments, other fixed asset investments or 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.

Impairment losses on available-for-sale fixed asset investments are measured as the difference between cost (net of any principal repayment and amortisation) and the current fair value. When a decline in the fair value of an available-for-sale financial asset has been recognised through the statement of total recognised gains and losses and there is evidence that the asset is impaired, the cumulative loss that had been recognised through the statement of total recognised gains and losses is removed from reserves and recognised in the profit and loss account within 'Net gains and losses on fixed asset investments in available-for-sale financial assets'.

Impairment losses on fixed asset investments in subsidiary and associated undertakings, measured as the difference between cost and the current estimated recoverable amount, are recognised within the profit and loss account in 'Net gains and losses on fixed asset investments in subsidiary and associated undertakings' and are reflected against the carrying amount of the impaired asset on the balance sheet.

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 profit and loss account within 'Other expenses' and are reflected against the carrying amount of the impaired asset on the balance sheet. Interest on the impaired asset continues to be accrued on the reduced carrying amount based on the original effective interest rate of the asset.

Subsequent increases in fair value of previously impaired equity available-for-sale financial assets are reported as fair value gains in the profit and loss account and not separately identified as an impairment reversal. For all other financial assets, if in a subsequent year, 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 1(e)(ii, iii and iv).

**h) Fees and commissions**

Fees and commissions classified within 'Other income' in the profit and loss account include advisory fees. These amounts are recognised as the related services are performed.

**i) Taxation**

UK corporation tax is provided at amounts expected to be paid / recovered using the tax rates and laws that have been enacted or substantively enacted at the balance sheet date.

Full provision has been made for deferred tax assets and liabilities arising from timing differences. Deferred tax is measured using the average tax rates that are expected to apply in the periods in which the timing differences are expected to reverse, based on tax rates and laws that have been enacted or substantively enacted by the balance sheet date. Deferred tax assets are recognised to the extent that it is regarded as more likely than not that they will be recovered. Deferred tax assets and liabilities are not discounted.

**j) Cash flow statement**

The Company's ultimate parent undertaking produces a cash flow statement. Accordingly, the Company, which is a wholly-owned subsidiary, has elected to avail itself of the exemption provided in FRS 1 (Revised 1996) *Cash Flow Statements* and not present a cash flow statement.



# MORGAN STANLEY & CO. LIMITED

## NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2009

### 2. NET GAINS ON INVESTMENTS IN AVAILABLE-FOR-SALE FINANCIAL ASSETS

|   | Year ended<br>31<br>December<br>2009<br>\$'000 | 1<br>December<br>2007 to 31<br>December<br>2008<br>\$'000 |
|---|--|---|
| Net fair value gains transferred from the fair value reserve on disposal of asset | -  | 6,386   |
|   | <u>-</u>                                       | <u>6,386</u>  |

### 3. INTEREST INCOME

|   | Year<br>ended 31<br>December<br>2009<br>\$'000 | 1<br>December<br>2007 to 31<br>December<br>2008<br>\$'000 |
|---|--|---|
| Interest income from loans to Morgan Stanley Group undertakings | 25,122   | 55,971  |
|   | <u>25,122</u>                                  | <u>55,971</u>   |

### 4. INTEREST EXPENSE

|  | Year<br>ended 31<br>December<br>2009<br>\$'000 | 1<br>December<br>2007 to 31<br>December<br>2008<br>\$'000 |
|--|--|---|
| Interest expense on loans from Morgan Stanley Group undertakings | 5,665  | 20,111  |
|  | <u>5,665</u>                                   | <u>20,111</u>   |

### 5. OTHER INCOME

|                              | Year<br>ended 31<br>December<br>2009<br>\$'000 | 1<br>December<br>2007 to 31<br>December<br>2008<br>\$'000 |
|------------------------------|--|---|
| Fee and commission income    | 588,771  | 601,655   |
| Other foreign exchange gains | 99   | 669   |
|                              | <u>588,870</u>                                 | <u>602,324</u>  |

# MORGAN STANLEY & CO. LIMITED

## NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2009

### 6. OTHER EXPENSE

|   | Year<br>ended 31<br>December<br>2009<br>\$'000 | 1<br>December<br>2007 to 31<br>December<br>2008<br>\$'000 |
|---|--|---|
| Staff costs (note 7)  | 280,569  | 216,245   |
| Auditors' remuneration – fees for audit of statutory accounts | 42   | 69  |
| Other expenses  | 146,552  | 212,287   |
|   | <u>427,163</u>                                 | <u>428,601</u>  |

#### Non-audit fees

The Company's ultimate UK parent undertaking, Morgan Stanley International Limited, prepares consolidated financial statements, which include disclosure of fees paid to the Company's auditors for non-audit services. Accordingly, the Company is exempt from disclosing fees payable to the Company's auditors for non-audit services to the Company.

### 7. STAFF COSTS

The Company employed no staff during the year but incurred management charges in respect of staff costs from other Morgan Stanley Group undertakings. Recharges in respect of staff costs totalled \$280,569,000 (2008: \$216,245,000) and are recognised in 'Other expense'.

The Company paid no remuneration to its Directors during the current year or prior period but incurred management charges in respect of Directors' services provided to the Company. The amount of remuneration received by Directors in respect of their services to the Company is disclosed in note 8.

### 8. DIRECTORS' BENEFITS

|   | Year<br>ended 31<br>December<br>2009<br>\$'000 | 1<br>December<br>2007 to 31<br>December<br>2008<br>\$'000 |
|---|--|---|
| <b>Total emoluments of all Directors:</b>                       |  |   |
| Aggregate emoluments  | 5,172  | 5,980   |
| Long term incentive schemes                                     | 167  | 77  |
| Company contributions to pension schemes                        | <u>52</u>                                      | <u>70</u>   |
| <br><b>Disclosures in respect of the highest paid Director:</b> |  |   |
| Aggregate emoluments  | 2,236  | 2,144   |
| Long term incentive schemes                                     | 42   | 77  |
| Company pension contributions to a money purchase scheme        | <u>20</u>                                      | <u>19</u>   |

# MORGAN STANLEY & CO. LIMITED

## NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2009

### 8. DIRECTORS' BENEFITS (CONTINUED)

Directors' emoluments have been calculated as the sum of cash, bonuses, and benefits in kind

All Directors who are employees of the Morgan Stanley Group are eligible for shares and share options of the parent company, Morgan Stanley, awarded under the Morgan Stanley Group's equity based long term incentive schemes. In accordance with Schedule 5 paragraph 1(3)(a) of The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008, the above disclosures include neither the value of shares or share options awarded, nor the gains made on exercise of share options. During the year no Directors exercised share options awarded under these incentive schemes, including the highest paid Director (2008: two)

The value of assets (other than shares or share options) awarded under other long term incentive schemes has been included in the above disclosures when the awards vest, which is generally within three years from the date of the award

There are five Directors to whom retirement benefits are accruing under a money purchase scheme (2008: four). Two Directors have benefits accruing under the US defined benefits scheme (2008: two). The Morgan Stanley UK Group Pension Plan operated a defined benefit pension scheme, which closed in September 1996. No Directors have deferred defined benefits under the scheme (2008: one)

The Company has provided no advances and credit to its Directors during the year

### 9. TAX ON PROFIT ON ORDINARY ACTIVITIES

Analysis of (credit)/charge in the period

|   | Year<br>ended 31<br>December<br>2009<br>\$'000 | 1<br>December<br>2007 to 31<br>December<br>2008<br>\$'000 |
|---|--|---|
| UK corporation tax at 28% (2008: 28.62%)                    |  |   |
| - Current period  | -  | -   |
| - Adjustment in respect of prior periods                    | -  | 3,309   |
| <b>Total current tax</b>                                    | <b>-</b>                                       | <b>3,309</b>  |
| Deferred taxation   |  |   |
| - Current period  | (41)   | (34)  |
| - Adjustment in respect of prior periods                    | (28)   | (44)  |
| <b>Total deferred tax</b>                                   | <b>(69)</b>                                    | <b>(78)</b>   |
| <b>Tax (credit)/charge on profit on ordinary activities</b> | <b>(69)</b>                                    | <b>3,231</b>  |

**NOTES TO THE FINANCIAL STATEMENTS**

**Year ended 31 December 2009**

**9. TAX ON PROFIT ON ORDINARY ACTIVITIES (CONTINUED)**

**Factors affecting the tax charge for the period**

The current year UK taxation charge is lower than that resulting from applying the standard UK corporation tax rate of 28% (2008 28.62%). The main differences are explained below

|   | Year<br>ended 31<br>December<br>2009<br>\$'000 | 1<br>December<br>2007 to 31<br>December<br>2008<br>\$'000 |
|---|--|---|
| Profit on ordinary activities before tax  | 181,164  | 215,969   |
| Profit on ordinary activities multiplied by the standard rate of corporation tax in the UK of 28% (2008 28.62%) | 50,726   | 61,810  |
| <b>Effects of:</b>  |  |   |
| Expenses not deductible for tax purposes  | 406  | 1,096   |
| Group relief received for nil consideration   | (55,658)                                       | (58,620)  |
| Adjustments to the tax charge in respect of previous periods  | -  | 3,697   |
| Capital allowances for the year in excess of depreciation   | (15)   | (27)  |
| Non-taxable gain on disposal of fixed assets  | -  | (1,828)   |
| Ten year spreading of FRS 26 transitional adjustment  | 56   | 62  |
| Currency translation on tax   | -  | (388)   |
| Income not subject to UK taxes  | -  | (2,493)   |
| Other   | 4,485  | -   |
| <b>Current tax charge for the period</b>  | <b>-</b>                                       | <b>3,309</b>  |

**10. FIXED ASSET INVESTMENTS**

Movements in fixed asset investments classified as available-for-sale during the year are as follows

|  | 2009<br>\$'000 | 2008<br>\$'000 |
|--|----------------|----------------|
| <b>Fair value</b>                        |                |                |
| At 1 January 2009 and 1 December 2007    | -              | 10,000         |
| Changes in fair value                    |                |                |
| - recognised in the 'Fair value reserve' | -              | 6,386          |
| Disposals and other settlements          | -              | (16,386)       |
| At 31 December                           | -              | -              |

All investments classified as available-for-sale financial assets are unlisted

# MORGAN STANLEY & CO. LIMITED

## NOTES TO THE FINANCIAL STATEMENTS Year ended 31 December 2009

### 10. FIXED ASSET INVESTMENTS (CONTINUED)

#### Fixed asset investments in subsidiary and associated undertakings

Subsidiary  
undertakings  
\$'000

#### Cost and Net Book Value

At 1 January 2009 and 31 December 2009

-

#### Subsidiaries and significant holdings

Details of the investments in which the Company holds more than 20% of the nominal value of any class of share capital, and investments with a book value greater than 20% of the Company's own assets at 31 December 2009, are as follows

| Name of company               | Country of incorporation | Holding | Type of shares held | Proportion of voting rights | Nature of business |
|-------------------------------|--------------------------|---------|---------------------|-----------------------------|--------------------|
| East Sussex Financing Limited | Jersey                   | 100%    | Ordinary            | 100%                        | Holding company    |

The carrying value of this investment is \$100. In the opinion of the Directors, neither the results nor the financial position of any of the Company's subsidiary undertakings has a significant effect on the figures shown in these financial statements. A full list of the Company's subsidiary undertakings will be annexed to the Company's next Annual return and filed with the Registrar of Companies.

### 11. DEBTORS

|  | 2009<br>\$'000 | 2008<br>\$'000   |
|--|----------------|------------------|
| <b>Debtors classified within loans and receivables at amortised cost</b> |                |                  |
| Trade debtors  |                |                  |
| - External counterparties  | 30,153         | 159,391          |
| Other amounts due from Morgan Stanley Group undertakings                 | 917,162        | 1,064,235        |
|  | <u>947,315</u> | <u>1,223,626</u> |

Amounts falling due after more than one year included in the above are as follows

|  | 2009<br>\$'000 | 2008<br>\$'000 |
|--|----------------|----------------|
| Other amounts due from Morgan Stanley Group undertakings | -              | 400,000        |
|  | <u>-</u>       | <u>400,000</u> |

# MORGAN STANLEY & CO. LIMITED

## NOTES TO THE FINANCIAL STATEMENTS Year ended 31 December 2009

### 12. OTHER ASSETS

|                                 | 2009<br>\$'000 | 2008<br>\$'000 |
|---------------------------------|----------------|----------------|
| Deferred taxation (see note 13) | 73             | 60             |
| Other taxes                     | 35             | 609            |
| Prepayments and accrued income  | 1,144          | 2,139          |
|                                 | <u>1,252</u>   | <u>2,808</u>   |

### 13. DEFERRED TAX

Deferred tax has been fully recognised and is analysed as follows

|   | Asset<br>\$'000 | 2009<br>Liability<br>\$'000 | Asset<br>\$'000 | 2008<br>Liability<br>\$'000 |
|---|-----------------|-----------------------------|-----------------|-----------------------------|
| Deferred tax arising on prior year hedges of forecasted currency transactions | -               | (387)                       | -               | (443)                       |
| Accelerated capital allowances  | 73              | -                           | 60              | -                           |
|   | <u>73</u>       | <u>(387)</u>                | <u>60</u>       | <u>(443)</u>                |

The movement in the provision for deferred tax during the year is analysed as follows

|   | Asset<br>\$'000 | Liability<br>\$'000 |
|---|-----------------|---------------------|
| At 1 January 2009                                 | 60              | (443)               |
| Amounts recognised in the profit and loss account |                 |                     |
| - Current year timing differences                 | (15)            | -                   |
| - Prior year timing differences                   | 28              | -                   |
| - Other timing difference                         | -               | 56                  |
| At 31 December 2009                               | <u>73</u>       | <u>(387)</u>        |

### 14. FINANCIAL LIABILITIES AT AMORTISED COST

|  | 2009<br>\$'000 | 2008<br>\$'000 |
|--|----------------|----------------|
| <b>Financial liabilities at amortised cost falling due within one year</b> |                |                |
| Trade creditors  |                |                |
| - External counterparties  | 2              | -              |
| Other amounts owing to Morgan Stanley Group undertakings                   | 113,340        | 145,688        |
|  | <u>113,342</u> | <u>145,688</u> |

# MORGAN STANLEY & CO. LIMITED

## NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2009

### 15. OTHER CREDITORS

|  | 2009<br>\$'000 | 2008<br>\$'000 |
|--|----------------|----------------|
| <b>Amounts falling due within one year</b> |                |                |
| Other taxes                                | 535            | -              |
| Accruals and deferred income               | 16,705         | 14,844         |
|  | <u>17,240</u>  | <u>14,844</u>  |

### 16. PROVISIONS FOR LIABILITIES AND CHARGES

|                     | Deferred<br>Tax (note<br>13)<br>\$'000 |
|---------------------|--|
| At 1 January 2009   | 443                                    |
| Provisions utilised | (56)                                   |
| At 31 December 2009 | <u>387</u>                             |

### 17. CALLED UP SHARE CAPITAL

|  | 2009<br>\$'000 | 2008<br>\$'000 |
|--|----------------|----------------|
| <b>Allotted and fully paid:</b>  |                |                |
| <b>Equity shares</b>   |                |                |
| 1,001,000 ordinary shares of \$1 each                                      | 1,001          | 1,001          |
| 10,000,000 (2008 440,000,000) non-cumulative preference shares of \$1 each | 10,000         | 440,000        |
|  | <u>11,001</u>  | <u>441,001</u> |

#### Equity shares

On 5 June 2009, the board approved the reduction of 430,000,000 non-cumulative preference shares of \$1 each at par. This non-cumulative preference share capital was previously held by a fellow Morgan Stanley group undertaking.

No dividends (2008 \$17,093,000) were paid to the Company's ordinary shareholders.

Dividends on the non-cumulative preference shares are LIBOR based and are paid following a declaration made by the Directors. The timing of the declaration of the dividend payment is entirely at the discretion of the Directors. The shares carry 10% of the voting rights in the Company.

**NOTES TO THE FINANCIAL STATEMENTS**

**Year ended 31 December 2009**

**18. RECONCILIATION OF SHAREHOLDERS' FUNDS AND MOVEMENTS ON RESERVES**

|                                   | <b>Called up<br/>share capital<br/>\$'000</b> | <b>Profit and loss<br/>account<br/>\$'000</b> | <b>Total<br/>\$'000</b> |
|-----------------------------------|---|---|-------------------------|
| At 1 December 2007                | 441,001                                       | 429,719                                       | 870,720                 |
| Total recognised gains and losses | -   | 212,738                                       | 212,738                 |
| Dividends                         | -   | (17,093)                                      | (17,093)                |
|                                   | <u>441,001</u>                                | <u>625,364</u>                                | <u>1,066,365</u>        |
| At 1 January 2009                 |   |   |                         |
| Total recognised gains and losses | -   | 181,233                                       | 181,233                 |
| Reduction of share capital        | (430,000)                                     | -   | (430,000)               |
|                                   | <u>11,001</u>                                 | <u>806,597</u>                                | <u>817,598</u>          |
| At 31 December 2009               |   |   |                         |

**19. SEGMENTAL REPORTING**

The Company has only one class of business as described in the Directors' report and operates in one geographic market, Europe, Middle East and Africa

**20. RELATED PARTY TRANSACTIONS**

The Company is exempt from the requirement to disclose transactions with fellow wholly owned Morgan Stanley Group undertakings under paragraph 3(c) of FRS 8 *Related Party Disclosures*. There were no other related party transactions requiring disclosure.

**21. POST BALANCE SHEET EVENTS**

On 8 April 2010 the UK government enacted legislation as part of the 2010 Finance Act imposing a Bank Payroll Tax. The tax applies to discretionary bonuses over a certain amount awarded to certain employees within scope ("Banking Employees") in the period from 9 December 2009 to 5 April 2010. The liability for the tax will be that of the entity that benefits from the services of the Banking Employees, rather than the employing entity. The Company is still evaluating the impact of this legislation and has recognised a charge of \$24,821,000 in 2010, when the legislation was enacted, based on the minimum amount currently estimated will be payable by the Company in August 2010. Due to the ongoing uncertainties regarding the application, scope and implementation of the legislation, the final payment amount may differ from this estimated financial effect.

**22. PARENT UNDERTAKINGS**

The ultimate parent undertaking and controlling entity and the 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 Delaware, the United States of America and copies of its financial statements can be obtained from 25 Cabot Square, Canary Wharf, London E14 4QA.

The parent undertaking of the smallest group of companies for which group financial statements are drawn up and of which the Company is a member is Morgan Stanley International Limited which is registered in England and Wales. Copies of its financial statements can be obtained from the Registrar of Companies for England and Wales, Companies House, Crown Way, Mandy, Cardiff CF14 3UZ.