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MORGAN STANLEY & CO. INTERNATIONAL plc

Report and financial statements

31 December 2017

MORGAN STANLEY & CO. INTERNATIONAL plc

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STRATEGIC REPORT

The Directors present their Strategic Report for Morgan Stanley & Co. International plc (the "Company") and all of its subsidiary undertakings (together "the Group") for the year ended 31 December 2017.

PRINCIPAL ACTIVITY

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

The Company operates branches in the Dubai International Financial Centre, the Netherlands, Poland, the Qatar Financial Centre, South Korea and Switzerland. On 1 February 2017, the Company transferred the assets and liabilities of the former French branch to Morgan Stanley (France) S.A., a wholly owned subsidiary, following which, the branch was dissolved.

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

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

The Morgan Stanley Group is a global financial services firm that maintains significant market positions in each of its business segments: Institutional Securities, Wealth Management and Investment Management. The Morgan Stanley Group provides a wide variety of products and services to a large and diversified group of clients and customers, including corporations, governments, financial institutions and individuals.

The Group is a key contributor to the execution of the Morgan Stanley Group's Institutional Securities strategy in Europe, the Middle East and Africa ("EMEA"). Institutional Securities provides investment banking, sales and trading, lending and other services to corporations, governments, financial institutions and high to ultra-high net worth clients. Investment banking services consist of capital raising and financial advisory services, including services relating to the underwriting of debt, equity and other securities, as well as advice on mergers and acquisitions, restructurings, real estate and project finance. Sales and trading services include sales, financing and market making activities in equity and fixed income products, including prime brokerage services, global macro, credit and commodities products. Lending services include originating and/or purchasing corporate loans, commercial and residential mortgage loans, asset-backed loans, and financing extended to clients. Other services include research activities.

Certain disclosures required by relevant accounting frameworks in relation to the Company's and Group's financial risk management have been presented alongside other risk management information in this Strategic Report. Such disclosures are identified as audited. All other information in the Strategic Report is unaudited.

REGULATION

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

STRATEGIC REPORT

BUSINESS REVIEW

Global market and economic conditions

Global economic growth accelerated in 2017 and has grown by slightly more than its long-term average rate. Strength was broad-based across both developed economies and emerging markets. Growth was 2.3% in the US, 2.5% in the Euro area and 1.7% in both Japan and the UK. In Emerging markets, Chinese growth proved much more resilient than expected at 6.9%, whilst annual growth in Brazil and Russia returned to positive territory. In terms of policy, the Federal Reserve increased interest rates three times to 1.375% in December and began the process of balance sheet normalisation in October. Shortly before year end, the US government passed a fiscal stimulus package, which included a significant reduction in the headline corporate tax rate and personal income tax cuts. In Europe, the ECB extended its Quantitative Easing program to September 2018 at its October meeting, but halved the size of its monthly purchases to €30 billion from the beginning of 2018. The Bank of England raised interest rates by 25bps at its November meeting amid above target inflation. The Chinese authorities implemented further measures to reduce overcapacity and future financial sector risks, whilst central banks in Brazil and Russia cut interest rates materially in 2017.

UK referendum

On 23 June 2016, the UK electorate voted to leave the EU. On 29 March 2017, the UK invoked Article 50 of the Lisbon Treaty, which triggered a two-year period, subject to extension (which would need the unanimous approval of the EU Member States), during which the UK government is expected to negotiate its withdrawal agreement with the EU. Absent any extension, the UK is expected to leave the EU in March 2019. The terms and conditions of the anticipated withdrawal from the EU, and which of the several alternative models of relationship that the UK might ultimately negotiate with the EU, remain uncertain. However, the UK government has stated that the UK will leave the EU single market and will seek a phased period of implementation for the new relationship that may cover the legal and regulatory framework applicable to financial institutions with significant operations in Europe, such as Morgan Stanley. Since any transition or implementation periods and the eventual successor arrangements require agreement of both the UK and the EU, there is a risk that these arrangements may not be agreed by March 2019.

It is difficult to predict the future of the UK’s relationship with the EU, which uncertainty may increase the volatility in the global financial markets in the short- and medium-term. Potential effects of the UK exit from the EU and potential mitigation actions may vary considerably depending on the timing of withdrawal and the nature of any transition, implementation or successor arrangements. The Group is taking steps to make changes to European operations in an effort to ensure that it can continue to provide cross-border banking and investment services in EU Member States without the need for separate regulatory authorisations in each member state. These changes must be approved by the relevant regulatory authorities and therefore it is currently unclear what the final post-Brexit structure of European operations will be. Depending on the extent to which the Group may be required to make material changes to European operations beyond those currently planned, results of the Group’s operations and business prospects could be negatively affected.

STRATEGIC REPORT

BUSINESS REVIEW (CONTINUED)

Overview of 2017 financial results

The Group's revenues are best reviewed across the aggregate of 'Net gains on financial instruments classified as held for trading', 'Net gains on financial instruments designated at fair value through profit or loss', 'Interest income', 'Interest expense' and 'Other income' ("aggregate revenues").

Set out below is an overview of the Group's financial results for the year ended 31 December 2017 and 31 December 2016:

	Year ended 31 December 2017	Year ended 31 December 2016
	$millions	$millions
Aggregate revenues	**5,703**	**4,458**
Staff related expenses	(1,733)	(1,654)
Non-staff related expenses	(2,692)	(2,069)
Expenses	**(4,425)**	**(3,723)**
Profit before tax	**1,278**	**735**
Income tax expense	(414)	(284)
Profit after tax	**864**	**451**
Total Assets	461,362	423,346
Total Liabilities	442,675	406,543
Total Equity	18,687	16,803

The consolidated income statement for the year is set out on page 55. The Group reported a profit after tax for the year of $864 million, compared to a profit after tax of $451 million for the year ended 31 December 2016 as a result of increased revenues, partially offset by an increase in expenses.

Aggregate revenues for the year increased by 27.9% to $5,703 million compared to $4,458 million in 2016.

The increase in aggregate revenues was primarily driven by increased revenues in the Institutional Equities division and the Investment Banking division partially offset by a decrease in Fixed Income division revenues. In addition, revenues increased in the period as a result of the Group and Morgan Stanley Group updating its Global Transfer Pricing Policy, effective 1 January 2017. This change in transfer pricing policy is consistent with evolving transfer pricing guidance under the Organisation for Economic Co-operation and Development ("OECD")'s and evolving regulatory guidance. The transfer pricing method selected for implementation is one of the methods specified under the 2017 OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations. This new policy is the subject of a multilateral Advanced Pricing Agreement that is currently under review by relevant tax authorities.

The increase in Institutional Equities revenues was primarily driven by Cash Equities as a result of increased client activity, with 2016 having been impacted by challenging market conditions. Prime Brokerage revenues increased due to greater client balances and financing revenues as a result of client growth and market appreciation.

The increase in Investment Banking revenues was due to increased underwriting revenues, with 2016 revenues having been lower as a result of market uncertainty.

Fixed Income revenues decreased year on year primarily due to lower revenues from interest rate products. Gains in 2016 driven by specific market events, such as the UK Referendum, were not replicated in 2017, which was more characterised by reduced volatility and tighter margins on bond trading. This was partially offset by an increase in revenues from credit products due to favourable market conditions with credit spreads tightening and increased client appetite.

BUSINESS REVIEW (CONTINUED)

Overview of 2017 financial results (continued)

Expenses increased by 18.9% from $3,723 million for the year ended 31 December 2016 to $4,425 million for the year ended 31 December 2017.

Staff related expenses increased by 4.8% from $1,654 million for the year ended 31 December 2016 to $1,733 million for the year ended 31 December 2017. The increase was primarily driven by higher discretionary compensation due to the higher revenues, partially offset by lower salary costs due to the weakening of the British Pound against the US dollar.

Non-staff related expenses increased by 30.1% from $2,069 million for the year ended 31 December 2016 to $2,692 million for the year ended 31 December 2017. The increase in non-staff related costs is principally as a result of the Group and Morgan Stanley Group updating its Global Transfer Pricing Policy, effective 1 January 2017.

The Group's tax expense for the year ended 31 December 2017 was $414 million compared to $284 million for the year ended 31 December 2016. This represents an effective tax rate of 32.4% (31 December 2016: 38.6%), which is higher than the average standard rate of UK corporation tax (inclusive of the UK Banking surcharge) of 27.25% (31 December 2016: 28%). See note 7 for further details.

The Group's total assets and liabilities increased by $38,016 million and $36,132 million respectively, an increase of 9.0% and 8.9% respectively as at 31 December 2017 when compared to 31 December 2016.

The increase in total assets is principally driven by an increase of $17,214 million in trade receivables resulting from greater Prime Brokerage receivables and additional amounts of cash collateral pledged against increased derivative exposures. Total assets also increased as a result of an increase in 'financial assets classified as held for trading' of $16,613 million driven by higher corporate equities hedging, increased client trading activity during the year, partially offset by a decrease in derivative assets as the impact of trades maturing exceeded that of market movements.

The increase in total liabilities is driven by an increase in other payables of $20,236 million driving greater long-term borrowings to fund the increase in business activity. 'Financial liabilities designated at fair value through profit or loss' increased $16,279 million as result of an increase in client financing transactions.

Shareholder's equity increased by $1,877 million during the year as a result of profit after tax of $864 million and an ordinary share issuance of $1,000 million.

The consolidated statement of cash flows presented on page 59 shows a net increase in cash and cash equivalents of $5,017 million during the year (2016: net inflow of $8,439 million). The increase in cash mainly reflects higher amounts held at central banks resulting from net cash inflows from operating activities, which were $3,403 million (31 December 2016: net increase of $8,672 million). This has been partially offset by net cash outflows from financing activities of $212 million (2016: $292 million) due to the net repayment of the subordinated loans of $906 million (31 December 2016: $nil), payment of interest on subordinated loans of $220 million and payment of the Additional Tier 1 ("AT1") capital instrument coupon of $86 million (31 December 2016: $117 million), partially offset by an increase from an issuance of ordinary share capital of $1,000 million.

BUSINESS REVIEW (CONTINUED)

Key performance indicators

The Board of directors monitors the results of the Group by reference to a range of performance and risk based metrics. For the risk information, refer to the Risk reporting and measurement section of the Risk Management later in this report. Certain performance based metrics are shown below:

Profitability metrics

Return on ordinary shareholder's equity. The Group's return on ordinary shareholder's equity (profit/ loss for the year attributable to the parent less dividends paid on AT1 instruments as a percentage of ordinary shareholder's equity at the beginning of the year (total equity less AT1 Instruments and Non-controlling Interest)) was 5.0% (2016: 2.2%).

Return on assets: The Group's return on assets (profit/ loss for the year as a percentage of total assets at the beginning of the year) was 0.2% (2016: 0.1%).

Balance Sheet Assets

Total assets: Total assets of the Group continue to be closely monitored. The Group's total assets, as disclosed on page 58, increased by 9.0% to $461 billion at 31 December 2017.

Capital

The Group continues to closely monitor its capital position against a range of key metrics including the following:

Tier 1 regulatory capital: The Company's Tier 1 capital as calculated in accordance with PRA rules which are based on the fourth EU Capital Requirements Directive ("CRD") and EU Capital Requirements Regulation ("CRR"), collectively known as "CRD IV", was $16,971 million (2016: $15,185 million) and its Tier 1 capital ratio was 12.8% (2016: 14.8%), which is in excess of the required minimum regulatory ratio. Tier 1 capital ratio is defined as Tier 1 capital divided by risk-weighted assets ("RWAs").

Leverage ratio: CRD IV, as amended by the European Commission Delegated Act, compares Tier 1 capital to a measure of leverage exposure, defined as the sum of leverage assets less Tier 1 capital deductions plus off-balance sheet exposures. As at 31 December 2017, the Company had a leverage ratio of 3.8% (2016: 4.0%), which is above the expected minimum regulatory ratio of 3% that will apply once European legislation has been finalised.

KEY MANAGEMENT CONSIDERATIONS

In the preparation of the financial results throughout 2017, management have considered and challenged accounting and reporting matters to ensure appropriate recognition, measurement, presentation and disclosure. These matters include the fair value of financial instruments, revenue recognition, intercompany transactions, impairment of financial assets and recognition of uncertain litigation and tax provisions. The significant matters considered and challenged by management during 2017 include:

Valuation of financial instruments

As a result of the trading and risk management activities of the Group, management are required to determine appropriate fair values for a significant range of financial instruments. To the extent that the fair valuation is based on models or inputs that are less observable or unobservable in the market, the determination of fair value requires more judgement.

Management reviewed key valuation metrics, assumptions and methodologies involved in the determination of the fair value of financial instruments and determined that the valuations were reasonable.

Refer to accounting policy note 3(d) for more detail on the Group’s fair value measurement and valuation methods.

Intercompany transactions

The Morgan Stanley Group conducts business for clients globally through a combination of both functional and legal entity organisational structures. Accordingly, the Group 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 operation of these activities on an arm’s length basis includes Morgan Stanley’s Global Transfer Pricing Policy. Given the volume and nature of the intercompany transactions there is an inherent complexity in ensuring the accounting and reporting reflects the contractual arrangements of those transactions.

Effective 1 January 2017, Morgan Stanley updated its Global Transfer Pricing Policy. Management have assessed the design and operating effectiveness of the Global Transfer Pricing Policy and the processes and controls which support it and have determined that they have been implemented appropriately.

In addition, during 2017, management identified that the control environment relating to certain business funding transactions and allocations required further enhancements. For the year ended 31 December 2017 many of the control enhancements had already been implemented with further enhancements in progress, therefore management are satisfied that the financial performance of the Group is appropriately reported.

Uncertain Tax Provisions

The preparation of the Group’s consolidated financial statements requires management to make judgements, estimates and assumptions regarding the outcome matters that are uncertain, including those relating to tax.

The Group has reserves arising on a number of uncertain tax matters, for which management has made judgements and interpretations about the application of inherently complex tax laws when determining these provisions. Whilst a range of outcomes is foreseeable, management considers the amount reserved to be a reasonable estimate of expected future liabilities after consideration of all pertinent facts, based on the status of inquiries at the date of approval of the accounts.

Refer to note 19 for further details of the estimates used in determining provisions on uncertain tax balances.

RISK MANAGEMENT

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

Note 27 to the consolidated financial statements provides additional qualitative and quantitative disclosures about the Group's management of and exposure to financial risks.

Risk strategy and appetite

The Group Risk Appetite Statement articulates the aggregate level and type of risk that the Group is willing to accept in order to execute its business strategy and is set to be within the resource capacity constraints.

The combination of qualitative risk appetite and tolerance statements and quantitative limits aims to ensure that the Group's businesses are carried out in line with the risk appetite approved by the Board, and to protect Morgan Stanley's reputation in both normal and stressed environments.

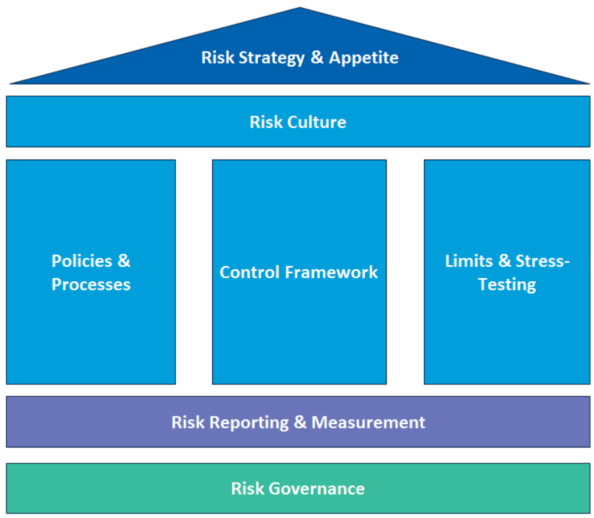
The Group has no risk appetite for conduct risk or reputational risk. It acknowledges, however, that conduct risk or reputational risk remains inherent in doing business and thus cannot be entirely eliminated.

The Group risk appetite is set by the MSI Board in conjunction with the MSI Group's strategy and the MSI Group capital and liquidity resource adequacy framework.

Risk management framework

Risk of loss is an inevitable consequence of the Group's businesses activities and effective risk management is vital to the Group's success. The Risk Management Framework includes a well-defined, comprehensive risk governance structure with appropriate risk management expertise, including processes for periodically assessing the efficacy of the Risk Management Framework. The key elements of the Risk Management Framework are outlined in Figure 1.

Figure 1 Risk management framework



Risk policies and processes

Morgan Stanley Group has a number of well-established policies and processes which establish the standards that govern the identification, assessment, monitoring, management and mitigation of the various types of risk involved in its business activities. Specific risk management policies have been implemented to address local business and regulatory requirements, where appropriate. The policies are approved by the MSI Board and reviewed annually.

RISK MANAGEMENT (CONTINUED)

Control framework

The MSI Group operates a control framework consistent with the "Three Lines of Defence" model. This structure creates clear delineation of responsibilities between the elements of risk control (1st Line), independent oversight and challenge (2nd Line) and audit assurance (3rd Line).

Business unit management has primary responsibility and accountability for managing all the business unit risks, including market, credit, operational, liquidity and funding risks. It implements policy and ensures compliance with applicable laws, rules and regulations, for every legal entity in the MSI Group and in all jurisdictions business is undertaken and booked.

Independent Risk Management provides governance and oversight of activities carried out by the business units. The EMEA Risk Management Division is responsible for the independent identification, analysis, monitoring, reporting and escalation of all market, credit operational and liquidity risks arising from Group business activities. The EMEA Risk Management Division is independent of both the Firm's Business Units and Support and Control Functions and assists senior management and the Firm Risk Committee in monitoring and managing risk through a number of control processes.

The Internal Audit Department ("IAD") are the 3rd line of defence, and are an independent source of assurance to the MSI Board on financial, operational, and compliance controls. EMEA Internal Audit Department reports to the MSI Audit Committee and is independent of the Business Units, Support and Control Functions and Risk Management. Internal Audit independently verifies that the Risk Management Framework has been implemented as intended and is functioning effectively, including opining on the overall appropriateness and adequacy of the framework and the associated governance processes.

Limits and tolerance framework

The MSI Group Risk Appetite is translated into a comprehensive Risk Limit and Tolerance framework across four primary areas: market risk, credit risk, operational risk and liquidity risk. Other risks that are monitored regularly include leverage risk, valuation risk, conduct risk, reputational risk, model risk and earnings at risk.

The MSI Group maintains risk limits and tolerances at various levels of the governance structure to support linkages between the Group's overall risk appetite and more granular risk-taking decisions and activities. Using a suite of tools, most notably limits, these risks are tracked, monitored and reported to the appropriate executive risk committees, MSI Risk Committee and the MSI Board. All risk limits are reviewed periodically as appropriate and at least annually. Figure 2 outlines the MSI Group's Risk Limit Framework for specific risk areas.

Figure 2 MSI group risk limit framework

	MARKET RISK	CREDIT RISK	OPERATIONAL RISK	LIQUIDITY AND FUNDING RISK
RISK METRICS AND LIMITS	• MSI Group-wide macroeconomic scenario loss limits and proprietary tail risk metric • Legal entity Value at Risk ("VaR") and exposure limits • Detailed risk exposure limits are allocated by desk/products	• MSI Group-wide macroeconomic scenario loss limits and proprietary tail risk metric • MSI Group credit limits • Single name, country and industry credit limits	• Quantitative tolerances for each top operational risk and against an aggregate risk tolerance level	• Liquidity and parent support limits • Portfolio level liquidity and funding mix limits • Granular business area specific limits on liquidity and funding

RISK MANAGEMENT (CONTINUED)

Stress testing

Stress testing is one of the Group's principal risk management tools, used to identify and assess the impact of severe stresses on its portfolios. It informs a number of processes and associated decisions. It complements other Group risk metrics by providing a clear and flexible approach to assessing the Group's resilience in the face of various scenarios over a range of severities, relevant to current market conditions and forward looking macroeconomic views. Most notably, stress testing is used for:

- Risk Management: Identifying areas of potential vulnerabilities in the portfolio, measuring portfolio losses and concentrations as a basis for senior management to review portfolio-level risk and determine risk mitigation actions and set exposure limits.
- Capital and Liquidity planning: Informing the proposed stressed capital and liquidity forecasts through severe but plausible stress tests.
- Strategy Planning: Identifying business model vulnerabilities through Reverse Stress Testing and identifying the potential mitigating actions available as part of recovery planning.

Risk reporting and measurement

The Group has a suite of risk reporting across the main risk types highlighted above. The risk reporting includes quantitative indicators and qualitative assessments that enable a comparison of the Group's risk profile against risk limits and risk tolerance statements. Reporting identifies matters for escalation and highlights emerging risks. Material risk issues are investigated and escalated where appropriate, as per the specific escalation procedures set down by the Group. Escalation triggers have been articulated, with separate triggers for notification and further escalation including to the MSIP Board where relevant. The EMEA Risk Management Division has constituted specific committees which provide senior management review of the risk reporting including stress testing and data quality information.

Risk reporting capabilities are supported by a well-controlled infrastructure, including Front Office risk systems and the Group's Risk Management systems. Key risk data are subject to several control assessments, including: self-assessments, attestations, independent validation, reconciliation and internal audit reviews.

Risk governance

The Group has a comprehensive risk management governance framework which includes Board approved policies and a defined senior management risk oversight and escalation process. The MSIP Board has overall responsibility for the business affairs of the Group and it is ultimately responsible for the Group's risk management. The MSI Risk Committee and EMEA Risk Committee assist and provide guidance to the MSIP Board on the oversight of Group's risk management activities.

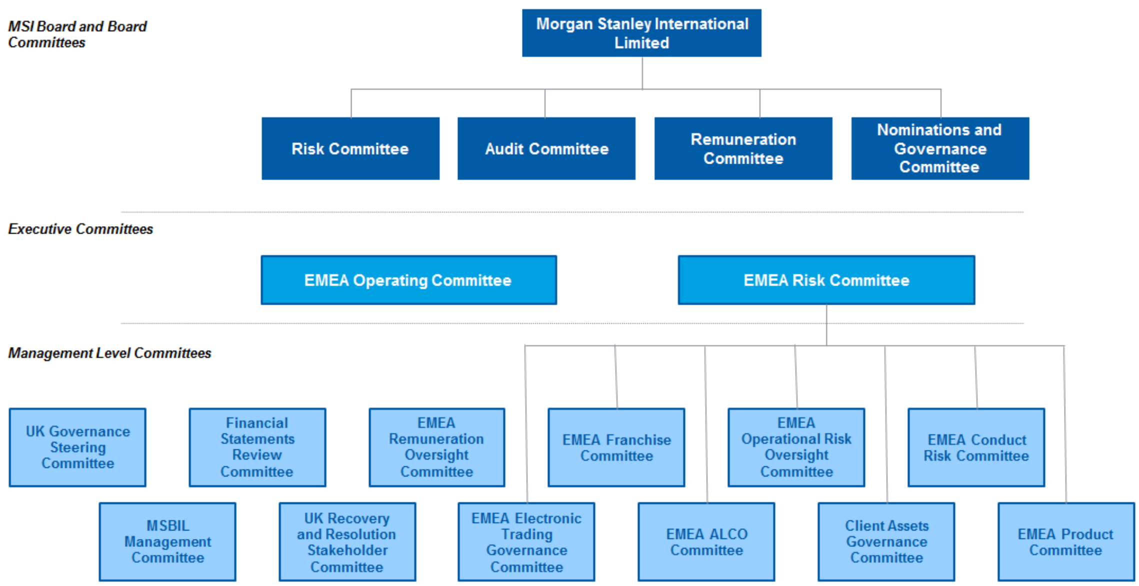
RISK MANAGEMENT (CONTINUED)

Risk governance (continued)

The MSI Board (and its committees) determines the strategy for the MSI Group and provides oversight of the key risk and control issues that the execution of the strategy presents, or is likely to present. The MSI Board has delegated authority to its Audit, Risk, Remuneration and Nomination and Governance committees. Each of the committees is comprised solely of non-executive directors. The MSI Board, through the MSI Risk Committee, is regularly informed of the MSI Group's risk profile and relevant trends impacting its risk profile.

Day to day management of the MSI Group's business is delegated to executive management. The executive committees are the most senior MSI Group executive management committees and have responsibility for overseeing business performance, operations and risks identified in relation to the MSI Group. The management level committees support the executive committees in their oversight of specific areas of the MSI Group's activities.

Figure 3 MSI Board Committee Structure and EMEA Executive Management Structure



MSI board committees

The **MSI Risk Committee** is appointed by the MSI Board to assist and provide guidance to the MSI Board on the management of financial and non-financial risks, including: (i) risk strategy and appetite; (ii) risk identification and management; (iii) risk governance framework and policies; (iv) measurement of risk and risk tolerance levels and limits; (v) risk culture; and (vi) financial resource management and capital. The MSI Risk Committee met 13 times in 2017. The MSI Risk Committee review detailed risk reports including but not limited to, portfolio risk, market risk, credit risk, operational risk and model changes.

The Committee's focus during the year included:

- The MSI Group risk appetite framework and appetite statement;
- Enhancements to the MSI Group risk framework;
- Oversight of material event risks;
- Areas of regulatory focus and corresponding risk projects.

RISK MANAGEMENT (CONTINUED)

Risk governance (continued)

MSI board committees (continued)

The **MSI Audit Committee** is appointed by the MSI Board to assist and provide guidance to the MSI Board in monitoring: (i) financial reporting; (ii) internal controls; (iii) legal and regulatory compliance; (iv) internal audit; and (v) external auditors. The Audit Committee focused on certain key items during 2017. These include, but are not limited to:

- Cyber risk;
- Valuation of financial instruments;
- Uncertain provisions, including litigation and taxation;
- Intercompany transactions;
- European Market Infrastructure Reporting II and Markets in Financial Instruments Directive II.

In addition to the Risk and Audit Committees, the MSI Board has also appointed a **MSI Nomination and Governance Committee** and a **MSI Remuneration Committee**.

EMEA executive committees

The **EMEA Operating Committee** is the forum for key decisions regarding matters affecting the operations and performance of the MSI Group and is responsible for the execution of strategy. The Committee provides oversight of: (i) strategy; (ii) financial performance; (iii) risk and control; (iv) operational, legal and regulatory matters; and (v) human resources.

The **EMEA Risk Committee** ("ERC") assists in the oversight of the MSI Group's management of risk (including both financial and non-financial risks) within the MSI Group. The Committee provides oversight of: (i) risk strategy and appetite; (ii) risk identification and measurement; (iii) risk framework and policies; (iv) culture; and (v) financial resource management.

Management committees (associated with risk governance)

The **EMEA Franchise Committee** assists in the oversight of potentially significant franchise risks including by reviewing relevant activities, transactions and clients, and reviewing the franchise implications of situations that involve suitability or conflicts of interest concerns.

The **EMEA Asset and Liability Committee ("EMEA ALCO")** assists the ERC to oversee the capital adequacy, including the risk of excessive leverage, and liquidity risk management of the MSI Group.

The **EMEA Operational Risk Oversight Committee** provides guidance to the ERC in relation to the oversight of the management of operational risk of the MSI Group.

The **Client Assets Governance Committee** provides support for MSI Group's compliance with Client Assets Sourcebook (CASS) requirements, and acts as the principal body for providing governance of CASS related issues, being responsible for co-ordinating the approach to managing Client Money and Client Assets.

The **EMEA Conduct Risk Committee** assists the ERC in the oversight and management of conduct risk within the MSI Group.

The **EMEA Electronic Trading Governance Committee** reviews and challenges the controls applicable to the electronic trading business. Further, the Committee will monitor the risk appetite and limits set by the ERC which is applicable to electronic trading, and provide a forum to oversee the resolution of identified control issues in an appropriate and timely manner and escalate matters to the ERC as necessary.

RISK MANAGEMENT (CONTINUED)

Risk governance (continued)

Management committees (associated with risk governance)

The **EMEA Product Committee** assists the ERC in discharging its responsibilities for the oversight of approvals of New Products (“NPA”) and the oversight of product governance. In particular, the EMEA Product Committee reviews and challenges Heightened Risk NPA proposals and provides recommendation to the ERC.

Management committees (associated with financial reporting)

The **EMEA Financial Statement Review Committee** is appointed to review certain external reporting, which includes the financial statements and Pillar 3 disclosures of MSI and its regulated subsidiaries and their branches.

Market risk (audited)

Market risk refers to the risk that a change in the level of one or more market prices, rates, indices, volatilities, correlations or other market factors, such as market liquidity, will result in losses for a position or portfolio.

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

Sound market risk management is an integral part of the Group’s culture. The Group is responsible for ensuring that market risk exposures are well-managed and monitored. The Group also ensures transparency of material market risks, monitors compliance with established limits, and escalates risk concentrations to appropriate senior management.

To execute these responsibilities, the Group monitors its market risk against limits on aggregate risk exposures, performs a variety of risk analyses including monitoring Value at Risk ("VaR”) and stress testing analyses, routinely reports risk summaries and maintains the VaR and scenario analysis methodologies. The material risks identified by these processes are summarised and reported to senior management.

The market risk management policies and procedures for the Group are consistent with those of the Morgan Stanley Group and include escalation to the Group’s Board of Directors and appropriate management personnel.

Primary market risk exposures and market risk management

During the year, the Group had exposures to a wide range of market risk factors related to the global markets in which it conducts its trading activities. These market risk factors include interest rate and credit spread risk, equity prices, foreign exchange rates and commodity prices and the associated implied volatilities.

The Group is exposed to interest rate and credit spread risk, as well as associated implied volatility risks, as a result of its market making activities in interest rate or credit sensitive financial instruments (e.g. risk arising from changes in the level of interest rates, the shape of the yield curve and credit spreads). The activities from which those exposures arise and the markets in which the Group is active include, but are not limited to: interest rate and credit derivatives, corporate and government debt across both developed and emerging markets and asset-backed debt (including mortgage-related securities).

RISK MANAGEMENT (CONTINUED)

Market risk (audited) (continued)

Primary market risk exposures and market risk management (continued)

The Group is exposed to equity price and implied volatility risk as a result of making markets in equity securities and derivatives and maintaining other positions (including positions in non-public entities). Positions in non-public entities may include, but are not limited to, exposures to private equity, venture capital, private partnerships, real estate funds and other funds. Such positions are less liquid, have longer investment horizons and are more difficult to hedge than listed equities.

The Group is exposed to foreign exchange rate and implied volatility risk as a result of making markets in foreign currencies and foreign currency derivatives, from maintaining foreign exchange positions and from holding non-US dollar-denominated financial instruments.

The Group has very limited exposure to commodities. This exposure is due to price and implied volatility risk as a result of market-making activities in crude and refined oil products, natural gas, electricity, and precious, base metals and agriculture.

The Group manages its trading positions by employing a variety of risk mitigation strategies. These strategies include diversification of risk exposures and hedging. Hedging activities consist of the purchase or sale of positions in related securities and financial instruments, including a variety of derivative products (e.g., futures, forwards, swaps and options). Hedging activities may not always provide effective mitigation against trading losses due to differences in the terms, specific characteristics or other basis risks that may exist between the hedge instrument and the risk exposure that is being hedged. The Group manages and monitors its market risk exposures, including outright and basis risks, in such a way as to maintain a portfolio that the Group believes is well-diversified in the aggregate with respect to market risk factors and that reflects the Group’s aggregate risk tolerance, as established by the Group’s Board of Directors. The effectiveness of hedges and mitigants is monitored using processes such as risk and limit reporting.

Aggregate market risk limits have been approved for the Group in line with the risk appetite set by the Board of Directors. Additional market risk limits are assigned, as appropriate, to trading desks, products and/ or regions and are commensurate with the aggregate limits. The Market Risk Department (“MRD”) monitors market risk measures against limits in accordance with policies set by the Board of Directors and senior management.

Value at Risk

The Group uses the statistical technique known as VaR as one of the tools used to measure, monitor and review the market risk exposures of its trading portfolios. MRD calculates and distributes daily VaR-based risk measures to various levels of management.

RISK MANAGEMENT (CONTINUED)

Market risk (audited) (continued)

VaR methodology, assumptions and limitations

The Group calculates VaR using a model based on volatility adjusted historical simulation for general market risk factors and Monte Carlo simulation for name-specific risk in corporate shares, bonds, loans and related derivatives. Market risk factors' daily moves are modelled either as difference changes or relative changes, dependent on the most suitable stochastic process (normal or lognormal diffusion process) to describe the daily risk factor changes. The model constructs a distribution of hypothetical daily changes in the value of trading portfolios based on: historical observation of daily changes in key market indices or other market risk factors; and information on the sensitivity of the portfolio values to these market risk factor changes.

The basic methodology for VaR at Morgan Stanley is a 4-year filtered historical simulation to account for current volatility levels. The risk exposures used for the daily VaR calculation are based on greeks and full-revaluation grids, and simulations cover both systematic and specific risk components. The same valuation approach is used for Stressed VaR. The time series data is updated on a weekly basis, with the exception of idiosyncratic risk factors which are updated quarterly. A set of internal processes and controls ensure that all trading positions booked by the Group are being included in VaR. Management VaR is computed at a 95% level of confidence over a one day time horizon, which is a useful indicator of possible trading losses resulting from adverse daily market moves. The 95%/one-day VaR corresponds to the unrealised loss in portfolio value that, based on historically observed market risk factor movements, could have been exceeded with a frequency of 5%, or five times in every 100 trading days, if the portfolio were held constant for one day.

The Group uses VaR as one of a range of risk management tools. Among their benefits, VaR models permit estimation of a portfolio's aggregate market risk exposure, incorporating a range of market risks and portfolio assets. One key element of the VaR model is that it reflects portfolio diversification or hedging activities. However, VaR has various limitations, which include but are not limited to: use of historical changes in market risk factors, which may not be accurate predictors of future market conditions, and may not fully incorporate the risk of extreme market events that are outsized relative to observed historical market behaviour or reflect the historical distribution of results beyond the 95% confidence interval; and reporting of losses in a single day, which does not reflect the risk of positions that cannot be liquidated or hedged in one day. A small proportion of market risk generated by trading positions is not included in VaR. The modelling of the risk characteristics of some positions relies on approximations that, under certain circumstances, could produce significantly different results from those produced using more precise measures. VaR is most appropriate as a risk measure for trading positions in liquid financial markets and will understate the risk associated with severe events, such as periods of extreme illiquidity. The Group is aware of these and other limitations and, therefore, uses VaR as only one component in its risk management oversight process. This process also incorporates stress testing and scenario analyses and extensive risk monitoring, analysis, quantification of risk not captured in VaR, and control at the trading desk, division, entity and Group levels.

The Group is committed to continuous review and enhancement of VaR methodologies and assumptions in order to capture evolving risks associated with changes in market structure and dynamics. As part of regular process improvement, additional systematic and name-specific risk factors may be added to improve the VaR model's ability to more accurately estimate risks to specific asset classes or industry sectors.

Since the reported VaR statistics are estimates based on historical data, VaR should not be viewed as predictive of the Group's future revenues or financial performance or of its ability to manage risk. There can be no assurance that the Group's actual losses on a particular day will not exceed the VaR amounts indicated in the following paragraphs or that such losses will not occur more than five times in 100 trading days for a 95%/one-day VaR. VaR does not predict the magnitude of losses which, should they occur, may be significantly greater than the VaR amount.

RISK MANAGEMENT (CONTINUED)

Market risk (audited) (continued)

VaR statistics are not readily comparable across firms because of differences in the firms' portfolios, modelling assumptions and methodologies. These differences can result in materially different VaR estimates across firms for similar portfolios. The impact of such differences varies depending on the factor history assumptions, the frequency with which the factor history is updated and the confidence level. As a result, VaR statistics are more useful when interpreted as indicators of trends in a firm's risk profile rather than as an absolute measure of risk to be compared across firms.

The table below shows the summarised Group's VaR for primary risk categories and total Management VaR for the year ended 31 December 2017 and for the year ended 31 December 2016. The detailed table can be found in note 27 to the consolidated financial statements.

	95%/ one-day VaR for the year ended 31 December 2017		95%/ one-day VaR for the year ended 31 December 2016	
	Period end $millions	**Average $millions**	**Period end $millions**	**Average $millions**
Primary Risk Categories	20	21	16	17
Credit Portfolio (1)	5	6	7	8
Less diversification benefit (2)	(3)	(4)	(6)	(5)
Total Management VaR	**22**	**23**	**17**	**20**

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

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

The Group's average VaR for Primary Risk Categories for 2017 was $21 million compared with $17 million for 2016. The increase in average VaR for Primary Risk Categories is due to risk increases across interest rate, equity and foreign exchange.

The average Credit Portfolio VaR for 2017 was $6 million compared with $8 million for 2016. The decrease in the average VaR over the year was driven by exposure changes during 2017.

The average total VaR for 2017 was $23 million compared with $20 million for 2016.

Additional information on non-trading risks and currency risk together with an analysis of VaR sensitivity is presented in note 27 to the consolidated financial statements.

RISK MANAGEMENT (CONTINUED)

Credit risk

Credit risk management framework (Audited)

Credit risk refers to the risk of loss arising when a borrower, counterparty or issuer does not meet its financial obligations to the Group. Credit risk includes country risk, which is further described below.

The Group primarily incurs credit risk to institutions and sophisticated investors, mainly through its Institutional Securities business segment. This risk may be incurred through a variety of activities, including, but not limited to, the following:

- entering into derivative contracts under which counterparties may have obligations to make payments to the Group;
- extending credit to clients through lending commitments;
- providing short- or long-term funding that is secured by physical or financial collateral whose value may at times be insufficient to fully cover the repayment amount;
- posting margin and/ or collateral to clearing houses, clearing agencies, exchanges, banks, securities firms and other financial counterparties;
- placing funds on deposit at other financial institutions to support the Group's clearing and settlement obligations; and
- investing or trading in securities and loan pools, whereby the value of these assets may fluctuate based on realised or expected defaults on the underlying obligations or loans.

Credit Risk exposure is managed on a global basis and in consideration of each significant legal entity within the Morgan Stanley Group. The credit risk management policies and procedures establish the framework for identifying, measuring, monitoring and controlling credit risk whilst ensuring transparency of material credit risks, compliance with established limits and escalating risk concentrations to appropriate senior management.

Monitoring and control (audited)

In order to help protect the Group from losses, the Credit Risk Management Department establishes Firm-wide practices to evaluate, monitor and control credit risk at the transaction, obligor and portfolio levels. The Credit Risk Management Department approves extensions of credit, evaluates the creditworthiness of the Group's counterparties and borrowers on a regular basis, and helps ensure that credit exposure is actively monitored and managed. The evaluation of counterparties and borrowers includes an assessment of the probability that an obligor will default on its financial obligations and any subsequent losses that may occur when an obligor defaults. In addition, credit risk exposure is actively managed by credit professionals and committees within the Credit Risk Management Department and through various risk committees, whose membership includes individuals from the Credit Risk Management Department.

A Credit Limits Framework is utilised to manage credit risk levels across the MSI Group. The Credit Limits Framework is calibrated within the MSI Group's risk tolerance and includes single-name limits and portfolio concentration limits by country and industry. The Credit Risk Management Department helps ensure timely and transparent communication of material credit risks, compliance with established limits and escalation of risk concentrations to appropriate senior management.

The Credit Risk Management Department also works closely with the Market Risk Department and applicable business units to monitor risk exposures and to perform stress tests to identify, analyse and, control credit risk concentrations arising from the Group's lending and trading activities. The stress tests shock market factors (e.g. interest rates, commodity prices, credit spreads), and risk parameters (e.g. default probabilities and loss given default), in order to assess the impact of stresses on exposures, profit and loss, and the Group's capital position. Stress tests are conducted in accordance with established Group policies and procedures.

RISK MANAGEMENT (CONTINUED)

Credit risk (continued)

Credit evaluation (audited)

The evaluation of corporate and institutional counterparties includes assigning obligor credit ratings, which reflect an assessment of an obligor's probability of default and loss given default. Credit evaluations typically involve the assessment of financial statements, leverage, liquidity, capital strength, asset composition and quality, market capitalisation, access to capital markets, the adequacy of collateral, if applicable, and in the case of certain loans, cash flow projections and debt service requirements. The Credit Risk Management Department also evaluates strategy, market position, industry dynamics, management and other factors that could affect the obligor's risk profile. Additionally, the Credit Risk Management Department evaluates the relative position of the Group's exposure in the borrower's capital structure and relative recovery prospects, as well as adequacy of collateral (if applicable) and other structural elements of the particular transaction.

In addition to assessing and monitoring its credit exposure and risk at the individual obligor level, the Group also reviews its credit exposure and risk to geographic regions. As at 31 December 2017, credit exposure was spread across Asian, North American, and Western European countries. In addition, the Group pays particular attention to smaller exposures in emerging markets given their unique risk profile. Sovereign ceiling ratings, i.e. the maximum credit rating that can be assigned to a counterparty with a designated country of risk, are derived using methodologies generally consistent with those employed by external rating agencies.

The Group also reviews its credit exposure and risk to certain types of customers. At 31 December 2017, the Group's material credit exposure was to central clearing counterparties, corporate entities, financial institutions and sovereign-related entities.

Risk mitigation (audited)

The Credit Risk Management Department may seek to mitigate credit risk from its lending and trading activities in multiple ways, including collateral provisions, guarantees and hedges. At the transaction level, the Credit Risk Management Department seeks to mitigate risk through management of key risk elements such as size, tenor, financial covenants, seniority and collateral. The Group actively hedges its lending and derivatives exposure through various financial instruments that may include single-name, portfolio and structured credit derivatives. Additionally, the Group may sell, assign or syndicate funded loans and lending commitments in the primary and secondary loan market. In connection with its derivatives trading activities, the Group generally enters into master netting agreements and collateral arrangements with counterparties. These agreements provide the Group with the ability to demand collateral, as well as to liquidate collateral and offset receivables and payables covered under the same master agreement in the event of a counterparty default.

- *Securities purchased under agreements to resell and securities borrowed*

The Group manages credit exposure arising from securities purchased under agreements to resell and securities borrowed transactions by, in appropriate circumstances, entering into master netting agreements and collateral agreements with counterparties that provide the Group, in the event of a counterparty default, with the right to net a counterparty's rights and obligations under such agreements and to liquidate and set off collateral held by the Group against the net amount owed by the counterparty. Under these securities purchased under agreements to resell and securities borrowed transactions, the Group receives collateral, including US government and agency securities, other sovereign government obligations, corporate and other debt and corporate equities. The Group also monitors the fair value of the underlying securities as compared with the related receivable or payable, including accrued interest, and, as necessary, requests additional collateral to ensure such transactions are adequately collateralised.

RISK MANAGEMENT (CONTINUED)

Credit risk (continued)

Risk mitigation (audited) (continued)

- *Derivatives*

The Group may seek to mitigate credit risk from its derivatives transactions in multiple ways, including documentation, collateral provisions, guarantees and hedges. At the transaction level, the Group seeks to mitigate risk through management of key risk elements such as size, tenor, financial covenants, seniority and collateral. The Group actively hedges its derivatives exposure through various financial instruments that may include single-name, portfolio and structured credit derivatives. The Group may enter into master netting agreements and collateral arrangements with counterparties. These master netting agreements and collateral arrangements may provide the Group with the ability to demand collateral, as well as to liquidate collateral and offset receivables and payables covered under the same master netting agreement in the event of counterparty default. The Group monitors the creditworthiness of counterparties to these transactions on an ongoing basis and requests additional collateral in accordance with collateral arrangements when deemed necessary.

Exposure to credit risk (audited)

- *Counterparty risk exposure*

The table below shows the Group's maximum exposure to credit risk and credit exposure for certain financial assets the Group believes are subject to credit risk and where the Group has entered into credit enhancements, including receiving cash and security as collateral and master netting agreements. The financial effect of the credit enhancements is also disclosed in the table. The net credit exposure represents the credit exposure remaining after the effect of the credit enhancements. Exposure to other Morgan Stanley Group undertakings is included in this table.

	31 December 2017			31 December 2016		
	Gross credit exposure (1)	Credit enhancements	Net credit exposure	Gross credit exposure (1)	Credit enhancements	Net credit exposure
Class	$millions	$millions	$millions	$millions	$millions	$millions
Cash collateral on securities borrowed	17,828	(17,410)	418	19,601	(18,900)	701
Securities purchased under agreements to resell	70,739	(66,887)	3,852	77,446	(75,053)	2,393
Financial assets classified as held for trading - derivatives	167,008	(159,176)	7,832	183,553	(175,809)	7,744
Financial assets designated at fair value through profit or loss	11,496	(11,299)	197	4,312	(3,697)	615

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

Additional information on the exposure to credit risk, including the maximum exposure to credit risk by credit rating is presented in note 27 to the consolidated financial statements.

RISK MANAGEMENT (CONTINUED)

Credit risk (continued)

Exposure to credit risk (audited)

- *Country risk exposure*

Country risk is the risk that events in, or affecting, a foreign country might adversely affect the Group. “Foreign country” means any country other than the UK. Sovereign Risk, by contrast, is the risk that a government will be unwilling or unable to meet its debt obligations, or renege on the debt it guarantees. Sovereign risk is single-name risk for a sovereign government, its agencies and guaranteed entities.

Country risk exposure is measured in accordance with the Group’s internal risk management standards and includes obligations from sovereign governments, corporations, clearing houses and financial institutions. The Group actively manages country risk exposure through a comprehensive risk management framework that combines credit and market fundamentals and allows the Group to effectively identify, monitor and limit country risk.

The Group’s obligor credit evaluation process may also identify indirect exposures whereby an obligor has vulnerability or exposure to another country or jurisdiction. Examples of indirect exposures include mutual funds that invest in a single country, offshore companies whose assets reside in another country to that of the offshore jurisdiction and finance company subsidiaries of corporations. Indirect exposures identified through the credit evaluation process may result in a reclassification of country of risk.

Stress testing is one of the Group’s principal risk management tools, used to identify and assess the impact of severe stresses on its portfolios. A number of different scenarios are used to measure the impact on the Group’s credit risks and market risks stemming from negative economic and political scenarios, including possible contagion effects where appropriate. The results of the stress tests may result in the amendment of limits or exposure mitigation.

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

Each reference entity within an index is allocated to that reference entity’s country of risk. Index exposures are allocated to the underlying reference entities in proportion to the notional weighting of each reference entity in the index, adjusted for any fair value receivable/ payable for that reference entity. Where credit risk crosses multiple jurisdictions, for example, a credit default swap (“CDS”) purchased from an issuer in a specific country that references bonds issued by an entity in a different country, the fair value of the CDS is reflected in the Net counterparty exposure column based on the country of the CDS issuer. Further, the notional amount of the CDS, adjusted for the fair value of the receivable/ payable, is reflected in the Net inventory column, based on the country of the underlying reference entity.

RISK MANAGEMENT (CONTINUED)

Credit risk (continued)

Exposure to credit risk (audited)

Five largest non-UK country risk net exposures:

Country	Net inventory[(1)] $millions	Net counterparty exposure[(2)] $millions	Funded lending $millions	Unfunded commitments $millions	Exposure before hedges $millions	Hedges[(3)] $millions	Net exposure [(4)] $millions
Germany							
Sovereigns	4,412	765	-	-	5,177	(826)	4,351
Non-sovereigns	171	2,066	3	47	2,287	(327)	1,960
Total Germany	4,583	2,831	3	47	7,464	(1,153)	6,311
United States							
Sovereigns	(211)	58	-	-	(153)	-	(153)
Non-sovereigns	2,713	1,696	20	605	5,034	(246)	4,788
Total United States	2,502	1,754	20	605	4,881	(246)	4,635
France							
Sovereigns	(210)	-	-	-	(210)	(50)	(260)
Non-sovereigns	42	1,386	-	1,020	2,448	(389)	2,059
Total France	(168)	1,386	-	1,020	2,238	(439)	1,799
Italy							
Sovereigns	621	(19)	-	-	602	50	652
Non-sovereigns	292	379	2	247	920	(150)	770
Total Italy	913	360	2	247	1,522	(100)	1,422
Australia							
Sovereigns	1,201	1	-	-	1,202	-	1,202
Non-sovereigns	4	123	18	-	145	-	145
Total Australia	1,205	124	18	-	1,347	-	1,347

- Net inventory represents exposure to both long and short single-name and index positions (i.e. bonds and equities at fair value and CDS based on notional amount assuming zero recovery adjusted for any fair value receivable or payable). As a market maker, the Group transacts in these CDS positions to facilitate client trading.
- Net counterparty exposure (i.e. repurchase transactions, securities lending and over the counter (“OTC”) derivatives) taking into consideration legally enforceable master netting agreements and collateral.
- Represents CDS hedges (purchased and sold) on net counterparty exposure and lending executed by trading desks responsible for hedging counterparty and lending credit risk exposures for the Group. Amounts are based on the CDS notional amount assuming zero recovery adjusted for any fair value receivable or payable.
- In addition, as at 31 December 2017, the Group had exposure to these countries for overnight deposits with banks of approximately $326 million.

RISK MANAGEMENT (CONTINUED)

Liquidity risk

Liquidity risk management framework (audited)

Liquidity and funding risk refers to the risk that the Group will be unable to finance its operations due to a loss of access to the capital markets or difficulty in liquidating its assets. Liquidity and funding risk also encompasses the Group's ability (or perceived ability) to meet its financial obligations without experiencing significant business disruption or reputational damage that may threaten its viability as a going concern. Liquidity risk also encompasses the associated funding risks triggered by the market or idiosyncratic stress events that may cause unexpected changes in funding needs or an inability to raise new funding. Generally, the Group incurs liquidity and funding risk as a result of its trading, investing and client facilitation activities.

The Group's liquidity and funding risk management policies and procedures are consistent with those of the Morgan Stanley Group. The Board of Directors of the Group is ultimately responsible for establishing the liquidity risk tolerance and ensuring the Group's liquidity risk is appropriately managed. In addition to the internal liquidity risk management framework, the Group is subject to the liquidity regulations prescribed by the PRA. The Group has daily monitoring and reporting processes in place to ensure compliance with its regulatory requirements.

The Liquidity Risk Department ("LRD") oversees and monitors liquidity risk, ensuring transparency of material liquidity and funding risks, compliance with established risk limits and escalation of risk concentrations to various levels of management. To execute these responsibilities, the LRD:

- establishes limits in line with the Morgan Stanley Group's liquidity and funding risk appetite;
- identifies and analyses emerging liquidity and funding risks to ensure such risks are appropriately mitigated;
- monitors and reports risk exposures against metrics and limits, and;
- reviews the methodologies and assumptions underpinning the Morgan Stanley Group's Liquidity Stress Tests to ensure sufficient liquidity and funding under a range of adverse scenarios.

The Treasury Department and applicable business units have primary responsibility for evaluating, monitoring and controlling the liquidity and funding risks arising from the Group's business activities, and maintain processes and controls to manage the key risks inherent in their respective areas.

The following principles guide the Group's liquidity and funding risk management framework:

- Sufficient liquid assets should be maintained to cover maturing liabilities and other planned and contingent outflows;
- Maturity profile of assets and liabilities should be aligned, with limited reliance on short-term funding;
- Source, counterparty, currency, region, and term of funding should be diversified; and
- Liquidity Stress Tests should anticipate, and account for, periods of limited access to funding.

The core components of the Group's liquidity and funding risk management framework, are the Required Liquidity Framework, Liquidity Stress Tests and the Liquidity Reserve (as defined below), which supports its target liquidity profile.

RISK MANAGEMENT (CONTINUED)

Liquidity risk (continued)

Required liquidity framework (Audited)

The Required Liquidity Framework establishes the amount of liquidity the Group must hold in both normal and stressed environments to ensure that its financial condition and overall soundness is not adversely affected by an inability (or perceived inability) to meet its financial obligations in a timely manner. The Required Liquidity Framework considers the most constraining liquidity requirement to satisfy all regulatory and internal limits at a Morgan Stanley Group and legal entity level.

Liquidity stress tests (audited)

The Group uses Liquidity Stress Tests to model liquidity inflows and outflows across multiple scenarios over a range of time horizons. These scenarios contain various combinations of idiosyncratic and systemic stress events of different severity and duration. The methodology, implementation, production and analysis of the Group's Liquidity Stress Tests are important components of the Required Liquidity Framework.

Liquidity Stress Tests are produced for the Group, to capture specific cash requirements and cash availability. The Liquidity Stress Tests assume that a legal entity will use its own liquidity first to fund its obligations before drawing liquidity from its ultimate parent undertaking, Morgan Stanley. Morgan Stanley will support its subsidiaries and will not have access to subsidiaries' liquidity reserves that are subject to any regulatory, legal or tax constraints. In addition to the assumptions underpinning the Liquidity Stress Tests, the Group takes into consideration the settlement risk related to intra-day settlement and clearing of securities and financing activities.

At 31 December 2017 and 31 December 2016, the Group maintained sufficient liquidity to meet current and contingent funding obligations as modelled in its Liquidity Stress Tests.

Liquidity reserves (audited)

The Group maintains sufficient liquidity reserves ("Liquidity Reserve") to cover daily funding needs and to meet strategic liquidity targets sized by the Required Liquidity Framework and Liquidity Stress Tests. The size of the Liquidity Reserve is actively managed by the Group. The following components are considered in sizing the Liquidity Reserve: unsecured debt maturity profile, balance sheet size and composition, funding needs in a stressed environment inclusive of contingent cash outflows and collateral requirements. In addition, the Group's Liquidity Reserve includes a discretionary surplus based on risk tolerance and is subject to change depending on market and firm-specific events.

The Group's Liquidity Reserve is composed of diversified cash and cash equivalents and unencumbered highly liquid securities. Eligible unencumbered highly liquid securities include highly liquid non-US government securities, US government securities and other highly liquid investment grade securities.

Funding management (audited)

The Group manages its funding in a manner that reduces the risk of disruption to the Group's operations. The Group pursues a strategy of diversification of secured and unsecured funding sources and attempts to ensure that the tenor of the Group's liabilities equals or exceeds the expected holding period of the assets being financed.

The Group funds itself through diverse sources. These sources may include equity capital, long-term debt, securities sold under agreements to repurchase, securities lending, deposits, commercial paper, letters of credit and lines of credit. The Group has active financing programmes for both standard and structured products, targeting global investors and currencies.

RISK MANAGEMENT (CONTINUED)

Liquidity risk (continued)

Balance sheet management (audited)

In managing the Group's funding risk, the composition and size of the statement of financial position is monitored and evaluated. A substantial portion of the Group's total assets consists of liquid marketable securities and short-term receivables arising principally from the Institutional Securities business segment's sales and trading activities. The liquid nature of these assets provides the Group with flexibility in managing the size of its statement of financial position.

The Group continues to actively manage its capital and liquidity position to ensure adequate resources are available to support its activities, to enable it to withstand market stresses, and to meet regulatory stress testing requirements proposed by its regulators globally. The Group's capital and liquidity is deemed sufficient to exceed regulatory minimums under both a normal and in a stressed market environment for the foreseeable future. Additionally, the Group has access to further Morgan Stanley Group capital and liquidity as required.

The maturity analysis of financial liabilities, derivative contracts and other financial liabilities held as part of the Group's trading activities is presented in note 25 to the consolidated financial statements.

Secured funding

A substantial portion of the Group's total assets consists of liquid marketable securities and short term receivables arising principally from its sales and trading activities. The liquid nature of these assets provides the Group with flexibility in funding these assets with secured financing. The Group's goal is to achieve an optimal mix of durable secured and unsecured financing. Secured financing investors principally focus on the quality of the eligible collateral posted. Accordingly, the Group actively manages its secured financing book based on the quality of the assets being funded.

The Group utilises shorter-term secured financing only for highly liquid assets and has established longer tenor limits for less liquid asset classes, for which funding may be at risk in the event of a market disruption. The Group defines highly liquid assets as those that are consistent with the standards of the Liquidity Reserve, and less liquid assets as those that do not meet these standards. To further minimise the refinancing risk of secured financing for less liquid assets, the Group has established concentration limits to diversify its investor base and reduce the amount of monthly maturities for secured financing of less liquid assets. Furthermore, the Group obtains term secured funding liabilities in excess of less liquid inventory, as an additional risk mitigant to replace maturing trades in the event that secured financing markets or our ability to access them become limited. Finally, in addition to the above risk management framework, the Group holds a portion of its Liquidity Reserve against the potential disruption to its secured financing capabilities.

Credit ratings

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

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

RISK MANAGEMENT (CONTINUED)

Liquidity risk (continued)

Credit ratings (continued)

At 31 December 2017, the Company's senior unsecured ratings were as follows:

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

Collateral impact of a downgrade

In connection with certain OTC trading agreements and certain other agreements where the Company is a liquidity provider to certain financing vehicles, the Company may be required to provide additional collateral or immediately settle any outstanding liability balances with certain counterparties or pledge additional collateral to certain exchanges and clearing organisations in the event of a future credit rating downgrade, irrespective of whether the Company is in a net asset or net liability position. The additional collateral or termination payments that may be called in the event of a future credit rating downgrade vary by contract and can be based on ratings by either or both of Moody's and S&P.

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

Operational risk

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

RISK MANAGEMENT (CONTINUED)

Operational risk (continued)

The Group has established an operational risk framework to identify measure, monitor and control risk across the Group. This framework is consistent with the framework established by the Morgan Stanley Group and includes escalation to the Group's Board of directors and appropriate senior management personnel. Effective operational risk management is essential to reducing the impact of operational risk incidents and mitigating legal and reputational risks. The framework is continually evolving to reflect changes in the Group and to respond to the changing regulatory and business environment. The Group has implemented operational risk data and assessment systems to monitor and analyse internal and external operational risk events, to assess business environment and internal control factors and to perform scenario analysis. The collected data elements are incorporated in the operational risk capital model. The model encompasses both quantitative and qualitative elements. Internal loss data and scenario analysis results are direct inputs to the capital model, while external operational incidents, business environment and internal control factors are evaluated as part of the scenario analysis process.

In addition, the Group employs a variety of risk processes and mitigants to manage its operational risk exposures. These include a strong governance framework, a comprehensive risk management program and insurance. Operational risks and associated risk exposures are assessed relative to the risk tolerance established by the Board and are prioritised accordingly. The breadth and variety of operational risks are such that the types of mitigating activities are wide-ranging. Examples of such activities include enhancement of defences against cyberattacks; use of legal agreements and contracts to transfer and/or limit operational risk exposures; due diligence; implementation of enhanced policies and procedures; exception management processing controls; and segregation of duties.

Primary responsibility for the management of operational risk is with the business, the control groups and the business managers therein. The business managers maintain processes and controls designed to identify, assess, manage, mitigate and report operational risk. Each of the business segments has a designated operational risk coordinator. The operational risk coordinator regularly reviews operational risk issues and reports to the Group's senior management within each business. Each control group also has a designated operational risk coordinator and a forum for discussing operational risk matters with the Group's senior management. Oversight of operational risk is provided by the Operational Risk Oversight Committee, regional risk committees and senior management. In the event of a merger; joint venture; divestiture; reorganisation; or creation of a new legal entity, a new product or a business activity, operational risks are considered, and any necessary changes in processes or controls are implemented.

The Operational Risk Department provides oversight of operational risk management and independently assesses, measures and monitors operational risk. The Operational Risk Department works with the business divisions and control groups to help ensure a transparent, consistent and comprehensive framework for managing operational risk within each area and across the Group. The Operational Risk Department scope includes oversight of the technology and data risk management programs (e.g. cybersecurity), fraud risk management and prevention program and a supplier management (vendor risk oversight and assessment) program. Furthermore, the Operational Risk Department supports the collection and reporting of operational risk incidents and the execution of operational risk assessments; provides the infrastructure needed for risk measurement and risk management; and ensures ongoing validation and verification of the Group's advanced measurement approach for operational risk capital.

Business Continuity Management is responsible for identifying key risks and threats to the Group's resiliency and planning to ensure that a recovery strategy and required resources are in place for the resumption of critical business functions following a disaster or other business interruption. Disaster recovery plans are in place for critical facilities and resources on a Group-wide basis, and redundancies are built into the systems as deemed appropriate. The key components of the Group's Business Continuity Management Program include: crisis management; business recovery plans; applications/data recovery; work area recovery; and other elements addressing management, analysis, training and testing.

RISK MANAGEMENT (CONTINUED)

Operational risk (continued)

The Group maintains a program that oversees our cyber and information security risks and is designed to address regulatory requirements. Cybersecurity and information security policies, procedures and technologies are designed to protect the Group's information assets against unauthorised disclosure, modification or misuse. These policies cover a broad range of areas, including: identification of internal and external threats, access control, data security, protective controls, detection of malicious or unauthorised activity, incident response and recovery planning.

In connection with its ongoing operations, the Group utilises the services of external vendors, which it anticipates will continue and may increase in the future. These services include, for example, outsourced processing and support functions and consulting and other professional services. The Group manages its exposures to these services through a variety of means such as the performance of due diligence, consideration of operational risk, implementation of service level and other contractual agreements, and ongoing monitoring of the vendors' performance. The Group maintains a supplier risk management program with policies, procedures, organisation, governance and supporting technology that aligns with our risk tolerance and is designed to meet regulatory requirements. The program includes the adoption of appropriate risk management controls over the services exist, including, but not limited to information security, operational failure, financial stability, disaster recoverability, reputational risk, safeguards against corruption and termination.

Conduct risk

Conduct risk is defined within the MSI Group as the risk of an adverse impact on clients, markets or Morgan Stanley's reputation as a consequence of the conduct of Morgan Stanley and/or its employees. Conduct includes both intentional and unintentional behaviours.

The MSI Group has no risk appetite for Conduct Risk. It acknowledges, however, that Conduct Risk remains inherent in doing business and thus cannot be entirely eliminated.

The MSI Group has an approved Conduct Risk Management Policy. The Policy covers the two main strands of Morgan Stanley's Conduct Risk management:

- Managing the risk posed by MSI Group's business activity, for example risks posed by the MSI Group strategy or risks created in the execution of that strategy; and
- Managing the risk that employees of the MSI Group pose, for example risks arising from poor culture or failure to consider Morgan Stanley's values when conducting duties.

The policy sets out four statements outlining what the MSI Group must do to manage Conduct Risk:

- **Identification and Assessment**: Business and Support units must identify and assess the Conduct Risks which arise from their current or planned strategies and activities.
- **Management**: Internal controls and processes must be implemented to manage Conduct Risks identified. Reasonable steps must be taken to ensure effectiveness.
- **Incidents**: Areas must identify and record Conduct Risk Incidents ("CRIs").
- **Escalation & Reporting**: Processes must be established to report risks and incidents, ensuring prompt escalation and appropriate notification.

Furthermore, the policy sets out key roles and responsibilities and a framework identifying key functions and processes for the good management of Conduct Risk. The framework also sets out various key support and governance mechanisms, such as the production of key metrics and management information, and the establishment of a Conduct Risk Committee to oversee the management of Conduct Risk and the implementation of the framework.

RISK MANAGEMENT (CONTINUED)

Operational risk (continued)

Legal, regulatory and compliance risk

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

The Group, principally through the Morgan Stanley Group's Legal and Compliance Division, has established procedures based on legal and regulatory requirements on a worldwide basis that are designed to facilitate compliance with applicable statutory and regulatory requirements and to require that the Group's policies relating to business conduct, ethics and practices are followed globally.

In addition, the 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 heightened legal and regulatory focus on the financial services and banking industries globally presents a continuing business challenge for the Group.

Cyber and information security risk management

As a general matter, the financial services industry faces increased global regulatory focus regarding cyber and information security risk management practices. Many aspects of the businesses are subject to cybersecurity legal and regulatory requirements enacted by U.S. federal and state governments and other non-U.S. jurisdictions in Europe and Asia. These laws are aimed at codifying basic cybersecurity protections and mandating data breach notification requirements.

Certain of the Group's businesses are also subject to privacy and data protection information security legal requirements concerning the use and protection of certain customer information. For example, the General Data Protection Regulation ("GDPR") is scheduled to become effective in the EU on 25 May 2018 as a replacement for the EU Data Protection Directive. The GDPR imposes mandatory breach notification obligations, including significant fines for noncompliance, enhanced governance and accountability requirements and has extraterritorial impact. In addition, other jurisdictions have adopted or are proposing GDPR or similar standards, such as Australia, Singapore, Japan, Columbia, Argentina, India, Turkey, Hong Kong and Switzerland.

CAPITAL MANAGEMENT (audited)

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

In line with Morgan Stanley Group's capital management policies, the Group actively manages its 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. Therefore, in the future it may adjust its capital base in reaction to the changing needs of its businesses. The appropriate level of capital is determined at a legal entity level to safeguard that entity's ability to continue as a going concern and ensure that it meets all regulatory capital requirements. The key components of the capital management framework used by the Group are set out in the Group's Capital Management Policy and include a point in time risk and leverage based capital assessment, forward-looking capital projections and stress testing.

CAPITAL MANAGEMENT (audited) (continued)

The MSI Group conducts an Internal Capital Adequacy Assessment Process ("ICAAP") at least annually to meet its obligations under CRD IV and the requirements of the PRA. The ICAAP is one of the key tools used to inform the MSI Group's capital adequacy assessment, planning and management. The MSI Group ICAAP:

- Is designed to ensure the risks to which the MSI Group is exposed are appropriately capitalised and risk managed, including those risks that are either not captured, or not fully captured under Pillar 1;
- Uses stress testing to size a capital buffer aimed at ensuring that the MSI Group will continue to operate above regulatory requirements under a range of severe but plausible stress scenarios; and
- Assesses capital adequacy under normal and stressed operating environments over the 3 year capital planning horizon to ensure that the MSI Group maintains a capital position in line with pre- and post-stress minimum levels.

The key elements of the ICAAP are embedded in the MSI Group's day-to-day management processes and decision making culture.

The PRA reviews the ICAAP through its Supervisory Review Process and issues an Individual Capital Guidance which establishes the minimum level of regulatory capital for the MSI Group. In addition, the PRA sets a buffer if required in addition to the Basel Combined Buffers, which is available to support the MSI Group in a stressed market environment.

MSI Group capital is managed to ensure risk and leverage based requirements assessed through the ICAAP and SREP are met. Internal capital ratio minima are set to ensure the MSI Group and its subsidiaries have sufficient capital to meet their regulatory requirements at all times.

The capital managed by the Group broadly includes share capital, Additional Tier 1 capital instruments, subordinated debt and reserves. In order to maintain or adjust its capital structure, the Group may pay dividends, return capital to its shareholder, issue new shares, or issue or repay subordinated debt or Additional Tier 1.

REGULATORY REQUIREMENTS

Regulatory capital

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

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

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

REGULATORY REQUIREMENTS (CONTINUED)

Regulatory capital (continued)

Own funds

Set out below are details of the Company's Capital Resources, described in accordance with CRR and tables below as Own Funds, as at 31 December 2017 and 31 December 2016:

	2017	2016
	$millions	**$millions**
Common Equity Tier 1 ("CET1")	15,671	13,885
Additional Tier 1 ("AT1")	1,300	1,300
Tier 1 Capital	16,971	15,185
Tier 2 Capital	7,000	7,906
Total Own Funds	23,971	23,091
RWAs	132,724	102,350
CET1 Ratio	11.8%	13.6%
Tier 1 Capital Ratio	12.8%	14.8%
Total Capital Ratio	18.1%	22.6%
Leverage Exposure	448,591	379,464
Leverage Ratio	3.8%	4.0%

(1) The sum of CET 1 capital before deductions and Additional Tier 1 capital agrees to the Company's managed capital in note 28 of the Company's financial statements, with the exception of $199 million of current year profit after tax which was not eligible as CET 1 capital as at the balance sheet date.

CET1 capital during the year largely increased as a result of profits during the year and the $1,000 million share issuance.

Tier 2 capital decreased as a result of a net subordinated loans repayment of $906 million. Refer to note 17 for further detail.

Leverage ratio framework

The Basel III framework introduced a simple, transparent, non-risk based leverage ratio to act as a credible supplementary measure to the risk-based capital requirements. The Basel Committee is of the view that a simple leverage ratio framework is critical and complementary to the risk-based capital framework and that a credible leverage ratio is one that ensures broad and adequate capture of both the on- and off-balance sheet sources of banks' leverage.

Although there is no current binding leverage requirement under CRDIV, the MSI Group manages its risk of excessive leverage through the application of Business Unit leverage exposure limits and leverage ratio early warning trigger levels. Limits are calibrated in line with legal entity capacity and ensure that leverage exposure remains within the MSI Board's risk appetite. MSI Group and the Group's leverage exposures are calculated monthly and weekly, respectively, and reported to EMEA ALCO who monitor this, as well as maturity mismatches and Asset Encumbrance metrics, to ensure that any excessive risk is highlighted, assessed and mitigated appropriately. During the period the MSIP Group leverage ratio has moved from 4.0% in December 2016 to 3.8% as of December 2017, mainly driven by an increase in the leverage exposure.

REGULATORY REQUIREMENTS (CONTINUED)

Resolution and recovery planning

Both the Morgan Stanley Group and the MSI Group prepare, on an annual basis, a recovery plan which identifies mitigation tools available to both groups in times of severe stress.

The Morgan Stanley Group has developed a resolution plan in accordance with the requirements of Section 165(d) of Title I of the Dodd-Frank Wall Street Reform and Consumer Protection Act and its implementing regulations adopted by the Federal Reserve Board and the Federal Deposit Insurance Corporation. The resolution plan presents the Firm's strategy for resolution of the Firm upon material financial distress or failure in a severely adverse macroeconomic environment. The Company is a Material Operating Entity of the Morgan Stanley Group and is within the scope of the single point of entry resolution strategy adopted by the Morgan Stanley Group.

The EU Bank Recovery and Resolution Directive ("BRRD") has established a recovery and resolution framework for EU credit institutions and investment firms, including the Company. The Company produces information required by the UK Resolution Authority in the form of a resolution pack and ad hoc regulatory submissions, as necessary under BRRD and UK regulatory requirements.

MiFID II

Following the global financial crisis, the European Commission reviewed the Markets in Financial Instruments framework. The Markets in Financial Instruments Regulation and a revision of the Markets in Financial Instruments Directive (together, "MiFID II"), became effective on 3 January 2018 and introduced comprehensive and new trading and market infrastructure reforms in the EU, including new trading venues, enhancements to pre- and post-trading transparency, and additional investor protection requirements, among others.

Derivatives regulation

The Group is subject to swap regulations under the Dodd-Frank Act, including requirements relating to public and regulatory reporting in the US, central clearing and mandatory trading on certain US exchanges. U.S. and other global regulators, including the European Supervisory Authorities, have also finalised margin requirements for uncleared derivatives that apply to various entities in the Group, including the Company. Initial margin requirements are phasing in between September 2016 and September 2020 depending on the parties' trading activity, and variation margin requirements began applying to most in-scope counterparties on 1 March 2017.

Basel liquidity framework

The Basel Committee on Banking Supervision (the "Basel Committee") has developed two standards intended for use in liquidity risk supervision: the Liquidity Coverage Ratio ("LCR") and the Net Stable Funding Ratio ("NSFR").

Liquidity Coverage Ratio: The LCR was developed to ensure that banking organisations have sufficient high quality liquid assets to cover net cash outflows arising from significant stress over 30 calendar days. The standard's objective is to promote the short-term resilience of the liquidity risk profile of banking organisations. The Group was required to comply with LCR minimum standards from 1 October 2015. The Group is compliant with the minimum required LCR based on current interpretation. These minimum standards are increasing each year until 2018. The Group continues to evaluate the impact on its liquidity and funding requirements.

REGULATORY REQUIREMENTS (CONTINUED)

Basel liquidity framework (continued)

Net Stable Funding Ratio: The objective of the NSFR is to reduce funding risk over a one year horizon by requiring banking organisations to fund their activities with sufficiently stable sources of funding in order to mitigate the risk of future funding stress. In October 2014, the Basel Committee finalised revisions to the NSFR, which became effective on 1 January 2018. In November 2016, as part of the European Commission's comprehensive regulatory reform package, the proposed NSFR rules are expected to be introduced in the EU in 2019 at the earliest, with Member States implementing the new rules in 2021 based on current estimates. The Company and MSI Group continue to evaluate the NSFR and its potential impact on the Company's and MSI Group's current liquidity and funding requirements.

Finalising Basel III Reforms

On 7 December 2017, the Basel Committee released the final part of its Basel III reform package. The key amendments provide updates to the standardised measures for calculating capital requirements and include a risk-weighted asset ("RWA") floor, calculated as 72.5% of total standardised RWA. These proposals will need to be transposed into national/EU law, however the timing of this is still uncertain.

European Financial Regulation Reform

European Financial Regulation Reform

In November 2016, the European Commission published a comprehensive regulatory reform package which aims to continue the reforms that the EU implemented in the wake of the financial crisis. The proposals seek to amend to the existing prudential regime (CRR and CRDIV), including amendments to the risk-based capital, liquidity, leverage and large exposures regimes (known as "CRD5" and "CRR2"), the Bank Recovery and Resolution Directive ("BRRD") and the Single Resolution Mechanism ("SRM").

The key amendments to the CRR include:

- A binding leverage ratio;
- A new standard on the total loss-absorbing capacity ("TLAC") for globally systemically important institutions ("G-SIIs") which will require those institutions to have more loss-absorbing and recapitalisation capacity, and to tackle interconnections in the global financial markets;
- A binding NSFR to establish how much stable, long-terms sources of funding an institution needs to weather periods of market or funding stress;
- A new standardised approach for the calculation of counterparty credit exposures for derivatives;
- New standardised and advanced calculation approaches for market risk requirements.

REGULATORY REQUIREMENTS (CONTINUED)

European Financial Regulation Reform (continued)

Amongst key amendments to the CRDIV the following are worth noting:

- Provisions harmonising the application of the Pillar 2 framework by supervisors across the EU;
- Harmonisation of the calculation of the distributable amount (e.g., dividends) by introducing a common 'stacking order' for capital requirements calculated at different levels (such as Pillar 1 capital requirements, TLAC requirements, capital buffers);
- Modifications to the framework for Interest Rate Risk in the Banking book ("IRRBB");
- Bringing certain holding companies directly in scope of the EU prudential framework;
- Introducing a requirement for certain large non-EU financial groups to set up EU Parent Intermediate Holding Companies ("EU IHC") which will bring their EU-based regulated subsidiaries under common prudential consolidation groups. EU IHCs would be subject to direct supervision and authorisation by the European Central Bank ("ECB") or the relevant national EU regulator.

Although progress has been made by European policy-makers during 2017, these legislative proposals continue to be discussed and negotiated amongst them and it is not possible to anticipate their final content or time of application.

EMPLOYEE MATTERS

Culture, values and conduct of employees

All employees of the Morgan Stanley Group are accountable for conducting themselves in accordance with Morgan Stanley Group's core values - *Putting Clients First, Doing the Right Thing, Leading with Exceptional Ideas, and Giving Back*. The Morgan Stanley Group is committed to reinforcing and confirming adherence to the core values, through our governance framework, tone from the top, management oversight, risk management and controls, and a three lines of defence structure (business, control functions such as Risk Management and Compliance, and Internal Audit).

The Morgan Stanley Group's Board is responsible for overseeing the Morgan Stanley Group's practices and procedures relating to culture, values and conduct, as set forth in the Morgan Stanley Group's Corporate Governance Policies. The Morgan Stanley Group's Culture, Values and Conduct Committee, which is part of the Enterprise Risk Management framework, is the senior management committee that oversees the Firm-wide culture, values and conduct program. A fundamental building block of this program is the Morgan Stanley Group's Code of Conduct, which establishes standards for employee conduct that further reinforce the Morgan Stanley Group's commitment to integrity and ethical conduct. Every new employee and every current employee, annually, must attest to their understanding of and adherence to the Code of Conduct.

The annual employee performance appraisal process includes an evaluation of employee conduct related to risk management practices and the Morgan Stanley Group's expectations. The Morgan Stanley Group also has several mutually reinforcing processes to identify employee conduct that may have an impact on employment status, current year compensation and/or prior year compensation. For example, the Global Incentive Compensation Discretion Policy sets forth standards for managers when making annual compensation decisions and specifically requires managers to consider whether their employees effectively managed and/or supervised risk control practices during the performance year. Management committees from control functions periodically meet to discuss employees whose conduct does not meet the Firm's standards. These results are incorporated in the employees' performance evaluation, which links to compensation and promotion decisions.

EMPLOYEE MATTERS (CONTINUED)

Culture, values and conduct of employees (continued)

The Morgan Stanley Group's clawback and cancellation provisions permit recovery of deferred incentive compensation, and cover a broad scope of employee conduct, including any act or omission (including with respect to direct supervisory responsibilities) that constitutes a breach of obligation to the Morgan Stanley Group or causes a restatement of the Morgan Stanley Group's financial results, constitutes a violation of the Morgan Stanley Group's global risk management principles, policies and standards, or causes a loss of revenue associated with a position on which the employee was paid and the employee operated outside of internal control policies.

Morgan Stanley Group is an equal opportunity employer committed to ensuring, within the framework of the law, that the work place is free from unlawful discrimination on the grounds of race, colour, nationality (including citizenship), ethnic or national origin, religion or belief, gender, gender reassignment, sexual orientation, pregnancy and maternity, age, marriage and civil partnership or disability. This commitment is stated in the Morgan Stanley Group's UK Equal Opportunities Statement.

The Morgan Stanley Group aims to ensure that staff achieve their full potential and that all employment decisions are taken without reference to irrelevant or discriminatory criteria. The Dignity at Work Policy for the Group aims to draw attention to, and therefore prevent, all forms of unacceptable behaviour and to ensure all staff are treated with dignity and respect.

Breach of the UK Equal Opportunity Statement and/or Dignity at Work Policy may result in disciplinary action being taken, up to and including termination of employment. Anyone who believes that they, or indeed anyone else employed by the Group, may have been disadvantaged on discriminatory grounds is entitled, and encouraged, to raise the matter through the Morgan Stanley Group's Grievance Procedure, as set out in the UK Employee Handbook.

The correlation between inclusive teams and improved decision-making, innovation and performance aligns with Morgan Stanley Group's core values of leading with exceptional ideas, putting clients first, and doing the right thing. The EMEA Diversity Action Council acts as a catalyst to drive forward the EMEA diversity strategy in partnership with the Human Resources, Diversity and Inclusion and Talent teams. Accountability is underscored by quarterly meetings with the European Operating Committee and regular discussion at Divisional Operating Committees.

The Group commits to complying with the spirit and intention of rules, employment laws and regulatory requirements in all office locations and acknowledges where meaningful and sustainable change may take time.

MSI is proud to be a signatory of the UK Government's Women in Finance Charter and to have been the first major US Investment bank to do so. The charter is a pledge to increase gender balance across the UK Financial Services Industry. Signing it reflects a long term commitment to support the advancement of women into senior roles and publicly demonstrating progress against diversity goals. In accordance with the UK Government regulations, the Group recently published the Group's UK gender pay gap figures. The gender pay gap is the average pay difference between men and women across a company, irrespective of role or level. Equal pay, in contrast, is ensuring men and women are paid equally for the same or similar role, or for work of equal value. The Group is committed to making sure that every individual, regardless of gender, is compensated fairly for their role, performance and experience. The gender pay gap is impacted by the proportion of men and women in more senior, and therefore more highly paid roles – an issue affecting many companies. The Group acknowledges that meaningful and sustainable change will take time and reiterates its strong commitment to making this change happen. For further information on the Group's and Morgan Stanley Group's commitment to a culture that is diverse and inclusive, as well as details on the UK gender pay gap, see http://www.morganstanley.com/about-us/diversity.

EMPLOYEE MATTERS (CONTINUED)

Culture, values and conduct of employees (continued)

Both the Company and the Morgan Stanley Group place considerable value on the investment in their employees and have continued their practice of keeping employees informed on matters affecting them. Employees are encouraged to present their suggestions and views on Morgan Stanley Group's performance to management and employees participate directly in the success of the business through the Morgan Stanley Group's various compensation incentive plans.

Every effort is also made to ensure that disabled applicants, or those existing employees who are disabled or may have become disabled, are treated as fairly as possible on terms comparable with those of other employees. Appropriate training is arranged for disabled persons, including retraining for alternative work for employees who become disabled, to promote their career development within the organisation.

RESPECT FOR HUMAN RIGHTS

Morgan Stanley Group's Modern Slavery and Human Trafficking Statement displays the Firm's commitment to supporting the protection and advancement of human rights in our business and throughout our supply chain. With operations around the world, the Group strives to uphold global standards for responsible business, including equal opportunity, freedom to associate and bargain collectively, and the elimination of child and forced labour.

The Group endeavours to exercise its influence in part by conducting business operations in ways that attempt to preserve, protect and promote the full range of human rights, such as those described in the United Nations Universal Declaration of Human Rights ("UDHR"). All employees must read and acknowledge the Morgan Stanley Code of Conduct annually, which underscores the Group's values and our commitment to ensuring a workplace that includes equal opportunity, dignity and respect, including with respect to suppliers, affiliates and partners.

The Group's vendor due diligence program assesses risk associated with third party suppliers. The assessment includes a review of the supplier's litigation history, regulatory profile and negative media coverage using publicly available material and news sources. This assessment identifies, among other things, potential for risks associated with human rights and other social and/or environmental issues. Where appropriate, issues are escalated to and considered by senior management.

To mitigate risk, the Group has identified spend categories (and the vendors associated with those spend categories) that may be subject to additional review, including for potential modern slavery related issues and reviewed supplier agreement templates to ascertain whether such agreements impose obligations on our suppliers to address modern slavery issues in their business and supply chains.

If the Group becomes aware that any of its existing vendors have modern slavery related issues, the Group will review and address those situations as deemed appropriate.

ENVIRONMENTAL, SOCIAL AND GOVERNANCE

Morgan Stanley, the Group's ultimate parent company, endeavours to advance sustainability by considering environmental, social and governance (ESG) matters throughout the Firm's operations and businesses.

Through Morgan Stanley's three businesses, in partnership with the Global Sustainable Finance function, Morgan Stanley offers financial solutions and advisory services that create positive long-term benefits for clients and shareholders as well as the environment and communities across the world. The Morgan Stanley Institute for Sustainable Investing's advisory board, chaired by our CEO, helps to ensure that our sustainability strategy is comprehensive, rigorous and innovative.

ESG initiatives are overseen by the Morgan Stanley Group Nominating and Governance Committee and reported to the Board. In fulfilling its duties, the Nominating and Governance Committee receives reports from the Chief Sustainability Officer, who oversees the Firm's efforts to promote global sustainability through the capital markets. The Firm's ESG initiatives include:

Institute for Sustainable Investing

The Morgan Stanley Group launched the Institute for Sustainable Investing in 2013 to accelerate the adoption of sustainable investing. The Institute partners with business units across the Morgan Stanley Group to create scalable sustainable financing solutions, new sustainable investing tools and industry-leading insights.

Institutional Securities

Within the Institutional Securities business, Morgan Stanley Group provides capital for clean technology and renewable companies, issues green bonds and integrates ESG considerations into how companies are analysed within the Equity Research team. In 2017, the Firm helped integrate ESG considerations into coverage for 1,000 stocks, led $18.7 billion in green bonds and provided $16.8 billion in clean-tech and renewable energy financing.

Reducing the Morgan Stanley Footprint

Since 2006, the Morgan Stanley Group has reduced greenhouse gas emissions by 36%, and pursued energy efficient building standards for offices across the globe, with 30 Leadership in Energy and Environmental Design ("LEED") certifications globally and a solar array and fuel cells generating more than 9 million kWh of clean electricity on-site annually.

In 2017, Morgan Stanley Group announced a five-year carbon neutrality goal, committing to source 100% of global energy needs from renewable energy by 2022 and joining the initiative RE100, a collaborative initiative uniting more than 100 influential businesses committed to 100% renewable electricity, working to massively increase demand for and delivery of renewable energy.

Environmental and Social Risk Management

Underpinning these goals are policies and procedures that enhance the Morgan Stanley Group's management of ESG issues including: Global Environmental and Social Risk Policy, Environmental Policy Statement, Coal and Oil Sands Policy Statement, Statement on Human Rights and Code of Conduct, as well as the Modern Slavery and Human Trafficking Statement, which enhances the Firm's commitment to monitoring and minimising exposure to human rights risks in supply chain and business operations.

ANTI-CORRUPTION AND ANTI-BRIBERY

The Group, principally through Morgan Stanley Group's Legal and Compliance Division, has established and implemented policies, procedures, and internal controls reasonably designed to comply with applicable anti-corruption laws and regulations in the jurisdictions in which it operates.

Morgan Stanley Group's Global Anti-Corruption Policy, which is updated annually and approved by the Group's Audit Committee, addresses corruption risks and prohibits offering, promising, giving or authorising others to give anything of value, either directly or indirectly, to any party, in order to improperly obtain or retain business or gain an improper business advantage. It also prohibits receiving, or agreeing to receive, anything of value that results or may result in the improper performance of employees' duties at the firm. These values are embedded within the Morgan Stanley Group's Code of Conduct, to which employees must attest their understanding of, and adherence to, on an annual basis.

The Global Anti-Corruption Policy sets forth rules and procedures designed to address corruption risk, including:

- Governance and oversight responsibilities;
- Pre-clearance, due diligence and monitoring requirements for engaging with certain third parties who will act on behalf of Morgan Stanley;
- Pre-approval requirements for certain meals, entertainment, gifts and charitable contributions;
- Transactional due diligence requirements;
- Pre-clearance, in certain circumstances, of candidates for employment;
- Prohibition on facilitation payments; and
- Maintenance of accurate books and records.

An annual risk assessment is performed to consider key areas of potential corruption risk to the Morgan Stanley Group, including business conducted in jurisdictions and industries deemed higher risk from a corruption perspective, the use of third party introducers and intermediaries, and the provision of gifts and entertainment.

Anti-corruption training is provided to all staff globally on an annual basis via a mandatory financial crimes training module, and targeted training is additionally conducted to particular business units or on specific topics as necessary, such as where a particular risk is identified through the risk assessment.

The Group maintains whistleblowing policies and procedures to ensure that individuals can confidentially report concerns when these arise. Management information regarding the Group's anti-corruption program is reported to appropriate senior management personnel through Legal and Compliance Division governance frameworks.

GIVING BACK TO THE COMMUNITY

Morgan Stanley is committed to giving back to the communities in which it operates through a range of philanthropic programs. The impact of these philanthropic initiatives includes:

Volunteering

Global Volunteer Month is Morgan Stanley Group's annual global initiative focused on encouraging all employees to give their time to local communities. Through Global Volunteer Month and other campaigns, in 2017, employees logged 518,000 volunteer hours for charities around the world.

In EMEA, over 92% of employees participated in volunteering service in 2017, with employees taking part in hundreds of activities, from packing nutritious food to restoring parks, cleaning waterfronts, mentoring students, and hosting fitness activities for children.

GIVING BACK TO THE COMMUNITY (CONTINUED)

Volunteering (continued)

Morgan Stanley Group's largest *pro bono* initiative is the Strategy Challenge, a program where selected top-performing employees embark on an eight-week consulting project with charity partners, resulting in the delivery of a fully implementable strategic plan to enable the charities to achieve their goals. Since inception in London in 2014, employees have contributed more than 13,000 service hours, valued at over $2 million, to 19 charities in the UK. In 2017, five charities benefitted from the program. The winning team, working with Save the Children, developed an ambitious strategy around the charity's vision to build the most effective business model to grow its parental engagement program in the UK.

Giving

Morgan Stanley and employee philanthropic giving continues to rise. In 2017, over 25,000 employees donated over $40 million to charities globally.

In EMEA, employees nominate a charity partner, raising funds over a one or two year period, supported by the Morgan Stanley International Foundation (the "Foundation").

In London, since February 2015, employees and the Foundation have raised £1.7 million towards accommodation for parents of children in intensive care and other wards at Great Ormond Street Hospital ("GOSH"). The new facility, Morgan Stanley House, officially opened on 19 October 2017.

In 2017, UK employees and the Foundation set out to raise over £1 million over the next two years.

In London, employees nominated the children's charity, NSPCC as the new charity partner, raising funds to help create the UK's first "Child's House", bringing together therapeutic support and local services under one roof to provide care for children who have been abused.

In Glasgow, employees nominated Marie Curie, raising funds to help create the first full time Child Bereavement Counsellor and enable a full time Bereavement Helpline service.

Other employee nominated charity partners across EMEA were; Orzok Foundation in Budapest, Hilfe für krebskranke Kinder Frankfurt e.V in Frankfurt, L'Envol in Paris, Fundacion Aladina in Milan and Association CAF Onlus in Madrid. These charities all work to support a range of children's causes.

Community Impact

For more than 50 years, the Morgan Stanley Foundation has supported healthy starts and solid educations for the children in our communities, and has continued to expand the reach of those initiatives globally for the past 20 years through the Morgan Stanley International Foundation.

Healthy London is part of a Morgan Stanley Global Program – Healthy Cities. The program is designed to bring together local charities to offer parents better access to wellness, nutrition and play resources for children to get a healthy start in life. The program provides funding to five local charities in Poplar, Tower Hamlets.

2017 was the third year of the Healthy London program. To date 28,000 meals have been delivered. Children and parents have received health care advice, attended exercise and wellbeing workshops. Three new safe places have been created and play specialists have led over 4,500 hours of play for local children. Employees have also engaged in the program and logged over 4,000 volunteer hours. Due to the success of the program, Healthy Glasgow was launched in November 2017, focusing on the Sighthill Estate in the northeast of Glasgow.

GOING CONCERN

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

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

Approved by the Board and signed on its behalf by

Director

19 April 2018

DIRECTORS' REPORT

The Directors present their report and consolidated financial statements of Morgan Stanley & Co. International plc and all of its subsidiary undertakings , which comprise the consolidated income statement, consolidated statement of comprehensive income, consolidated statement of changes in equity, consolidated statement of financial position, consolidated statement of cash flows and the related notes 1 to 35, together with the Company's statement of comprehensive income, statement of changes in equity, statement of financial position and related notes 1 to 31 and the appendix to the financial statements for the year ended 31 December 2017.

RESULTS AND DIVIDENDS

The Group's profit for the year, after tax, was $864 million (2016: $451 million profit after tax).

On 31 May 2017, the Directors approved a coupon payment on the Additional tier 1 capital instrument of $119 million (2016: $158 million; see note 23). No other dividends were proposed or paid during the year ended 31 December 2017 (2016: $nil).

REGULATION, RISK MANAGEMENT, BRANCHES AND FUTURE DEVELOPMENTS

Information regarding regulation, risk management, branches and future developments has been included in the Strategic report.

EMPLOYEES

Information on employee matters has been included in the Strategic Report on pages 35 to 37.

PILLAR 3 DISCLOSURES

The regulatory disclosures made in order to comply with the EU Directives and Regulation implementing the Basel capital framework ("the Pillar 3 disclosures") are available on the Morgan Stanley website (see note 28 of the Company's financial statements for further details).

CAPITAL REQUIREMENTS COUNTRY-BY-COUNTRY REPORTING

The disclosures made in order to comply with the Capital Requirements (Country-by-Country Reporting) Regulations 2017 will be made available on the Morgan Stanley website (see note 28 of the Company's financial statements for further details).

DIRECTORS

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

J Bloomer	(appointed Chairman from 31 March 2018)
D O Cannon	
C Castello	
T Duhon	
L Guy	
J Horder	
A Kohli	
M C Phibbs	
I Plenderleith	(Chairman until resigned on 31 March 2018)
R P Rooney	
D A Russell	

DIRECTORS' AND OFFICERS' LIABILITY INSURANCE

Directors' and Officers' Liability Insurance is taken out by Morgan Stanley, for the benefit of the Directors and Officers of the Group.

DIRECTORS' INDEMNITY

Qualifying third party indemnity provisions (as defined in section 234 of the Companies Act 2006) were in force during the year and up to and including the date of the Directors' report for the benefit of the Directors of the Group.

AUDIT COMMITTEE

MSI, the Company's ultimate UK parent undertaking, has an Audit Committee which assists the Boards of MSI, the Company, other MSI regulated subsidiary undertakings and certain other Morgan Stanley Group undertakings in meeting their responsibilities in ensuring an effective system of internal control and compliance, and in meeting their external financial reporting obligations. For details on the Risk governance framework, refer to pages 12 to 15 of the Strategic Report.

EMPLOYEE REMUNERATION

The Group employs staff directly, in addition to utilising staff employed by other Morgan Stanley Group undertakings. The Group's policies are comparable and consistent with those of the Morgan Stanley Group, which include the deferral of significant portions of certain key employees' discretionary compensation. Notes 6 and 34 to the consolidated financial statements provides additional information and disclosure regarding the Group's compensation policies.

CHARITABLE CONTRIBUTIONS

During the year the Group made donations to various charities totalling $2.1 million (2016: $3.5 million), of which $1.5 million (£1.2 million) was donated to the Morgan Stanley International Foundation (2016: $1.7 million).

AUDITOR

Deloitte LLP have expressed their willingness to continue in office as auditor of the Group and a resolution to re-appoint them will be proposed at the forthcoming annual general meeting.

Statement as to disclosure of information to the auditor

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 Group's auditor in connection with preparing their report) of which the Group's auditor is 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 Group's auditor is aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of section 418 of the Companies Act 2006.

Approved by the Board and signed on its behalf by

C Castello

Director

19 April 2018

DIRECTORS' RESPONSIBILITIES STATEMENT

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 prepared the financial statements in accordance with International Financial Reporting Standards ("IFRS") as adopted by the EU and Article 4 of the International Accounting Standards ("IAS") Regulation and have elected to prepare the parent company financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law), including FRS 101 "Reduced Disclosure Framework" ("FRS 101"). 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 Group and of the profit or loss of the Group for that period.

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

- properly select and apply accounting policies;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- 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
- make an assessment of the Group's ability to continue as a going concern.

In preparing the Company 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; 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 Group's transactions and disclose with reasonable accuracy at any time the financial position of the Group 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 Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Directors, the names of whom are set out on page 42, confirm to the best of their knowledge:

- in accordance with rule 4.1.12(3)(a) of the FCA's Disclosure and Transparency Rules, the consolidated 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 profit or loss of the Group and the undertakings included in the consolidation taken as a whole; and
- the management report represented by the Strategic report has been prepared in accordance with rule 4.1.12(3)(b) of the FCA's Disclosure and Transparency Rules, and includes a fair review of the development and performance of the business and the position of the Group and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that the Group faces.

Approved by the Board and signed on its behalf by

Director, 19 April 2018

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF MORGAN STANLEY & CO. INTERNATIONAL plc

REPORT ON THE AUDIT OF THE FINANCIAL STATEMENTS

Opinion

In our opinion:

- **the financial statements give a true and fair view of the state of the Group's and of the 'parent company's affairs as at 31 December 2017 and of the Group's profit for the year then ended;**
- **the Group financial statements have been properly prepared in accordance with International Financial Reporting Standards ("IFRSs") as adopted by the European Union;**
- **the parent company financial statements have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice including Financial Reporting Standard ("FRS") 101 "Reduced Disclosure Framework"; and**
- **the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards to the Group financial statements, Article 4 of the International Accounting Standards ("IAS") Regulation.**

We have audited the financial statements of Morgan Stanley & Co. International plc (the "parent company") and its subsidiaries (the "Group") which comprise:

Group	Parent company
• Consolidated income statement for the year ended 31 December 2017; • Consolidated statement of comprehensive income for the year then ended; • Consolidated statement of changes in equity for the year then ended; • Consolidated statement of financial position as at 31 December 2017; • Consolidated statement of cash flows for the year then ended; • Relevant notes 1 to 35 to the consolidated financial statements; and • Information identified as "audited" in the Risk Management section of the Strategic Report on pages 15 to 26 and 30 to 31.	• Statement of comprehensive income for the year ended 31 December 2017; • Statement of changes in equity for the year then ended; • Statement of financial position as at 31 December 2017; and • Relevant notes 1 to 31 to the financial statements.

The financial reporting framework that has been applied in the preparation of the Group financial statements is applicable law and IFRSs as adopted by the European Union. The financial reporting framework that has been applied in the preparation of the parent company financial statements is applicable law and United Kingdom Accounting Standards, including FRS 101 "Reduced Disclosure Framework" (United Kingdom Generally Accepted Accounting Practice).

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the auditor's responsibilities for the audit of the financial statements section of our report.

We are independent of the Group and the parent company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the Financial Reporting Council's

("FRC") Ethical Standard as applied to listed public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We confirm that the non-audit services prohibited by the FRC's Ethical Standard were not provided to the Group or the parent company.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Summary of our audit approach

Key audit matters	The key audit matters that we identified in the current year were: • Valuation of Level 3 financial instruments; • The completeness and accuracy of intercompany transactions; and • The appropriateness of provisions for uncertain tax positions.
Materiality	The materiality that we used in the current year was $275 million, which is 1.5% of Total Equity.
Scoping	The planning and scoping of our audit reflects the Group's business and operational structure which follows Morgan Stanley's global operating model. This model comprises a common control structure for key business processes and internal controls over financial reporting. Based on this global operating model, our audit scope is globally integrated with the audit testing procedures performed by Deloitte & Touche LLP, US, the lead auditor of the ultimate parent company, Morgan Stanley. The scope of our audit for the Group identifies those components that are financially significant to the Group and the locations where account balances included in the Group's financial statements are managed and controlled As a result, we identified North America (New York) and Asia Pacific (Hong Kong) to be components of the Group respectively.

Conclusions related to going concern

We are required by ISAs (UK) to report in respect of the following matters where:

- the directors' use of the going concern basis of accounting in the preparation of the financial statements is not appropriate; or
- the directors have not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the Group's or the parent company's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.

We have nothing to report in respect of these matters.

Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) that we identified. These matters included those which had the greatest effect on: the overall audit strategy, the allocation of resources in the audit; and directing the efforts of the engagement team.

These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Valuation of Level 3 financial instruments	
Relevant references in the financial statements	Group financial statements: • Note 3 – Summary of significant accounting policies – (d) Fair value • Note 31 – Assets and liabilities measured at fair value – (a) (c) (d) (e) Parent company financial statements: • Note 26 – Assets and liabilities measured at fair value – (a) (c) (d) (e)
Key audit matter description	The Group's trading and financing activities will at times result in the Group carrying material financial asset and liability positions having limited price transparency. These financial instruments generally include derivative, security or lending positions spanning a broad array of product types. Under IFRS 13 *Fair Value Measurement*, these financial instruments are generally classified as Level 3 financial assets or liabilities. Unlike other financial instruments whose values or inputs are readily observable and therefore more easily independently corroborated, the valuation of financial instruments classified as Level 3 are inherently subjective, and often involve the use of proprietary valuation models whose underlying algorithms and valuation methodologies are complex. This degree of subjectivity may also give rise to potential fraud through management intentionally inflating fair vales or incorporating management bias in determining fair values. Auditing the Group's valuation of Level 3 financial instruments is therefore subjective and presents certain challenges in evaluating the appropriateness of the Group's valuation judgements and estimates. Significant judgements made by the Group include the derivation of key model inputs which are not observable in the marketplace, the completeness of risk characteristics to be captured by the model, and the underlying valuation methodologies used by the pricing model to determine an appropriate fair value. Evaluating these judgements is subjective and complex, and requires the auditor to possess certain skills and expertise to effectively challenge the significant judgements made by management when pricing such instruments. As at 31 December 2017, the Group's total financial assets and liabilities measured at fair value were \$276.5 billion and \$240.3 billion, respectively,

	of which Level 3 financial assets and liabilities were $4.2 billion and $3.9 billion, respectively.

How the scope of our audit responded to the key audit matter	To address the complexities associated with auditing the value of Level 3 financial instruments, our team included valuation specialists having significant quantitative and modelling expertise to assist in performing our audit procedures. Our valuation audit procedures included the following control and substantive procedures:
	
	• We tested the design and operating effectiveness of Morgan Stanley's valuation controls including the:
	  o Model certification control, which is designed to review a model's theoretical soundness and the appropriateness of its valuation methodology, including whether any limitations or valuation adjustments should be placed on a model's implementation or use given subjectivities in calibrating to varying market conditions.
	  o Independent Price Verification control, which is designed to review the appropriateness of valuation methodologies to derive model inputs which are not observable and are significant to the financial instrument's valuation, and
	  o The Group's daily trading profit and loss analysis, as well as its trade confirmation, and collateral dispute resolution controls.
	
	• Our substantive test procedures included:
	  o Benchmarked Group management's input assumptions against the expected assumptions of other market participants leveraging relevant external data.
	  o Performed a retrospective assessment of Group management's valuation estimate by comparing such estimate against relevant subsequent transactions.
	  o Developed independent valuation estimates, using externally sourced inputs and challenger models, and used such estimates to further evaluate Group management's fair value measurement by evaluating whether the differences between our independent estimates and the Group's estimates were within a reasonable range.
	
	Where differences between our independent valuations and those of the Group were outside our audit thresholds, we performed additional procedures including 1) evaluating the fair value estimate against recent comparable transactions, 2) comparing the Group's estimate against implied valuations from collateral disputes and 3) analysing associated valuation adjustments, which may be reflective of relevant uncertainty given the illiquid nature of Level 3 instruments.

Key observations	Based on our audit procedures performed, we concluded that the valuation of Level 3 financial instruments was appropriate.

The completeness and accuracy of intercompany transactions	
Relevant references in the financial statements	Group financial statements: • Note 35 – Related party disclosures
Key audit matter description	As part of its normal business operations, the Group transacts extensively with other legal entities within the Morgan Stanley Group. These transactions include bilateral trading transactions with other legal entities, funding arrangements entered into with other group entities and Morgan Stanley Group transfer pricing allocations where revenues and related costs are attributed to the business activities undertaken at a legal entity level. Effective 1 January 2017, the transfer pricing allocations were calculated using the updated global transfer pricing policies implemented by the management of Morgan Stanley, across the wider Morgan Stanley group. Given the large volume and nature of intercompany transactions which the Group is a party to, there is an inherent complexity in determining the completeness and accuracy of intercompany transactions impacting both the balance sheet and the income statement of the Group which may result in misstatements in the financial statements.
How the scope of our audit responded to the key audit matter	Our procedures over the completeness and accuracy of intercompany transactions included the following control and substantive procedures: • We assessed and tested the design and operating effectiveness of key controls over intercompany transactions. This included controls over the performance of intercompany reconciliations and the identification and subsequent investigation of intercompany breaks. • Specifically for Morgan Stanley Group transfer pricing allocations, we tested the design and operating effectiveness of the initial set-up of the transfer pricing policies and for the determination of the calculations of transfer pricing entries at a legal entity level. • For a sample of intercompany transactions, we independently re-performed the calculations of the related intercompany charge to assess whether they reflected the agreed contractual arrangements and they had been correctly recorded in the underlying accounting books and records. • We assessed the adequacy of the disclosure in the Group financial statements.
Key observations	During the course of the financial year, Group management identified that certain business funding allocations relating to, amongst others, re-hypothecated securities transactions and collateral funding client transactions, resulted in inconsistent legal entity treatment once the operation of transfer pricing had also been factored in. Whilst we concluded

	that the accounting for intercompany transactions was appropriate, management identified that the design of controls over ensuring the timeliness with which business funding allocations and transfer pricing across legal entities are applied requires further enhancements. Group management are in the process of implementing these enhancements.

The appropriateness of provisions for uncertain tax positions	
Relevant references in the financial statements	Group financial statements: • Note 3 – Summary of significant accounting policies – (o) Provisions • Note 19 – Provisions Parent company financial statements: • Note 15 – Provisions
Key audit matter description	The Group operates in multiple tax jurisdictions and is subject to complex tax laws. These laws can be subject to changes in interpretation by the relevant governmental taxing authorities. Disputes over the interpretation of tax laws may be settled with the taxing authorities by mutual agreement or, in certain circumstances, following litigation. Management evaluate the likelihood of tax assessments arising in each taxing jurisdiction as a result of current examinations, prospective submissions and changing interpretation of tax laws. Where a provision is required in respect of an uncertain tax position, management make judgements on the applicability of the relevant tax law in order to determine the appropriate amount of the provision. Management then periodically review the need for and quantification of provisions held. Significant judgements are involved in the recognition and valuation of provisions for uncertain tax positions and related disclosures made by the Group. Evaluating these judgements is subjective and complex, and requires the auditor to possess certain skills and expertise to effectively challenge the significant judgements made by management.
How the scope of our audit responded to the key audit matter	Our procedures to assess the appropriateness and quantification of provisions for uncertain tax positions included the following control and substantive procedures: • We assessed and tested the design and operating effectiveness of key controls over the identification and determination of the amounts of provisions for uncertain tax positions on initial recognition and subsequent re-measurement events. • With the assistance from our tax specialists, we reviewed:

	o Management's correspondence with HMRC and other tax authorities; o Advice received from professional tax advisers, where obtained; and o Materials available from management regarding transactions and re-organisations undertaken in the current year in order to evaluate whether (i) relevant factors were included as assumptions in the determination of provisions made, and (ii) there were any other matters in respect of which a provision could be required. • With the assistance from our tax specialists, we performed an independent assessment of the assumptions used in determining the quantification of a sample of the Group's provisions for uncertain tax positions, in evaluating the reasonableness of the assumptions and the accuracy of the calculation made on the basis of those assumptions. • We assessed the adequacy of the disclosure in the Group financial statements.
Key observations	Based on our audit procedures performed, we concluded that the valuation of provisions for uncertain tax positions was appropriate.

Our application of materiality

We defined materiality as the magnitude of misstatement in the financial statements that makes it probable that the economic decisions of a reasonably knowledgeable person would be changed or influenced. We use materiality both in planning the scope of our audit work and in evaluating the results of our work.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

	Group financial statements	**Parent company financial statements**
Materiality	$275 million	$273 million
Basis for determining materiality	The Group materiality of $275 million represents 1.5% of Total Equity	The parent company materiality of $273 million represents 1.5% of Total Equity
Rationale for the benchmark applied	We have considered Total Equity to be the most appropriate benchmark as the Group is a wholly owned subsidiary of the ultimate parent entity Morgan Stanley and is a regulated entity where its capital position is of importance to the key users of the financial statements. These key users include Regulators, external rating agencies and the ultimate parent entity.	We have considered it appropriate to maintain the same benchmark as that for the Group as the parent company is the most significant member of the Group and its solo capital position is of importance to the key users of the financial statements who are common with those for the Group.

We may also judge something to be material based on qualitative factors where balances may be below the quantitative materiality figure set out above. For example, this may be the case where a balance is based on a management estimate and therefore involves a degree of subjectivity in determining the carrying value in the financial statements.

We agreed with the Audit Committee of the Group (the "Audit Committee") that we would report to the Audit Committee all audit differences in excess of a clearly trivial amount of $5.5 million for both the Group and the parent company, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds. We also report to the Audit Committee on disclosure matters that we identified when assessing the overall presentation of the financial statements.

An overview of the scope of our audit

Morgan Stanley is a globally managed business with a global operating model in which major classes of transactions are subject to a common control processing environment irrespective of product, region or legal entity. Given this global operating model for the Group, we audit controls and financial reporting processes in the location in which they are performed and we audit balances where they are controlled.
Based on the above, we identified North America (New York) and Asia Pacific (Hong Kong) to be the components for the purposes of our audit of the Group financial statements. We instructed our North America (New York) and Asia Pacific (Hong Kong) component auditors to perform their audit procedures at a materiality level of $234 million being 85% of our Group materiality. - This enabled us to obtain audit coverage of 99% of the Group's Total Assets, 100% of the Group's Revenue and 99% of the Group's Profit Before Tax.

Involvement with component auditors

We exercised oversight over the work of our component auditors by remaining in active dialogue at regular intervals throughout the duration of the audit. We attended the audit planning meetings in New York and Hong Kong, involved both of the component auditors in our team briefing and issued a set of instructions to each component auditor setting out the audit work and the specified audit procedures we requested them to undertake. We undertook a visit to our North America (New York) component auditor during the final stage of our audit to discuss key findings arising from their work and to review their audit work papers. We also formally received audit clearance documentation from both component auditors confirming that they had performed the audit and the specified audit procedures in accordance with our instructions.

Audit procedures undertaken at the Group level

We designed our audit approach for the Group based on our understanding of the business undertaken by the Group and our independent assessment of the risks of material misstatement arising in the financial statements. These procedures included, amongst others, auditing the consolidation of the Group's results and the preparation of the financial statements as well as testing the design, implementation and operating effectiveness of the internal controls over financial reporting.

Other information

The directors are responsible for the other information. The other information comprises the information included in the annual report, including the Strategic Report and the Directors' Report, other than the financial statements and our auditor's report thereon.

Our opinion on the financial statements does not cover the other information, except to the extent otherwise explicitly stated in our report, and we do not express any form of assurance conclusion thereon.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF MORGAN STANLEY & CO. INTERNATIONAL plc

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

We have nothing to report in respect of these matters.

Responsibilities of directors

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, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the Group's and the parent company's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the directors intend to liquidate the Group or the parent company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the FRC's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

Use of our report

This report is made solely to the parent 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 parent 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 parent company and the parent company's members as a body, for our audit work, for this report, or for the opinions we have formed.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

Opinions on other matters prescribed by the Companies Act 2006

In our opinion, based on the work undertaken in the course of an audit:

- the information given in the Strategic Report and the Directors’ Report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the Strategic Report and the Directors’ Report have been prepared in accordance with applicable legal requirements.

In light of the knowledge and understanding of the Group and of the parent company and their environment obtained in the course of the audit, we have not identified any material misstatements in the Strategic Report or the Directors’ Report.

Matters on which we are required to report by exception

Adequacy of explanations received and accounting records

Under the Companies Act 2006 we are required to report to you if, in our opinion:

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

We have nothing to report in respect of these matters.

Directors’ remuneration

Under the Companies Act 2006 we are also required to report if in our opinion certain disclosures of directors’ remuneration have not been made.

We have nothing to report in respect of this matter.

Other matters

Auditor tenure

Following the recommendation of the Audit Committee of the Group, we were appointed by the Board of Directors on 17 November 1997 to audit the financial statements for the year ended 31 December 1997 and subsequent financial periods. The period of total uninterrupted engagement including previous renewals and reappointments of the firm is 21 years, covering the years ended 30 November 1997 to 31 December 2017.

Consistency of the audit report with the additional report to the Audit Committee

Our audit opinion is consistent with the additional report to the Audit Committee we are required to provide in accordance with ISAs (UK).

Manbhinder Rana, FCA (Senior statutory auditor)
For and on behalf of Deloitte LLP
Statutory Auditor
London, United Kingdom
19 April 2018

MORGAN STANLEY & CO. INTERNATIONAL plc

CONSOLIDATED INCOME STATEMENT
Year ended 31 December 2017

	Note	2017 $millions	2016 $millions
Net gains on financial instruments classified as held for trading		5,697	3,816
Net (losses)/gains on financial instruments designated at fair value through profit or loss		(258)	94
Interest income	4	174	(88)
Interest expense	4	(1,581)	(599)
Other income	5	1,671	1,235
Other expense	6	(4,425)	(3,723)
PROFIT BEFORE INCOME TAX		1,278	735
Income tax expense	7	(414)	(284)
PROFIT FOR THE YEAR		864	451
Attributable to:			
Owners of the parent		864	450
Non-controlling interests		-	1
PROFIT FOR THE YEAR		864	451

All operations were continuing in the current and prior year.

The notes on pages 60 to 152 form an integral part of the consolidated financial statements.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
Year ended 31 December 2017

	Note	2017 $millions	2016 $millions
PROFIT FOR THE YEAR		864	451
OTHER COMPREHENSIVE INCOME, NET OF TAX			
Items that will not be reclassified subsequently to profit or loss:			
Changes in fair value attributable to own credit risk on financial liabilities designated at fair value	7	(73)	(42)
Items that may be reclassified subsequently to profit or loss:			
Currency translation reserve:			
Foreign currency translation differences arising on foreign operations	7	111	(8)
Available-for-sale reserve:			
Net change in fair value of the available-for-sale financial assets	7, 13	68	(8)
OTHER COMPREHENSIVE INCOME AFTER INCOME TAX FOR THE YEAR		106	(58)
TOTAL COMPREHENSIVE INCOME FOR THE YEAR		970	393
Attributable to:			
Owners of the parent		963	406
Non-controlling interest		7	(13)
TOTAL COMPREHENSIVE INCOME FOR THE YEAR		970	393

The notes on pages 60 to 152 form an integral part of the consolidated financial statements.

MORGAN STANLEY & CO. INTERNATIONAL plc

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
Year ended 31 December 2017

	Note	Equity instruments $millions	Share premium $millions	Currency translation reserve $millions	Available-for-sale reserve $millions	Capital contribution reserve $millions	Capital redemption reserve $millions	Debt valuation adjustment reserve $millions	Retained earnings $millions	Attributable to owners of the parent $millions	Non-controlling interests $millions	Total equity $millions
Balance at 1 January 2016		12,765	513	(12)	3	3	1,400	-	1,790	16,462	65	16,527
Restated for adoption of new accounting standard		-	-	-	-	-	-	(3)	3	-	-	-
Profit for the year		-	-	-	-	-	-	-	450	450	1	451
Other comprehensive income/(loss)		-	-	6	(8)	-	-	(42)	-	(44)	(14)	(58)
Total comprehensive income/(loss)		-	-	6	(8)	-	-	(42)	450	406	(13)	393
Transactions with owners:												
Dividends		-	-	-	-	-	-	-	(117)	(117)	-	(117)
Balance at 31 December 2016		12,765	513	(6)	(5)	3	1,400	(45)	2,126	16,751	52	16,803
Profit for the year		-	-	-	-	-	-		864	864	-	864
Other comprehensive income/(loss)		-	-	104	68	-	-	(73)	-	99	7	106
Total comprehensive income/(loss)		-	-	104	68	-	-	(73)	864	963	7	970
Transactions with owners:												
Issue of ordinary share capital	22	1,000	-	-	-	-	-	-	-	1,000	-	1,000
Dividends	23	-	-	-	-	-	-	-	(86)	(86)	-	(86)
Balance at 31 December 2017		13,765	513	98	63	3	1,400	(118)	2,904	18,628	59	18,687

The notes on pages 60 to 152 form an integral part of the consolidated financial statements.

MORGAN STANLEY & CO. INTERNATIONAL plc

Registered number: 2068222

CONSOLIDATED STATEMENT OF FINANCIAL POSITION
As at 31 December 2017

	Note	2017	2016
		$millions	$millions
ASSETS			
Loans and receivables:			
Cash and short term deposits	24	25,461	20,346
Cash collateral on securities borrowed		17,828	19,601
Securities purchased under agreements to resell		70,739	77,446
Trade receivables		68,873	51,659
Other receivables	9	1,749	1,480
		184,650	170,532
Financial assets classified as held for trading (of which $58,785 million (2016: $50,011 million) were pledged to various parties)	10	264,793	248,180
Financial assets designated at fair value through profit or loss	12	11,496	4,312
Available-for-sale financial assets	13	161	29
Current tax assets		139	163
Deferred tax assets	20	107	84
Prepayments and accrued income		6	38
Property, plant and equipment	16	8	6
Intangible assets		2	2
TOTAL ASSETS		461,362	423,346
LIABILITIES AND EQUITY			
Financial liabilities at amortised cost:			
Bank loans and overdrafts	24	123	25
Cash collateral on securities loaned		17,487	21,224
Securities sold under agreements to repurchase		52,155	48,416
Trade payables		94,378	85,634
Subordinated loans	17	7,000	7,906
Other payables	18	31,025	10,789
		202,168	173,994
Financial liabilities classified as held for trading	10	217,977	226,187
Financial liabilities designated at fair value through profit or loss	12	22,299	6,020
Provisions	19	54	85
Current tax liabilities		28	80
Deferred tax liabilities	20	-	11
Accruals and deferred income		144	161
Post employment benefit obligations	34	5	5
TOTAL LIABILITIES		442,675	406,543
EQUITY			
Equity instruments	22	13,765	12,765
Share premium account	22	513	513
Currency translation reserve	22	98	(6)
Available-for-sale reserve	22	63	(5)
Capital contribution reserve	22	3	3
Capital redemption reserve	22	1,400	1,400
Debt valuation adjustment reserve	22	(118)	(45)
Retained earnings		2,904	2,126
Equity attributable to the owners of the parent		18,628	16,751
Non-controlling interests		59	52
TOTAL EQUITY		18,687	16,803
TOTAL LIABILITIES AND EQUITY		461,362	423,346

These consolidated financial statements were approved by the Board and authorised for issue on 19 April 2018.

Signed on behalf of the Board

C Castello, Director

The notes on pages 60 to 152 form an integral part of the consolidated financial statements.

MORGAN STANLEY & CO. INTERNATIONAL plc

CONSOLIDATED STATEMENT OF CASH FLOWS
Year ended 31 December 2017

	Note	2017 $millions	2016 $millions
NET CASH FLOWS FROM OPERATING ACTIVITIES	24b	3,403	8,672
INVESTING ACTIVITIES			
Purchase of property, plant and equipment	16	(3)	(6)
Proceeds from sale of property, plant and equipment		-	1
Purchase of intangible assets		-	(2)
Purchase of available-for-sale financial assets	13	(65)	(1)
Proceeds from disposal of available-for-sale financial assets	13	1	3
NET CASH FLOWS USED IN INVESTING ACTIVITIES		(67)	(5)
FINANCING ACTIVITIES			
Issue of ordinary share capital	22	1,000	-
Dividends paid	23	(86)	(117)
Issue of subordinated loan liabilities	17, 24c	5,000	-
Repayments of subordinated loan liabilities	17, 24c	(5,906)	-
Interest on subordinated loan liabilities		(220)	(175)
NET CASH FLOWS USED IN FINANCING ACTIVITIES		(212)	(292)
NET INCREASE IN CASH AND CASH EQUIVALENTS		3,124	8,375
Currency translation differences on foreign currency cash balances		1,893	64
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE YEAR	24a	20,321	11,882
CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR	24a	25,338	20,321

The notes on pages 60 to 152 form an integral part of the consolidated financial statements.

1. CORPORATE INFORMATION

The Company is incorporated and domiciled in England and Wales, at the following address: 25 Cabot Square, Canary Wharf, London, E14 4QA.

The Group's immediate parent undertaking is Morgan Stanley Investments (UK) 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, Cardiff CF14 3UZ.

The Group's ultimate parent undertaking and controlling entity is Morgan Stanley which, together with the Group and Morgan Stanley's other subsidiary undertakings, form the Morgan Stanley Group. Morgan Stanley is incorporated in the state of Delaware, the United States of America. Copies of its financial statements can be obtained from www.morganstanley.com/investorrelations.

2. BASIS OF PREPARATION

Statement of compliance

The Group has prepared its annual consolidated financial statements in accordance with IFRSs issued by the IASB as adopted by the EU, Interpretations issued by the IFRS Interpretations Committee ("IFRIC") and the Companies Act 2006.

New standards and interpretations adopted during the year

The following amendments to standards relevant to the Group's operations were adopted during the year. Except where otherwise stated, these amendments to standards did not have a material impact on the Group's consolidated financial statements.

An amendment to IAS 7 '*Statement of Cash Flows*' was issued by the IASB in January 2016, as part of the Disclosure Initiative project. The amendment is applicable to annual periods beginning on or after 1 January 2017. The amendment requires disclosure regarding changes in liabilities arising from financing activities, which is included in note 24.

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

As part of the 2014 - 2016 Annual Improvements Cycle published in December 2016, the IASB made amendments to the following standard that is relevant to the Group's operations: IFRS 12 '*Disclosure of Interests in Other Entities*', for application in accounting periods beginning on or after 1 January 2017.

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

New standards and interpretations not yet adopted

At the date of authorisation of these consolidated financial statements, the following standards, amendments to standards and interpretations relevant to the Group's operations were issued by the IASB but not mandatory for annual periods beginning 1 January 2017. Except where otherwise stated, the Group does not expect that the adoption of the following standards, amendments to standards and interpretations will have a material impact on the Group's consolidated financial statements.

2. BASIS OF PREPARATION (CONTINUED)

New standards and interpretations not yet adopted (continued)

IFRS 9 '*Financial instruments*' ("IFRS 9") was issued by the IASB in November 2009, reissued in October 2010, amended in November 2013, and revised and reissued by the IASB in July 2014. IFRS 9 is applicable retrospectively, except where otherwise prescribed by transitional provisions of the standard, and is effective for annual periods beginning on or after 1 January 2018. The standard was endorsed by the EU in November 2016. The Group early adopted in isolation the requirements relating to the presentation of fair value movements due to changes in credit risk on financial liabilities designated at fair value through profit or loss, but has not early adopted the remaining requirements of IFRS 9.

A further amendment to IFRS 9, relating to the accounting treatment of financial instruments with prepayment features including negative compensation, was issued by the IASB in October 2017. The amendment is applicable retrospectively, except where otherwise prescribed by transitional provisions of the amendment, and is effective for annual periods beginning on or after 1 January 2019. The amendment was endorsed by the EU in March 2018. The Group has early adopted this amendment from 1 January 2018.

The main aspects of IFRS 9 which impact the Group are requirements relating to:

- Classification and measurement of financial assets

  The classification and measurement of financial assets is determined based upon how these financial assets are managed and their contractual cash flow characteristics. Measurement will be either at amortised cost, fair value through other comprehensive income ('FVOCI') or fair value through profit or loss ('FVPL').

- Impairment of financial assets

  The impairment requirements are based on expected credit losses and apply to financial assets measured at amortised cost and FVOCI, and to lease receivables and to certain loan commitments and financial guarantee contracts.

The Group has undertaken a project to implement IFRS 9. As part of this project the Group has completed an evaluation of its business models and a review of the contractual terms of financial assets.

As a result of this evaluation, certain financial assets will move from amortised cost and designated at FVPL under IAS 39 to mandatorily at FVPL under IFRS 9. Equity investments currently held as available-for-sale ("AFS") will move to FVPL. Additionally, certain financial liabilities will change classification from amortised cost to designated at FVPL as they are part of a group of financial assets and financial liabilities which are managed on a fair value basis. In line with the transitional provisions of IFRS, the Group's retained earnings has increased by $67 million, offset by a corresponding decrease in other comprehensive income of $67 million. This change had no impact on total shareholders' equity as at 1 January 2018 and is not material to the Group.

The Group has also completed its implementation of a revised approach for asset impairment, recognising an expected credit loss ("ECL") allowance for financial instruments not held at FVPL.

2. BASIS OF PREPARATION (CONTINUED)

New standards and interpretations not yet adopted (continued)

For lending products and other debt financial instruments, a model-based approach has been adopted, the key aspects of which are:

- The allowance is based on ECLs associated with the lifetime cash shortfalls that will result if a default occurs in the twelve months after the reporting date ('the twelve month ECL'), unless there has been a significant increase in credit risk since origination, in which case the ECL is based on all possible defaults over the total expected life of the instrument (the 'lifetime' ECL).
- Identifying whether assets have experienced a significant increase in credit risk since origination. When determining whether credit risk has increased significantly since initial recognition, the Group considers both quantitative and qualitative information, based on the Group's historical experience and expert credit risk assessment, including forward-looking information.
- Estimating expected credit losses, reflecting an unbiased and the probability-weighted impact of multiple future economic scenarios. Expected credit losses are calculated using three main components: probability of default ("PD"), the expected loss given default ("LGD") and an estimated exposure at default ("EAD"). These parameters are generally derived from internally developed statistical models, combined with historical, current and forward-looking customer and macro-economic data.

For trade receivables, a simplified approach has been adopted in line with the Standard, whereby an allowance is recognised for the lifetime ECLs of the financial asset. Practical expedients have been employed to calculate the ECLs for trade receivables. For some portfolios of financial assets, ECLs have been estimated to be close to zero, reflecting the benefit of collateral or other credit mitigants.

The impact of the implementation of the expected credit loss impairment approach on retained earnings as at 1 January 2018 is not material to the Group.

As a result of the transition to IFRS 9, the impact to the Group's Tier 1 capital as at 1 January 2018 is not material to the Group. The Group is not making use of the transitional arrangements introduced by Regulation (EU) 2017/2395 relating to the effects of unexpected credit losses for mitigating the impact of the introduction of IFRS 9 on own funds and the treatment of certain large exposures.

Under the transitional provisions of the Standard, the Group's opening balance sheet at the date of initial application (1 January 2018) will be restated, with no restatement of comparative periods. However, the Group will update the presentation of its primary statements on transition to IFRS 9 and the amounts presented for the comparative period will be represented to align to the new format in the annual accounts.

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

IFRS 15 '*Revenue from Contracts with Customers'* ("IFRS 15") was issued by the IASB in May 2014, for retrospective application in annual periods beginning on or after 1 January 2018. In addition, amendments to IFRS 15 were issued by the IASB in April 2016, requiring application in annual periods beginning on or after 1 January 2018. The standard and amendments were endorsed by the EU in October 2016.

The principal impact of adopting IFRS 15 is the presentation on a gross basis of certain expenses relating to investment banking activities which had previously been recorded as a reduction in revenue. The adoption of this Standard is not expected to have a material impact on retained earnings of the Company.

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

2. BASIS OF PREPARATION (CONTINUED)

New standards and interpretations not yet adopted (continued)

An amendment to IAS 28 '*Investments in Associates and Joint Ventures'* was issued by the IASB in October 2017, for retrospective application in annual periods beginning on or after 1 January 2019. Early application is permitted.

An amendment to IAS 19 '*Employee Benefits'* was issued by the IASB in February 2018, for retrospective application to plan amendments, curtailments or settlements occurring on or after 1 January 2019. Early adoption is permitted.

As part of the 2014-2016 Annual Improvements Cycle published in December 2016, the IASB made amendments to the following standard that is relevant to the Group's operations: IAS 28 '*Investments in Associates'*, for application in accounting periods beginning on or after 1 January 2018.

As part of the 2015-2017 Annual Improvements Cycle published in December 2017, the IASB made amendments to the following standards that are relevant to the Company's operations: IAS 12 '*Income Taxes*' and IAS 23 '*Borrowing Costs*', for application in accounting periods beginning on or after 1 January 2019.

IFRIC 22 '*Foreign Currency Transactions and Advance Consideration*' was issued by the IASB in December 2016 for application in annual periods beginning on or after 1 January 2018. The Group is currently assessing the impact of IFRIC 22 on its consolidated financial statements.

IFRIC 23 '*Uncertainty over Income Tax Treatments*' was issued by the IASB in June 2017 for application in annual periods beginning on or after 1 January 2019. The Group is currently assessing the impact of IFRIC 23 on its consolidated financial statements.

Basis of measurement

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

Critical judgements in applying the Group's accounting policies

The preparation of the Group's consolidated financial statements requires management to make judgements regarding the recognition of deferred tax balances, the consolidation of structured entities, legal, tax and property provisions that can significantly affect the amounts recognised in the consolidated financial statements. The Group believes that the judgements utilised in preparing the consolidated financial statements are reasonable, relevant and reliable.

The Group used judgements to determine which valuation approaches are most appropriate in calculating fair value. For further details on the judgements used in determining fair value of certain assets and liabilities, see accounting policy note 3(d) and note 31.

Judgements are used in determining what tax-deductible losses are to be surrendered to other members of the Morgan Stanley UK tax group and the factors for consideration of tax-related provisions and the timing of their recognition. For further details on the judgements used in determining tax balances, see accounting policy note 3(m) and notes 6, 7 and 19.

The Group determines whether it controls, and therefore should consolidate, a structured entity upon its initial involvement and reassesses on an ongoing basis for as long as it has any continuing involvement with the structured entity. For further details on the judgements used in determining whether the Group should consolidate a structured entity see note 15.

2. BASIS OF PREPARATION (CONTINUED)

Key sources of estimation uncertainty

The preparation of the Group's consolidated financial statements requires management to make assumptions regarding the valuation of certain financial instruments, impairment of assets, tax balances, pension obligations, the outcome of litigation, and other matters that affect the consolidated financial statements and related disclosures.

Estimates are used in the calculation of property, litigation, and tax-related provisions. Provisions are calculated based on the net present value of expected future cash flows, although the Group recognises that it is inherently difficult to estimate the amount of the future losses in certain instances. For further detail, see accounting policy note 3(o) and note 19.

The Group believes that the estimates utilised in preparing the consolidated financial statements are reasonable, relevant and reliable. Actual results could differ from these estimates.

Basis of consolidation

The consolidated financial statements of the Group comprise the financial statements of the Company and its subsidiaries as at 31 December 2017. Subsidiaries are all entities over which the Group has control. The Group controls an entity when the Group is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. The financial statements for the subsidiaries are prepared for the same reporting year as the Group, using consistent accounting policies. The financial statements of non-US dollar reporting currency subsidiaries are translated into US dollars as described in note 3(b). Subsidiaries are consolidated from the date that the Group gains control until the date that control ceases.

In certain cases, the Group may exercise control over another entity on behalf of investors or other parties. In such cases it is necessary, as part of the assessment of whether it should consolidate the entity, for the Group to determine whether it exercises such control primarily as an agent for the other investors or whether it does so primarily as principal on its own behalf. In making such a determination, the management will consider all relevant factors, including in particular:

- the scope of the Group's decision-making authority over the investee;
- the rights, including removal rights, held by other parties;
- the remuneration to which the Group is entitled; and
- the significance of the Group's exposure to variability of returns from its interests in the entity.

Intra-group balances, transactions, income and expenses and profits and losses resulting from intra-group transactions are eliminated in preparing the consolidated financial statements.

Non-controlling interests represent the portion of profit or loss and total equity not owned, directly or indirectly, by the Group and are presented separately in the consolidated income statement, consolidated statement of comprehensive income and within equity in the consolidated statement of financial position, separately from parent shareholders' equity. The amount of non-controlling interest is measured at the non-controlling interest's proportionate share of the identifiable net assets.

Details of the Group's interests in other entities are given in note 15 to these financial statements.

2. BASIS OF PREPARATION (CONTINUED)

The going concern assumption

The Group's business activities, together with the factors likely to affect its future development, performance and position, and the Group's objectives, policies and processes for managing its capital; its financial risk management objectives; and its exposures to credit risk and liquidity risk, are reflected in the Strategic Report on pages 3 to 41. In addition, the notes to the consolidated financial statements include the details of its financial instruments and additional detail, not included in the Strategic Report, on its credit risk and liquidity risk.

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

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

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

a. Functional currency

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

All currency amounts in the consolidated financial statements, Strategic report and Directors' report are rounded to the nearest million US dollars (unless otherwise stated).

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 and non-monetary assets and liabilities denominated in currencies other than US dollars are recorded at the rates prevailing at the dates of the transactions. Foreign exchange differences on available-for-sale financial assets are recorded in the 'Available-for-sale reserve' in equity, with the exception of translation differences on the amortised cost of monetary available-for-sale assets, which are recognised through the income statement. Assets and liabilities of foreign operations are translated into US dollars using the closing rate method. Translation differences arising from the net investment(s) in the foreign operations are taken to the 'currency translation reserve'.

The amount of change in the fair value of financial liabilities designated at fair value through profit or loss that is attributable to changes in the credit risk of these liabilities ("DVA") includes foreign exchange differences thereon. All other translation differences are taken through the consolidated income statement. Exchange differences recognised in the consolidated income statement are presented in 'Other income' or 'Other expense', except where noted in 3(c) below.

On disposal of a foreign operation, the related cumulative gain or loss in the 'currency translation reserve' attributable to the owners of the parent is reclassified to the consolidated income statement and recorded within 'Net currency translation gain / (loss) on disposal of subsidiary'.

c. Financial instruments

The Group classifies its financial assets into the following categories on initial recognition: financial assets classified as held for trading; financial assets designated at fair value through profit or loss; available-for-sale financial assets; and loans and receivables.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

c. Financial instruments (continued)

The Group classifies its financial liabilities into the following categories on initial recognition: financial liabilities classified as held for trading; financial liabilities designated at fair value through profit or loss; and financial liabilities at amortised cost.

More information regarding these classifications is included below:

i) Financial instruments classified as held for trading

Purchases and sales of non-derivative financial instruments classified as held for trading are initially recognised on settlement date at fair value, including regular way securities transactions. For purchases of non-derivative financial instruments classified as held for trading, from the date that the terms are agreed (trade date) until the settlement date, the Group recognises any unrealised fair value in the consolidated statement of financial position as ‘Financial instruments classified as held for trading’ with corresponding profit or loss recognised within the consolidated income statement in ‘Net gains/ (losses) on financial instruments classified as held for trading’. For sales of non-derivative financial instruments unrealised fair value changes are no longer recognised in the consolidated income statement from trade date. Upon settlement date the resulting financial instrument is recognised or de-recognised from the consolidated statement of financial position.

Derivatives are initially recognised on trade date at fair value. All subsequent changes in fair value are reflected in the consolidated income statement in ‘Net gains/ (losses) on financial instruments classified as held for trading’.

All changes in fair value, foreign exchange differences, interest and dividends are reflected in the consolidated income statement in ‘Net gains/ (losses) on financial instruments classified as held for trading’. When interest is included as a component of an instrument’s fair value, interest is also reflected in the income statement in ‘Net gains/ (losses) on financial instruments classified as held for trading’, otherwise, it is included within ‘Interest income’ or ‘Interest expense’.

For all financial instruments classified as held for trading, transaction costs are excluded from the initial fair value measurement of the financial instrument. These costs are recognised in the consolidated income statement in ‘Other expense’.

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

The Group has designated certain financial instruments at fair value through profit or loss when:

- the financial instruments are managed, evaluated and reported internally on a fair value basis; or
- the designation at fair value eliminates or significantly reduces an accounting mismatch which would otherwise arise; or
- the financial instrument contains an embedded derivative that significantly modifies the cash flows that would otherwise be required under the contract.

From the date that the transaction in a financial instrument designated at fair value through profit or loss is entered into (trade date) until settlement date, the Group recognises any unrealised fair value changes in the contract as financial instruments designated at fair value through profit or loss in the statement of financial position. 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 consolidated income statement in ‘Net gains / (losses) on financial instruments designated at fair value through profit or loss’, other than DVA on financial liabilities at fair value through profit or loss which is recognised in the Debt valuation adjustment reserve where those changes do not create or enlarge an accounting mismatch.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

c. Financial instruments (continued)

DVA presented within other comprehensive income is not subject to reclassification to the income statement, but is transferred to retained earnings when realised.

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

iii) Available-for-sale financial assets

Financial assets classified as available-for-sale are non-derivative financial assets that are either designated in this category or not classified in any of the other categories of financial instruments. Financial assets classified as available-for-sale are recorded on trade date and are initially recognised and subsequently measured at fair value (see note 3(d) below).

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

For equity instruments, dividend income and impairment losses are recognised in the consolidated income statement in 'Net gains/ (losses) on available-for-sale financial assets'. All other gains and losses on equity instruments classified as available-for-sale are recognised in the 'Available-for-sale reserve' within equity.

On disposal or impairment of an available-for-sale financial asset, the cumulative gain or loss in the 'Available-for-sale reserve' is reclassified to the consolidated income statement and reported in 'Net gains/ (losses) on available-for-sale financial assets'.

iv) Loans and receivables and financial liabilities at amortised cost

Financial assets classified as loans and receivables are recognised when the Group becomes a party to the contractual provisions of the instrument. They are initially measured at fair value (see note 3(d) below) and subsequently measured at amortised cost less allowance for impairment. Interest is recognised in the consolidated income statement 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 consolidated income statement in 'Other expense'.

Financial liabilities at amortised cost are recognised when the Group becomes a party to the contractual provisions of the instrument. They are initially measured at fair value (see note 3(d) below) and subsequently measured at amortised cost. Interest is recognised in the consolidated income statement 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 instrument (or a group of financial instruments) and of allocating the interest income or interest expense over the expected life of the financial instrument. The effective interest rate is the rate that exactly discounts the estimated future cash payments and receipts through the expected life of the financial instrument (or, where appropriate a shorter period) to the carrying amount of the financial instrument. The effective interest rate is established on initial recognition of the financial instrument. 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 instrument.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

c. Financial instruments (continued)

In the course of financing its business and as part of its trading activities, the Group 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 Group, 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 'Loans and receivables'. Securities received by the Group under resale arrangements and securities borrowing arrangements are generally not recognised on the consolidated statement of financial position.

d. Fair value

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.

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, assumptions are set to reflect those that the Group believes market participants would use in pricing the asset or liability at the measurement date.

Where the Group manages a group of financial assets and financial liabilities on the basis of its net exposure to either market risks or credit risk, the Group measures the fair value of that group of financial instruments consistently with how market participants would price the net risk exposure at the measurement date.

In determining fair value, the Group 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 that were developed based on market data obtained from sources independent of the Group. Unobservable inputs are inputs that reflect assumptions the Group believes other market participants would use in pricing the asset or liability, that are developed based on the best information available in the circumstances.

The hierarchy is broken down into three levels based on the observability of inputs as follows, with Level 1 being the highest and Level 3 being the lowest level:

- Level 1 - Quoted prices (unadjusted) in an active market for identical assets or liabilities

  Valuations based on quoted prices in active markets that the Morgan Stanley Group has the ability to access for identical assets or liabilities. 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.

- Level 2 - Valuation techniques using observable inputs

  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.

- Level 3 - Valuation techniques with significant unobservable inputs

  Valuations based on inputs that are unobservable and significant to the overall fair value measurement.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

d. Fair value (continued)

Fair value measurement (continued)

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. Accordingly, the degree of judgement exercised by the Group in determining fair value is greatest for instruments categorised in Level 3 of the fair value hierarchy.

The Group 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. This condition could cause an instrument to be reclassified from Level 1 to Level 2 or from Level 2 to Level 3 of the fair value hierarchy.

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, for disclosure purposes, the level in the fair value hierarchy within which the fair value measurement falls in its entirety is determined based on the lowest level input that is significant to the fair value measurement in its entirety.

The Group incorporates Funding Valuation Adjustment (“FVA”) in the fair value measurements of over-the-counter (“OTC”) uncollateralised or partially collateralised derivatives, and in collateralised derivatives where the terms of the agreement do not permit the re-use of the collateral received. In general, the FVA reflects a market funding risk premium inherent in the noted derivative instruments. The methodology for measuring FVA leverages the Group’s existing credit-related valuation adjustment calculation methodologies, which apply to both assets and liabilities.

For assets and liabilities that are transferred between levels in the fair value hierarchy during the period, fair values are ascribed as if the assets or liabilities had been transferred as of the beginning of the period.

Valuation techniques

Many cash instruments and OTC derivative contracts have bid and ask prices that can be observed in the marketplace. Bid prices reflect the highest price that a party is willing to pay for an asset. Ask prices represent the lowest price that a party is willing to accept for an asset. The Group carries positions at the point within the bid-ask range that meets the Group’s best estimate of fair value. For offsetting positions in the same financial instrument, the same price within the bid-ask spread is used to measure both the long and short positions.

Fair value for many cash instruments and OTC derivative contracts is derived using pricing models. Pricing models take into account the contract terms, as well as multiple inputs including, where applicable, commodity prices, equity prices, interest rate yield curves, credit curves, correlation, creditworthiness of the counterparty, creditworthiness of the Group, 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 mid-market levels of Level 2 and Level 3 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 trade 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.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

d. Fair value (continued)

Valuation techniques (continued)

The Group applies credit-related valuation adjustments ("CVA") to its borrowings (primarily structured notes) which are designated at fair value through profit or loss and to OTC derivatives. The Group considers the impact of changes in own credit spreads based upon observations of the secondary bond market spreads when measuring the fair value for borrowings. For OTC derivatives, the impact of changes in both the Group's and the counterparty's credit rating is considered when measuring fair value. In determining the expected exposure the Group 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 Group also considers collateral held and legally enforceable master netting agreements that mitigate the Group's exposure to each counterparty.

Adjustments for model uncertainty are taken for positions whose 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 Group 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.

Valuation process

The Valuation Review Group ("VRG") within the Financial Control Group ("FCG") is responsible for the Group's fair value valuation policies, processes and procedures. VRG is independent of the business units and reports to the Chief Financial Officer of the MSI Group ("CFO"), who has final authority over the valuation of the Group's financial instruments. VRG implements valuation control processes designed to validate the fair value of the Group's financial instruments measured at fair value including those derived from pricing models.

- *Model Review*. VRG, in conjunction with the Model Risk Management Department ("MRM") which reports to the Chief Risk Officer of the MSI Group ("CRO"), independently reviews 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 determine that 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 models. The Group generally subjects valuations and models to a review process initially and on a periodic basis thereafter.
- *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 (continued)

Valuation process (continued)

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 MSI Group's business segments (i.e. Institutional Securities and Investment Management), the CFO and the CRO on a regular basis.

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 designed to ensure that the highest-ranked market data source is used to validate the business unit's fair value of financial instruments.

VRG reviews the models and valuation methodology used to price all new material Level 3 transactions and both FCG and MRM must approve the fair value of the trade that is initially recognised.

- *Level 3 Transactions.* VRG reviews the business unit's valuation techniques to assess whether these are consistent with market participant assumptions.

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 Group recognises a gain or loss on inception of the transaction.

When the use of 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 consolidated income statement and is recognised instead when the market data becomes observable.

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

Certain of the Group's assets and liabilities are measured at fair value on a non-recurring basis. The Group incurs losses or gains for any adjustments of these assets or liabilities to fair value.

For assets and liabilities measured at fair value on a non-recurring basis, fair value is determined by using various valuation approaches. The same hierarchy for inputs as described above, which maximises the use of observable inputs and minimises the use of unobservable inputs by generally requiring that the observable inputs be used when available, is used in measuring fair value for these items.

e. Derecognition of financial assets and liabilities

The Group derecognises a financial asset 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.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

e. Derecognition of financial assets and liabilities (continued)

The Group derecognises financial liabilities when the Group's obligations are discharged, cancelled or they expire. Upon derecognition, those realised changes in the fair value of certain financial liabilities designated at fair value through profit or loss that are attributable to changes in the credit risk of those liabilities and are presented in other comprehensive income, are transferred from the 'Debt valuation adjustment reserve' to 'Retained earnings'.

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 either available-for-sale 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 financial assets are measured as the difference between cost (net of any principal repayment and amortisation) and the current fair value (see note 3(d) above). Where there is evidence that an available-for-sale financial asset is impaired, the cumulative loss that had been previously recognised in other comprehensive income is reclassified from the 'Available-for-sale reserve' and recognised in the consolidated income statement within 'Net gains/ (losses) on available-for-sale financial assets'.

Impairment losses on loans and receivables are measured as the difference between the carrying amount of the loans and receivables and the present value of estimated cash flows discounted at the asset's original effective interest rate. Such impairment losses are recognised in the consolidated income statement within 'Other expense' and are recognised against the carrying amount of the impaired asset on the consolidated 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.

Subsequent increases in fair value of previously-impaired equity available-for-sale financial assets are reported as fair value gains in the 'Available-for-sale reserve' through other comprehensive income 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 described for the relevant categories of financial asset in note 3(c)(iii) and (iv). 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. Impairment of non-financial assets

Non-financial assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and its value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash generating units). Non-financial assets, other than goodwill, that have suffered an impairment are reviewed for possible reversal of the impairment at the end of each reporting period. Such impairment losses are recognised in the consolidated income statement within 'Other expense' and are recognised against the carrying amount of the impaired asset on the consolidated statement of financial position.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

h. Fees and commissions

Fees and commissions classified within 'Other income' in the consolidated income statement include account servicing fees, investment management fees, sales commissions, placement fees, advisory fees and syndication fees. Fees and commissions classified within 'Other expense' in the consolidated income statement include transaction and service fees. These amounts are recognised as the related services are performed or received.

i. Property, plant and equipment

Property, plant and equipment are stated at cost net of depreciation and any provision for impairment in value, which are included within 'Other expense' in the consolidated income statement.

For premises held under operating leases, a reinstatement provision is recognised for the estimated cost to reinstate the premises at the end of the lease period. When the reinstatement provision is established and included within 'Provisions' in the consolidated statement of financial position, an equivalent asset is recognised and included in the cost of leasehold improvements at the initial present value of any reinstatement obligations. The discount effect included in the reinstatement provision is reversed over time using a constant effective yield method and included within 'Interest expense' in the consolidated income statement. The reinstatement asset is depreciated over the useful economic life of the relevant leasehold improvement asset and the depreciation charge is included within 'Other expense' in the consolidated income statement.

Depreciation is provided on property, plant and equipment at rates calculated to write off the cost of the assets on a straight line basis over their expected useful lives as follows:

Leasehold improvements including reinstatement assets	- shorter of remaining lease term and 25 years
Fixtures, fittings and equipment	- 1 to 8 years

j. Business combinations and disposals

i) Combination of businesses

Business combinations are accounted for using the acquisition method of accounting.

Consideration for each acquisition is measured at the date at which a business combination occurs (the "acquisition date") at the fair value of the assets transferred, liabilities incurred (including any asset or liability resulting from a contingent consideration arrangement) and equity instruments issued by the Group in exchange for control of the acquiree.

Acquisition related costs are recognised in the consolidated income statement as incurred.

Identifiable assets acquired and liabilities (including contingent liabilities) assumed, which meet the conditions for recognition under IFRS 3, are recognised initially at acquisition-date fair values, with the exception that:

- deferred tax assets and liabilities are recognised and measured in accordance with IAS 12;
- assets related to employee benefit arrangements are recognised and measured in accordance with IAS 19;
- liabilities or equity instruments related to the replacement of an acquiree's share-based payment award are measured in accordance with IFRS 2, and
- acquired non-current assets or disposal groups that are classified as held for sale at the acquisition date in accordance with IFRS 5 '*Non-current assets held for sale and discontinued operations'* are reported at their fair value less cost to sell.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

j. Business combinations and disposals (continued)

i) Combination of businesses (continued)

A contingent liability assumed is recognised where there is a present obligation that arises from past events and its fair value can be measured reliably, regardless of whether it is probable that an outflow of resources will be required to settle the obligation.

A non-controlling interest in the acquiree is recognised (in respect of any portion of the total assets less total liabilities of an acquired entity that is not owned by the Group) at fair value.

Any excess of the sum of the consideration and the amount of any non-controlling interest in the acquiree over the fair value of the identifiable assets acquired less liabilities assumed is recognised as goodwill. If the sum of the consideration and the amount of any non-controlling interest in the acquiree is less than the fair value of the identifiable assets acquired less liabilities assumed, the gain on acquisition is recognised in the consolidated income statement in the year of acquisition.

If the initial accounting for a business combination is incomplete by the end of the reporting period in which the combination occurred, the Group reports provisional amounts for the items for which the accounting is incomplete. The measurement period (which may not exceed one year) is the period from the date of acquisition to the date the Group obtains complete information about the facts and circumstances that existed as of the acquisition date. Provisional amounts may be adjusted during the measurement period, or additional assets or liabilities recognised, to reflect any new information obtained about the facts and circumstances that existed at the acquisition date that, if known, would have affected the amounts recognised at that date.

Subsequent changes to the fair value of any asset or liability resulting from a contingent consideration arrangement during the measurement period are adjusted against the cost of acquisition. Changes in the fair value of contingent consideration classified as equity are not recognised.

Post-acquisition, income received and expenses incurred by the entity or entities acquired are included in the consolidated income statement on a line-by-line basis in accordance with the accounting policies set out herein.

Disposal of subsidiaries

When subsidiaries are sold or the Group ceases to control an entity, the difference between the proceeds (plus the fair value of any investment retained), and the total assets less total liabilities disposed of, cumulative translation differences and unamortised goodwill, is recognised in the consolidated income statement within ‘Gain/ (loss) on disposal of subsidiary’. Where the disposal or loss of control over an entity includes a foreign operation, all foreign exchange differences accumulated in the ‘Currency translation reserve’ attributable to the equity holders of the parent are reclassified to the consolidated income statement within ‘Gain/ (loss) on disposal of subsidiary’.

ii) Combination of businesses under common control

Business combinations involving entities under common control, where all combining entities are ultimately controlled by the same entity before and after the business combination, are accounted for using the predecessor values method of accounting. This involves recognising assets and liabilities of the acquired business at the predecessors’ book value, without any change to reflect fair value of those assets and liabilities. Any difference between the cost of acquisition and the aggregate book value of the assets and liabilities as of the date of the transfer of the acquired entity is recorded as an adjustment to equity within the ‘Capital contribution reserve’. No additional goodwill is created by the business combination.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

j. Business combinations and disposals (continued)

ii) Combination of businesses under common control (continued)

Post-acquisition, income received and expenses incurred by the entity or entities acquired are included in the consolidated income statement on a line-by-line basis in accordance with the accounting policies set out herein.

A non-controlling interest is recognised by the Group in respect of any portion of the total assets less total liabilities of an acquired entity or entities that is not owned by the Group.

When subsidiaries are sold or transferred to another entity under common control, any difference between the consideration received and the aggregate book value of the assets and liabilities of the disposed of business is recorded as an adjustment to equity within the ‘Capital contribution reserve’. Where the consideration for the transfer is received in the form of shares, these are recorded at the aggregate book value of the assets and liabilities disposed of.

k. Intangible assets

Intangible assets are not amortised when their useful lives are assessed to be indefinite. Intangible assets are assessed to have an indefinite useful life when there are no contractual, economic or other factors that limit the useful lives. Intangible assets with indefinite useful lives owned by the Group are stated at cost less accumulated impairment losses (see note 3(g) above).

l. Cash and cash equivalents

For the purposes of the consolidated statement of cash flows, cash and cash equivalents comprise cash and demand deposits with banks, net of outstanding bank overdrafts, 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. This may include segregated client money, held in accordance with the FCA’s Client Money Rules or is otherwise not available for use by the Group.

m. Income tax

The tax expense represents the sum of the tax currently payable and deferred tax.

The tax currently payable is calculated based on taxable profit for the year. Taxable profit may differ from profit/ (loss) before income tax as reported in the consolidated income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Group’s liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the reporting date. Current tax is charged or credited in the consolidated income statement, except when it relates to items charged or credited directly to other comprehensive income or equity, in which case the current tax is also recorded within other comprehensive income or equity respectively.

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the consolidated financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised.

Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries, except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

The carrying amount of deferred tax assets is reviewed at each reporting date and limited to the extent that it is probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

m. Income tax (continued)

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised. Deferred tax is charged or credited in the consolidated income statement, except when it relates to items charged or credited directly to other comprehensive income or equity, in which case the deferred tax is reflected within other comprehensive income or equity, respectively.

Current tax assets are offset against current tax liabilities when there is a legally enforceable right to set off current tax assets against current tax liabilities and the Group intends to settle its current tax assets and current tax liabilities on a net basis or to realise the asset and settle the liability simultaneously. Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off deferred tax assets against deferred tax liabilities and when they relate to income taxes levied by the same taxation authority and the Group intends to settle its current tax assets and current tax liabilities on a net basis.

n. Operating leases

Rentals payable under operating leases are charged to 'Other expense' in the consolidated income statement on a straight line basis over the lease term. Lease incentives are allocated on a straight line basis over the lease term as a reduction to rental expense.

Rentals receivable under operating leases are credited to 'Other income' in the consolidated income statement on a straight line basis over the lease term. Initial direct costs incurred in negotiating and arranging the lease are added to the carrying amount of the leased asset and recognised in the consolidated income statement on a straight line basis over the lease term. Lease incentives are allocated on a straight line basis over the lease term.

o. Provisions

Provisions are recognised when the Group has a present obligation as a result of a past event, when it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and when a reliable estimate can be made of the amount of the obligation.

The amount recognised as a provision is the best estimate of the consideration required to settle the present obligation at the year end date, taking into account the risks and uncertainties surrounding the obligation. Where a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cash flows.

p. Employee compensation plans

i) Equity-settled share-based compensation plans

Morgan Stanley issues awards in the form of restricted stock units ("RSUs") and stock options to employees of the Morgan Stanley Group for services rendered to the Group. Awards are classified as equity-settled and the cost of equity-based transactions with employees is measured based on the fair value of the equity instruments at grant date. The fair value of RSUs is based on the market price of Morgan Stanley shares and the fair value of stock option awards is estimated using the Black-Scholes valuation model, which takes into account the option's exercise price, its expected term, the risk free interest rate and the expected volatility of the market price of Morgan Stanley shares. Awards are amortised over the future service period.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

p. Employee compensation plans (continued)

i) Equity-settled share-based compensation plans (continued)

The Group pays Morgan Stanley in consideration of the procurement of the transfer of shares to employees via a chargeback agreement under which it is committed to pay to Morgan Stanley the grant date fair value as well as subsequent movements in the fair value of those awards at the time of delivery to the employees.

Share-based compensation expense is recorded within 'Other expense' in the consolidated income statement.

ii) Other deferred compensation plans

Morgan Stanley also maintains deferred compensation plans on behalf of the Group for the benefit of certain current and former employees that provide a return to the participating employees based upon the performance of various referenced investments. Liabilities for these awards, which are included within 'Accruals and deferred income' in the consolidated statement of financial position, are measured at fair value and recognised over time in accordance with the awards' vesting conditions. The related expense is recorded within 'Other expense'. The Group economically hedges the exposure created by these deferred compensation schemes by entering into derivative transactions with other Morgan Stanley Group undertakings. The derivatives are recognised within 'Financial instruments classified as held for trading' in the consolidated statement of financial position and the related gains and losses are recorded within 'Net gains/ (losses) on financial instruments classified as held for trading' in the consolidated income statement.

q. Post-employment benefits

The Group operates defined contribution and defined benefit post-employment plans.

Contributions due in relation to the Group's defined contribution post-employment plan are recognised in 'Other expense' in the consolidated income statement when payable.

For the Group's defined benefit post-employment plan, the plan obligations are measured on an actuarial basis in accordance with the advice of an independent qualified actuary using the projected unit credit method and discounted at a rate that reflects the current rate of return on a high quality corporate bond of equivalent term and currency to the plan liabilities. Plan assets are measured at their fair value at the reporting date. A surplus or deficit of plan assets over liabilities is recognised in the consolidated statement of financial position as an asset or a liability respectively. If the fair value of the plan assets is higher than the present value of the defined benefit obligation, the measurement of the resulting defined benefit asset is limited to the present value of economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan. The current service cost and any past service costs together with the net interest on the net defined benefit obligation/ asset is charged to 'Staff costs' within 'Other expense' in the consolidated income statement. Remeasurements that arise in calculating the Group's obligation in respect of a plan are recognised in other comprehensive income, in the period in which they occur.

Details of the plans are given in note 34 to these consolidated financial statements.

r. Offsetting of financial assets and financial liabilities

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

4. INTEREST INCOME AND INTEREST EXPENSE

'Interest income' represents total interest generated from financial assets whilst 'interest expense' represents total interest arising on financial liabilities with the exception that:

(a) when interest is included as a component of the financial instrument's fair value, interest is reflected in 'net gains/(losses) on financial instruments classified as held for trading'; and
(b) interest expense otherwise arising on financial liabilities classified as held for trading is reported as a reduction in 'interest income'.

'Interest income' also includes fees paid on securities borrowed transactions and 'interest expense' includes fees received on securities loaned balances and from prime brokerage customers for stock loan transactions undertaken to cover customers' short positions.

Certain currencies, in which the Group's trades are denominated, may at times have negative interest rates, of which a current example is the Euro. When financial assets and financial liabilities are denominated in such currencies with negative interest rates, this results in negative 'Interest income' and positive 'Interest expense' being recognised. For 2016, this resulted in overall 'Interest income' in the consolidated income statement for the Group being negative.

No other gains or losses have been recognised in respect of loans and receivables other than as disclosed as 'Interest income', foreign exchange differences and impairment losses and reversals of impairment losses disclosed in 'Other expense' (note 6).

5. OTHER INCOME

	2017 $millions	2016 $millions
Fee and commission income:		
Underwriting and advisory fees	1,224	1,036
Trust and other fiduciary activities	164	81
Management charges to other Morgan Stanley Group undertakings	251	99
Other	32	19
	1,671	1,235

The increase in 'Management charges to other Morgan Stanley Group undertakings' was principally as a result of the Group and Morgan Stanley Group updating its Global Transfer Pricing Policy, effective 1 January 2017. Refer to note 35 for more details.

6. OTHER EXPENSE

	2017 $millions	2016 $millions
Direct staff costs	139	135
Management charges from other Morgan Stanley Group undertakings relating to staff costs	1,594	1,519
Management charges from other Morgan Stanley Group undertakings relating to other services	1,039	554
Brokerage fees	678	523
Administration and corporate services	92	351
Professional services	162	295
UK bank levy	120	78
Operating lease rentals	6	6
Depreciation on property, plant and equipment	3	2
Impairment losses on loans and receivables (see note 8)	50	26
Reversal of impairment losses on loans and receivables (see note 8)	(45)	(12)
Net foreign exchange losses	-	30
Auditor's remuneration:		
Fees payable to the Company's auditor and its associates for the audit of the Company's annual financial statements	4	4
Fees payable to the Company's auditor and its associates for other services to the Group [(1)]	1	1
Other	582	211
	4,425	3,723

[(1)] Fees payable to the Company's auditor for other services in 2017 comprise $237,000 for the audit of the Company's subsidiaries (2016: $229,000) and $749,000 for other assurance services (2016: $808,000).

The Group employs staff directly and also utilises the services of staff who are employed by other Morgan Stanley Group undertakings. Included within 'Direct staff costs' and 'Management charges from other Morgan Stanley Group undertakings relating to staff costs' are amounts totalling $217 million (2016: $234 million) in relation to equity-settled share-based compensation plans granted to employees of both the Group and the Morgan Stanley Group. These costs reflect the amortisation of equity-based awards in relation to current and previous years' awards and are therefore not directly aligned with other staff costs in the current year. Similarly, included within 'Direct Staff costs' and 'Management charges from other Morgan Stanley Group undertakings relating to staff costs' is an amount of $113 million (2016: $123 million) in relation to the amortisation of current and previous years' awards of deferred cash-based compensation, granted to employees of the Morgan Stanley Group.

Further information regarding employee compensation plans is provided in note 33.

The increases in 'Management charges from other Morgan Stanley Group undertakings relating to other services', and 'Other' and the decreases in 'Administration and corporate services' and 'Professional services' were principally as a result of the Group and Morgan Stanley Group updating its Global Transfer Pricing Policy, effective 1 January 2017.

6. OTHER EXPENSE (CONTINUED)

The UK Bank Levy (the "Levy") is an annual charge on a bank's balance sheet. It is applied to chargeable liabilities and equity of the Group and other Morgan Stanley UK tax-resident entities and their overseas subsidiaries. The Levy is non-deductible for UK corporation tax purposes and will impact the effective tax rate for the year (see note 7 for further details).

During his 2016 UK Budget speech, the Chancellor of the Exchequer announced that the rate at which the Levy is applied will reduce from 0.21% to 0.10% over the course of the period 2016-2021. While this decrease in rate, by itself, would reduce the impact of the Levy on the Group's net income and effective tax rate, the Levy for 2017 is higher than 2016 mainly due to an increase in the long-term intercompany borrowings to fund the increase in business activity.

The average number of direct employees of the Group is analysed below:

	Number	
	Year ended 31 December 2017	**Year ended 31 December 2016**
Company and institutional securities infrastructure	105	146
Business units and other	222	180
	327	326

	2017 $millions	**2016 $millions**
Wages and salaries	122	115
Social security costs	13	17
Pension costs	4	3
	139	135

The Group paid no direct remuneration to its Directors during the current or prior year but incurred management recharges in respect of Directors' qualifying services provided to the Group which are included within 'Management charges from other Morgan Stanley Group undertakings relating to staff costs'. The amount of remuneration received by Directors in respect of their qualifying services to the Group is disclosed in note 35.

7. INCOME TAX EXPENSE (CONTINUED)

	2017 $millions	2016 $millions
Current tax expense		
United Kingdom corporation tax charge		
- current year	355	162
- adjustments in respect of prior years	(2)	(5)
Double taxation relief		
- current year	(115)	(53)
- adjustments in respect of prior years	-	8
Overseas tax		
- current year	178	128
- adjustments in respect of prior years	4	5
	420	245
Deferred tax (benefit)/ expense		
Origination and reversal of temporary differences	(7)	33
Adjustment in respect of prior years	1	4
Effect of changes in tax rates	-	2
	(6)	39
Income tax expense	414	284

Reconciliation of effective tax rate

The Group's tax rate is sensitive to the geographic mix of profits and tax rates in non UK jurisdictions, the additional 8% UK banking surcharge, as well as the non-deductibility of certain expenses for tax purposes. Finance (No.2) Act 2015 enacted a reduction in the UK corporation tax rate to 19% with effect from 1 April 2017. Finance Act 2016 enacted a further reduction in the UK corporation tax rate to 17% with effect from 1 April 2020 which will impact the current tax charge in future periods. The main differences between the Group's tax charge and the tax charge that would have been calculated from applying the average standard rate of corporation tax for banking companies in the UK for the year of 27.25% (2016: 28.00%) are explained below:

7. INCOME TAX EXPENSE (CONTINUED)

Reconciliation of effective tax rate (continued)

	2017 $millions	2016 $millions
Profit before income tax	1,278	735
Income tax expense using the average standard rate of corporation tax for banking companies in the UK of 27.25% (2016: 28.00%)	348	206
Impact on tax of:		
Expenses not deductible for tax purposes:		
UK bank levy	33	22
Other expenses	9	(7)
Group relief surrendered for no cash consideration	-	1
Effect of tax rates in foreign jurisdictions	9	37
Impact of change in deferred tax rate	1	2
Under provided in prior years	2	14
Movement in tax reserves in respect of prior years	15	4
Other	(3)	5
Total income tax expense in the consolidated income statement	414	284

The Group has a policy of surrendering tax-deductible losses ('group relief') for no consideration to other members of the Morgan Stanley UK tax group, which consists of entities within the Group and the wider Morgan Stanley Group. Finance (No.2) Act 2015 enacted a reduction in the UK corporation tax rate to 19% with effect from 1 April 2017. Finance Act 2016 enacted a further reduction in the UK corporation tax rate to 17% with effect from 1 April 2020 which will impact the current tax charge in future periods. In addition, Finance (No. 2) Act 2015 introduced an 8% corporation tax surcharge on the profits of banking companies with effect from 1 January 2016 which impacts the current tax charge in the current period.

In addition to the amount charged to the consolidated income statement, the aggregate amount of current and deferred tax relating to each component of other comprehensive income was as follows:

	2017			2016		
	Before tax $millions	Tax expense $millions	Net of tax $millions	Before tax $millions	Tax expense $millions	Net of tax $millions
Foreign currency translation reserve:						
Foreign currency translation differences on foreign operations	111	-	111	(8)	-	(8)
Changes in fair value of liabilities designated at fair value through profit or loss due to changes in the Group's own credit risk	(99)	26	(73)	(58)	16	(42)
Available-for-sale reserve:						
Net change in fair value of available-for-sale financial assets	68	-	68	(8)	-	(8)
Other comprehensive income	80	26	106	(74)	16	(58)

8. LOANS AND RECEIVABLES

	2017 $millions	2016 $millions
Loans and receivables	184,691	170,572
Less impairment losses	(41)	(40)
	184,650	170,532
A reconciliation of impairment losses for loans and advances is as follows:		
At 1 January	40	28
Charge for the year (see note 6)	50	26
Reversal of impairment losses (see note 6)	(45)	(12)
Amounts written off	(6)	(1)
Net foreign exchange losses/(gains)	2	(1)
At 31 December	41	40

9. OTHER RECEIVABLES

	2017 $millions	2016 $millions
Amounts held at exchanges	928	532
Amounts due from other Morgan Stanley Group undertakings	720	858
Other amounts receivable	101	90
	1,749	1,480

10. FINANCIAL ASSETS AND FINANCIAL LIABILITIES CLASSIFIED AS HELD FOR TRADING

Financial assets and financial liabilities classified as held for trading are summarised as follows:

	2017		2016	
	Assets $millions	Liabilities $millions	Assets $millions	Liabilities $millions
Government debt securities	11,956	22,834	10,052	19,476
Corporate and other debt	9,756	2,864	8,550	2,853
Corporate equities	76,073	23,053	46,025	23,278
Derivatives (see note 11)	167,008	169,226	183,553	180,580
	264,793	217,977	248,180	226,187

11. DERIVATIVES CLASSIFIED AS HELD FOR TRADING

The fair value of derivative assets and liabilities classified as held for trading, split by instrument type, is summarised as follows:

2017	Bilateral OTC $millions	Cleared OTC $millions	Listed derivative contracts $millions	Total $millions
Derivative assets:				
Interest rate contracts	71,726	1,143	7	72,876
Credit contracts	4,227	94	-	4,321
Foreign exchange and gold contracts	54,731	801	-	55,532
Equity contracts	26,590	-	5,301	31,891
Commodity contracts	2,224	-	164	2,388
	159,498	2,038	5,472	167,008
Derivative liabilities:				
Interest rate contracts	65,223	654	3	65,880
Credit contracts	4,608	53	-	4,661
Foreign exchange and gold contracts	56,287	1,007	-	57,294
Equity contracts	34,063	-	4,953	39,016
Commodity contracts	2,353	-	22	2,375
	162,534	1,714	4,978	169,226

2016	Bilateral OTC $millions	Cleared OTC $millions	Listed derivative contracts $millions	Total $millions
Derivative assets:				
Interest rate contracts	77,183	3,260	9	80,452
Credit contracts	6,152	6	-	6,158
Foreign exchange and gold contracts	65,687	1,039	-	66,726
Equity contracts	23,330	-	4,518	27,848
Commodity contracts	2,279	-	90	2,369
	174,631	4,305	4,617	183,553
Derivative liabilities:				
Interest rate contracts	72,785	3,202	4	75,991
Credit contracts	6,332	16	-	6,348
Foreign exchange and gold contracts	65,522	975	-	66,497
Equity contracts	24,949	-	4,473	29,422
Commodity contracts	2,285	-	37	2,322
	171,873	4,193	4,514	180,580

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

	2017		2016	
	Assets $millions	Liabilities $millions	Assets $millions	Liabilities $millions
Prepaid OTC contracts	442	898	757	1,397
Corporate loans	276	-	305	-
Issued structured notes	-	3,858	-	1,958
Other financial assets and liabilities	10,778	17,543	3,250	2,665
	11,496	22,299	4,312	6,020

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

Prepaid OTC contracts: The risk on these financial instruments, both financial assets and financial liabilities, is primarily hedged using financial instruments classified as held for trading, including equity securities and interest rate swaps. These prepaid OTC contracts are designated at fair value through profit or loss as such contracts, as well as the financial instruments with which they are hedged, are risk managed on a fair value basis as part of the Group's trading portfolio and the risk is reported to key management personnel on this basis.

Corporate loans: Certain loans to customers are designated at fair value through profit or loss either because the risks of the loans have been matched with other financial instrument contracts accounted for at fair value and such a designation reduces an accounting mismatch; or as part of a documented risk management strategy the risks of the loan are managed on a fair value basis as part of the Group's trading portfolio and the risk is reported to key management personnel on this basis; or because the loan contract itself contains an embedded derivative that must otherwise be separated and measured at fair value.

Issued structured notes: These are financial liabilities which arise from selling structured products, generally in the form of notes or certificates. These structured notes are designated at fair value through profit or loss as the risks to which the Group is a contractual party are risk managed on a fair value basis as part of the Group's trading portfolio and the risk is reported to key management personnel on this basis.

Other financial assets and liabilities: These include financial assets and liabilities such as those that arise upon the consolidation of certain special purpose entities and those that arise as a result of continuing recognition of certain financial assets and the simultaneous recognition of an associated financial liability. These financial assets and liabilities are designated at fair value as the risks to which the Group is a contractual party are risk managed on a fair value basis as part of the Group's trading portfolio and the risk is reported to key management personnel on this basis. The increase during the year was driven by an increase in client financing transactions.

The maximum exposure to credit risk of corporate loans designated at fair value through profit or loss as at 31 December 2017 is $276 million (2016: $305 million). The cumulative change in fair value of loans attributable to changes in credit risk amounts to $nil (2016: $nil) and the change for the current year is $nil (2016: $nil). Corporate loans are fully collateralised with securities received by the Group.

The cumulative change in fair value recognised through other comprehensive income attributable to own credit risk for financial liabilities designated at fair value at 31 December 2017 is a loss of $160 million (2016: loss of $62 million). During the year, $nil (2016: $nil) was realised as a result of the derecognition of such financial liabilities and was transferred from the 'Debt valuation adjustment reserve' to 'Retained earnings'.

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

The Group determines the amount of changes in fair value attributable to changes in counterparty credit risk or own credit risk, as relating to loans and receivables and financial liabilities designated at fair value, by first determining the fair value including the impact of counterparty credit or own credit risk, and then deducting those changes in fair value representing managed market risk. In determining fair value, the Group considers the impact of changes in own credit spreads based upon observations of the secondary bond market spreads when measuring the fair value for issued structured notes. The Group considers that this approach most faithfully represents the amount of change in fair value due to both counterparty credit risk and the Group's own credit risk.

The carrying amount of financial liabilities designated at fair value, for which the effect of changes in those liabilities' credit risk is presented within other comprehensive income, was $28 million lower than the contractual amount due at maturity (2016: $49 million lower).

13. AVAILABLE-FOR-SALE FINANCIAL ASSETS

Financial assets that are classified as available-for-sale consist of corporate equities, of which $26 million are listed investments (2016: $nil).

Movement in available-for-sale financial assets

	2017 $millions	2016 $millions
Fair value		
At 1 January	29	39
Additions	65	1
Changes in fair value recognised in the available-for-sale reserve	68	(8)
Disposals	(1)	(3)
At 31 December	161	29

14. INTERESTS IN SUBSIDIARIES

Composition of the Group

Details of all subsidiary undertakings are provided in the Appendix to the Company's financial statements, including changes in holdings of subsidiaries.

The Group did not dispose of any wholly owned subsidiaries during the current year and the prior year.

All subsidiaries are included in the Group's consolidated financial statements.

Information regarding interests in structured entities is included in note 15.

The Group has not provided financial support to, or otherwise agreed to be responsible for supporting any subsidiary of the Group financially.

15. INTERESTS IN STRUCTURED ENTITIES

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

A structured entity is an entity that has been designed such that voting or similar rights are not the dominant factor in deciding who controls the entity. The party that consolidates the structured entity is the investor that controls the structured entity. An investor controls a structured entity when it is exposed, or has the rights, to variable returns from its involvement with the structured entity and has the ability to affect those returns through its power over the structured entity. The Group consolidates structured entities it controls.

The Group's interests in structured entities include certain debt and equity interests, commitments, guarantees, derivative instruments and certain fees arrangements. The Group's involvement with structured entities arises primarily from:

- Loans made to and investments in structured entities that hold debt, equity, real estate or other assets;
- Interests purchased in connection with market-making activities and retained interests held as a result of securitisation activities;
- Structuring of asset-repackaged notes designed to meet the investment objectives of clients; and
- Certain derivatives entered into with structured entities.

The Group determines whether it controls, and therefore should consolidate, a structured entity upon its initial involvement with the structured entity and reassesses whether it should continue to consolidate on an ongoing basis as long as it has any continuing involvement with the structured entity. This determination is based upon an analysis of the design of the structured entity, including the structured entity's structure and activities; assessment of the significance of the powers to make economic decisions which are held by the Group and its related parties and whether such powers may be used to affect its investor returns; and consideration of the significance of direct and indirect interests in the structured entity which are held by the Group and its related parties.

The power to make the most significant economic decisions may take a number of different forms. The Group considers servicing or collateral management decisions as generally representing the power to make the most significant economic decisions in transactions such as securitisations or collateralised debt obligations ("CDOs"). As a result, the Group does not consolidate securitisations or CDOs for which it does not act as the servicer or collateral manager unless it holds certain other rights to replace the servicer or collateral manager or to require the liquidation of the entity. In fund structures, the power to appoint or direct the fund manager is generally the most significant power.

For certain structured entities, such as entities which issued Credit Linked Notes ("CLNs") and other asset-repackaged notes, there are no significant economic decisions made on an ongoing basis. In these cases, the Group focuses its analysis on decision making powers relating to liquidation of the entity or unwinding or termination of the transaction structure. The Group concluded in most of these transactions that decisions made prior to the initial closing were shared between the group and the initial investors based upon the nature of the assets, including whether the assets were issued in a transaction sponsored by the Group, and the extent of the information available to the Group and to investors, the number, nature and involvement of investors, other rights held by the Group and investors, the standardisation of the legal documentation and the level of the continuing involvement by the Group, including the amount and type of interests owned by the Group and by other investors, the Group concluded in some of these transactions that decisions made prior to the initial closing were shared between the Group and the initial investors. The Group focused its control decision on any right held by the Group or investors related to the termination of the structured entity. Many CLNs and other asset repackaged notes have no such termination rights.

15. INTERESTS IN STRUCTURED ENTITIES (CONTINUED)

The assets owned by many consolidated structured entities cannot be removed unilaterally by the Group and are not generally available to the Group. The related liabilities issued by many consolidated structured entities are non-recourse to the Group. In certain other consolidated structured entities, the Group has the unilateral right to remove assets or provide additional recourse through derivatives such as total return swaps, guarantees or other forms of involvement.

The Group accounts for the assets held by structured entities primarily in 'Financial assets classified as held for trading – corporate and other debt' and the liabilities of the structured entities as 'Financial liabilities designated at fair value' in the consolidated statement of financial position.

The usage of structured entities is described below.

Securitisation Activities. In a securitisation transaction, the Group transfers assets (generally commercial or residential mortgage loans) to a structured entity, sells to investors most of the beneficial interests, such as notes or certificates, issued by the structured entity, and in many cases, retains other beneficial interests. The purchase of the transferred assets by the structured entity is financed through the sale of these interests. In many securitisations, particularly those involving residential mortgage loans, the Group also enters into derivative transactions, primarily interest rate swaps or interest rate caps with a senior payment priority, with the structured entity.

Collateralised Loan and Debt Obligations. Securitization transactions generally involve structured entities. Primarily as a result of its secondary market-making activities, the Group owns structured entity assets. These assets were either retained in connection with transfer of assets by the Group or acquired in connection with secondary market making activities.

A collateralised loan obligation ("CLO") or a CDO is a structured entity that purchases a pool of assets, consisting of corporate loans, corporate bonds, asset-backed securities or synthetic exposures on similar assets through derivatives, and issues multiple tranches of debt and equity securities to investors. The purchase of the assets by the structured entity is financed through the issuance of the tranches of securities. The Group underwrites the securities issued in CLO transactions on behalf of unaffiliated sponsors and provides advisory services to these unaffiliated sponsors. The Group sells corporate loans to many of these structured entities, in some cases representing a significant portion of the total assets purchased. If necessary, the Group may retain unsold securities issued in these transactions. Although not obligated, the Group generally makes a market in the securities issued by structured entities in these transactions. These beneficial interests are included in 'Financial assets classified as held for trading'.

Fund Investments. In a fund investment structure the Group provides clients with indirect access to specified underlying investments through total return swaps. The investments are purchased and held by a structured entity in which the Group holds an interest. The structured entity is financed through the sale of notes to investors.

Consolidated structured entities

As at 31 December 2017, the Group did not consolidate any significant structured entities (2016: nil).

Unconsolidated structured entities

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

15. INTERESTS IN STRUCTURED ENTITIES (CONTINUED)

Unconsolidated structured entities (continued)

The Group's transactions with unconsolidated structured entities primarily include securitisations, credit protection purchased through CLNs, other structured financings and collateralised loan and debt obligations. The Group's interests in structured entities that it does not consolidate can include ownership of retained interests in Group-sponsored transactions, interests purchased in the secondary market (both for Group-sponsored transactions and transactions sponsored by third parties), and certain derivatives with securitisation structured entities. The risks associated with derivatives entered into with structured entities are essentially the same as similar derivatives with non-structured entity counterparties and are managed as part of the Group's overall exposure.

The table below shows non-consolidated structured entities in which the Group had an interest at 31 December 2017 and at 31 December 2016. The tables include all structured entities in which the Group has determined that its maximum exposure to loss is greater than specific thresholds or meets certain other criteria. Most of the structured entities included in the tables below are sponsored by unrelated parties; the Group's involvement generally is the result of the Group's secondary market-making activities.

	Mortgage and asset-backed securitisations $millions	Collateralised debt obligations $millions	Fund investments $millions	Other $millions	Total $millions
31 December 2017					
Structured entity assets that the Group does not consolidate (unpaid principal balance)	6,998	5,365	856	2,302	15,521
Maximum exposure to loss:					
Debt and equity interests	441	142	755	-	1,338
Derivative and other contracts	-	-	101	1,450	1,551
Total maximum exposure to loss	441	142	856	1,450	2,889
Carrying value of exposure to loss - assets [(1)]:					
Debt and equity interests	441	142	755	-	1,338
Derivative and other contracts	-	-	40	132	172
Total carrying value of exposure to loss - assets	441	142	795	132	1,510
Carrying value of exposure to loss - liabilities [(1)]:					
Derivative and other contracts	-	-	61	4	65
Total carrying value of exposure to loss - liabilities	-	-	61	4	65

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

15. INTERESTS IN STRUCTURED ENTITIES (CONTINUED)

Unconsolidated structured entities (continued)

31 December 2016	Mortgage and asset-back securitisations $millions	Collateralised debt obligations $millions	Fund investments $millions	Other $millions	Total $millions
Structured entity assets that the Group does not consolidate (unpaid principal balance)	3,174	4,503	3,412	5	11,094
Maximum exposure to loss:					
Debt and equity interests	252	150	-	-	402
Derivative and other contracts	-	-	3,412	5	3,417
Total maximum exposure to loss	252	150	3,412	5	3,819
Carrying value of exposure to loss - assets (1):					
Debt and equity interests	252	150	-	-	402
Derivative and other contracts	-	-	12	5	17
Total carrying value of exposure to loss - assets	252	150	12	5	419
Carrying value of exposure to loss - liabilities (1):					
Derivative and other contracts	-	-	20	-	20
Total carrying value of exposure to loss - liabilities	-	-	20	-	20

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

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

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

Securitisation transactions generally involve structured entities. Primarily as a result of its secondary market-making activities, the Group owned additional securities issued by securitisation structured entities for which the maximum exposure to loss is less than specific thresholds. These additional securities which were retained in connection with transfers of assets by the Group totalled $392 million at 31 December 2017 (2016: $365 million). The fair value and type of securities retained are shown in the table below.

15. INTERESTS IN STRUCTURED ENTITIES (CONTINUED)

Unconsolidated structured entities (continued)

	2017 $millions	2016 $millions
Securities backed by:		
Residential mortgage loans	222	159
Commercial mortgage loans	26	35
CDOs or other CLOs	106	133
Other consumer loans	38	38
	392	365

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

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

Sponsored unconsolidated structured entities

The Group considers itself the sponsor of certain non-consolidated structured entities where it was primarily involved in the establishment of a structured entity and where, additionally, the Group has been involved in the transfer of assets; servicer of the assets; ability to access the assets; marketing; managing activities; purchasing protection or providing explicit guarantees; when Morgan Stanley's name is associated with the structured entity or where market participants may generally expect Morgan Stanley to be associated with the structured entity.

In some sponsored entities, the Group has been involved with the structured entity through establishing the structured entity, marketing of products associated with the structured entity in its own name, and/ or through involvement in the design of the structured entity. The Group has an interest at 31 December 2017 of $nil (2016: $15 million) in such sponsored entities.

The loss related to sponsored entities during 2017 was $1.5 million (2016: $1.5 million). These losses are reported under 'Net gains on financial instruments classified as held for trading' in the consolidated income statement. No assets were transferred to sponsored structured entities during 2017 (2016: $120 million).

16. PROPERTY, PLANT AND EQUIPMENT

2017	Leasehold improvements $millions	Fixtures, fittings and equipment $millions	Total $millions
Cost			
At 1 January 2017	22	21	43
Additions	1	2	3
Foreign exchange revaluation	2	3	5
At 31 December 2017	25	26	51
Depreciation			
At 1 January 2017	19	18	37
Charge for the year	1	1	2
Foreign exchange revaluation	2	2	4
At 31 December 2017	22	21	43
Carrying amount			
At 31 December 2017	3	5	8

2016	Leasehold improvements $millions	Fixtures, fittings and equipment $millions	Total $millions
Cost			
At 1 January 2016	20	19	39
Additions	3	3	6
Foreign exchange revaluation	(1)	-	(1)
Disposals	-	(1)	(1)
At 31 December 2016	22	21	43
Depreciation			
At 1 January 2016	19	17	36
Charge for the year	1	2	3
Impairment provisions	(1)	-	(1)
Disposals	-	(1)	(1)
At 31 December 2016	19	18	37
Carrying amount			
At 31 December 2016	3	3	6

17. SUBORDINATED LOANS

The amounts subject to subordinated loan agreements are wholly repayable as shown below:

Counterparty	Repayment Date	Interest Rate	2017 $millions	2016 $millions
Morgan Stanley Investments (UK)	21 December 2025	OBFR(1) plus 2.3%	5,000	-
Morgan Stanley International Finance S.A.	31 October 2025	LIBOR(2) plus 1.475%	2,000	-
Morgan Stanley UK Financing I LP	31 October 2025	LIBOR(2) plus 1.475%	-	7,906
			7,000	7,906

(1) Overnight Bank Funding Rate ("OBFR")

(2) London Interbank Offered Rate ("LIBOR")

The amount outstanding under the subordinated loan agreements is repayable at any time at the Group's option, subject to appropriate notice to the lender and at least three months' notice to the PRA.

The Group has not defaulted on principal, interest or made any other breaches with respect to its subordinated loans during the year.

On 3 January 2017, the subordinated loan of $7,906 million was reassigned from Morgan Stanley UK Financing I LP to Morgan Stanley International Finance S.A., another Morgan Stanley Group undertaking. On 8 February 2017, a new $5,000 million subordinated loan was issued by the Group to its' immediate parent undertaking, Morgan Stanley Investments (UK). $5,906 million of the existing subordinated loan with Morgan Stanley International Finance S.A. was repaid.

18. OTHER PAYABLES

	2017 $millions	2016 $millions
Amounts due to other Morgan Stanley Group undertakings	30,821	10,602
Other amounts payable	204	187
	31,025	10,789

The increase in other payables is driven by an increase in long-term intercompany borrowings to fund the increase in business activity.

19. PROVISIONS

	Property	Litigation	Taxes and levies	Total
	$millions	$millions	$millions	$millions
At 1 January 2017	4	9	72	85
Additional provisions	-	1	86	87
Provisions utilised	-	(9)	(120)	(129)
Unused amounts reversed during the period	-	-	(4)	(4)
Foreign exchange revaluation	-	1	14	15
At 31 December 2017	4	2	48	54

Property

Property provisions represent the net present value of expected future costs of excess office space (net of sublease income) and the net present value of expected future costs of reinstating leasehold improvements at the end of the lease term. Lease reinstatement provisions are released when the reinstatement obligations have been fulfilled. The related asset for lease reinstatement provisions is included in 'Leasehold improvements' within 'Property, plant and equipment' (note 16).

Litigation matters

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

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

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

In many proceedings and investigations, however, it is inherently difficult to determine whether any loss is probable or even possible, or to estimate the amount of any loss. The Group cannot predict with certainty if, how or when such proceedings or investigations will be resolved or what the eventual settlement, fine, penalty or other relief, if any, may be, particularly for proceedings and investigations where the factual record is being developed or contested or where plaintiffs or government entities seek substantial or indeterminate damages, restitution, disgorgement or penalties. Numerous issues may need to be resolved, including through potentially lengthy discovery and determination of important factual matters, determination of issues related to class certification and the calculation of damages or other relief, and by addressing novel or unsettled legal questions relevant to the proceedings or investigations in question, before a loss or additional loss or range of loss or additional loss can be reasonably estimated for a proceeding or investigation.

19. PROVISIONS (CONTINUED)

Litigation matters (continued)

Subject to the foregoing, the Group believes, based on current knowledge and after consultation with counsel, that the outcome of such proceedings and investigations will not have a material adverse effect on the financial condition of the Group, although the outcome of such proceedings or investigations could be material to the Group's operating results and cash flows for a particular period depending on, among other things, the level of the Group's revenues or income for such period.

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

On 15 July 2010, China Development Industrial Bank ("CDIB") filed a complaint against the Group and another Morgan Stanley Group affiliate, styled *China Development Industrial Bank v. Morgan Stanley & Co. Incorporated et al*., which is pending in the Supreme Court of the State of New York, New York County. The complaint relates to a $275 million credit default swap ("CDS") referencing the super senior portion of the STACK 2006-1 collateralised debt obligation ("CDO"). The complaint asserts claims for common law fraud, fraudulent inducement and fraudulent concealment and alleges that the Group and another Morgan Stanley Group affiliate misrepresented the risks of the STACK 2006-1 CDO to CDIB, and that the Group and another Morgan Stanley Group affiliate knew that the assets backing the CDO were of poor quality when it entered into the CDS with CDIB. The complaint seeks compensatory damages related to the approximately $228 million that CDIB alleges it has already lost under the CDS, rescission of CDIB's obligation to pay an additional $12 million, punitive damages, equitable relief, pre- and post-judgment interest, fees and costs. On 28 February 2011, the court denied the Group's and another Morgan Stanley Group affiliate's motion to dismiss the complaint.

On 1 April 2016, the California Attorney General's Office filed an action against certain Morgan Stanley Group affiliates in California state court styled *California v. Morgan Stanley, et al.*, on behalf of California investors, including the California Public Employees' Retirement System and the California Teachers' Retirement System. The complaint alleges that the Morgan Stanley Group affiliates made misrepresentations and omissions regarding residential mortgage backed securities and notes issued by the Cheyne SIV, and asserts violations of the California False Claims Act and other state laws and seeks treble damages, civil penalties, disgorgement, and injunctive relief. On 30 September 2016, the court granted the Morgan Stanley Group affiliates' demurrer, with leave to replead. On 21 October 2016, the California Attorney General filed an amended complaint. On 25 January 2017, the court denied the Morgan Stanley Group affiliates' demurrer with respect to the amended complaint.

On 11 October 2011, an Italian financial institution, Banco Popolare Societá Cooperativa ("Banco Popolare"), filed a civil claim against the Group and another Morgan Stanley Group affiliate in the Milan courts, styled *Banco Popolare Societá Cooperativa v Morgan Stanley & Co. International plc & others*, related to its purchase of €100 million of bonds issued by Parmalat. The claim asserted by Banco Popolare alleges, among other things, that the Group and another Morgan Stanley Group affiliate was aware of Parmalat's impending insolvency and conspired with others to deceive Banco Popolare into buying bonds by concealing both Parmalat's true financial condition and certain features of the bonds from the market and Banco Popolare. Banco Popolare seeks damages of €76 million (approximately $91 million) plus damages for loss of opportunity and moral damages. The Group and another Morgan Stanley Group affiliate filed its answer on 20 April 2012, and the hearing on the parties' final submissions is scheduled for 17 May 2018.

19. PROVISIONS (CONTINUED)

Litigation matters (continued)

On 22 June 2017, the public prosecutor for the Court of Accounts for the Republic of Italy filed a claim against the Group styled Case No. 2012/00406/MNV, which is pending in the Regional Prosecutor's Office at the Judicial Section of the Court of Auditors for Lazio, Italy. The claim relates to certain derivative transactions between the Republic of Italy and the Group and another Morgan Stanley Group affiliate. The transactions were originally entered into between 1999 and 2005, and were restructured (and certain of the transactions were terminated) in December 2011 and January 2012. The claim alleges, inter alia, that the Group effectively acted as an agent of the state in connection with these transactions and asserts claims related to, among other things, whether the Ministry of Finance was authorised to enter into these transactions, whether the transactions were appropriate and whether the Group's conduct related to the termination of certain transactions was proper. The prosecutor is seeking damages through an administrative process against the Group for €2.76 billion (approximately $3.3 billion). A hearing regarding this matter has been scheduled for 19 April 2018.

The Group is responding to a number of regulatory and governmental inquiries both in the United States and abroad related to its foreign exchange business.

In matters styled *Case number 15/3637* and *Case number 15/4353*, the Dutch Tax Authority ("Dutch Authority") is challenging in the District Court in Amsterdam the prior set-off by a subsidiary undertaking of the Group of approximately €124 million (approximately $149 million) plus accrued interest of withholding tax credits against the Group's corporation tax liabilities for the tax years 2007 to 2013. The Dutch Authority alleges that the subsidiary undertaking of the Group was not entitled to receive the withholding tax credits on the basis, inter alia, that the subsidiary undertaking of the Group did not hold legal title to certain securities subject to withholding tax on the relevant dates. The Dutch Authority has also alleged that the subsidiary undertaking of the Group failed to provide certain information to the Dutch Authority and keep adequate books and records. A hearing in this matter took place on 19 September 2017.

On 5 October 2017, various institutional investors filed a claim against the Group and another bank in a matter styled *Case number BS 99-6998/2017,* in the City Court of Copenhagen, Denmark concerning their roles as underwriters of the initial public offering ("IPO") in March 2014 of the Danish company OW Bunker A/S. The claim seeks damages of DKK 534,270,456 (approximately $86 million) plus interest in respect of alleged losses arising from investing in shares in OW Bunker, which entered into bankruptcy in November 2014. Separately, on 29 November, 2017, another group of institutional investors joined the Group and another bank as defendants to pending proceedings in the High Court of Eastern Denmark against various other parties involved in the IPO in a matter styled *Case number B-2073-16*. The investors claim damages of DKK 767,235,885 (approximately $124 million) plus interest, from the Group and the other bank on a joint and several basis with the defendants to these proceedings. Both claims are based on alleged prospectus liability; the second claim also alleges professional liability of banks acting as financial intermediaries.

19. PROVISIONS (CONTINUED)

Litigation matters (continued)

Beginning in February of 2016, the Group and certain Morgan Stanley Group affiliates were named as defendants in multiple purported antitrust class actions now consolidated into a single proceeding in the United States District Court for the Southern District of New York styled *In Re: Interest Rate Swaps Antitrust Litigation*. Plaintiffs allege, inter alia, that the Group and certain Morgan Stanley Group affiliates, together with a number of other financial institution defendants violated United States and New York state antitrust laws from 2008 through December of 2016 in connection with their alleged efforts to prevent the development of electronic exchange-based platforms for interest rates swaps trading. Complaints were filed both on behalf of a purported class of investors who purchased interest rates swaps from defendants, as well as on behalf of two swap execution facilities that allegedly were thwarted by the defendants in their efforts to develop such platforms. The consolidated complaints seek, among other relief, certification of the investor class of plaintiffs and treble damages. On 28 July 2017, the court granted in part and denied in part the defendants' motion to dismiss the complaints.

Tax related provisions

The Group is subject to income tax laws which are complex and subject to different interpretations by the taxpayer and the relevant governmental taxing authorities. Management makes judgments and interpretations about the application of these inherently complex tax laws when determining the provision for income taxes. Disputes over interpretations of the tax laws may be settled with the taxing authority upon examination or audit. The Group periodically evaluates the likelihood of assessments in each taxing jurisdiction resulting from current and subsequent years' examinations. Provisions related to potential losses that may arise from tax audits are established in accordance with the guidance on accounting for uncertain tax items. The Group has established provisions that it believes are adequate in relation to the potential for additional assessments. Whilst a range of outcomes is foreseeable, management considers the amount of the provision to be a reasonable estimate of expected future liabilities after consideration of all pertinent facts, based on the status of inquiries at the balance sheet date.

The Group self-identified an issue regarding VAT on intercompany services provided by certain overseas affiliates to the Group. The Group is reviewing the reporting of UK VAT as additional support service centres were added to the operations over the years, and the focus and nature of their intended services shifted among geographic locations. During the year, the Group recorded a provision of $86 million that incorporated potential additional VAT, interest and penalties for this exposure. Due to foreign exchange revaluation, prepayments and provision releases following further discussions with HMRC, this has decreased to $25 million at the balance sheet date. Management is actively working with Her Majesty's Revenue and Customs to resolve this matter. The provision reflected is based on currently available information and analyses, and the review of this matter is continuing.

20. DEFERRED TAX ASSETS AND LIABILITIES

Deferred taxes are calculated on all temporary differences under the liability method. The movement in the deferred tax account is as follows:

	2017		2016	
	Deferred tax asset $millions	**Deferred tax liability $millions**	**Deferred tax asset $millions**	**Deferred tax liability $millions**
At 1 January	84	(11)	120	(23)
Adjustment in respect of prior years	(2)	3	(4)	-
Amount recognised in the consolidated income statement	(1)	8	(46)	13
Amount recognised in other comprehensive income	26	-	17	(1)
Impact of changes in tax rates recognised in the consolidated income statement	-	-	(2)	-
Impact of changes in tax rates recognised in other comprehensive income	-	-	(1)	-
At 31 December	107	-	84	(11)

For the purpose of presentation in the consolidated statement of financial position, certain deferred tax assets and liabilities have been offset. The deferred tax included in the consolidated statement of financial position and changes recorded in 'Income tax expense' are as follows:

	Deferred tax asset 2017 $millions	**Consolidated income statement 2017 $millions**	**Deferred tax asset 2016 $millions**	**Deferred tax liability 2016 $millions**	**Consolidated income statement 2016 $millions**
Accelerated capital allowances	2	-	2	-	(2)
Deferred compensation	13	1	14	(2)	(3)
IFRS 9 transitional adjustment	-	-	-	(1)	-
Temporary differences arising in respect of changes in the Group's own credit risk	42	-	16	-	-
Forecast currency hedges	-	-	-	-	1
Amounts not recognised due to unobservable market data			-	-	(2)
Deferred interest	48	(3)	51	-	(44)
Unrealised gains/ (losses)	-	8	-	(8)	14
Other temporary differences	2	1	1	-	(3)
	107	7	84	(11)	(39)

20. DEFERRED TAX ASSETS AND LIABILITIES (CONTINUED)

Finance (No.2) Act 2015 enacted a reduction in the UK corporation tax rate to 19% with effect from 1 April 2017. Finance Act 2016 enacted a further reduction in the UK corporation tax rate to 17% with effect from 1 April 2020. These rate reductions have had an impact on the deferred tax balance as indicated above.

The deferred tax assets recognised are based on management assessment that it is probable that the Group will have taxable profits against which the temporary differences can be utilised.

Deferred tax assets have not been recognised in respect of the following items (amounts shown are as at the end of the reporting period):

	2017 $millions	2016 $millions
Unused tax losses	40	33

The aggregate amount of temporary differences associated with investments in subsidiaries and branches for which deferred tax liabilities have not been recognised is $nil (2016: $nil).

21. COMMITMENTS AND CONTINGENCIES

Leases

The Group has entered into non-cancellable commercial leases on premises and equipment. These leases have lives ranging from one to seven years. The leases on the premises include renewal options and escalation clauses in line with general rental market conditions and rent adjustments based on price indices. The lease agreements do not contain contingent rent payment clauses or purchase options and they do not impose any restrictions on the Group's ability to pay dividends, engage in debt financing transactions or enter into further lease agreements.

	2017 $millions	2016 $millions
Lease payments under non-cancellable operating leases recognised as an expense in the year		
- Minimum lease payments	6	6

Future minimum lease payments under non-cancellable operating leases at 31 December are due as follows:

	2017 $millions	2016 $millions
Within one year	9	10
In the second to fifth years inclusive	16	26
After five years	2	3
	27	39

Future minimum sub-lease receivables under non-cancellable operating leases at 31 December are due as follows:

	2017 $millions	2016 $millions
Within one year	1	3
In the second to fifth years inclusive	2	10
	3	13

21. COMMITMENTS AND CONTINGENCIES (CONTINUED)

Other commitments and contingent liabilities

At 31 December, the Group had the following outstanding commitments and contingent liabilities arising from off-balance sheet financial instruments:

	2017	2016
Contingent liabilities		
	$millions	$millions
Guarantees	577	1,135
Letters of credit	1	1
	578	1,136

Commitments	2017	2016
	$millions	$millions
Loan commitments	2,190	2,662
Underwriting commitments	336	1,309
Unsettled securities purchased under agreements to resell (1)	28,480	30,121
Unsettled securities sold under agreements to repurchase(2)	13,740	17,604

(1) Unsettled securities purchased under agreements to resell have a trade date at or prior to 31 December 2017 and settle subsequent to period end.

(2) Unsettled securities sold under agreements to repurchase have a trade date at or prior to 31 December 2017 and settle subsequent to period end.

22. EQUITY INSTRUMENTS

	Ordinary shares of $1 each $millions	Ordinary shares of £1 each $millions	Class A ordinary shares of $1 each $millions	Additional Tier 1 capital $millions	Total equity instruments $millions
Issued and fully paid:					
At 1 January 2016 and 31 December 2016	9,935	30	1,500	1,300	12,765
At 1 January 2017	9,935	30	1,500	1,300	12,765
Ordinary shares of $1 each issued	1,000	-	-	-	1,000
At 31 December 2017	10,935	30	1,500	1,300	13,765
Voting rights at 31 December 2017	99.9% (1)	0.1% (1)	Non-voting	Non-voting	100%

(1) Ordinary shares are pari passu with each other regardless of currency and together carry 100% of the voting rights (2016: 100%)

Equity instruments

At 1 January 2016 and 2017 the total equity instruments in issue of the Company equated to $12,765 million comprising 9,935,105,148 ordinary shares of $1 each (31 December 2016: 9,935,105,148), 17,615,107 ordinary shares of £1 each (31 December 2016: 17,615,107), 1,500,000,000 Class A Non-voting ordinary shares of $1 each (31 December 2016: 1,500,000,000) and Additional Tier 1 capital instruments of $1,300,000,000 (31 December 2016: $1,300,000,000). All equity instruments are fully paid.

On 28 September 2017, 1,000,000,000 ordinary shares of $1 each were issued at par to the Company's immediate parent undertaking for cash consideration.

22. EQUITY INSTRUMENTS (CONTINUED)

Ordinary shares

The holders of the ordinary shares are entitled to receive dividends as declared and are entitled, on a show of hands, to one vote and, on a poll, one vote per share at meetings of the shareholders of the Company. All shares rank equally with regard to the Company's residual net assets.

All ordinary shares are recorded at the rates of exchange ruling at the date the shares were paid up.

Additional Tier 1 capital

The Additional Tier 1 capital instruments (the "AT1") include a trigger mechanism whereby, if the Common Equity Tier 1 capital ratio of the Company falls below a pre-determined level, the Group will write-down the outstanding principal amount of the AT1, together with any accrued interest coupon. In this situation, Morgan Stanley UK Group, the purchaser of the AT1, would have no further rights against the Group in respect of the AT1. The AT1 have no defined maturity, are callable at the Group's discretion after five years from their date of issuance of 15 December 2014, and are subordinated to senior creditors and subordinated loan creditors of the Group. The AT1 are not entitled to any participation in the residual net assets of the Group. Coupons on the AT1s are non-cumulative and payable at a fixed rate of 9% per annum. Payment of the coupon is wholly at the discretion of the Group.

A payment of coupon interest was approved by the Board of Directors on 31 May 2017 and paid on the same day (see note 23).

Reserves

Share premium

The 'Share premium account' comprises capital raised in the issue of shares that exceeded the nominal value of the shares.

Currency translation reserve

The 'Currency translation reserve' comprises all foreign exchange differences arising from the translation of the total assets less total liabilities of foreign operations. The tax effect of these movements is also included in the 'currency translation reserve'.

Available-for-sale reserve

The 'Available-for-sale reserve' includes the cumulative net change in the fair value of available-for-sale financial assets held at the reporting date. The tax effect of these movements is also included in the 'Available-for-sale reserve'.

Capital contribution reserve

The 'Capital contribution reserve' comprises contributions of capital from the Group's parent company to subsidiaries of the Group.

Capital redemption reserve

The 'Capital redemption reserve' represents transfers in prior years from retained earnings in accordance with relevant legislation.

Pension reserve

The 'Pension reserve' comprises cumulative actuarial gains or losses on scheme assets and obligations net of current tax and the impact of the asset surplus ceiling (see note 34).

22. EQUITY INSTRUMENTS (CONTINUED)

Reserves (continued)

Debt valuation adjustment reserve

The 'Debt valuation adjustment reserve' includes the cumulative change in fair value of certain financial liabilities designated at fair value through profit or loss that is attributable to changes in the credit risk of those liabilities at the reporting date. The tax effect of these movements is also included in the 'Debt valuation adjustment reserve'.

23. DIVIDENDS

On 31 May 2017, the Directors approved a coupon payment on the Additional Tier 1 capital instruments of $118,625,000 (31 December 2016: $157,625,000) out of reserves available for distribution at 31 December 2016. The coupon was paid on 31 May 2017 and has a related tax benefit of $33,121,579 (2016: $40,253,052).

The Directors have not proposed the payment of a final dividend out of reserves available at 31 December 2017.

24. ADDITIONAL CASH FLOW INFORMATION

a. Cash and cash equivalents

For the purposes of the consolidated statement of cash flows, cash and cash equivalents comprise the following balances, which have less than three months maturity from the date of acquisition:

	2017 $millions	2016 $millions
Cash and short term deposits	25,461	20,346
Bank loans and overdrafts	(123)	(25)
	25,338	20,321

Included within 'Cash and short term deposits' is $12,007 million (2016: $9,446 million) of segregated client money, held in accordance with the FCA's Client Money Rules, and an amount of $133 million (2016: $99 million) which represents other client money, that is not available for use by the Group. The corresponding payable is recognised and included in 'Trade payables' within 'Financial liabilities at amortised cost'.

24. ADDITIONAL CASH FLOW INFORMATION (CONTINUED)

b. Reconciliation of cash flows from operating activities

	Note	2017 $millions	2016 $millions
Profit for the year		864	451
Adjustments for:			
Net impairment movement and write-offs on financial assets	6	1	14
Depreciation on property, plant and equipment	16	2	3
Interest income		(174)	88
Interest expense		1,581	599
Income tax expense	7	414	284
Operating cash flows before changes in operating assets and liabilities		2,688	1,439
Changes in operating assets			
(Increase) in loans and receivables, excluding cash and short term deposits		(9,200)	(16,294)
(Increase) in financial assets classified as held for trading		(16,613)	(1,907)
(Increase) in financial assets designated at fair value through profit or loss		(7,184)	(2,676)
		(32,997)	(20,877)
Changes in operating liabilities			
Increase in financial liabilities at amortised cost, excluding bank loans and overdrafts		28,906	17,942
(Decrease) / increase in financial liabilities classified as held for trading		(8,210)	9,681
Increase / (decrease) in financial liabilities designated at fair value through profit or loss		16,206	1,113
Increase / (decrease) in provisions		(31)	64
		36,871	28,800
Interest received		254	(195)
Interest paid		(1,365)	(304)
Income taxes paid		(264)	(113)
Effect of foreign exchange movements		(1,784)	(78)
Net cash flows from operating activities		3,403	8,672

24. ADDITIONAL CASH FLOW INFORMATION (CONTINUED)

c. Reconciliation of liabilities arising from financing activities

	Balance at 1 January 2017	**Net cash flows**	**Balance at 31 December 2017**
	$millions	$millions	$millions
Subordinated loans	7,906	(906)	7,000
Total liabilities from financing activities	7,906	(906)	7,000

For further information on subordinated debt cash flows during the year refer to note 17.

25. 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 2017	Less than or equal to twelve months $millions	More than twelve months $millions	Total $millions
ASSETS			
Loans and receivables:			
Cash and short term deposits	25,461	-	25,461
Cash collateral on securities borrowed	17,828	-	17,828
Securities purchased under agreements to resell	70,730	9	70,739
Trade receivables	68,873	-	68,873
Other receivables	709	1,040	1,749
	183,601	1,049	184,650
Financial assets classified as held for trading	264,793	-	264,793
Financial assets designated at fair value through profit or loss	10,804	692	11,496
Available-for-sale financial assets	-	161	161
Current tax assets	139	-	139
Deferred tax assets	9	98	107
Prepayments and accrued income	6	-	6
Property, plant and equipment	-	8	8
Intangible assets	-	2	2
	459,352	2,010	461,362
LIABILITIES			
Financial liabilities at amortised cost:			
Bank loans and overdrafts	123	-	123
Cash collateral on securities loaned	16,674	813	17,487
Securities sold under agreements to repurchase	46,782	5,373	52,155
Trade payables	94,378	-	94,378
Subordinated loans	-	7,000	7,000
Other payables	3,805	27,220	31,025
	161,762	40,406	202,168
Financial liabilities classified as held for trading	217,977	-	217,977
Financial liabilities designated at fair value through profit or loss	18,203	4,096	22,299
Provisions	54	-	54
Current tax liabilities	28	-	28
Accruals and deferred income	144	-	144
Post-employment benefit obligations	-	5	5
	398,168	44,507	442,675

25. EXPECTED MATURITY OF ASSETS AND LIABILITIES (CONTINUED)

At 31 December 2016	Less than or equal to twelve months $millions	More than twelve months $millions	Total $millions
ASSETS			
Loans and receivables:			
Cash and short term deposits	20,346	-	20,346
Cash collateral on securities borrowed	19,601	-	19,601
Securities purchased under agreements to resell	77,099	347	77,446
Trade receivables	51,659	-	51,659
Other receivables	860	620	1,480
	169,565	967	170,532
Financial assets classified as held for trading	248,180	-	248,180
Financial assets designated at fair value through profit or loss	3,340	972	4,312
Available-for-sale financial assets	-	29	29
Current tax assets	163	-	163
Deferred tax assets	51	33	84
Prepayments and accrued income	38	-	38
Property, plant and equipment	-	6	6
Intangible assets	-	2	2
	421,337	2,009	423,346
LIABILITIES			
Financial liabilities at amortised cost:			
Bank loans and overdrafts	25	-	25
Cash collateral on securities loaned	21,119	105	21,224
Securities sold under agreements to repurchase	44,033	4,383	48,416
Trade payables	85,634	-	85,634
Subordinated loans	-	7,906	7,906
Other payables	3,548	7,241	10,789
	154,359	19,635	173,994
Financial liabilities classified as held for trading	226,187	-	226,187
Financial liabilities designated at fair value through profit or loss	3,262	2,758	6,020
Provisions	-	85	85
Current tax liabilities	80	-	80
Deferred tax liabilities	-	11	11
Accruals and deferred income	161	-	161
Post-employment benefit obligations	-	5	5
	384,049	22,494	406,543

26. SEGMENT REPORTING

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

Business segment

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

The Group has one reportable business segment, Institutional Securities, which includes capital raising and financial advisory services; corporate lending; sales, trading, financing and market-making activities in equity and fixed income securities and related products, including global macro, credit and commodities products; and investment activities.

Geographical segments

The Group operates in three geographic regions being Europe, Middle East and Africa ("EMEA"), the Americas and Asia.

The following table presents selected consolidated income statement and consolidated statement of financial position information of the Group's operations by geographic area. The external revenues (net of interest expense) and total assets disclosed in the following table reflect the regional view of the Group's operations, on a managed basis. The basis for attributing external revenues (net of interest expense) and total assets is determined by a combination of client and trading desk location.

	EMEA		Americas		Asia		Total	
	2017 $millions	2016 $millions	2017 $millions	2016 $millions	2017 $millions	2016 $millions	2017 $millions	2016 $millions
External revenues net of interest	4,508	4,354	255	19	941	85	5,703	4,458
Profit before income tax	981	730	85	(14)	212	19	1,278	735
Total assets	337,863	296,942	58,299	58,324	65,200	68,080	461,362	423,346

Results reflect the impact of the Group and Morgan Stanley updating its Global Transfer Pricing Policy, effective 1 January 2017. This change in transfer pricing policy is consistent with evolving transfer pricing guidance under OECD's and evolving regulatory guidance. The transfer pricing method selected for implementation is one of the methods specified under the 2017 OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations. This new policy is the subject of a multilateral Advanced Pricing Agreement that is currently under review by relevant tax authorities.

27. FINANCIAL RISK MANAGEMENT

Risk management procedures

Risk is an inherent part of the Group's business activity. The Group seeks to identify, assess, monitor and manage each of the various types of risk involved in its business activities in accordance with defined policies and procedures. The Group has developed its own risk management policy framework, which is consistent with and leverages the risk management policies and procedures of the Morgan Stanley Group and which include escalation to the Group's Board of Directors and to appropriate senior management personnel of the Group.

Significant risks faced by the Group resulting from its trading, financing and investment activities are set out below.

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 market liquidity, will result in losses for a position or portfolio.

Additional information on primary market risk exposures, market risk management as well as VaR methodology, assumptions and limitations is presented in the Strategic Report and forms part of the audited financial statements.

VaR for the year ended 31 December 2017

The table below presents the Management VaR for the Group's trading portfolio on a year-end, average and annual high and low basis for 31 December 2017 and 31 December 2016.

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

27. FINANCIAL RISK MANAGEMENT (CONTINUED)

Market risk (continued)

VaR for the year ended 31 December 2017(continued)

	95%/ one-day VaR for the year ended 31 December 2017				95%/ one-day VaR for the year ended 31 December 2016			
	Period end $millions	Average $millions	High $millions	Low $millions	Period end $millions	Average $millions	High $millions	Low $millions
Market risk category:								
Interest rate and credit spread	15	15	22	10	12	12	20	9
Equity price	9	12	18	8	11	11	15	9
Foreign exchange rate	2	5	9	2	3	3	6	2
Commodity price	1	1	2	-	-	1	3	-
Less diversification benefit (1)(2)	(7)	(12)	N/A	N/A	(10)	(10)	N/A	N/A
Primary Risk Categories	20	21	29	15	16	17	24	14
Credit Portfolio (3)	5	6	8	4	7	8	10	6
Less diversification benefit (1)(2)	(3)	(4)	N/A	N/A	(6)	(5)	N/A	N/A
Total Management VaR	22	23	31	16	17	20	27	15

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

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

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

The Group's average VaR for Primary Risk Categories for 2017 was $21 million compared with $17 million for 2016. The increase in average VaR for Primary Risk Categories is due to risk increase across interest rate, equity and foreign exchange.

The average Credit Portfolio VaR for 2017 was $6 million compared with $8 million for 2016. The decrease in the average VaR over the year was driven by exposure changes during 2017.

The average total VaR for 2017 was $23 million compared with $20 million for 2016.

Non-trading risks for the year ended 31 December 2017

The Group believes that sensitivity analysis is an appropriate representation of the Group's non-trading risks. Reflected below is this analysis, which covers substantially all of the non-trading risks in the Group's portfolio, with the exception of counterparty credit valuation adjustments, which are covered in the previous section.

Interest rate risk

The Group's VaR excludes certain funding liabilities and money market transactions. The application of a parallel shift in interest rates of 200 basis points increase or decrease to these positions would result in a net gain or loss, respectively, of approximately $20.8 million as at 31 December 2017, compared to a net loss or gain of $8.0 million as at 31 December 2016.

27. FINANCIAL RISK MANAGEMENT (CONTINUED)

Market risk (continued)

Funding liabilities

The credit spread risk sensitivity of the Group's mark-to-market funding liabilities corresponds to an increase in value of approximately $1.8 million and $0.8 million for each 1 basis point widening in the Group's credit spread level at 31 December 2017 and 31 December 2016, respectively.

Equity investments price risk

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

	31 December 2017 10% sensitivity $millions	31 December 2016 10% sensitivity $millions
Available-for-sale financial assets	16	3

Currency risk

The Group has foreign currency exposure arising from foreign operations. The majority of this foreign currency risk has been hedged by other members of the Morgan Stanley Group, primarily Morgan Stanley, by utilising forward foreign currency exchange contracts.

The Group also has foreign currency exposure arising from its trading activities in currencies other than US dollars. It actively manages this exposure by hedging with other Morgan Stanley Group undertakings.

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

	2017			2016		
		Sensitivity to applied percentage change in currency (+/-)			Sensitivity to applied percentage change in currency (+/-)	
	Foreign currency exposure $millions	Percentage change applied %	Other comprehensive income $millions	Foreign currency exposure $millions	Percentage change applied %	Other comprehensive income $millions
Euro	648	14%	91	282	12%	34
Taiwan New Dollar	82	8%	7	73	6%	4
Polish Zloty	5	17%	1	3	17%	1
South Korean Won	234	11%	26	177	8%	14
Swedish Krona	13	21%	3	12	21%	3
Swiss Franc	17	12%	2	13	12%	2
	999		130	560		58

27. FINANCIAL RISK MANAGEMENT (CONTINUED)

Market risk (continued)

Currency risk (continued)

The reasonably possible percentage change in the currency rate in relation to US dollars has been calculated based on the greatest annual percentage change over the 5 year period from 1 January 2013 to 31 December 2017 (2016: 1 January 2012 to 31 December 2016).

The Group also has foreign currency exposure arising from its trading activities and assets and liabilities in currencies other than US dollars, which it actively manages by hedging with other Morgan Stanley Group undertakings.

Credit risk

Credit risk refers to the risk of loss arising when a borrower, counterparty or issuer does not meet its financial obligations to the Group. Credit risk includes country risk, which is further described below.

Additional information on credit risk monitoring, control and mitigation is presented in the Strategic report and forms part of the audited financial statements.

Exposure to credit risk

The maximum exposure to credit risk ("gross credit exposure") of the Group as at 31 December 2017 is disclosed below, based on the carrying amounts of the financial assets the Group believes are subject to credit risk. Exposure arising from financial instruments not recognised on the consolidated statement of financial position is measured as the maximum amount that the Group could have to pay, which may be significantly greater than the amount that would be recognised as a liability. Where the Group enters into credit enhancements, including receiving cash and security as collateral and master netting agreements, to manage the credit exposure on these financial instruments the financial effect of the credit enhancements is also disclosed below. The net credit exposure represents the credit exposure remaining after the effect of the credit enhancements. The "unrated" balance in the 'Maximum exposure to credit risk by credit rating' represents the pool of counterparties that either do not require a rating or are under review in accordance with the Group's rating policies. These counterparties individually generate no material credit exposure and this pool is highly diversified, monitored and subject to limits.

Financial assets classified as held for trading, excluding derivatives, are subject to traded credit risk through exposure to the issuer of the financial asset; the Group manages this issuer credit risk through its market risk management infrastructure and this traded credit risk is incorporated within the VaR based risk measures included in the market risk disclosure.

27. FINANCIAL RISK MANAGEMENT (CONTINUED)

Credit risk (continued)

Exposure to credit risk (continued)
Exposure to credit risk by class:

Class	2017 Gross credit exposure (1) $millions	2017 Credit enhancements $millions	2017 Net credit exposure (2) $millions	2016 Gross credit exposure (1) $millions	2016 Credit enhancements $millions	2016 Net credit exposure (2) $millions
Loans and receivables:						
Cash and short term deposits	25,461	-	25,461	20,346	-	20,346
Cash collateral on securities borrowed	17,828	(17,410)	418	19,601	(18,900)	701
Securities purchased under agreements to resell	70,739	(66,887)	3,852	77,446	(75,053)	2,393
Trade receivables (3)	68,873	-	68,873	51,659	-	51,659
Other receivables	720	-	720	858	-	858
Financial assets classified as held for trading:						
Derivatives	167,008	(159,176)	7,832	183,553	(175,809)	7,744
Financial assets designated at fair value through profit or loss	11,496	(11,299)	197	4,312	(3,697)	615
	362,125	(254,772)	107,353	357,775	(273,459)	84,316
Unrecognised financial instruments						
Guarantees	577	-	577	1,135	-	1,135
Letters of credit	1	-	1	1	-	1
Loan commitments	2,190	(105)	2,085	2,662	(777)	1,885
Underwriting commitments	336	-	336	1,309	-	1,309
Unsettled securities purchased under agreements to resell (4)	28,480	-	28,480	30,121	-	30,121
	393,709	(254,877)	138,832	393,003	(274,236)	118,767

(1) The carrying amount recognised in the consolidated statement of financial position best represents the Group's maximum exposure to credit risk.
(2) Of the residual net credit exposure, intercompany cross product netting arrangements are in place which would allow for an additional $5,364 million of an available $29,930 million (2016: $3,696 million of an available $22,660 million) to be offset in the event of default by certain Morgan Stanley counterparties.
(3) Trade receivables primarily include cash collateral pledged against the payable on OTC derivative positions. These derivative liabilities are included within financial liabilities classified as held for trading in the consolidated statement of financial position.
(4) For unsettled securities purchased under agreement to resell, collateral in the form of securities will be received at the point of settlement. Since the value of collateral is determined at a future date it is currently unquantifiable and not included in the table.

The impact of master netting arrangements and similar agreements on the Group’s ability to offset financial assets and financial liabilities is further disclosed in note 30.

27. FINANCIAL RISK MANAGEMENT (CONTINUED)

Credit risk (continued)

Exposure to credit risk (continued)

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

	Gross credit exposure 2017	2016
Credit rating:	**$millions**	**$millions**
AAA	21,290	16,728
AA	72,095	75,018
A	207,875	213,176
BBB	64,896	67,212
BB	14,803	11,556
B	7,414	5,179
CCC	2,233	1,387
D	10	9
Unrated	3,093	2,738
	393,709	393,003

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

Financial assets past due but not impaired:

At 31 December 2017, $2,310 million of financial assets included in loans and receivables in the consolidated statement of financial position were past due but not impaired (31 December 2016: $1,414 million).

The main considerations for the impairment assessment include whether there are any known difficulties in the cash flows of counterparties, credit rating downgrades, or infringement of the original terms of the contract. The Group determines the allowance appropriate for each individually significant asset on an individual basis. Items considered when determining the allowance amount include the sustainability of the counterparty's business plan, the counterparty's ability to improve performance once a financial difficulty has arisen, the realisable value of collateral, and the timing of expected cash flows. The impairment losses are evaluated at least at each reporting date.

Financial assets individually impaired

Class	**2017 $millions**	**2016 $millions**
Loans and receivables:		
Trade receivables	41	40

Liquidity and funding risk

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

27. FINANCIAL RISK MANAGEMENT (CONTINUED)

Liquidity and funding risk (continued)

Additional information on liquidity and funding risk management is presented in the Strategic Report and forms part of the audited financial statements.

Maturity analysis

In the following maturity analysis of financial liabilities, derivative contracts and other financial liabilities held as part of the Group's trading activities are presented at fair value, consistent with how these financial liabilities are managed, and disclosed as on demand. Derivatives not held as part of the Group's trading activities 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 liabilities are managed. All other amounts represent undiscounted cash flows payable by the Group arising from its financial liabilities to their earliest contractual maturities as at 31 December 2017 and 31 December 2016. 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 Group to appropriately reflect the liquidity risk arising from those financial liabilities, and is consistent with how the liquidity risk on these financial liabilities is managed by the Group.

27. FINANCIAL RISK MANAGEMENT (CONTINUED)

Liquidity and funding risk (continued)

31 December 2017	On demand $millions	Less than 1 month $millions	Equal to or more than 1 month but less than 3 months $millions	Equal to or more than 3 months but less than 1 year $millions	Equal to or more than 1 year but less than 5 years $millions	Equal to or more than 5 years $millions	Total $millions
Financial liabilities							
Financial liabilities at amortised cost:							
Bank loans and overdrafts	123	-	-	-	-	-	123
Cash collateral on securities loaned	14,234	560	1,399	481	813	-	17,487
Securities sold under agreements to repurchase	22,414	14,585	3,203	6,607	5,392	-	52,201
Trade payables	94,377	-	1	1	25	-	94,404
Subordinated loans	-	-	-	227	1,318	8,029	9,574
Other payables	3,536	28	55	289	25,086	2,902	31,896
Financial assets classified as held for trading:							
Derivatives	169,226	-	-	-	-	-	169,226
Other	48,752	-	-	-	-	-	48,752
Financial liabilities designated at fair value through profit or loss	17,548	304	29	322	510	3,586	22,299
Total financial liabilities	370,210	15,477	4,687	7,927	33,144	14,517	445,962
Unrecognised financial instruments							
Guarantees	575	-	-	-	2	-	577
Letters of credit	-	-	-	-	1	-	1
Loan commitments	2,190	-	-	-	-	-	2,190
Underwriting commitments	-	-	-	336	-	-	336
Unsettled securities purchased under agreements to resell(1)	28,246	234	-	-	-	-	28,480
Total unrecognised financial instruments	31,011	234	-	336	3	-	31,584

(1) The Group enters into forward starting reverse repurchase agreements (agreements which have a trade date at or prior to 31 December 2017 and settle subsequent to period end). These agreements primarily settle within three business days and of the total amount at 31 December 2017, $28,246 million settled within three business days.

27. FINANCIAL RISK MANAGEMENT (CONTINUED)

Liquidity and funding risk (continued)

	On demand	Less than 1 month	Equal to or more than 1 month but less than 3 months	Equal to or more than 3 months but less than 1 year	Equal to or more than 1 year but less than 5 years	Equal to or more than 5 years	Total
31 December 2016	**$millions**	**$millions**	**$millions**	**$millions**	**$millions**	**$millions**	**$millions**
Financial liabilities							
Financial liabilities at amortised cost:							
Bank loans and overdrafts	25	-	-	-	-	-	25
Cash collateral on securities loaned	15,911	678	2,224	2,306	105	-	21,224
Securities sold under agreements to repurchase	22,188	9,549	5,683	6,614	4,379	52	48,465
Trade payables	85,634	-	4	22	-	-	85,660
Subordinated loans	-	48	-	156	1,105	9,099	10,408
Other payables	3,188	12	118	141	5,145	2,841	11,445
Financial liabilities classified as held for trading:							
Derivatives	180,580	-	-	-	-	-	180,580
Other	45,607	-	-	-	-	-	45,607
Financial liabilities designated at fair value through profit or loss	2,651	38	89	484	965	1,793	6,020
Total financial liabilities	355,784	10,325	8,118	9,723	11,699	13,785	409,434
Unrecognised financial instruments							
Guarantees	1,135	-	-	-	-	-	1,135
Letters of credit	-	-	-	-	1	-	1
Loan commitments	2,662	-	-	-	-	-	2,662
Underwriting commitments	-	-	-	1,309	-	-	1,309
Unsettled securities purchased under agreements to resell [(1)]	30,121	-	-	-	-	-	30,121
Total unrecognised financial instruments	33,918	-	-	1,309	1	-	35,228

(1) The Group enters into forward starting reverse repurchase agreements (agreements which have a trade date at or prior to 31 December 2016 and settle subsequent to period end). These agreements primarily settle within three business days and of the total amount at 31 December 2016, $30,121 million settled within three business days.

The Group does not expect that all of the cash flows associated with financial guarantees, letters of credits and loan commitments will be required.

28. TRANSFERS OF FINANCIAL ASSETS, INCLUDING PLEDGES OF COLLATERAL

Transferred financial assets that are not derecognised in their entirety

In the ordinary course of business, the Group enters into various arrangements including selling securities under agreements to repurchase, purchasing securities under agreements to resell, securities borrowed and securities loaned to, amongst other things, acquire securities to cover short positions and settle other securities obligations, to accommodate customers' needs and to finance the Group's inventory positions.

The Group pledges certain financial instruments to collateralise repurchase agreements and other securities financings. Pledged financial instruments that can be sold or repledged by the secured party are identified as financial instruments classified as held for trading (pledged to various parties) in the consolidated statement of financial position. The Group has determined that it retains substantially all the risks and rewards of these financial instruments including credit risk, settlement risk, country risk and market risk, and therefore has not derecognised them. In addition, it recognises a financial liability in respect of the consideration received.

Other financial assets transferred that continue to be recognised for accounting purposes include pledges of securities as collateral for derivative transactions or otherwise, as well as certain sales of securities with related transactions, such as derivatives, that result in the Group retaining substantially all the risks and rewards of the financial assets transferred. In such cases the Group recognises a financial liability in respect of the consideration received.

These transactions are mostly conducted under standard agreements used by financial market participants and are undertaken with counterparties subject to the Group's normal credit risk control processes. The resulting credit exposures are controlled by daily monitoring and collateralisation of the positions. The carrying amount of the associated financial liabilities related to financial assets transferred that continue to be recognised is $70,487 million (2016: $47,077 million).

The following table presents those financial assets which have been sold or otherwise transferred, but which for accounting purposes remain recognised on the consolidated statement of financial position.

	2017 $millions	**2016 $millions**
Financial assets classified as held for trading		
Debt securities	17,613	15,867
Equity instruments	62,762	40,359
	80,375	56,226

29. FINANCIAL ASSETS ACCEPTED AS COLLATERAL

The Group's policy is generally to take possession of securities received as collateral, securities purchased under agreements to resell and securities borrowed. The Group monitors the fair value of the underlying securities as compared with the related receivable or payable, including accrued interest, and, as necessary, requests additional collateral to ensure such transactions are adequately collateralised. Where deemed appropriate, the Group's agreements with third parties specify its rights to request additional collateral. These transactions are mostly conducted under standard documentation used by financial market participants.

The fair value of collateral accepted under these arrangements as at 31 December 2017 was $290,046 million (2016: $205,103 million). Of this amount $261,224 million (2016: $179,524 million) has been sold or repledged to third parties in connection with financing activities, or to comply with commitments under short sale transactions.

30. FINANCIAL ASSETS AND FINANCIAL LIABILITIES SUBJECT TO OFFSETTING

In order to manage credit exposure arising from its business activities, the Group applies various credit risk management policies and procedures, see note 27 for further details. Primarily in connection with securities purchased under agreements to resell and securities sold under agreements to repurchase, securities borrowed and securities loaned transactions and derivative transactions, the Group enters into master netting arrangements and collateral arrangements with its counterparties. These agreements provide the Group with the right, in the ordinary course of business and/ or in the event of a counterparty default (such as bankruptcy or a counterparty's failure to pay or perform), to net a counterparty's rights and obligations under such agreement and, in the event of counterparty default, set off collateral held by the Group against the net amount owed by the counterparty. However, in certain circumstances, the Group may not have such an agreement in place; the relevant insolvency regime (which is based on type of counterparty entity and the jurisdiction of organisation of the counterparty) may not support the enforceability of the agreement; or the Group may not have sought legal advice to support the enforceability of the agreement. In cases where the Group has not determined an agreement to be enforceable, the related amounts are not offset. The Group's policy is generally to take possession of securities purchased under agreements to resell and securities borrowed, and to receive securities and cash posted as collateral (with rights of rehypothecation), although in certain cases the Group may agree for such collateral to be posted to a third party custodian under a tri-party arrangement that enables the Group to take control of such collateral in the event of a counterparty default. The enforceability of the master netting agreement is taken into account in the Group's risk management practices and application of counterparty credit limits. The Group also monitors the fair value of the underlying securities as compared with the related receivable or payable, including accrued interest, and, as necessary, requests additional collateral as provided under the applicable agreement to ensure such transactions are adequately collateralised.

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

The following tables present information about the offsetting of financial instruments and related collateral amounts. The tables do not include information about financial instruments that are subject only to a collateral agreement. The effect of master netting arrangements, collateral agreements and other credit enhancements, on the Group's exposure to credit risk is disclosed in note 27.

30. FINANCIAL ASSETS AND FINANCIAL LIABILITIES SUBJECT TO OFFSETTING (CONTINUED)

	Gross amounts (1)	Amounts offset in the consolidated statement of financial position (2) (3)	Net amounts presented in the consolidated statement of financial position	Amounts not offset in the consolidated statement of financial position (4) (5) (6)		
				Financial instruments	Cash collateral	Net exposure (7)
	$millions	$millions	$millions	$millions	$millions	$millions
31 December 2017						
Assets						
Loans and receivables:						
Cash collateral on securities borrowed	28,639	(10,811)	17,828	(17,410)	-	418
Securities purchased under agreement to resell	140,530	(69,791)	70,739	(66,887)	-	3,852
Financial assets classified as held for trading:						
Derivatives	216,599	(49,591)	167,008	(136,287)	(22,844)	7,877
TOTAL	385,768	(130,193)	255,575	(220,584)	(22,844)	12,147
Liabilities						
Financial liabilities at amortised cost:						
Cash collateral on securities loaned	28,299	(10,812)	17,487	(17,208)	-	279
Securities sold under agreement to repurchase	121,947	(69,792)	52,155	(48,380)	-	3,775
Derivatives	215,199	(45,973)	169,226	(133,480)	(24,038)	11,708
TOTAL	365,445	(126,577)	238,868	(199,068)	(24,038)	15,762

(1) Amounts include $134 million of cash collateral on securities borrowed, $3,581 million of securities purchased under agreements to resell, $2,103 million of financial assets classified as held for trading - derivatives, $271 million of cash collateral on securities loaned, $3,362 million of securities sold under agreements to repurchase and $2,465 million of financial liabilities classified as held for trading – derivatives which are either not subject to master netting agreements or collateral agreements or are subject to such agreements but the Group has not determined the agreements to be legally enforceable.

(2) Amounts are reported on a net basis in the consolidated statements of financial position when there is a legally enforceable master netting arrangement that provides for a current right of offset and there is an intention to either settle on a net basis or to realise the asset and liability simultaneously.

(3) Amounts include $6,418 million and $2,800 million of cash collateral related to financial assets classified as held for trading - derivatives recognised in amounts offset in the consolidated statement of financial positions for assets and liabilities respectively.

(4) Amounts relate to master netting arrangements and collateral arrangements which have been determined by the Group to be legally enforceable but do not meet all criteria required for net presentation within the consolidated statement of financial position.

(5) The cash collateral not offset is recognised in the consolidated statement of financial position within trade receivables and trade payables respectively.

(6) In addition to the balances disclosed in the table certain financial assets and financial liabilities designated at fair value through profit or loss have legally enforceable master netting arrangements in place. As a result, $1,760 million of netting is included within the condensed consolidated statement of financial position. $32 million not presented net within the consolidated statement of financial position have legally enforceable netting arrangements in place and can be offset in the ordinary course of business and/ or in the event of default.

(7) Intercompany cross-product legally enforceable netting arrangements are in place which would allow for an additional $5,364 million of the total consolidated statement of financial position, to be offset in the ordinary course of business and/ or in the event of default. The additional amounts for offset would include a portion of the residual net exposure.

30. FINANCIAL ASSETS AND FINANCIAL LIABILITIES SUBJECT TO OFFSETTING (CONTINUED)

	Gross amounts (1)	Amounts offset in the consolidated statement of financial position (2) (3)	Net amounts presented in the consolidated statement of financial position	Amounts not offset in the consolidated statement of financial position (4) (5) (6)		
				Financial instruments	Cash collateral	Net exposure (7)
	$millions	$millions	$millions	$millions	$millions	$millions
31 December 2016						
Assets						
Loans and receivables:						
Cash collateral on securities borrowed	32,385	(12,784)	19,601	(18,900)	-	701
Securities purchased under agreement to resell	107,120	(29,674)	77,446	(75,053)	-	2,393
Financial assets classified as held for trading:						
Derivatives	236,829	(53,276)	183,553	(149,865)	(25,944)	7,744
TOTAL	376,334	(95,734)	280,600	(243,818)	(25,944)	10,838
Liabilities						
Financial liabilities at amortised cost:						
Cash collateral on securities loaned	34,008	(12,784)	21,224	(20,228)	-	996
Securities sold under agreement to repurchase	78,091	(29,675)	48,416	(46,876)	-	1,540
Derivatives	230,135	(49,555)	180,580	(149,813)	(19,764)	11,003
TOTAL	342,234	(92,014)	250,220	(216,917)	(19,764)	13,539

(1) Amounts include $427 million of cash collateral on securities borrowed, $2,319 million of securities purchased under agreements to resell, $2,299 million of financial assets classified as held for trading - derivatives, $995 million of cash collateral on securities loaned, $1,535 million of securities sold under agreements to repurchase and $2,435 million of financial liabilities classified as held for trading – derivatives which are either not subject to master netting agreements or collateral agreements or are subject to such agreements but the Group has not determined the agreements to be legally enforceable.

(2) Amounts are reported on a net basis in the consolidated statements of financial position when there is a legally enforceable master netting arrangement that provides for a current right of offset and there is an intention to either settle on a net basis or to realise the asset and liability simultaneously.

(3) Amounts include $5,821 million and $2,099 million of cash collateral related to financial assets classified as held for trading – derivatives recognized in amounts offset in the consolidated statement of financial positions for assets and liabilities respectively.

(4) Amounts relate to master netting arrangements and collateral arrangements which have been determined by the Group to be legally enforceable but do not meet all criteria required for net presentation within the consolidated statement of financial position.

(5) The cash collateral not offset is recognised in the consolidated statement of financial position within trade receivables and payables respectively.

(6) In addition to the balances disclosed in the table certain financial assets and financial liabilities designated at fair value through profit or loss have legally enforceable master netting arrangements in place; however, these are not eligible for netting within the consolidated statement of financial position. $408 million not presented net within the consolidated statement of financial position have legally enforceable netting arrangements in place and can be offset in the ordinary course of business and/ or in the event of default.

(7) Intercompany cross-product legally enforceable netting arrangements are in place which would allow for an additional $3,696 million of the total consolidated statement of financial position, to be offset in the ordinary course of business and/ or in the event of default. The additional amounts for offset would include a portion of the residual net exposure.

31. ASSETS AND LIABILITIES MEASURED AT FAIR VALUE

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

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

2017	Quoted prices in active market (Level 1) $millions	Valuation techniques using observable inputs (Level 2) $millions	Valuation techniques with significant unobservable inputs (Level 3) $millions	Total $millions
Financial assets classified as held for trading:				
Government debt securities	8,150	3,805	1	11,956
Corporate and other debt	-	9,355	401	9,756
Corporate equities	75,722	274	77	76,073
Derivatives:				
Interest rate contracts	6	71,701	1,169	72,876
Credit contracts	-	4,155	166	4,321
Foreign exchange and gold contracts	-	55,469	63	55,532
Equity contracts	297	29,726	1,868	31,891
Commodity contracts	104	2,273	11	2,388
Total financial assets classified as held for trading	84,279	176,758	3,756	264,793
Financial assets designated at fair value through profit or loss	-	11,161	335	11,496
Available-for-sale financial assets:				
Corporate equities	26	42	93	161
Total financial assets measured at fair value	84,305	187,961	4,184	276,450
Financial liabilities classified as held for trading:				
Government debt securities	21,231	1,603	-	22,834
Corporate and other debt	-	2,864	-	2,864
Corporate equities	22,966	72	15	23,053
Derivatives:				
Interest rate contracts	4	65,218	658	65,880
Credit contracts	-	4,474	187	4,661
Foreign exchange and gold contracts	-	57,210	84	57,294
Equity contracts	384	36,196	2,436	39,016
Commodity contracts	13	2,355	7	2,375
Total financial liabilities classified as held for trading	44,598	169,992	3,387	217,977
Financial liabilities designated at fair value through profit or loss	-	21,769	530	22,299
Total financial liabilities measured at fair value	44,598	191,761	3,917	240,276

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

2016	Quoted prices in active market (Level 1) $millions	Valuation techniques using observable inputs (Level 2) $millions	Valuation techniques with significant unobservable inputs (Level 3) $millions	Total $millions
Financial assets classified as held for trading:				
Government debt securities	7,185	2,863	4	10,052
Corporate and other debt	-	8,332	218	8,550
Corporate equities	45,746	218	61	46,025
Derivatives:				
Interest rate contracts	9	79,664	779	80,452
Credit contracts	-	6,047	111	6,158
Foreign exchange and gold contracts	-	66,658	68	66,726
Equity contracts	329	26,350	1,169	27,848
Commodity contracts	75	2,275	19	2,369
Total financial assets classified as held for trading	53,344	192,407	2,429	248,180
Financial assets designated at fair value through profit or loss	-	4,134	178	4,312
Available-for-sale financial assets:				
Corporate equities	-	-	29	29
Total financial assets measured at fair value	53,344	196,541	2,636	252,521
Financial liabilities classified as held for trading:				
Government debt securities	17,171	2,305	-	19,476
Corporate and other debt	-	2,848	5	2,853
Corporate equities	23,217	33	28	23,278
Derivatives:				
Interest rate contracts	4	75,031	956	75,991
Credit contracts	-	6,232	116	6,348
Foreign exchange and gold contracts	-	66,443	54	66,497
Equity contracts	470	27,150	1,802	29,422
Commodity contracts	32	2,268	22	2,322
Total financial liabilities classified as held for trading	40,894	182,310	2,983	226,187
Financial liabilities designated at fair value through profit or loss	-	5,752	268	6,020
Total financial liabilities measured at fair value	40,894	188,062	3,251	232,207

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

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

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

Financial assets and financial liabilities classified as held for trading and available for sale financial assets

Asset and Liability / Valuation Technique	Valuation Hierarchy Classification
Government Debt Securities	
U.S. Treasury Securities • Fair value is determined using quoted market prices.	• Generally Level 1
Non-US Sovereign Government Obligations • Fair value is determined using quoted prices in active markets when available.	• Generally Level 1 • Level 2—if the market is less active or prices are dispersed • Level 3—in instances where the prices are unobservable
Corporate and Other Debt	
Residential Mortgage-Backed Securities ("RMBS"), Commercial Mortgage-Backed Securities ("CMBS") and other Asset-Backed Securities ("ABS")(collectively known as Mortgage- and Asset backed-securities "MABS") • MABS may be valued based on price or spread data obtained from observed transactions or independent external parties such as vendors or brokers. • When position-specific external price data are not observable, the fair value determination may require benchmarking to comparable instruments, and/or analysing expected credit losses, default and recovery rates, and/or applying discounted cash flow techniques. When evaluating the comparable instruments for use in the valuation of each security, security collateral-specific attributes, including payment priority, credit enhancement levels, type of collateral, delinquency rates and loss severity, are considered. In addition, for RMBS borrowers, Fair Isaac Corporation scores and the level of documentation for the loan are considered. • Market standard models, such as Intex, Trepp or others, may be deployed to model the specific collateral composition and cash flow structure of each transaction. Key inputs to these models are market spreads, forecasted credit losses, and default and prepayment rates for each asset category. • Valuation levels of RMBS and CMBS indices are used as an additional data point for benchmarking purposes or to price outright index positions.	• Generally Level 2—if value based on observable market data for comparable instruments • Level 3—if external prices or significant spread inputs are unobservable or if the comparability assessment involves significant subjectivity related to property type differences, cash flows, performance and other inputs
Corporate Bonds • Fair value is determined using recently executed transactions, market price quotations, bond spreads, CDS spreads, or at the money volatility and/or volatility skew obtained from independent external parties, such as vendors and brokers, adjusted for any basis difference between cash and derivative instruments. • The spread data used are for the same maturity as the bond. If the spread data do not reference the issuer, then data that reference a comparable issuer are used. When position-specific external price data are not observable, fair value is determined based on either benchmarking to comparable instruments or cash flow models with yield curves, bond or single name CDS spreads and recovery rates as significant inputs.	• Generally Level 2—if value based on observable market data for comparable instruments • Level 3—in instances where prices or significant spread inputs are unobservable or the credit correlation input is significant

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

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

Asset and Liability / Valuation Technique	Valuation Hierarchy Classification
Collateralised Debt Obligations ("CDO") and Collateralised Loan Obligations ("CLO") • The Group holds cash CDOs/CLOs that typically reference a tranche of an underlying synthetic portfolio of single name CDS spreads collateralised by corporate bonds ("credit-linked notes") or cash portfolio of asset-backed securities/loans ("asset-backed CDOs/CLOs"). • Credit correlation, a primary input used to determine the fair value of credit-linked notes, is usually unobservable and derived using a benchmarking technique. Other model inputs such as credit spreads, including collateral spreads, and interest rates are typically observable. • Asset-backed CDOs/CLOs are valued based on an evaluation of the market and model input parameters sourced from comparable instruments as indicated by market activity. Each asset-backed CDO/CLO position is evaluated independently taking into consideration available comparable market levels, underlying collateral performance and pricing, deal structures and liquidity.	• Level 2—when either comparable market transactions are observable or credit correlation input is insignificant • Level 3—when either comparable market transactions are unobservable or the credit correlation input is significant
Corporate loans and Lending Commitments • Fair value of corporate loans is determined using recently executed transactions, market price quotations (where observable), implied yields from comparable debt, market observable CDS spread levels obtained from independent external parties adjusted for any basis difference between cash and derivative instruments, along with proprietary valuation models and default recovery analysis where such transactions and quotations are unobservable. • Fair value of contingent corporate lending commitments is determined by using executed transactions on comparable loans and the anticipated market price based on pricing indications from syndicate banks and customers. The valuation of loans and lending commitments also takes into account fee income that is considered an attribute of the contract.	• Level 2—if value based on observable market data for comparable instruments • Level 3—in instances where prices or significant spread inputs are unobservable
Corporate Equities	
• Exchange-traded equity securities are generally valued based on quoted prices from the exchange. To the extent these securities are actively traded, valuation adjustments are not applied. • Unlisted equity securities are generally valued based on an assessment of each underlying security, considering rounds of financing and third-party transactions, discounted cash flow analyses and market- based information, including comparable Group transactions, trading multiples and changes in market outlook, among other factors. • Listed fund units are generally marked to the exchange-traded price, while listed fund units if not actively traded and unlisted fund units are generally marked to Net Asset Value ("NAV").	• Level 1—exchange-traded securities and fund units if actively traded • Level 2—exchange-traded securities (including direct equity investments) if not actively traded or if undergoing a recent mergers and acquisitions event or corporate action; non-exchange-traded direct equity investments and investments in various investment management funds if valued based on rounds of financing or third-party transactions • Level 3—unlisted equity securities, fund units, and exchange-traded securities if not actively traded or if marked to an aged mergers and acquisitions event or corporate action, and non-exchange-traded direct equity investments and investments in various investment management funds where rounds of financing or third-party transactions are not available.
Derivatives	
Listed Derivative Contracts • Listed derivatives that are actively traded are valued based on quoted prices from the exchange. • Listed derivatives that are not actively traded are valued using the same approaches as those applied to OTC derivatives.	• Level 1—listed derivatives that are actively traded • Level 2—listed derivatives that are not actively traded

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

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

Asset and Liability / Valuation Technique	Valuation Hierarchy Classification
OTC Derivative Contracts • OTC derivative contracts include forward, swap and option contracts related to interest rates, foreign currencies, credit standing of reference entities, equity prices or commodity prices. • Depending on the product and the terms of the transaction, the fair value of OTC derivative products can be modeled using a series of techniques, including closed-form analytic formulas, such as the Black-Scholes option-pricing model, simulation models or a combination thereof. Many pricing models do not entail material subjectivity as the methodologies employed do not necessitate significant judgment, since model inputs may be observed from actively quoted markets, as is the case for generic interest rate swaps, many equity, commodity and foreign currency option contracts, and certain CDS. In the case of more established derivative products, the pricing models used by the Group are widely accepted by the financial services industry. • More complex OTC derivative products are typically less liquid and require more judgment in the implementation of the valuation technique since direct trading activity or quotes are unobservable. This includes certain types of interest rate derivatives with both volatility and correlation exposure, equity, commodity or foreign currency derivatives that are either longer-dated or include exposure to multiple underlyings, and credit derivatives, including CDS on certain mortgage- or asset-backed securities and basket CDS. Where these inputs are unobservable, relationships to observable data points, based on historic and/or implied observations, may be employed as a technique to estimate the model input values.	• Generally Level 2—OTC derivative products valued using observable inputs, or where the unobservable input is not deemed significant. • Level 3—OTC derivative products for which the unobservable input is deemed significant
Financial assets and financial liabilities designated at fair value through profit and loss	
Prepaid OTC contracts and issued structured notes designated at fair value through profit or loss • The Group issues structured notes and trades prepaid OTC contracts that have coupon or repayment terms linked to the performance of debt or equity securities, indices, currencies or commodities. • Fair value of structured notes and traded prepaid OTC contract is determined using valuation models for the derivative and debt portions of the notes and traded prepaid OTC contracts. 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 rates, and commodity or equity prices. • Independent, external and traded prices for the notes are considered as well. The impact of the Group's own credit spreads is also included based on observed secondary bond market spreads.	• Generally Level 2 • Level 3—in instances where the unobservable inputs are deemed significant
Corporate loans and lending commitments • Fair value of corporate loans is determined using recently executed transactions, market price quotations (where observable), implied yields from comparable debt, market observable CDS spread levels obtained from independent external parties adjusted for any basis difference between cash and derivative instruments, along with proprietary valuation models and default recovery analysis where such transactions and quotations are unobservable. • Fair value of contingent corporate lending commitments is determined by using executed transactions on comparable loans and the anticipated market price based on pricing indications from syndicate banks and customers. The valuation of loans and lending commitments also takes into account fee income that is considered an attribute of the contract. • Fair value of equity margin loans is determined by discounting future interest cash flows, net of estimated credit losses. The estimated credit losses are derived by benchmarking to market observable CDS spreads, implied debt yields or volatility metrics of the loan collateral company.	• Level 2—if value based on observable market data for comparable instruments • Level 3—in instances where prices or significant spread inputs are unobservable

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

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

During the year the Group reclassified approximately $1,200 million of European government debt securities assets (2016: $910 million) and $968 million of European government debt securities liabilities (2016: $602 million) from Level 2 to Level 1 due to increased market activity in these instruments.

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

The following tables present the changes in the fair value of the Group's Level 3 financial assets and financial liabilities for the years ended 31 December 2017 and 31 December 2016. Level 3 instruments may be hedged with instruments classified in Level 1 and Level 2. As a result, the realised and unrealised gains/ (losses) for assets and liabilities within the Level 3 category presented in the tables below do not reflect the related realised and unrealised gains/ (losses) on hedging instruments that have been classified by the Group within the Level 1 and/or Level 2 categories.

Unrealised gains/ (losses) during the period for assets and liabilities within the Level 3 category presented in the following tables herein may include changes in fair value during the period that were attributable to both observable and unobservable inputs.

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

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

2017

	Balance at 1 January 2017	Total gains/ (losses) recognised in consolidated income statement (1)	Total gains/ (losses) recognised in consolidated statement of comprehensive income (1)	Purchases	Sales & Issuances (2)	Settlements	Net transfers in and/or (out) of Level 3 (3)	Balance at 31 December 2017	Unrealised gains/ (losses) for Level 3 assets/ liabilities outstanding as at 31 December 2017 (4)
	$millions	$millions	$millions	$millions	$millions	$millions	$millions	$millions	$millions
Financial assets classified as held for trading:									
Government debt securities	4	-	-	-	(3)	-	-	1	-
Corporate and other debt	218	14	-	329	(146)	-	(14)	401	-
Corporate equities	61	(6)	-	45	(53)	-	30	77	(5)
Total financial assets classified as held for trading	283	8	-	374	(202)	-	16	479	(5)
Financial assets designated at fair value through profit or loss	178	30	-	94	(75)	-	108	335	29
Available-for-sale financial assets:									
Corporate equities	29	-	40	40	-	-	(16)	93	40
Total financial assets measured at fair value	490	38	40	508	(277)	-	108	907	64
Financial liabilities classified as held for trading:									
Corporate and other debt	5	-	-	(5)	-	-	-	-	-
Corporate equities	28	1	-	(8)	4	-	(8)	15	-
Net derivative contracts (5)	804	(162)	-	(705)	928	(1,171)	77	95	(100)
Total financial liabilities classified as held for trading	837	(161)	-	(718)	932	(1,171)	69	110	(100)
Financial liabilities designated at fair value through profit or loss	268	(11)	(12)	-	335	(59)	(37)	530	(11)
Total financial liabilities measured at fair value	1,105	(172)	(12)	(718)	1,267	(1,230)	32	640	(111)

(1) The total gains or (losses) are recognised in the consolidated income statement and the consolidated statement of comprehensive income as detailed in the financial instruments accounting policy (note 3c).
(2) Amounts related to entering into net derivative contracts, and financial liabilities designated at fair value through profit or loss represent issuances. Amounts for other line items represent sales.
(3) 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.
(4) Amounts represent unrealised gains or (losses) for the year ended 31 December 2017 related to assets and liabilities still outstanding at 31 December 2017. The unrealised gains or (losses) are recognised in the consolidated income statement or consolidated statement of comprehensive income as detailed in the financial instruments accounting policy (note 3c).
(5) Net derivative contracts represent Financial liabilities classified as held for trading – derivative contracts net of Financial assets classified as held for trading – derivative contracts.

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

2016	Balance at 1 January 2016	Total gains/ (losses) recognised in consolidated income statement (1)	Total gains/ (losses) recognised in consolidated statement of comprehensive income (1)	Purchases	Sales & Issuances (2)	Settlements	Net transfers in and/or (out) of Level 3 (3)	Balance at 31 December 2016	Unrealised gains/ (losses) for Level 3 assets/ liabilities outstanding as at 31 December 2016 (4)
	$millions	$millions	$millions	$millions	$millions	$millions	$millions	$millions	$millions
Financial assets classified as held for trading:									
Government debt securities	4	-	-	2	(4)	-	2	4	-
Corporate and other debt	576	8	-	71	(409)	-	(28)	218	(5)
Corporate equities	228	(13)	-	32	(24)	-	(162)	61	-
Total financial assets classified as held for trading	808	(5)	-	105	(437)	-	(188)	283	(5)
Financial assets designated at fair value through profit or loss	381	7	-	15	(236)	-	11	178	7
Available-for-sale financial assets:									
Corporate equities	38	-	(8)	1	(2)	-	-	29	(8)
Total financial assets measured at fair value	1,227	2	(8)	121	(675)	-	(177)	490	(6)
Financial liabilities classified as held for trading:									
Corporate and other debt	5	-	-	(1)	1	-	-	5	-
Corporate equities	15	12	-	(3)	24	-	4	28	-
Net derivative contracts (5)	1,006	212	-	(355)	543	301	(479)	804	13
Total financial liabilities classified as held for trading	1,026	224	-	(359)	568	301	(475)	837	13
Financial liabilities designated at fair value through profit or loss	160	8	-	-	223	(89)	(18)	268	8
Total financial liabilities measured at fair value	1,186	232	-	(359)	791	212	(493)	1,105	21

(1) The total gains or (losses) are recognised in the consolidated income statement and the consolidated statement of comprehensive income as detailed in the financial instruments accounting policy (note 3c).

(2) Amounts related to entering into net derivative contracts, and financial liabilities designated at fair value through profit or loss represent issuances. Amounts for other line items represent sales.

(3) 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.

(4) Amounts represent unrealised gains or (losses) for the year ended 31 December 2016 related to assets and liabilities still outstanding at 31 December 2016. The unrealised gains or (losses) are recognised in the consolidated income statement or consolidated statement of comprehensive income as detailed in the financial instruments accounting policy (note 3c).

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

There were no material transfers from Level 2 to Level 3 or from Level 3 to Level 2 of the fair value hierarchy during the year (2016: $nil).

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

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

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

i. Quantitative information about and qualitative sensitivity if significant unobservable inputs

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

The level of aggregation and breadth of products cause the range of inputs to be wide and not evenly distributed across the inventory. Further, the range of unobservable inputs may differ across groups in the financial services industry because of diversity in the types of products included in each group's inventory. The following disclosures also include qualitative information on the sensitivity of the fair value measurements to changes in the significant unobservable inputs. There are no predictable relationships between multiple significant unobservable inputs attributable to a given valuation technique. A single amount is disclosed when there is no significant difference between the minimum, maximum and average (weighted average or similar average / median).

31 December 2017	**Fair value $millions**	**Predominant valuation techniques/ Significant unobservable inputs**	**Range (2) (Weighted averages or simple averages/median)(3)**
ASSETS			
Financial assets classified as held for trading:			
- Corporate and other debt:			
- Mortgage- and asset-backed securities	151	Comparable pricing	
		Comparable bond price	0 to 100 pts (35 pts)
- Corporate bonds	213	Comparable pricing	
		Comparable bond price	65 to 134 pts (70 pts)
- Loans and lending commitments	36	Comparable pricing	
		Comparable loan price	78.5 to 100 pts (92.59 pts)
- Corporate equities	77	Comparable pricing	
		Comparable equity price	100% (100%)
Financial assets designated at fair value through profit or loss:			
- Customer loans	229	Option model	
		Volatility skew	-1% (-1%)
- Prepaid OTC contracts	106	Discounted cash flow	
		Recovery rate	15% (15%)
Available-for-sale financial assets:			
- Corporate equities	93	Comparable pricing	
		Comparable equity price	100%(100%)

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

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

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

31 December 2017 LIABILITIES	Fair value $millions	Predominant valuation techniques/ Significant unobservable inputs	Range[2] (Weighted averages or simple averages/median)[3]
Financial liabilities classified as held for trading:			
- Net derivatives contracts:[1][4][5]			
- Interest rate	511	Option model	
		Inflation volatility	23% to 63% (44%/41%)
		Interest rate - foreign exchange correlation	54% to 57% (56%/56%)
		Interest rate curve correlation	55% to 90% (75%/76%)
		inflation curve	2% to 2% (2%/2%)
		Interest rate volatility skew	31% to 99% (42%/45%)
- Credit	(21)	Comparable pricing	
		Funding spreads	93bp to 96bp (96bp)
		Comparable bond price	1 to 140 pts (40 pts)
		Credit spreads	150 bp (150 bp)
- Foreign exchange and gold	(21)	Option model	
		Interest rate - foreign exchange correlation	54% to 57% (56%/56%)
		Interest rate volatility skew	31% to 99% (42%/45%)
		Deal execution probability	95% to 100% (96%/95%)
- Equity	(568)	Option model	
		At the money volatility	5% to 53% (23%)
		Volatility skew	-2% to 0% (-1%)
		Equity equity correlation	25% to 99% (73%)
		Equity foreign exchange correlation	-60% to 40% (26%)
- Commodity	4	Comparable pricing	
		Comparable price	$557 to $1,552 ($1,233)
Financial liabilities designated at fair value through profit or loss:			
- Issued structured notes	(361)		
		Option Model	5% to 35% (25%)
		At the money volatility	-1% to 0% (0%)
		Volatility skew	46% to 86% (68%)
		Equity-equity correlation	
		Equity-foreign exchange correlation	-60% to 10% (4%)
- Prepaid OTC contracts	(169)	Discounted cash flow	
		Recovery rate	15% (15%)

(1) Net derivative contracts represent financial liabilities classified as held for trading – derivative contracts net of financial assets classified as held for trading – derivative contracts.
(2) The ranges of significant unobservable inputs are represented in points, percentages, basis points or times. Points are a percentage of par; for example, 100 points would be 100% of par. A basis point equals 1/100th of 1%; for example, 353 basis points would equal 3.53%.
(3) Amounts represent weighted averages except where simple averages and the median of the inputs are provided when more relevant.
(4) CVA and FVA are included in fair value, but excluded from the valuation techniques and significant unobservable inputs in the previous table. CVA is a Level 3 input when the underlying counterparty credit curve is unobservable. FVA is a Level 3 input in its entirety given the lack of observability of funding spreads in the principal market.
(5) Includes derivative contracts with multiple risks (i.e. hybrid products)

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

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

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

31 December 2016	Fair value $millions	Predominant valuation techniques/ Significant unobservable inputs	Range [2] (Weighted averages or simple averages/median)[3]
ASSETS			
Financial assets classified as held for trading:			
- Corporate and other debt:			
- Mortgage- and asset-backed securities	104	Comparable pricing	
		Comparable bond price	2 to 100 pts (40 pts)
- Corporate bonds	91	Comparable pricing	
		Comparable bond price	5 to 130 pts (99 pts)
- Corporate equities	61	Comparable pricing	
		Comparable equity price	100% (100%)
Financial assets designated at fair value through profit or loss:			
- Customer loans	152	Margin loan model	
		Discount rate	9% (9%)
		Option model	
		Volatility skew	-1% (-1%)
Available-for-sale financial assets:			
- Corporate equities	29	Comparable pricing	
		Comparable equity price	100%(100%)
LIABILITIES			
Financial liabilities classified as held for trading:			
- Corporate equities	(28)	Comparable pricing	
		Comparable equity price	100%(100%)
- Net derivatives contracts:[1][4][5]			
- Interest rate	(177)	Option model	
		Inflation volatility	24% to 55% (40%/39%)
		Interest rate-foreign exchange correlation	28% to 58% (44%/43%)
		Interest rate curve correlation	28% to 98% (67%/69%)
		Interest rate quanto correlation	-8% to 37% (6%/-7%)
		Interest rate curve	1.5% to 1.6% (1.5%/1.5%)
		Interest rate volatility skew	31% to 116% (47%/50%)
- Credit	(5)	Correlation model	
		Credit correlation	35% to 59% (44%)
		Comparable pricing	
		Comparable bond price	2 to 100 pts (39 pts)

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

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

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

31 December 2016

LIABILITIES	**Fair value $ millions**	**Predominant valuation techniques/ Significant unobservable inputs**	**Range [2] (Weighted averages or simple averages/median)[3]**
Financial liabilities classified as held for trading:			
- Foreign exchange and gold	14	Option model	
		Interest rate-foreign exchange correlation	28% to 58% (44%/43%)
		Interest rate volatility skew	31% to 116% (47%/50%)
		Credit-foreign exchange correlation	0% (0%)
- Equity	(633)	Option model	
		At the money volatility	16% to 66% (32%)
		Volatility skew	-2% to 0% (-1%)
		Equity-equity correlation	35% to 99% (74%)
		Equity-foreign exchange correlation	-63% to -5% (-41%)
- Commodity	(3)	Comparable pricing	
		Comparable price	$508 to $1,626 ($829)
Financial liabilities designated at fair value through profit or loss:			
- Issued structured notes	(242)	Option model	
		At the money volatility	7% to 34% (29%)
		Volatility skew	-1% to 0% (-1%)
		Equity-equity correlation	46% to 98% (82%)
		Equity-foreign exchange correlation	-55% to -6% (-41%)

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

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

(3) Amounts represent weighted averages except where simple averages and the median of the inputs are provided when more relevant.

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

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

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

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

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

Significant Unobservable Inputs — Description	Sensitivity
Comparable bond or loan price—A pricing input used when prices for the identical instrument are not available. Significant subjectivity may be involved when fair value is determined using pricing data available for comparable instruments. Valuation using comparable instruments can be done by calculating an implied yield (or spread over a liquid benchmark) from the price of a comparable bond, or loan, then adjusting that yield (or spread) to derive a value for the bond or loan. The adjustment to yield (or spread) should account for relevant differences in the bonds or loans such as maturity or credit quality. Alternatively, a price-to-price basis can be assumed between the comparable instrument and the bond or loan being valued in order to establish the value of the bond or loan. Additionally, as the probability of default increases for a given bond or loan (*i.e.*, as the bond or loan becomes more distressed), the valuation of that bond or loan will increasingly reflect its expected recovery level assuming default. The decision to use price-to-price or yield/spread comparisons largely reflects trading market convention for the financial instruments in question. Price-to-price comparisons are primarily employed for RMBS, CMBS, ABS, CDOs, CLOs, Other debt, interest rate contracts, foreign exchange contracts, Other secured financings and distressed corporate bonds. Implied yield (or spread over a liquid benchmark) is utilised predominately for non-distressed corporate bonds, loans and credit contracts.	In general, an increase (decrease) to the comparable bond price for an asset would result in a higher (lower) fair value.
Comparable equity price—A price derived from equity raises, share buybacks and external bid levels, etc. A discount or premium may be included in the fair value estimate.	In general, an increase (decrease) to the comparable equity price of an asset would result in a higher (lower) fair value.
Correlation—A pricing input where the payoff is driven by more than one underlying risk. Correlation is a measure of the relationship between the movements of two variables (*i.e.*, how the change in one variable influences a change in the other variable). Credit correlation, for example, is the factor that describes the relationship between the probability of individual entities to default on obligations and the joint probability of multiple entities to default on obligations.	In general, an increase (decrease) to the correlation would result in an impact to the fair value, but the magnitude and direction of the impact would depend on whether the Group is long or short the exposure.
Credit spread—The difference in yield between different securities due to differences in credit quality. The credit spread reflects the additional net yield an investor can earn from a security with more credit risk relative to one with less credit risk. The credit spread of a particular security is often quoted in relation to the yield on a credit risk-free benchmark security or reference rate, typically either U.S. Treasury or London Interbank Offered Rate ("LIBOR").	In general, an increase (decrease) to the credit spread of an asset would result in a lower (higher) fair value.
EBITDA multiple / Exit multiple—The ratio of the Enterprise Value to EBITDA, where the Enterprise Value is the aggregate value of equity and debt minus cash and cash equivalents. The EBITDA multiple reflects the value of the company in terms of its full-year EBITDA, whereas the exit multiple reflects the value of the company in terms of its full-year expected EBITDA at exit. Either multiple allows comparison between companies from an operational perspective as the effect of capital structure, taxation and depreciation/amortisation is excluded.	In general, an increase (decrease) to the EBITDA or Exit multiple of an asset would result in a higher (lower) fair value.
Interest rate curve—The term structure of interest rates (relationship between interest rates and the time to maturity) and a market's measure of future interest rates at the time of observation. An interest rate curve is used to set interest rate and foreign exchange derivative cash flows and is a pricing input used in the discounting of any OTC derivative cash flow.	In general, an increase (decrease) to the interest rate curve would result in an impact to the fair value, but the magnitude and direction of the impact would depend on whether the Group is long or short the exposure.

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

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

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

Recovery rate – Amount expressed as a percentage of par that is expected to be received when a credit event occurs.	In general, an increase (decrease) to the recovery rate for an asset would result in a higher (lower) fair value.
Volatility—The measure of the variability in possible returns for an instrument given how much that instrument changes in value over time. Volatility is a pricing input for options, and, generally, the lower the volatility, the less risky the option. The level of volatility used in the valuation of a particular option depends on a number of factors, including the nature of the risk underlying that option (*e.g.*, the volatility of a particular underlying equity security may be significantly different from that of a particular underlying commodity index), the tenor and the strike price of the option.	In general, an increase (decrease) to the volatility would result in an impact to the fair value, but the magnitude and direction of the impact would depend on whether the Group is long or short the exposure.
Volatility skew—The measure of the difference in implied volatility for options with identical underliers and expiry dates but with different strikes. The implied volatility for an option with a strike price that is above or below the current price of an underlying asset will typically deviate from the implied volatility for an option with a strike price equal to the current price of that same underlying asset.	In general, an increase (decrease) to the volatility skew would result in an impact to the fair value, but the magnitude and direction of the impact would depend on whether the Group is long or short the exposure.

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

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

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

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

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

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

ii. Sensitivity of fair values to changing significant assumptions to reasonably possible alternatives (continued)

		Effect of reasonably possible alternative assumptions	
31 December 2017	**Fair value $millions**	**Increase in fair value $millions**	**Decrease in fair value $millions**
Financial assets classified as held for trading:			
Corporate and other debt:	401	15	(19)
Corporate equities	77	5	(15)
Financial assets designated at fair value through profit or loss:			
Prepaid OTC contracts	106	135	(58)
Customer loans	229	-	-
Available-for-sale financial assets:			
Corporate equities	93	32	(45)
Financial liabilities classified as held for trading:			
Net derivatives contracts:(1)(2)	95	9	(5)
Financial liabilities designated at fair value through profit or loss:			
Prepaid OTC contracts	169	135	(58)
Issued structured notes	361	2	(1)

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

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

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

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

ii. Sensitivity of fair values to changing significant assumptions to reasonably possible alternatives (continued)

		Effect of reasonably possible alternative assumptions	
2016	**Fair value**	**Increase in fair value**	**Decrease in fair value**
	$millions	**$millions**	**$millions**
Financial assets classified as held for trading:			
Corporate and other debt	218	10	(10)
Corporate equities	61	10	(13)
Financial assets designated at fair value through profit or loss:			
Customer loans	152	1	(1)
Available-for-sale financial assets:			
Corporate equities	29	6	(10)
Financial liabilities classified as held for trading:			
Corporate equitites	28	-	(4)
Net derivative contracts [(1)(2)]	804	37	(57)
Financial liabilities designated at fair value through profit or loss:			
Issued structured notes	242	2	(2)

(1) Net derivative contracts represent financial assets classified as held for trading – derivative contracts net of financial liabilities classified as held for trading – derivative contracts.
(2) CVA and FVA are included in the fair value, but excluded from the effect of reasonably possible alternative assumptions in the table above. CVA is deemed to be a level 3 input when the underlying counterparty credit curve is unobservable. FVA is deemed to be a Level 3 input in its entirety given the lack of observability of funding spreads in the principle market.

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

e. Financial instruments valued using unobservable market data

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

	2017 $millions	2016 $millions
At 1 January	245	216
New transactions	211	70
Amounts recognised in the consolidated income statement during the year	(126)	(41)
At 31 December	330	245

The balance above predominately relates to derivatives.

The consolidated statement of financial position categories ‘Financial assets and financial liabilities classified as held for trading’, ‘Financial assets and financial liabilities designated at fair value through profit or loss’, and ‘Available-for-sale financial assets’ include financial instruments whose fair value is based on valuation techniques using unobservable market data.

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

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

32. ASSETS AND LIABILITIES NOT MEASURED AT FAIR VALUE

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

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

			Fair value measurement using:		
	Carrying value $millions	Fair value $millions	Quoted prices in active market (Level 1) $millions	Valuation techniques using observable inputs (Level 2) $millions	Valuation techniques with significant unobservable inputs (Level 3) $millions
Financial liabilities					
Subordinated loans at 31 December 2017	7,000	7,310	-	7,310	-
Financial liabilities					
Other payables at 31 December 2016	7,240	7,069	-	7,069	-
Subordinated loans at 31 December 2016	7,906	8,004	-	8,004	-

Also included in the statement of financial position is $31,017 million (2016: $7,240 million) of other payables where the carrying value is a reasonable approximation of fair value. The fair value of other payables is determined based on current interest rates and credit spreads for debt instruments with similar terms and maturity.

33. EMPLOYEE COMPENSATION PLANS

Morgan Stanley maintains various equity-settled share-based and cash-based deferred compensation plans for the benefit of certain current and former employees.

Equity-settled share-based compensation plans

- **Restricted stock units**

Morgan Stanley has granted restricted stock unit ("RSU") awards pursuant to several equity-based compensation plans. The plans provide for the deferral of a portion of certain employees' incentive compensation with awards made in the form of restricted common stock or in the right to receive unrestricted shares of common stock in the future. Awards under these plans are generally subject to vesting over time, generally three years from the date of award, and are generally contingent upon continued employment and subject to restrictions on sale, transfer or assignment until the end of a specified period. All or a portion of an award may be cancelled if employment is terminated before the end of the relevant vesting period and after the vesting period in certain situations. Recipients of stock-based awards may have voting rights, at the Morgan Stanley Group's discretion, and generally receive dividend equivalents if the awards vest.

During the year, Morgan Stanley granted 213,021 units (2016: 417,411) of restricted stock to employees of the Group with a weighted average fair value per unit of $42.64 (2016: $25.22), based on the market value of Morgan Stanley shares at grant date.

Included within 'Direct Staff costs' within the 'Other expense' note is an amount of $18 million (2016: $19 million) in relation to restricted stock units equity-based compensation plans, granted to employees of the Group.

The Group has no options outstanding at 31 December 2017 (2016: nil) and Morgan Stanley has not granted stock options in 2017 or 2016.

Deferred cash-based compensation plans

Morgan Stanley has granted deferred cash-based compensation awards to certain employees which defer a portion of the employees' discretionary compensation. The plans generally provide a return based upon the performance of various referenced investments. Awards under these plans are generally subject to a sole vesting condition of service over time, which normally ranges from one to three years from the date of grant. All or a portion of an award may be cancelled if employment is terminated before the end of the relevant vesting period. The awards are settled in cash at the end of the relevant vesting period.

Awards with a value of $6 million (2016: $9 million) have been granted to employees of the Group during the year. The liability to employees at the end of the year, reported within 'Accruals and deferred income' in the consolidated statement of financial position, is $22 million (2016: $23 million).

The Group economically hedges the exposure created by these deferred compensation schemes by entering into derivative transactions with other Morgan Stanley Group undertakings. The derivative balance at the end of the year, recognised within 'Financial liabilities classified as held for trading' in relation to these deferred compensation schemes is $nil (2016: $3 million). The related profit recorded within 'Net gains/(losses) on financial instruments classified as held for trading' for the year is $nil (2016: $nil).

Plans operated by fellow Morgan Stanley undertakings

As described in note 6, the Group utilises the services of staff who are employed by other Morgan Stanley Group undertakings. Management charges are incurred in respect of these employee services which include the cost of equity-settled share-based compensation plans and deferred cash-based compensation plans.

34. POST EMPLOYMENT BENEFITS

Defined contribution plans

The Group operates several Morgan Stanley defined contribution plans, which require contributions to be made to funds held separately from the assets of the Group, under the control of a trustee.

The defined contribution plans are as follows:

- Morgan Stanley Flexible Company Pension Plan (Amsterdam);
- MSII Offshore Retirement Benefit Plan IV, Dubai Section;
- Morgan Stanley Asia Limited Retirement Benefit Plan (Taiwan);
- Morgan Stanley & Co International plc, Seoul Branch Defined Contribution Plan; and
- Morgan Stanley & Co. International plc Zurich Branch Top-up Plan

The Group pays fixed contributions to the funds, with no legal or constructive obligation to pay further contributions.

Following a legislative change in Switzerland during 2017, a benefit guarantee was removed from the Morgan Stanley & Co. International plc Zurich Branch Top-up Plan. As a result a credit of $1.8 million has been recognised in the Group's income statement, reflecting the settlement of the defined benefit obligation under the plan. The Group has no further legal or constructive obligations under the plan which is now recognised as a defined contribution scheme.

The defined contribution pension charge in relation to the above schemes recognised within 'Direct staff costs' in 'Other expense' in the consolidated income statement was $4 million for the year (2016: $3 million) of which $nil was accrued at 31 December 2017 (2016: $nil).

Defined benefit plans

The Group also operates several Morgan Stanley defined benefit plans, which provide post-employment benefits that are based on length of service and salary. The Group's policy is to fund at least the amounts sufficient to meet minimum funding requirements under applicable employee benefit and tax regulations.

The defined benefits plans are as follows:

- Morgan Stanley France (SAS) Leaving Indemnity Plan (Indemnites de Fin de Carriere);
- Morgan Stanley Asia (Taiwan) Limited Retirement Scheme;
- Morgan Stanley Asia (Taiwan) Limited Book Reserve Plan;
- Morgan Stanley & Co. International plc Zurich Branch Base Plan; and
- Morgan Stanley & Co. International plc Dubai Branch End of Service Gratuity

On 1 February 2017, obligations of the Morgan Stanley & Co. International plc Paris Branch IFC (Indemnites de Fin de Carriere) plan were transferred to Morgan Stanley (France) S.A..

The cumulative amount of actuarial gains and losses recognised in other comprehensive income is a $2 million loss (2016: $2 million loss). A net liability of $5 million (2016: $5 million) is recognised in the Group's consolidated statement of financial position in respect of the above plans.

34. POST EMPLOYMENT BENEFITS (CONTINUED)

Plans operated by fellow Morgan Stanley undertakings

In addition to the above, along with a number of other Morgan Stanley Group companies, the Group incurs management charges from fellow Morgan Stanley undertakings in respect of post-employment benefits provided to staff utilised by the Group but employed by other Morgan Stanley entities. These management recharges include post-employment benefit costs related to the Morgan Stanley UK Group Pension Plan ('the Plan') and the Alternative Retirement Plan, both operated by Morgan Stanley UK Limited ("MSUK"). The Plan is a defined contribution scheme with a closed defined benefit section.

Defined benefit section of the Plan ("DB Plan")

The DB Plan has been closed to new members since 1996. The DB Plan was previously open to permanent employees of the Morgan Stanley Group employed in the UK, and with the consent of the Trustees, other Morgan Stanley employees located outside of the UK who had previously been employed in the UK and who at some point had been members of the Plan. The amount of pension benefit that a member is entitled to receive on retirement is dependent on years of service and salary at the time of closure of the Plan in 1996. Additionally, the DB Plan also includes a Guaranteed Minimum Pension ("GMP") underpin in respect of certain defined contribution members who transferred their benefits from the defined benefit section into the defined benefit contribution section in the past. Under the GMP underpin, if the value of each member's investment at retirement is less than the amount needed to secure the GMP benefits that accrued under the defined benefit section, the shortfall must be covered by the DB Plan.

The DB Plan assets are held in a separate Trustee-administered fund to meet long-term pension liabilities. The Trustees of the fund are required to act in the best interests of the fund's beneficiaries. The appointment of Trustees to the DB Plan is determined by the Plan's trust documentation. MSUK has a policy that one third of Trustees should be nominated by members of the fund.

A full actuarial valuation of the DB Plan is conducted at least every three years. The most recent full actuarial valuation was carried out at 31 December 2015.

The full actuarial valuation provides both an accounting valuation and a funding basis for the DB Plan. The funding basis is determined using assumptions reflective of the cost of securing the benefits built up in the DB Plan with an insurance company and therefore can be different to the valuation for accounting purposes. The funding position is reviewed each year as part of the annual funding update and the strategy is to maintain the DB Plan at close to fully funded on the funding basis. Significant factors impacting the funding basis are interest rates, longevity and insurance market trends.

The full actuarial valuation at 31 December 2015 indicated a surplus on a funding basis of $16 million. Accordingly, no new schedule of contributions has been put in place. Future contributions may be agreed between the Trustees and MSUK following the next triennial valuation in 2018 or in the event of a material worsening of the position of the DB Plan before the next triennial valuation.

On an accounting basis, the DB Plan has a surplus of scheme assets over liabilities. The full actuarial valuation as at 31 December 2015, adjusted as appropriate for the requirements of IAS 19, was updated by a qualified actuary at 31 December 2017 to allow for changes in market conditions and actuarial assumptions. The liabilities of the DB Plan are measured by discounting the best estimate of future cash flows to be paid out by the DB Plan using the projected unit method. Under this method, each participant's benefits under the DB Plan are attributed to years of service, taking into consideration the DB Plan's benefit allocation formula. For the DB Plan, accrual of future benefits ceased in 1996 and no further benefit has been attributed to service during subsequent reporting periods.

The accumulated benefit obligation is therefore an actuarial measure of the present value of benefits for service already rendered and requires no assumption for future salary increases. An assumption for revaluation in deferment is built into the valuation of the scheme. This revaluation preserves the benefits accrued and prevents the benefit diminishing over time through the effects of inflation.

34. POST EMPLOYMENT BENEFITS (CONTINUED)

Defined benefit section of the Plan ("DB Plan") (continued)

Under contractual group recharging arrangements, the net defined benefit cost for the DB Plan as a whole, measured in accordance with IAS 19, is recharged to the Group and information on the MSUK DB Plan is provided below. On this basis, the management recharge for the year in respect of the DB Plan recognised within 'Management charges from other Morgan Stanley Group undertakings relating to 'Direct staff costs' in 'Other expense' was $nil (2016: $nil).

The following table provides a summary of the present value of the defined benefit obligation and fair value of Plan assets included in the MSUK statement of financial position:

	2017 $millions	2016 $millions
Present value of the funded defined benefit obligation	(285)	(262)
Fair value of plan assets	371	337
Surplus of the funded defined benefit plan	86	75
Impact of asset ceiling	(86)	(75)
Net liability	-	-

The DB Plan has a surplus that is not recognised in the MSUK statement of financial position on the basis that future economic benefits are not unconditionally available to the entity in the form of reduced contributions or a cash refund.

The weighted average duration of the defined benefit obligation at 31 December 2017 is 28 years (2016: 28 years).

34. POST EMPLOYMENT BENEFITS (CONTINUED)

Movement in the net defined benefit asset and impact of asset ceiling

The following tables provide a summary of the present value of the obligation, the fair value of the Plan assets and the impact of the asset ceiling:

2017	**Present value of obligation $millions**	**Fair value of plan assets $millions**	**Total $millions**	**Impact of asset ceiling $millions**	**Total $millions**
At 1 January 2017	(262)	337	75	(75)	-
Net interest (expense)/income	(7)	9	2	(2)	-
Amounts recognised in the income statement	(7)	9	2	(2)	-
Remeasurements:					
The return on scheme assets (excluding amounts included in net interest expense)	-	2	2	-	2
Actuarial gain/(loss) arising from changes in financial assumptions	(3)	-	(3)	-	(3)
Effect of experience adjustments	3	-	3	-	3
Adjustments for restrictions on the defined benefit asset	-	-	-	(2)	(2)
Amounts recognised in the statement of comprehensive income	-	2	2	(2)	-
Foreign exchange rate changes	(25)	32	7	(7)	-
Contributions:					
Benefit payments	9	(9)	-	-	-
At 31 December 2017	(285)	371	86	(86)	-

34. POST EMPLOYMENT BENEFITS (CONTINUED)

Movement in the net defined benefit asset and impact of asset ceiling (continued)

2016	**Present value of obligation $millions**	**Fair value of plan assets $millions**	**Total $millions**	**Impact of asset ceiling $millions**	**Total $millions**
At 1 January 2016	(243)	325	82	(82)	-
Net interest (expense)/income	(8)	10	2	(2)	-
Amounts recognised in the income statement	(8)	10	2	(2)	-
Remeasurements:					
The return on scheme assets (excluding amounts included in net interest expense)	-	70	70	-	70
Actuarial gain arising from changes in demographic assumptions	10	-	10	-	10
Actuarial gain/(loss) arising from changes in financial assumptions	(79)		(79)	-	(79)
Actuarial gain arising from experience adjustments	4	-	4	-	4
Adjustments for restrictions on the defined benefit asset	-	-	-	(5)	(5)
Amounts recognised in the statement of comprehensive income	(65)	70	5	(5)	-
Foreign exchange rate changes	45	(59)	(14)	14	-
Contributions:					
Benefit payments	9	(9)	-	-	-
At 31 December 2016	(262)	337	75	(75)	-

Actuarial assumptions

The following table presents the principal actuarial assumptions used in the valuation of the DB Plan:

	2017	**2016**
	%	**%**
Pre retirement discount rate	2.3	2.5
Post retirement discount rate	1.9	1.9
Inflation	3.3	3.5
Revaluation in deferment	2.3	2.5

The mortality assumptions used give the following life expectancy:

	Life expectancy at age 65 for a male member currently:		**Life expectancy at age 65 for a female member currently:**	
	Aged 65	**Aged 45**	**Aged 65**	**Aged 45**
31 December 2017				
UK	89.7	91.8	91.4	93.6
31 December 2016				
UK	89.7	91.7	91.2	93.5

34. POST EMPLOYMENT BENEFITS (CONTINUED)

Actuarial assumptions (continued)

The sensitivities regarding the principal assumptions used to measure the defined benefit obligation are as follows:

2017

Assumption	**Change in assumption**	**Impact on scheme liabilities**
Discount rate	Increase/ decrease by 0.25%	Decrease/ increase by 7.35%/7.96%
Inflation assumption	Increase/ decrease by 0.25%	Increase/ decrease by 4.27%/4.08%
Life expectancy	Increase by 1 year	Increase by 3.55%

2016

Assumption	**Change in assumption**	**Impact on scheme liabilities**
Discount rate	Increase/ decrease by 0.25%	Decrease/ increase by 7.36%/7.97%
Inflation assumption	Increase/ decrease by 0.25%	Increase/ decrease by 4.20%/4.01%
Life expectancy	Increase by 1 year	Increase by 3.44%

The sensitivity analysis presented above has been determined based on reasonably possible changes of the assumptions occurring at 31 December 2017 and 31 December 2016 assuming that all other assumptions are held constant. The methods and types of assumptions used in preparing the sensitivity analysis did not change compared to the prior year.

DB Plan assets

MSUK and the Trustees, in consultation with their independent investment consultants and actuaries, determine the asset allocation targets based on their assessment of business and financial conditions, demographic and actuarial data, funding characteristics and related risk factors. Other relevant factors, including industry practices and long-term historical and prospective capital market returns, are also considered. The overall investment objective is expected to minimise the volatility of the DB Plan's surplus or deficit through asset liability matching. The investment strategy is low risk.
Specific risks which are managed through the asset allocation targets include:

- Interest rate and inflation risk – DB Plan liabilities will change in response to changes in interest rates and inflation. The policy is to hedge this risk as far as possible;
- Asset volatility – investment in asset classes such as equities gives rise to volatility in the value of the assets. The policy is to invest in asset classes which closely match the DB Plan's liabilities;
- Credit risk – any default or downgrade in instruments such as corporate bonds and money market instruments may result in losses. The policy is to partially mitigate this risk by investment in a range of different credit instruments via pooled funds;
- Liquidity risk – the liquidity of investments may change over time which may have an impact on the expected transaction costs. The Trustees and MSUK have reviewed the likely cash requirements of the DB Plan and are satisfied that the investment arrangements provide sufficient liquidity;
- Longevity risk – the longevity experience may differ from expectations and expectations may change over time. The purchase of annuities for pensioners mitigates a substantial portion of this risk.

In line with the above investment objectives, the DB Plan holds investments in a range of pooled investment vehicles of varying maturities intended to broadly reflect the expected liability profile of the Plan. The major categories and fair values of scheme assets at the end of the reporting period are set out below. All investments are quoted in an active market in both years.

34. POST EMPLOYMENT BENEFITS (CONTINUED)

DB Plan assets (continued)

	2017 $millions	2016 $millions
Cash funds	30	35
Corporate bond index funds	58	51
Government bond index funds:		
UK Gilt index funds	217	193
GBP fixed liability matching funds	54	47
Fixed Gilts	12	11
	371	337

An asset-liability review occurs every three years and is used to assist the Trustees and the Company in determining the optimal long-term asset allocation with regard to the structure of liabilities within the scheme.

On the basis of the 2016 review, the main strategic choices formulated in the actuarial and technical policy documents of the scheme are:

a) Assets invested in hedging assets such as gilts, corporate bonds and swap-based hedging funds in order to hedge liability-related risks.
b) Interest rate sensitivity caused by the duration of the defined benefit obligation should be reduced by the use of debt instruments such as gilts in combination with interest rate swap-based hedging funds.
c) In respect of GMP underpin liabilities, investment in long-dated corporate bonds to approximately hedge annuity prices, provide a degree of liquidity and generate modest degree of excess investment return.

35. RELATED PARTY DISCLOSURES

Parent and subsidiary relationships

Parent and ultimate controlling entity

The Group's immediate parent undertaking is Morgan Stanley Investments (UK) 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, Cardiff CF14 3UZ.

The ultimate parent undertaking and controlling entity is Morgan Stanley. This is the largest group of which the Group is a member and for which group financial statements are prepared. Morgan Stanley has its registered office c/o The Corporation Trust Company, The Corporation Trust Center, 1209 Orange Street, Wilmington, DE 19801, United States of America and is incorporated in the state of Delaware, in the United States of America. 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 Group.

The Morgan Stanley Group's corporate governance framework gives consideration to legal, geographical and business lines through a combination of boards of directors, and regional and global management committees. Accordingly, in addition to the Directors of the Company, key management personnel of the Group is considered to include the boards of directors of certain parent companies, including that of Morgan Stanley, certain members of key Morgan Stanley Group management committees, and certain executive officers of Morgan Stanley.

The boards of the Group's parent companies, the management committees and the executive officers cover the full range of the Morgan Stanley Group's business activities. Only those members with responsibility for the Institutional Securities business, being the reportable business segment of the Group, are considered to be key management personnel of the Group. The aggregate compensation below represents the proportion of compensation paid to these key management personnel, including the Directors of the Company, in respect of their services to the Group.

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

	2017 $millions	2016 $millions
Short-term employee benefits	52	48
Share-based payments	29	27
Other long-term employee benefits	22	18
	103	93

The share-based payment costs disclosed above reflect the amortisation of equity-based awards granted to key management personnel over the last three years and are therefore not directly aligned with other staff costs in the current year.

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

35. RELATED PARTY DISCLOSURES (CONTINUED)

Directors' emoluments

	2017 $millions	2016 $millions
Total emoluments of all Directors:		
Aggregate remuneration	14	14
Long term incentive schemes	5	5
	19	19
Disclosures in respect of the highest paid Director:		
Aggregate remuneration	4	5
Long term incentive schemes	2	2
	6	7

Directors' remuneration has 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 awarded, nor the gains made on exercise of share options. During the year under these incentive schemes, no Directors exercised share options (2016: none) and six Directors received restricted stock unit awards in respect of qualifying services (2016: eight).

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.

Two Directors have retirement benefits accruing under a non-UK defined benefits scheme (2016: three). In addition one Director has benefits accruing under the Alternative Retirement Plan, a defined benefit scheme, operated by Morgan Stanley UK Limited (2016: one).

The Morgan Stanley Group operates a defined contribution pension scheme, the Morgan Stanley UK Group Pension Plan. There are three Directors to whom retirement benefits are accruing under this UK defined contribution scheme (2016: four). Two directors have benefits accruing under a non-UK defined contribution scheme (2016: two).

The Group has not provided any loans or other credit advances to its Directors during the year (2016: nil).

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 Group 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 Group has not recognised any expense and has made no provision for impairment relating to the amount of outstanding balances from related parties (2016: $nil).

35. RELATED PARTY DISCLOSURES (CONTINUED)

Transactions with related parties (continued)

Cash

The Group places cash with other Morgan Stanley Group undertakings. All such transactions are entered into on an arm's length basis.

	2017		2016	
	Interest $millions	Balance $millions	Interest $millions	Balance $millions
Amounts due from other Morgan Stanley Group undertakings	-	118	-	572

Funding

The Group receives funding from and provides funding to other Morgan Stanley Group undertakings in the following forms:

- *General funding*

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.

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

	2017		2016	
	Interest $millions	Balance $millions	Interest $millions	Balance $millions
Amounts due from the Group's direct and indirect parent undertakings	2	32	5	154
Amounts due from other Morgan Stanley Group undertakings	21	688	16	704
	23	720	21	858
Amounts due to the Group's direct and indirect parent undertakings	683	25,644	119	4,527
Amounts due to other Morgan Stanley Group undertakings	143	5,177	134	6,075
	826	30,821	253	10,602

- *Subordinated loans*

The Group received a subordinated loan from another Morgan Stanley Group undertaking. Details of the terms of the loan, including the contractual maturity and the interest rate are shown in note 17. The interest rate is established by the Morgan Stanley Group Treasury function based on available market information at the time the loan is provided or subsequently amended.

35. RELATED PARTY DISCLOSURES (CONTINUED)

Transactions with related parties (continued)

Trading and risk management

In the course of funding its business, the Group enters into collateralised financing transactions with other Morgan Stanley Group undertakings. All such transactions are entered into on an arm's length basis.

Details of the outstanding balances included in cash collateral on securities borrowed/ loaned and securities purchased/ sold under agreements to resell/ repurchase in the consolidated statement of financial position on such transactions and the related interest income or expense recognised in the consolidated income statement during the year are shown in the table below:

	2017		2016	
	Interest $millions	Balance $millions	Interest $millions	Balance $millions
Amounts due from other Morgan Stanley Group undertakings	94	18,101	(37)	30,019
Amounts due to the Group's direct and indirect parent undertakings	(23)	3,753	(13)	11,787
Amounts due to other Morgan Stanley Group undertakings	124	16,588	136	18,039
	101	20,341	123	29,826

The Group enters into purchases and sales of securities and derivative transactions with other Morgan Stanley Group undertakings to facilitate the provision of financial services to clients on a global basis and to manage the market risks associated with such business. The Group also enters into derivative transactions with other Morgan Stanley Group undertakings to manage the market risks associated with certain of its compensation plans. All such transactions are entered into on an arm's length basis. The total amounts receivable and payable from such transactions are included within trade receivables and trade payables in the consolidated statement of financial position and the fair value of such derivatives contracts outstanding included in financial assets/ liabilities classified as held for trading in the consolidated statement of financial position at the year end were as follows:

	2017 $millions	2016 $millions
Amounts due from the Group's direct and indirect parent undertakings on securities and derivative transactions	1,101	2,554
Amounts due from other Morgan Stanley Group undertakings on securities and derivative transactions	46,185	46,096
	47,286	48,650
Amounts due to the Group's direct and indirect parent undertakings on securities and derivative transactions	1,070	2,023
Amounts due to other Morgan Stanley Group undertakings on securities and derivative transactions	47,704	45,300
	48,774	47,323

35. RELATED PARTY DISCLOSURES (CONTINUED)

Transactions with related parties (continued)

Trading and risk management (continued)

The Group has received collateral of $1,146 million (2016: $658 million) from the Group's direct and indirect parent undertaking and $2,456 million (2016: $3,084 million) from other Morgan Stanley Group undertakings. The Group has pledged collateral of $19 million (2016: nil) to the Group's direct and indirect parent undertaking and $28,256 million (2016: $21,486 million) to other Morgan Stanley Group undertakings. The Group has received and pledged collateral in order to mitigate credit risk on exposures arising under derivatives contracts between the Group and other Morgan Stanley Group undertakings.

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 entities. The Morgan Stanley Group operates a number of intra-group policies to ensure that, where possible, revenues and related costs are matched. For the year ended 31 December 2017, a net amount of $1,056 million was transferred to other Morgan Stanley Group undertakings relating to such revenue transfer pricing policies and recognised in the consolidated income statement arising from such policies (2016: net amount of $1,578 million).

Effective 1 January 2017, Morgan Stanley updated its Global Transfer Pricing Policy. This change in transfer policy is consistent with evolving transfer pricing guidance as part of the Organization for Economic Cooperation and Development ("OECD")'s Base Erosion and Profit Shifting initiative and evolving regulatory guidance. The transfer pricing method selected for implementation is one of the methods specified under the 2017 OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations. This new policy is the subject of a multilateral Advanced Pricing Agreement that is currently under review by relevant tax authorities.

Infrastructure services

The Group receives and incurs management charges to and from other Morgan Stanley Group undertakings for infrastructure services, including the provision of staff and office facilities. Management recharges received and incurred during the year are as follows:

	2017		2016	
	Staff costs $millions	Other services $millions	Staff costs $millions	Other services $millions
Amounts recharged from the Group's direct and indirect parent undertakings	64	45	361	168
Amounts recharged from other Morgan Stanley Group undertakings	1,530	994	1,158	386
	1,594	1,039	1,519	554

Amounts outstanding at the reporting date are included within the general funding balances disclosed above.

Taxation

The Group has surrendered group relief to other members of the Morgan Stanley UK tax group for no cash consideration (see note 7).

35. RELATED PARTY DISCLOSURES (CONTINUED)

Transactions with related parties (continued)

Other related party transactions

The Group has received a guarantee from Morgan Stanley International, to guarantee the obligations under derivative contracts of certain fellow Morgan Stanley Group undertakings to the Company. As at 31 December 2017, no call had been made by the Group under this arrangement.

MORGAN STANLEY & CO. INTERNATIONAL plc

COMPANY FINANCIAL STATEMENTS

31 December 2017

MORGAN STANLEY & CO. INTERNATIONAL plc

COMPANY STATEMENT OF COMPREHENSIVE INCOME
Year ended 31 December 2017

	Note	2017 $millions	2016 $millions
PROFIT FOR THE YEAR	3	821	469
OTHER COMPREHENSIVE INCOME, NET OF TAX			
Items that will not be reclassified subsequently to profit or loss:			
Changes in fair value attributable to own credit risk on financial liabilities designated at fair value		(73)	(42)
Items that may be reclassified subsequently to profit or loss:			
Currency translation reserve:			
Foreign currency translation differences arising on foreign operations		32	(14)
Available-for-sale reserve:			
Net change in fair value of available-for-sale financial assets	10	67	(7)
OTHER COMPREHENSIVE INCOME AFTER INCOME TAX FOR THE YEAR		26	(63)
TOTAL COMPREHENSIVE INCOME FOR THE YEAR		847	406

The notes on pages 157 to 200 form an integral part of the financial statements.

COMPANY STATEMENT OF CHANGES IN EQUITY
Year ended 31 December 2017

	Note	Equity instruments $millions	Share premium $millions	Currency translation reserve $millions	Available-for-sale reserve $millions	Capital contribution reserve $millions	Capital redemption reserve $millions	Debt valuation adjustment reserve $millions	Retained earnings $millions	Total equity $millions
Balance at 1 January 2016		12,765	513	(120)	3	3	1,400	-	1,920	16,484
Restated for adoption of new accounting standard		-	-	-	-	-	-	(3)	3	-
Profit for the year		-	-	-	-	-	-	-	469	469
Other comprehensive income/(loss)		-	-	(14)	(7)	-	-	(42)	-	(63)
Total comprehensive income/(loss)		-	-	(14)	(7)	-	-	(42)	469	406
Transactions with owners:										
Dividends		-	-	-	-	-	-	-	(117)	(117)
Balance at 31 December 2016		12,765	513	(134)	(4)	3	1,400	(45)	2,275	16,773
Profit for the year		-	-	-	-	-	-		821	821
Other comprehensive income/(loss)		-	-	32	67	-	-	(73)	-	26
Total comprehensive income/(loss)		-	-	32	67	-	-	(73)	821	847
Transactions with owners:									-	-
Dividends	19	-	-	-	-	-	-	-	(86)	(86)
Issue of ordinary share capital	18	1,000	-	-	-	-	-		-	1,000
Balance at 31 December 2017		13,765	513	(102)	63	3	1,400	(118)	3,010	18,534

The notes on pages 157 to 200 form an integral part of the financial statements.

MORGAN STANLEY & CO. INTERNATIONAL plc
Registered number: 2068222

COMPANY STATEMENT OF FINANCIAL POSITION
As at 31 December 2017

	Note	2017 $millions	2016 $millions
ASSETS			
Loans and receivables:			
Cash and short-term deposits	4	24,736	20,205
Cash collateral on securities borrowed		24,156	19,601
Securities purchased under agreements to resell		70,739	77,446
Trade receivables		68,661	51,751
Other receivables	6	1,807	1,355
		190,099	170,358
Financial assets classified as held for trading (of which $56,081 million (2016: $50,743 million) were pledged to various parties)	7	255,363	246,739
Financial assets designated at fair value through profit or loss	9	13,058	4,449
Available-for-sale financial assets	10	160	27
Current tax assets		133	161
Deferred tax assets	16	100	79
Prepayments and accrued income		6	38
Investments in subsidiaries	11	524	85
Property, plant and equipment	12	4	5
Intangible assets		2	2
TOTAL ASSETS		459,449	421,943
LIABILITIES AND EQUITY			
Financial liabilities at amortised cost:			
Bank loans and overdrafts		122	25
Cash collateral on securities loaned		20,761	21,224
Securities sold under agreements to repurchase		52,266	48,416
Trade payables		93,024	85,722
Subordinated loans	13	7,000	7,906
Other payables	14	30,278	10,704
		203,451	173,997
Financial liabilities classified as held for trading	7	214,967	224,737
Financial liabilities designated at fair value through profit or loss	9	22,299	6,157
Provisions	15	50	85
Current tax liabilities		30	45
Deferred tax liabilities	16	1	3
Accruals and deferred income		113	142
Post employment benefit obligations	30	4	4
TOTAL LIABILITIES		440,915	405,170
EQUITY			
Equity instruments	18	13,765	12,765
Share premium account		513	513
Currency translation reserve		(102)	(134)
Available-for-sale reserve		63	(4)
Capital contribution reserve		3	3
Capital redemption reserve		1,400	1,400
Debt valuation adjustment reserve		(118)	(45)
Retained earnings		3,010	2,275
TOTAL EQUITY ATTRIBUTABLE TO THE OWNER OF THE COMPANY		18,534	16,773
TOTAL LIABILITIES AND EQUITY		459,449	421,943

These financial statements were approved by the Board and authorised for issue on 19 April 2018.

Signed on behalf of the Board

C Castello, Director

The notes on pages 157 to 200 form an integral part of the financial statements.

NOTES TO THE COMPANY FINANCIAL STATEMENTS
Year ended 31 December 2017

1. BASIS OF PREPARATION

These financial statements contain information about the Company as an individual company and do not contain consolidated financial information as the parent of a group.

Statement of compliance

These financial statements are prepared in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law), including FRS 101 with a departure from the requirement of Schedule 1 paragraph 40 to The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 ("the Regulations") as described in note 2(c) below for the overriding purpose of giving a true and fair view.

The Company meets the definition of a qualifying entity and is a Financial Institution as defined in FRS 100. The Company has taken advantage of the disclosure exemptions available under FRS 101 in relation to share-based payments, fair value measurements (as applicable to assets and liabilities other than financial instruments), presentation of comparative information in respect of certain assets and shares outstanding, presentation of a cash flow statement, accounting standards not yet adopted and related party transactions.

Where relevant, equivalent disclosures have been provided in the Group accounts in which the Company is consolidated.

New standards and interpretations adopted during the year

The following amendments to standards and interpretations relevant to the Company's operations were adopted during the year. Except where otherwise stated, these amendments to standards and interpretations did not have a material impact on the Company's financial statements.

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

As part of the 2014 - 2016 Annual Improvements Cycle published in December 2016, the IASB made amendments to the following standard that is relevant to the Group's operations: IFRS 12 'Disclosure of Interests in Other Entities', for application in accounting periods beginning on or after 1 January 2017.

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

1. BASIS OF PREPARATION (CONTINUED)

Basis of measurement

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

Critical judgements in applying the Company's accounting policies

The preparation of the Company's financial statements requires management to make judgements regarding the recognition of deferred tax balances and legal, tax and property provisions that can significantly affect the amounts recognised in the financial statements. The Company believes that the judgements utilised in preparing the financial statements are reasonable, relevant and reliable.

The Company used judgements to determine which valuation approaches are most appropriate in determining fair value. For further details on the judgements used in determining fair value of certain assets and liabilities, see accounting policy note 3(d) in the consolidated financial statements and note 26.

Judgements are used in determining what tax-deductible losses are to be surrendered to other members of the Morgan Stanley UK tax group and in determining the factors for consideration and the timing of recognition of tax-related provisions. The level of provisions held by the Group in association to the Bank Levy is also subject to management review. For further details on the judgements used in determining tax balances, see note 15.

Key sources of estimation uncertainty

The preparation of the Company's financial statements requires management to make assumptions regarding the valuation of certain financial instruments, impairment of assets, tax balances, pension obligations, the outcome of litigation, and other matters that affect the financial statements and related disclosures.

Estimates are used in the calculation of property, litigation, and tax-related provisions. Provisions are calculated based on the net present value of expected future cash flows, although the Company recognises that it is inherently difficult to estimate the amount of the future losses in certain instances. For further detail, see note 15.

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, and the Company's objectives, policies and processes for managing its capital; its financial risk management objectives; and its exposures to credit risk and liquidity risk, are reflected in the Strategic Report on pages 3 to 41. In addition, the notes to the financial statements include the details of its financial instruments and additional detail, not included in the Strategic Report, on its credit risk and liquidity risk.

As set out in the Group's Strategic 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 above 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.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting policies of the Company are the same as those of the Group which are set out in note 3 to the consolidated financial statements, except the policy 3(j) on business combinations and disposals which is not applicable to the Company. The Group accounting policy 3(c)(ii) on financial instruments designated at fair value through profit or loss is applied by the Company, however, for the Company this represents a departure from the Regulations (see 2(c) below). Investments in subsidiaries held by the Company are carried at historical cost less provision for impairment in accordance with the policy 2(a) and 2(b) as noted below.

a. Investments in subsidiaries

Subsidiaries are entities over which the Company has control. The Company controls an entity when it is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity.

In certain cases, the Company may exercise control over another entity on behalf of investors or other parties. In such cases it is necessary, as part of the assessment of whether it should consolidate the entity, for the Company to determine whether it exercises such control primarily as an agent for the other investors or whether it does so primarily as principal on its own behalf. In making such a determination, Management will consider all relevant factors, including in particular

- The scope of the Company's decision-making authority over the investee;
- The rights, including removal rights, held by other parties;
- The remuneration to which the Company is entitled;
- The significance of the Company's exposure to variability of returns from its interests in the entity.

Investments in subsidiaries are stated at cost, less provision for any impairment (see note 2(b) below). Dividends, impairment losses and reversals of impairment losses are recognised in total profit or loss. Dividends from investments which would be classified as financial liabilities by the investee are classified as interest and recognised in total profit or loss.

b. Impairment of subsidiaries

Impairment losses on investment in subsidiaries are measured as the difference between cost and the current estimated recoverable amount. When the recoverable amount is less than the cost, an impairment is recognised within total profit or loss and is reflected against the carrying amount of the impaired asset on the statement of financial position. Investments in subsidiaries which have suffered an impairment are reviewed for possible reversal of the impairment at the end of each reporting period.

c. Financial instruments designated at fair value through profit or loss

The presentation of Debt valuation adjustment within other comprehensive income represents a departure from Schedule 1 paragraph 40 to the Regulations, which requires that changes in the value of financial instruments be included in the profit and loss account. The Directors consider that this departure is necessary in order that the accounts give a true and fair view of the results of the Company. All other subsequent changes in fair value, foreign exchange differences not relating to changes in the credit risk of those liabilities, interest and dividends are reflected in the income statement.

3. PROFIT OR LOSS FOR THE YEAR

As permitted by section 408 of the Companies Act 2006, the Company has elected not to present its own income statement for the period. The Company reported a profit after tax of $821 million for the year ended 31 December 2017 (2016: $469 million).

4. CASH AND SHORT TERM DEPOSITS

Included within 'Cash and short term deposits' is $12,007 million (2016: $9,446 million) of segregated client money, held in accordance with the FCA's Client Money Rules, and an amount of $74 million (2016: $59 million) which represents other client money that is not available for use by the Company. The corresponding payable is recognised and included in 'Trade payables' within 'Financial liabilities at amortised cost'.

5. LOANS AND RECEIVABLES

	2017 $millions	2016 $millions
Loans and receivables	190,140	170,398
Less impairment losses	(41)	(40)
	190,099	170,358

A reconciliation of impairment losses for loans and receivables is as follows:

	2017 $millions	2016 $millions
At 1 January	40	28
Charge for the year	50	26
Reversal of impairment losses	(45)	(12)
Amounts written off	(6)	(1)
Net foreign exchange gains	2	(1)
At 31 December	41	40

6. OTHER RECEIVABLES

	2017 $millions	2016 $millions
Amounts held at exchanges	928	532
Amounts due from other Morgan Stanley Group undertakings	789	716
Other amounts receivable	90	107
	1,807	1,355

7. FINANCIAL ASSETS AND FINANCIAL LIABILITIES CLASSIFIED AS HELD FOR TRADING

Financial assets and financial liabilities classified as held for trading are summarised as follows:

	2017		2016	
	Assets $millions	Liabilities $millions	Assets $millions	Liabilities $millions
Government debt securities	11,956	22,835	10,052	19,476
Corporate and other debt	9,756	2,864	8,552	2,855
Corporate equities	67,043	20,461	46,026	23,278
Derivatives (see note 8)	166,608	168,807	182,109	179,128
	255,363	214,967	246,739	224,737

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

8. DERIVATIVES CLASSIFIED AS HELD FOR TRADING

The fair value of derivative assets and liabilities classified as held for trading, split by instrument type, is summarised as follows:

	2017			
	Bilateral OTC $millions	Cleared OTC $millions	Listed derivative contracts $millions	Total $millions
Derivative assets:				
Interest rate contracts	71,426	1,143	7	72,576
Credit contracts	4,227	94	-	4,321
Foreign exchange and gold contracts	54,338	801	-	55,139
Equity contracts	26,883	-	5,301	32,184
Commodity contracts	2,224	-	164	2,388
	159,098	2,038	5,472	166,608
Derivative liabilities:				
Interest rate contracts	64,933	654	3	65,590
Credit contracts	4,608	53	-	4,661
Foreign exchange and gold contracts	55,895	1,007	-	56,902
Equity contracts	34,327	-	4,953	39,280
Commodity contracts	2,352	-	22	2,374
	162,115	1,714	4,978	168,807

8. DERIVATIVES CLASSIFIED AS HELD FOR TRADING (CONTINUED)

	2016			
	Bilateral OTC $millions	**Cleared OTC $millions**	**Listed derivative contracts $millions**	**Total $millions**
Derivative assets:				
Interest rate contracts	76,154	3,260	9	79,423
Credit contracts	6,152	6	-	6,158
Foreign exchange and gold contracts	65,226	1,039	-	66,265
Equity contracts	23,376	-	4,518	27,894
Commodity contracts	2,279	-	90	2,369
	173,187	4,305	4,617	182,109
Derivative liabilities:				
Interest rate contracts	71,777	3,202	4	74,983
Credit contracts	6,332	16	-	6,348
Foreign exchange and gold contracts	65,066	975	-	66,041
Equity contracts	24,961	-	4,473	29,434
Commodity contracts	2,285	-	37	2,322
	170,421	4,193	4,514	179,128

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

A description of financial instruments designated at fair value through profit and loss is provided in note 12 of the consolidated financial statements and consists of the following:

	2017		2016	
	Assets $millions	**Liabilities $millions**	**Assets $millions**	**Liabilities $millions**
Prepaid OTC contracts	442	898	894	1,397
Corporate loans	276	-	305	-
Issued structured notes	-	3,653	-	2,096
Other financial assets and liabilities	12,340	17,748	3,250	2,664
	13,058	22,299	4,449	6,157

The maximum exposure to credit risk of corporate loans which are designated at fair value through profit or loss as at 31 December 2017 is $276 million (2016: $305 million). The cumulative change in fair value of such corporate loans attributable to changes in credit risk amounts to $nil (2016: nil) and the change for the current year is $nil (2016:$nil). Corporate loans are fully collateralised with securities received by the Company.

The cumulative change in fair value recognised through other comprehensive income attributable to own credit risk for financial liabilities designated at fair value at 31 December 2017 is a loss of $160 million (2016: loss of $62 million). During the year $nil (2016: $nil) was realised as a result of the derecognition of such financial liabilities and was transferred from the ‘Debt valuation adjustment reserve’ to ‘Retained earnings’.

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

The Company determines the amount of changes in fair value attributable to changes in counterparty credit risk or own credit risk, as relating to loans and receivables and financial liabilities designated at fair value, by first determining the fair value including the impact of counterparty credit risk or own credit risk, and then deducting those changes in fair value representing managed market risk. In determining fair value, the Company considers the impact of changes in own credit spreads based upon observations of the secondary bond market spreads when measuring the fair value for issued structured notes. The Company considers that this approach most faithfully represents the amount of change in fair value due to both counterparty credit risk and the Company's own credit risk.

The carrying amount of financial liabilities designated at fair value for which the effect of changes in those liabilities' credit risk is presented within other comprehensive income was $28 million lower than the contractual amount due at maturity (2016: $49 million lower).

10. AVAILABLE-FOR-SALE FINANCIAL ASSETS

Financial assets that are classified as available-for-sale consists of corporate equities, of which $26 million are listed investments (2016: $nil). All other investments classified as available-for-sale financial assets are unlisted.

Movement in available-for-sale financial assets:

	2017 $millions	2016 $millions
Fair value		
At 1 January	27	35
Additions	66	-
Changes in fair value recognised in the available-for-sale reserve	67	(7)
Disposals and other settlements	-	(1)
At 31 December	160	27

11. INVESTMENTS IN SUBSIDIARIES

	Subsidiary undertakings $millions
Cost	
At 1 January 2017	1,081
Additions	439
At 31 December 2017	1,520
Impairment provisions	
At 1 January 2017	(996)
At 31 December 2017	(996)
Carrying amounts	
At 31 December 2016	85
At 31 December 2017	524

On 1 February 2017, the Company transferred the assets and liabilities of the French branch to Morgan Stanley (France) S.A. The Company invested further capital of €241 million in Morgan Stanley (France) S.A. Upon transfer, the branch was dissolved.

Details of all subsidiary undertakings (including indirect subsidiaries) of the Company at 31 December 2017 and 31 December 2016 are provided in the Appendix to the financial statements (see pages 201 to 202).

12. PROPERTY, PLANT AND EQUIPMENT

	Leasehold improvement $millions	Fixtures, fittings and equipment $millions	Total $millions
Cost			
At 1 January 2017	15	14	29
Additions	1	1	2
Foreign exchange revaluation	1	1	2
Disposals	(5)	(6)	(11)
At 31 December 2017	12	10	22
Depreciation			
At 1 January 2017	13	11	24
Charge for the year	1	1	2
Foreign exchange revaluation	2	1	3
Disposals	(5)	(6)	(11)
At 31 December 2017	11	7	18
Carrying amount			
At 31 December 2017	1	3	4

13. SUBORDINATED LOANS

The amounts subject to subordinated loan agreements are wholly repayable as shown below:

Counterparty	Repayment Date	Interest Rate	2017 $millions	2016 $millions
Morgan Stanley Investments (UK)	21 December 2025	OBFR[(1)] plus 2.3%	5,000	-
Morgan Stanley International Finance S.A.	31 October 2025	LIBOR[(2)] plus 1.475%	2,000	-
Morgan Stanley UK Financing I LP	31 October 2025	LIBOR[(2)] plus 1.475%	-	7,906
			7,000	7,906

[(1)] Overnight Bank Funding Rate ("OBFR")

[(2)] London Interbank Offered Rate ("LIBOR")

The amount outstanding under the subordinated loan agreement is repayable at any time at the Company's option, subject to appropriate notice to the lender and at least three months' notice to the PRA.

The Company has not defaulted on principal, interest or made any other breaches with respect to its subordinated loans during the year.

On 3 January 2017, the subordinated loan of $7,906 million was reassigned from Morgan Stanley UK Financing I LP to Morgan Stanley International Finance S.A., another Morgan Stanley Group undertaking. On 8 February 2017 a new $5,000 million subordinated loan was issued by the Group to its' immediate parent undertaking, Morgan Stanley Investments (UK). $5,906 million of the existing subordinated loan with Morgan Stanley International Finance S.A. was repaid.

14. OTHER PAYABLES

	2017 $millions	2016 $millions
Amounts due to other Morgan Stanley Group undertakings	30,090	10,537
Other amounts payable	188	167
	30,278	10,704

15. PROVISIONS

	Property	Litigation	Taxes and levies	Total
	$millions	$millions	$millions	$millions
At 1 January 2017	4	9	72	85
Additional provisions	-	-	86	86
Provisions utilised	-	(9)	(120)	(129)
Unused provisions reversed	(2)	-	(4)	(6)
Foreign exchange revaluation	-	-	14	14
At 31 December 2017	2	-	48	50

Property

Property provisions represent the net present value of expected future costs of excess office space (net of sublease income) and the net present value of expected future costs of reinstating leasehold improvements at the end of the lease term. Lease reinstatement provisions are released when the reinstatement obligations have been fulfilled. The related asset for lease reinstatement provisions is included in 'Leasehold improvements' within 'Property, plant and equipment' (note 12).

Litigation matters and other provisions

Litigation matters and other provisions related to the Company are largely the same as the Group. Refer to note 19 of the consolidated financial statements for a description of these matters and provisions.

16. DEFERRED TAX ASSETS AND LIABILITIES

Deferred taxes are calculated on all temporary differences under the liability method. The movement in the deferred tax account is as follows:

	2017		2016	
	Deferred tax asset	Deferred tax liability	Deferred tax asset	Deferred tax liability
	$millions	$millions	$millions	$millions
At 1 January	79	(3)	110	(1)
Amount recognised in the income statement	(5)	2	(45)	(1)
Amount recognised in other comprehensive income	26	-	16	(1)
Impact of change in tax rates recognised in the income statement	-	-	(2)	-
At 31 December	100	(1)	79	(3)

16. DEFERRED TAX ASSETS AND LIABILITIES (CONTINUED)

	2017		2016	
	Deferred tax asset $millions	Deferred tax liability $millions	Deferred tax asset $millions	Deferred tax liability $millions
Accelerated capital allowances	3	-	2	-
Deferred compensation	7	-	4	-
IFRS 9 transitional adjustment	-	(1)	-	(1)
Temporary differences arising in respect of changes in the Company's own credit risk	42	-	16	-
Deferred interest	48	-	51	-
Other temporary differences	-	-	6	(2)
	100	(1)	79	(3)

Finance (No. 2) Act 2015 enacted reductions in the UK corporation tax main rate to 19% with effect from 1 April 2017. Finance Act 2016 enacted reductions in the UK corporation tax main rate to 17% with effect from 1 April 2020. This reduction in the tax rate will impact the current tax charge for future periods.

The deferred tax asset recognised is based on management assessment that it is probable that the Company will have taxable profits against which the temporary differences can be utilised.

17. COMMITMENTS AND CONTINGENCIES

Leases

The Company has entered into non-cancellable commercial leases on premises and equipment. These leases have an average life of between three and five years. The leases on the premises include renewal options and escalation clauses in line with general rental market conditions and rent adjustments based on price indices. The lease agreements do not contain contingent rent payment clauses or purchase options and they do not impose any restrictions on the Company's ability to pay dividends, engage in debt financing transactions or enter into further lease agreements. Future minimum payments and receivables decreased from 2016 as a result of the closure of the Paris branch.

Future minimum lease payments under non-cancellable operating leases at 31 December are due as follows:

	2017 $millions	2016 $millions
Within one year	3	7
In the second to fifth years inclusive	4	18
After five years	2	3
	9	28

Future minimum sub-lease receivables under non-cancellable operating leases at 31 December are due as follows:

	2017 $millions	2016 $millions
Within one year	-	3
In the second to fifth years inclusive	-	10
	-	13

17. COMMITMENTS AND CONTINGENCIES (CONTINUED)

Other commitments and contingent liabilities

At 31 December, the Company had the following outstanding commitments and contingent liabilities arising from off-balance sheet financial instruments:

Contingent liabilities	**2017 $millions**	**2016 $millions**
Guarantees	577	1,135
Letters of credit	-	1
	577	1,136

Commitments	**2017 $millions**	**2016 $millions**
Loan commitments	2,190	2,662
Underwriting commitments	336	1,309
Unsettled securities purchased under agreements to resell (1)	28,480	30,121
Unsettled securities sold under agreements to repurchase (2)	13,740	17,604

(1) Unsettled securities purchased under agreements to resell have a trade date at or prior to 31 December 2017 and settle subsequent to period end.

(2) Unsettled securities sold under agreements to repurchase have a trade date at or prior to 31 December 2017 and settle subsequent to period end.

18. EQUITY INSTRUMENTS

	Ordinary shares of $1 each $millions	**Ordinary shares of £1 each $millions**	**Class A ordinary shares of $1 each $millions**	**Additional Tier 1 capital $millions**	**Total equity instruments $millions**
Issued and fully paid up:					
At 1 January 2016 and at 31 December 2016	9,935	30	1,500	1,300	12,765
At 1 January 2016	9,935	30	1,500	1,300	12,765
Issued in the year:					
Ordinary shares of $1 each issued	1,000	-	-	-	1,000
At 31 December 2017	10,935	30	1,500	1,300	13,765
Voting rights as 31 December 2017	99.7% (1)	0.3% (1)	Non-voting	Non-voting	100%

(1) Ordinary shares are pari passu with each other regardless of currency and together carry 100% of the voting rights (2016: 100%).

18. EQUITY INSTRUMENTS (CONTINUED)

Equity instruments

At 1 January 2016 and 2017, the total equity instruments in issue of the Company equated to $12,765 million comprising 9,935,105,148 ordinary shares of $1 each (31 December 2016: 9,935,105,148), 17,615,107 ordinary shares of £1 each (31 December 2016: 17,615,107), 1,500,000,000 Class A Non-voting ordinary shares of $1 each (31 December 2016: 1,500,000,000) and Additional Tier 1 capital instruments of $1,300,000,000 (31 December 2016: $1,300,000,000). All equity instruments are fully paid.

On 28 September 2017, 1,000,000,000 ordinary shares of $1 each were issued at par, to the Company's immediate parent undertaking for cash consideration.

Ordinary shares

The holders of the ordinary shares are entitled to receive dividends as declared from time to time and are entitled, on a show of hands, to one vote and, on a poll, one vote per share at meetings of the shareholders of the Company. All shares rank equally with regard to the Company's residual net assets.

All ordinary shares are recorded at the rates of exchange ruling at the date the shares were paid up.

Additional Tier 1 capital

The Additional Tier 1 capital instruments (the "Instruments") includes a trigger mechanism whereby if the Common Equity Tier 1 capital ratio of the Company falls below a pre-determined level, the Company will write-down the outstanding principal amount of the Instruments, together with any unpaid interest coupon. In this situation, Morgan Stanley UK Group, the holder of the Instruments, would have no further rights against the Company in respect of the Instruments. The Instruments have no defined maturity, are callable at the Company's discretion after five years from their date of issuance and are subordinated to senior creditors and subordinated loan creditors of the Company. The Instruments are not entitled to any participation in the residual net assets of the Company. Coupons on the Instruments are non-cumulative and payable at a fixed rate of 9% per annum. Payment of the coupon is wholly at the discretion of the Company.

A payment of coupon interest was approved by the Board of Directors on 31 May 2017 and paid on the same day (see note 19).

Reserves

Details of each reserve are provided in note 22 of the consolidated financial statements.

19. DIVIDENDS

On 31 May 2017, the Directors approved a coupon payment on the Additional Tier 1 capital instruments of $118,625,000 (31 December 2016: $157,625,000 of pre-tax coupon interest on the AT1 instrument paid on 20 December 2016) out of reserves available for distribution at 31 December 2016. The coupon was paid on 31 May 2017 and has a related tax benefit of $33,121,579 (2016: $40,253,052).

The Directors have not proposed the payment of a final dividend out of reserves available at 31 December 2017 (2016: $nil).

20. 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 2017	Less than or equal to twelve months $millions	More than twelve months $millions	Total $millions
ASSETS			
Loans and receivables:			
Cash and short-term deposits	24,736	-	24,736
Cash collateral on securities borrowed	24,156	-	24,156
Securities purchased under agreements to resell	70,730	9	70,739
Trade receivables	68,661	-	68,661
Other receivables	775	1,032	1,807
	189,058	1,041	190,099
Financial assets classified as held for trading	255,363	-	255,363
Financial assets designated at fair value through profit or loss	12,366	692	13,058
Available-for-sale financial assets	-	160	160
Current tax assets	133	-	133
Deferred tax assets	10	90	100
Prepayments and accrued income	6	-	6
Investments in subsidiaries	-	524	524
Property, plant and equipment	-	4	4
Intangible assets	-	2	2
	456,936	2,513	459,449
LIABILITIES			
Financial liabilities at amortised cost:			
Bank loans and overdrafts	122	-	122
Cash collateral on securities loaned	19,948	813	20,761
Securities sold under agreements to repurchase	46,893	5,373	52,266
Trade payables	93,024	-	93,024
Subordinated loans	-	7,000	7,000
Other payables	3,058	27,220	30,278
	163,045	40,406	203,451
Financial liabilities classified as held for trading	214,967	-	214,967
Financial liabilities designated at fair value through profit or loss	18,213	4,086	22,299
Provisions	50	-	50
Current tax liabilities	30	-	30
Deferred tax liabilities	-	1	1
Accruals and deferred income	113	-	113
Post-employment benefit obligations	-	4	4
	396,418	44,497	440,915

20. EXPECTED MATURITY OF ASSETS AND LIABILITIES (CONTINUED)

At 31 December 2016	Less than or equal to twelve months $millions	More than twelve months $millions	Total $millions
ASSETS			
Loans and receivables:			
Cash and short term deposits	20,205	-	20,205
Cash collateral on securities borrowed	19,601	-	19,601
Securities purchased under agreements to resell	77,099	347	77,446
Trade receivables	51,751	-	51,751
Other receivables	737	618	1,355
	169,393	965	170,358
Financial assets classified as held for trading	246,739	-	246,739
Financial assets designated at fair value through profit or loss	3,478	971	4,449
Available-for-sale financial assets	-	27	27
Current tax assets	161	-	161
Deferred tax assets	51	28	79
Prepayments and accrued income	38	-	38
Investment in subsidiaries	-	85	85
Property, plant and equipment	-	5	5
Intangible assets	-	2	2
	419,860	2,083	421,943
LIABILITIES			
Financial liabilities at amortised cost:			
Bank loans and overdrafts	25	-	25
Cash collateral on securities loaned	21,119	105	21,224
Securities sold under agreements to repurchase	44,033	4,383	48,416
Trade payables	85,722		85,722
Subordinated loans	-	7,906	7,906
Other payables	3,463	7,241	10,704
	154,362	19,635	173,997
Financial liabilities classified as held for trading	224,737	-	224,737
Financial liabilities designated at fair value through profit or loss	3,262	2,895	6,157
Provisions	-	85	85
Current tax liabilities	45	-	45
Deferred tax liabilities	-	3	3
Accruals and deferred income	142	-	142
Post-employment benefit obligations	-	4	4
	382,548	22,622	405,170

21. SEGMENT REPORTING

Segment information is presented in respect of the Company's business and geographical segments. The Company operates in the same business and geographical segments as the Group. Refer to note 26 of the consolidated financial statements for details of business and geographical segments.

Business segments

In 2017 and 2016, the Company had one reportable business segment, Institutional Securities.

Geographical segments

The Company operates in three geographical regions being, EMEA, the Americas and Asia. The following table presents total assets of the Company's operations by geographic area.

	EMEA		Americas		Asia		Total	
	2017	2016	2017	2016	2017	2016	2017	2016
	$millions	$millions	$millions	$millions	$millions	$millions	$millions	$millions
Total assets	329,592	294,239	66,433	59,881	63,424	67,823	459,449	421,943

22. FINANCIAL RISK MANAGEMENT

Risk management procedures

The Company's risk management procedures are consistent with those of the Group. This disclosure is limited to quantitative data for each risk category and should be read in conjunction with the risk management procedures detailed in the Strategic report from pages 3 to 41.

Market risk

VaR

VaR for the year ended 31 December 2017

The table below presents the Management VaR for the Company's Trading portfolio on a year-end, average and annual high and low basis for 31 December 2017 and 31 December 2016.

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

	95%/ one-day VaR for the year ended 31 December 2017				**95%/ one-day VaR for the year ended 31 December 2016**			
	Period end	**Average**	**High**	**Low**	**Period end**	**Average**	**High**	**Low**
Market risk category:	**$millions**	**$millions**	**$millions**	**$millions**	**$millions**	**$millions**	**$millions**	**$millions**
Interest rate and credit spread	15	15	22	10	12	12	20	9
Equity price	9	12	18	8	11	11	15	9
Foreign exchange rate	2	5	9	2	3	3	6	2
Commodity price	1	1	2	-	-	1	3	-
Less diversification benefit (1)(2)	(7)	(12)	N/A	N/A	(10)	(10)	N/A	N/A
Primary Risk Categories VaR	20	21	29	15	16	17	24	14
Credit Portfolio VaR	5	6	8	4	7	8	10	6
Less diversification benefit (1)(2)	(3)	(4)	N/A	N/A	(6)	(5)	N/A	N/A
Total Management VaR	22	23	31	16	17	20	27	15

(1) Diversification benefit equals the difference between total Management VaR and the sum of the VaRs for the four risk categories. This benefit arises because the simulated one-day losses for each of the four primary market risk categories occur on different days; similar diversification benefits also are taken into account within each category.
(2) N/A - Not Applicable. The minimum and maximum VaR values for the total VaR and each of the component VaRs might have occurred on different days during the year and therefore the diversification benefit is not an applicable measure.
(3) The Credit Portfolio VaR is disclosed as a separate category from the Primary Risk Categories and includes loans that are carried at fair value and associated hedges as well as counterparty credit valuation adjustments and related hedges.

The Company's average VaR for Primary Risk Categories for 2017 was $21 million compared with $17 million for 2016. The increase in average VaR for Primary Risk Categories is due to risk increase across interest rate, equity and foreign exchange.

The average Credit Portfolio VaR for 2017 was $6 million compared with $8 million for 2016. The decrease in the average VaR over the year was driven by exposure changes during 2017.

The average total VaR for 2017 was $23 million compared with $20 million for 2016.

22. FINANCIAL RISK MANAGEMENT (CONTINUED)

Market risk (continued)

Non trading risks for the year ended 31 December 2017

The Company believes that sensitivity analysis is an appropriate representation of the Company's non-trading risks. Reflected below is this analysis, which covers substantially all of the non-trading risks in the Company's portfolio, with the exception of counterparty credit valuation adjustments, covered in the previous section.

Interest rate risk

The Company's VaR excludes certain funding liabilities and money market transactions. The application of a parallel shift in market interest rates of 50 basis points increase or decrease to these positions would result in a net gain or loss of approximately $20.8 million, compared to a net gain or loss of $2.0 million as at 31 December 2016.

Funding liabilities

The credit spread risk sensitivity of the Company's mark-to-market funding liabilities corresponds to an increase in value of approximately $1.8 million and $0.8 million for each 1 basis point widening in the Company's credit spread level for both 31 December 2017 and 31 December 2016.

Equity investments price risk

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

	31 December 2017 10% sensitivity $millions	31 December 2016 10% sensitivity $millions
Available-for-sale financial assets	16	3

Currency risk

The Company has foreign currency exposure arising from foreign operations. The majority of this foreign currency risk has been hedged by other members of the Morgan Stanley Group, primarily Morgan Stanley, by utilising forward foreign currency exchange contracts.

The Company also has foreign currency exposure arising from its trading activities in currencies other than US dollars. It actively manages this exposure by hedging with other Morgan Stanley Group undertakings.

22. FINANCIAL RISK MANAGEMENT (CONTINUED)

Currency risk (continued)

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

	2017			2016		
	Foreign currency exposure $millions	**Percentage change applied %**	**Other comprehensive income $millions**	**Foreign currency exposure $millions**	**Percentage change applied %**	**Other comprehensive income $millions**
Euro	5	14%	1	166	12%	20
Polish Zloty	5	17%	1	3	17%	1
South Korean Won	234	11%	26	177	8%	15
Swiss Franc	17	12%	2	13	12%	1
	261		30	359		37

The reasonably possible percentage change in the currency rate in relation to US dollars has been calculated based on the greatest annual percentage change over the 5 year period from 1 January 2013 to 31 December 2017 (2016: from 1 January 2012 to 31 December 2016). Thus, the percentage change applied may not be the same percentage as the actual change in the currency rate for the relevant year.

Credit risk

Exposure to credit risk

The maximum exposure to credit risk (“gross credit exposure”) of the Company as at 31 December 2017 is disclosed below, based on the carrying amounts of the financial assets the Company believes are subject to credit risk. Exposure arising from financial instruments not recognised on the consolidated statement of financial position is measured as the maximum amount that the Company could have to pay, which may be significantly greater than the amount that would be recognised as a liability. Where the Company enters into credit enhancements, including receiving cash and security as collateral and master netting agreements, to manage the credit exposure on these financial instruments the financial effect of the credit enhancements is also disclosed below. The net credit exposure represents the credit exposure remaining after the effect of the credit enhancements. The “unrated” balance in the ‘Maximum exposure to credit risk by credit rating’ represents the pool of counterparties that either do not require a rating or are under review in accordance with the Company’s rating policies. These counterparties individually generate no material credit exposure and this pool is highly diversified, monitored and subject to limits.

22. FINANCIAL RISK MANAGEMENT (CONTINUED)

Credit risk (continued)

Exposure to credit risk (continued)

Financial assets classified as held for trading, excluding derivatives, are subject to traded credit risk through exposure to the issuer of the financial asset; the Company manages this issuer credit risk through its market risk management infrastructure and this traded credit risk is incorporated within the VaR based risk measures included in the market risk disclosure.

Exposure to credit risk by class

	2017			2016		
Class	**Gross credit exposure (1) $millions**	**Credit enhancements $millions**	**Net credit exposure (1) $millions**	**Gross credit exposure (1) $millions**	**Credit enhancements $millions**	**Net credit exposure (1) $millions**
Loans and receivables:						
Cash and short-term deposits	24,736	-	24,736	20,205	-	20,205
Cash collateral on securities borrowed	24,156	(23,740)	416	19,601	(18,900)	701
Securities purchased under agreements to resell	70,739	(66,887)	3,852	77,446	(75,053)	2,393
Trade receivables (3)	68,661	-	68,661	51,751	-	51,751
Other receivables	790	-	790	716	-	716
Financial assets classified as held for trading:						
Derivatives	166,608	(158,829)	7,779	182,109	(174,236)	7,873
Financial assets designated at fair value through profit or loss	13,058	(12,861)	197	4,449	(3,697)	752
	368,748	(262,317)	106,431	356,277	(271,886)	84,391
Unrecognised financial instruments						
Guarantees	577	-	577	1,135	-	1,135
Letters of credit	-	-	-	1	-	1
Loan commitments	2,190	(40)	2,150	2,662	(777)	1,885
Underwriting commitments	336	-	336	1,309	-	1,309
Unsettled securities purchased under agreements to resell (4)	28,480	-	28,480	30,121	-	30,121
	400,331	(262,357)	137,974	391,505	(272,663)	118,842

(1) The carrying amount recognised in the statement of financial position best represents the Company's maximum exposure to credit risk.
(2) Of the residual net credit exposure, intercompany cross product netting arrangements are in place which would allow for an additional $5,193 million of an available $29,907 million (2016: $3,593 million of an available $22,613 million) to be offset in the event of default by certain Morgan Stanley counterparties.
(3) Trade receivables primarily include cash collateral pledged against the payable on OTC derivative positions. These derivative liabilities are included within financial liabilities classified as held for trading in the statement of financial position.
(4) For contingent settlement provisions, collateral in the form of securities will be received at the point of settlement. Since the value of collateral is determined at a future date it is currently unquantifiable and not included in the table.

22. FINANCIAL RISK MANAGEMENT (CONTINUED)

Credit risk (continued)

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

Credit rating	2017 $millions	2016 $millions
AAA	20,794	16,721
AA	72,070	74,995
A	216,059	212,166
BBB	64,072	66,757
BB	14,823	11,542
B	7,183	5,177
CCC	2,377	1,386
D	10	9
Unrated	2,943	2,752
Total	400,331	391,505

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

Financial assets past due but not impaired:

At 31 December 2017, $2,310 million of financial assets included in trade receivables in the statement of financial position were past due but not impaired (31 December 2016: $1,408 million).

Financial assets individually impaired:

Class	2017 $millions	2016 $millions
Loans and receivables:		
Trade receivables	41	40

22. FINANCIAL RISK MANAGEMENT (CONTINUED)

Liquidity and funding risk

Maturity analysis

In the following maturity analysis of financial liabilities, derivative contracts and other financial liabilities held as part of the Company's trading activities are presented at fair value, consistent with how these financial liabilities are managed, and disclosed as on demand. Derivatives not held as part of the Company's trading activities 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 liabilities are managed. All other amounts represent undiscounted cash flows payable by the Company arising from its financial liabilities to their earliest contractual maturities as at 31 December 2017 and 31 December 2016. 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 those financial liabilities, and is consistent with how the liquidity risk on these financial liabilities is managed by the Company.

31 December 2017	On demand $millions	Less than 1 month $millions	Equal to or more than 1 month but less than 3 months $millions	Equal to or more than 3 months but less than 1 year $millions	Equal to or more than 1 year but less than 5 years $millions	Equal to or more than 5 years $millions	Total $millions
Financial liabilities							
Financial liabilities at amortised cost:							
Bank loans and overdrafts	122	-	-	-	-	-	122
Cash collateral on securities loaned	17,508	560	1,399	481	813	-	20,761
Securities sold under agreements to repurchase	22,524	14,585	3,203	6,607	5,392	-	52,311
Trade payables	93,024	-	1	1	25	-	93,051
Subordinated loans	-	-	-	227	1,318	8,029	9,574
Other payables	2,818	26	52	275	25,084	2,902	31,157
Financial liabilities classified as held for trading:							
Derivatives	168,807	-	-	-	-	-	168,807
Other	46,158	-	-	-	-	-	46,158
Financial liabilities designated at fair value through profit or loss	17,558	304	29	322	510	3,576	22,299
Total financial liabilities	368,519	15,475	4,684	7,913	33,142	14,507	444,240
Unrecognised financial instruments							
Guarantees	575	-	-	-	2	-	577
Loan commitments	2,190	-	-	-	-	-	2,190
Underwriting commitments	-	-	-	336	-	-	336
Unsettled securities purchased under agreements to resell (1)	28,246	234	-	-	-	-	28,480
Total unrecognised financial instruments	31,011	234	-	336	2	-	31,583

(1) The Company enters into forward starting reverse repurchase agreements (agreements which have a trade date at or prior to 31 December 2017 and settle subsequent to period end). These agreements primarily settle within three business days and of the total amount at 31 December 2017, $28,246 million settled within three business days.

22. FINANCIAL RISK MANAGEMENT (CONTINUED)

Liquidity and funding risk

Maturity analysis

31 December 2016	On demand $millions	Less than 1 month $millions	Equal to or more than 1 month but less than 3 months $millions	Equal to or more than 3 months but less than 1 year $millions	Equal to or more than 1 year but less than 5 years $millions	Equal to or more than 5 years $millions	Total $millions
Financial liabilities							
Financial liabilities at amortised cost:							
Bank loans and overdrafts	25	-	-	-	-	-	25
Cash collateral on securities loaned	15,911	678	2,224	2,306	105	-	21,224
Securities sold under agreements to repurchase	22,188	9,549	5,683	6,614	4,379	52	48,465
Trade payables	85,721	-	4	22	-	-	85,747
Subordinated loans	-	48	-	156	1,105	9,099	10,408
Other payables	2,835	12	118	141	5,145	2,841	11,092
Financial liabilities classified as held for trading:							
Derivatives	179,128	-	-	-	-	-	179,128
Other	45,609	-	-	-	-	-	45,609
Financial liabilities designated at fair value through profit or loss	2,651	38	89	484	965	1,930	6,157
Total financial liabilities	354,068	10,325	8,118	9,723	11,699	13,922	407,855
Unrecognised financial instruments							
Guarantees	1,135	-	-	-	-	-	1,135
Letters of credit	-	-	-	-	1	-	1
Loan commitments	2,662	-	-	-	-	-	2,662
Underwriting commitments	-	-	-	1,309	-	-	1,309
Unsettled securities purchased under agreements to resell (1)	30,121	-	-	-	-	-	30,121
Total unrecognised financial instruments	33,918	-	-	1,309	1	-	35,228

(1) The Company enters into forward starting reverse repurchase agreements (agreements which have a trade date at or prior to 31 December 2016 and settle subsequent to period end). These agreements primarily settle within three business days and of the total amount at 31 December 2016, $30,121 million settled within three business days.

23. TRANSFERS OF FINANCIALS ASSETS, INCLUDING PLEDGES OF COLLATERAL

Transferred financial assets that are not derecognised in their entirety

In the ordinary course of business, the Company enters into various arrangements including selling securities under agreements to repurchase, purchasing securities under agreements to resell, securities borrowed and securities loaned to, amongst other things, acquire securities to cover short positions and settle other securities obligations, to accommodate customers' needs and to finance the Company's inventory positions.

The Company pledges certain financial instruments to collateralise repurchase agreements and other securities financings. Pledged financial instruments that can be sold or repledged by the secured party are identified as financial instruments classified as held for trading (pledged to various parties) in the statement of financial position. The Company has determined that it retains substantially all the risks and rewards of these financial instruments including credit risk, settlement risk, country risk and market risk, and therefore has not derecognised them. In addition, it recognises a financial liability in respect of the consideration received.

Other financial assets transferred that continue to be recognised for accounting purposes include pledges of securities as collateral for derivative transactions or otherwise, as well as certain sales of securities with related transactions, such as derivatives, that result in the Company retaining substantially all the risks and rewards of the financial assets transferred. In addition, it recognises a financial liability in respect of the consideration received.

These transactions are mostly conducted under standard agreements used by financial market participants and are undertaken with counterparties subject to the Company's normal credit risk control processes. The resulting credit exposures are controlled by daily monitoring and collateralisation of the positions. The carrying amount of the associated financial liabilities related to financial assets transferred that continue to be recognised is $67,817 million (2016: $47,426 million).

The following table presents those financial assets which have been sold of otherwise transferred, but which for accounting purposes remain recognised on the statement of financial position.

	2017 $millions	2016 $millions
Financial assets classified as held for trading		
Debt securities	17,613	15,868
Equity instruments	60,058	41,091
	77,671	56,959

24. FINANCIAL ASSETS ACCEPTED AS COLLATERAL

The Company's policy is generally to take possession of securities received as collateral, securities purchased under agreements to resell and securities borrowed. The Company monitors the fair value of the underlying securities as compared with the related receivable or payable, including accrued interest, and, as necessary, requests additional collateral to ensure such transactions are adequately collateralised. Where deemed appropriate, the Company's agreements with third parties specify its rights to request additional collateral. These transactions are mostly conducted under standard documentation used by financial market participants.

The fair value of collateral accepted under these arrangements as at 31 December 2017 was $297,781 million (2016: $202,920 million). Of this amount $269,115 million (2016: $175,104 million) has been sold or repledged to third parties in connection with financing activities, or to comply with commitments under short sale transactions.

25. FINANCIAL ASSETS AND FINANCIAL LIABILITIES SUBJECT TO OFFSETTING

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

The following tables present information about the offsetting of financial instruments and related collateral amounts. It does not include information about financial instruments that are subject only to a collateral agreement. The effect of master netting arrangements, collateral agreements and other credit enhancements, on the Company's exposure to credit risk is disclosed in note 22.

NOTES TO THE COMPANY FINANCIAL STATEMENTS
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25. FINANCIAL ASSETS AND FINANCIAL LIABILITIES SUBJECT TO OFFSETTING (CONTINUED)

	Gross amounts (1)	Amounts offset in the statement of financial position (2) (3)	Net amounts presented in the statement of financial position	Amounts not offset in the statement of financial position (4) (5) (6)		Net exposure (7)
				Financial instruments	Cash collateral	
	$millions	$millions	$millions	$millions	$millions	$millions
31 December 2017						
Assets						
Loans and receivables:						
Cash collateral on securities borrowed	34,969	(10,813)	24,156	(23,740)	-	416
Securities purchased under agreement to resell	140,530	(69,791)	70,739	(66,887)	-	3,852
Financial assets classified as held for trading:						
Derivatives	216,199	(49,591)	166,608	(135,934)	(22,850)	7,824
TOTAL	391,698	(130,195)	261,503	(226,561)	(22,850)	12,092
Liabilities						
Financial liabilities at amortised cost:						
Cash collateral on securities loaned	31,574	(10,813)	20,761	(20,485)	-	276
Securities sold under agreement to repurchase	122,057	(69,791)	52,266	(48,490)	-	3,776
Financial liabilities classified as held for trading:						
Derivatives	214,779	(45,972)	168,807	(133,324)	(23,956)	11,527
TOTAL	368,410	(126,576)	241,834	(202,299)	(23,956)	15,579

(1) Amounts include $134 million of cash collateral on securities borrowed, $3,581 million of securities purchased under agreements to resell, $2,076 million of financial assets classified as held for trading - derivatives, $271 million of cash collateral on securities loaned, $3,362 million of securities sold under agreements to repurchase and $2,461 million of financial liabilities classified as held for trading – derivatives which are either not subject to master netting agreements or collateral agreements or are subject to such agreements but the Group has not determined the agreements to be legally enforceable.

(2) Amounts are reported on a net basis in the consolidated statements of financial position when there is a legally enforceable master netting arrangement that provides for a current right of offset and there is an intention to either settle on a net basis or to realise the asset and liability simultaneously.

(3) Amounts include $6,418 million and $2,800 million of cash collateral related to financial assets classified as held for trading - derivatives recognised in amounts offset in the consolidated statement of financial positions for assets and liabilities respectively.

(4) Amounts relate to master netting arrangements and collateral arrangements which have been determined by the Group to be legally enforceable but do not meet all criteria required for net presentation within the consolidated statement of financial position.

(5) The cash collateral not offset is recognised in the consolidated statement of financial position within trade receivables and payables respectively.

(6) In addition to the balances disclosed in the table certain financial assets and financial liabilities designated at fair value through profit or loss have legally enforceable master netting arrangements in place. As a result, $1,760 million of netting is included within the condensed consolidated statement of financial position. $32 million not presented net within the statement of financial position have legally enforceable netting arrangements in place and can be offset in the ordinary course of business and/ or in the event of default.

(7) Intercompany cross-product legally enforceable netting arrangements are in place which would allow for an additional $5,193 million of the total consolidated statement of financial position, to be offset in the ordinary course of business and/ or in the event of default. The additional amounts for offset would include a portion of the residual net exposure.

25. FINANCIAL ASSETS AND FINANCIAL LIABILITIES SUBJECT TO OFFSETTING (CONTINUED)

	Gross amounts (1)	Amounts offset in the statement of financial position (2) (3)	Net amounts presented in the statement of financial position	Amounts not offset in the statement of financial position (4) (5) (6)		Net exposure (7)
				Financial instruments	Cash collateral	
	$millions	$millions	$millions	$millions	$millions	$millions
31 December 2016						
Assets						
Loans and receivables:						
Cash collateral on securities borrowed	32,385	(12,784)	19,601	(18,900)	-	701
Securities purchased under agreement to resell	107,121	(29,675)	77,446	(75,053)	-	2,393
Financial assets classified as held for trading:						
Derivatives	235,385	(53,276)	182,109	(148,377)	(25,859)	7,873
TOTAL	374,891	(95,735)	279,156	(242,330)	(25,859)	10,967
Liabilities						
Financial liabilities at amortised cost:						
Cash collateral on securities loaned	34,008	(12,784)	21,224	(20,228)	-	996
Securities sold under agreement to repurchase	78,091	(29,675)	48,416	(46,876)	-	1,540
Financial liabilities classified as held for trading:						
Derivatives	228,682	(49,554)	179,128	(148,519)	(19,665)	10,944
TOTAL	340,781	(92,013)	248,768	(215,623)	(19,665)	13,480

(1) Amounts include $427 million of cash collateral on securities borrowed, $2,319 million of securities purchased under agreements to resell, $2,540 million of financial assets classified as held for trading - derivatives, $995 million of cash collateral on securities loaned, $1,535 million of securities sold under agreements to repurchase and $2,435 million of financial liabilities classified as held for trading – derivatives which are either not subject to master netting agreements or collateral agreements or are subject to such agreements but the Group has not determined the agreements to be legally enforceable.

(2) Amounts are reported on a net basis in the consolidated statements of financial position when there is a legally enforceable master netting arrangement that provides for a current right of offset and there is an intention to either settle on a net basis or to realise the asset and liability simultaneously.

(3) Amounts include $5,821 million and $2,099 million of cash collateral related to financial assets classified as held for trading - derivatives recognised in amounts offset in the consolidated statement of financial positions for assets and liabilities respectively.

(4) Amounts relate to master netting arrangements and collateral arrangements which have been determined by the Group to be legally enforceable but do not meet all criteria required for net presentation within the consolidated statement of financial position.

(5) The cash collateral not offset is recognised in the consolidated statement of financial position within trade receivables and payables respectively.

(6) In addition to the balances disclosed in the table, certain financial assets and financial liabilities designated at fair value through profit or loss have legally enforceable master netting arrangements in place, however, these are not eligible for netting within the condensed consolidated statement of financial position. $408 million not presented net within the condensed consolidated statement of financial position have legally enforceable netting arrangements in place and can be offset in the ordinary course of business and/ or in the event of default.

(7) Intercompany cross-product legally enforceable netting arrangements are in place which would allow for an additional $3,593 million of the total consolidated statement of financial position, to be offset in the ordinary course of business and/ or in the event of default. The additional amounts for offset would include a portion of the residual net exposure.

26. ASSETS AND LIABILITIES MEASURED AT FAIR VALUE

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

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

2017	Quoted prices in active market (Level 1) $millions	Valuation techniques using observable inputs (Level 2) $millions	Valuation techniques with significant unobservable inputs (Level 3) $millions	Total $millions
Financial assets classified as held for trading:				
Government debt securities	8,150	3,805	1	11,956
Corporate and other debt	-	9,355	401	9,756
Corporate equities	66,690	276	77	67,043
Derivatives:				
Interest rate contracts	6	71,402	1,168	72,576
Credit contracts	-	4,155	166	4,321
Foreign exchange and gold contracts	-	55,076	63	55,139
Equity contracts	274	30,042	1,868	32,184
Commodity contracts	104	2,273	11	2,388
Total financial assets classified as held for trading	75,224	176,384	3,755	255,363
Financial assets designated at fair value through profit or loss	-	12,723	335	13,058
Available-for-sale financial assets:				
Corporate equities	26	42	92	160
Total financial assets measured at fair value	75,250	189,149	4,182	268,581
Financial liabilities classified as held for trading:				
Government debt securities	21,232	1,603	-	22,835
Corporate and other debt	-	2,864	-	2,864
Corporate equities	20,374	72	15	20,461
Derivatives:				
Interest rate contracts	4	64,929	657	65,590
Credit contracts	-	4,474	187	4,661
Foreign exchange and gold contracts	-	56,817	84	56,901
Equity contracts	384	36,460	2,436	39,280
Commodity contracts	13	2,355	7	2,375
Total financial liabilities classified as held for trading	42,007	169,574	3,386	214,967
Financial liabilities designated at fair value through profit or loss	-	21,769	530	22,299
Total financial liabilities measured at fair value	42,007	191,343	3,916	237,266

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

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

2016	Quoted prices in active market (Level 1) $millions	Valuation techniques using observable inputs (Level 2) $millions	Valuation techniques with significant unobservable inputs (Level 3) $millions	Total $millions
Financial assets classified as held for trading:				
Government debt securities	7,185	2,863	4	10,052
Corporate and other debt	-	8,334	218	8,552
Corporate equities	45,749	216	61	46,026
Derivatives:				
Interest rate contracts	9	78,641	773	79,423
Credit contracts	-	6,047	111	6,158
Foreign exchange and gold contracts	-	66,197	68	66,265
Equity contracts	329	26,396	1,169	27,894
Commodity contracts	75	2,275	19	2,369
Total financial assets classified as held for trading	53,347	190,969	2,423	246,739
Financial assets designated at fair value through profit or loss	-	4,271	178	4,449
Available-for-sale financial assets:				
Corporate equities	-	-	27	27
Total financial assets measured at fair value	53,347	195,240	2,628	251,215
Financial liabilities classified as held for trading:				
Government debt securities	17,171	2,305	-	19,476
Corporate and other debt	-	2,850	5	2,855
Corporate equities	23,218	32	28	23,278
Derivatives:				
Interest rate contracts	4	74,029	950	74,983
Credit contracts	-	6,232	116	6,348
Foreign exchange and gold contracts	-	65,987	54	66,041
Equity contracts	470	27,162	1,802	29,434
Commodity contracts	32	2,268	22	2,322
Total financial liabilities classified as held for trading	40,895	180,865	2,977	224,737
Financial liabilities designated at fair value through profit or loss	-	5,860	297	6,157
Total financial liabilities measured at fair value	40,895	186,725	3,274	230,894

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

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

The Company's valuation approach and fair value hierarchy categorisation for certain significant classes of financial instruments recognised at fair value on a recurring basis are consistent with those disclosed for the Group. Refer to note 32 to the consolidated financial statements for details.

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

During the year, the Company reclassified approximately $1,200 million of European government debt securities assets (2016: $910 million) and $968 million of European government debt securities liabilities (2016: $602 million) from Level 2 to Level due to increased market activity in these instruments.

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

The following tables present the changes in the fair value of the Company's Level 3 financial assets and financial liabilities for the years ended 31 December 2017 and 31 December 2016. Level 3 instruments may be hedged with instruments classified in Level 1 and Level 2. As a result, the realised and unrealised gains/ (losses) for assets and liabilities within the Level 3 category presented in the following tables do not reflect the related realised and unrealised gains/ (losses) on hedging instruments that have been classified by the Company within the Level 1 and/ or Level 2 categories.

Unrealised gains/ (losses) during the period for assets and liabilities within the Level 3 category presented in the following tables herein may include changes in fair value during the period that were attributable to both observable and unobservable inputs.

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

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

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

2017

	Balance at 1 January 2016 $millions	Total gains/ (losses) recognised in profit for the year (1) $millions	Total gains/ (losses) recognised in the statement of comprehensive income (1) $millions	Purchases $millions	Sales & Issuances $millions	Settlements $millions	Net transfers in and/or (out) of Level 3 (2) $millions	Balance at 31 December 2016 $millions	Unrealised gains/ (losses) for Level 3 assets/ liabilities outstanding as at 31 December 2016 (3)
Financial assets classified as held for trading:									
Government debt securities	4	-	-	-	(3)	-	-	1	-
Corporate and other debt	218	14	-	329	(146)	-	(14)	401	-
Corporate equities	61	(6)	-	45	(53)	-	30	77	(5)
Total financial assets classified as held for trading	283	8	-	374	(202)	-	16	479	(5)
Financial assets designated at fair value through profit or loss	178	30	-	94	(75)	-	108	335	29
Available-for-sale financial assets:									
Corporate equities	27	-	40	40	-	-	(15)	92	40
Total financial assets measured at fair value	488	38	40	508	(277)	-	109	906	64
Financial liabilities classified as held for trading:									
Corporate and other debt	5	-	-	(5)	-	-	-	-	-
Corporate equities	28	1	-	(8)	4	-	(8)	15	-
Net derivative contracts [(4)]	804	(162)	-	(705)	928	(1,171)	77	95	(99)
Total financial liabilities classified as held for trading	837	(161)	-	(718)	932	(1,171)	69	110	(99)
Financial liabilities designated at fair value through profit or loss	297	(11)	(12)	-	334	(59)	(65)	530	(11)
Total financial liabilities measured at fair value	1,134	(172)	(12)	(718)	1,266	(1,230)	4	640	(110)

(1) The total gains or (losses) are recognised in the income statement and the statement of comprehensive income as detailed in the financial instruments accounting policy (note (3c) of the consolidated financial statements).

(2) Amounts related to entering into net derivative contracts, and financial liabilities designated at fair value through profit or loss represent issuances. Amounts for other line items represent sales.

(3) 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.

(4) Amounts represent unrealised gains or (losses) for the year ended 31 December 2017 related to assets and liabilities still outstanding at 31 December 2017. The unrealised gains or (losses) are recognised in the income statement or statement of comprehensive income as detailed in the financial instruments accounting policy (note 3(c) of the consolidated financial statements).

(5) Net derivative contracts represent Financial Liabilities classified as held for trading – derivative contracts net of Financial Assets classified as held for trading – derivative contracts.

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

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

2016

	Balance at 1 January 2016 $millions	Total gains/ (losses) recognised in profit for the year (1) $millions	Total gains/ (losses) recognised in the statement of comprehensive income (1) $millions	Purchases $millions	Sales and issuances(2) $millions	Settlements $millions	Net transfers in and/or (out) of Level 3 (2) $millions	Balance at 31 December 2016 $millions	Unrealised gains/ (losses) for Level 3 assets/ liabilities outstanding as at 31 December 2016 (3) $millions
Financial assets classified as held for trading:									
Government debt securities	4	-	-	2	(4)	-	2	4	-
Corporate and other debt	576	8	-	71	(409)	-	(28)	218	(5)
Corporate equities	228	(13)	-	32	(24)	-	(162)	61	-
Total financial assets classified as held for trading	808	(5)	-	105	(437)	-	(188)	283	(5)
Financial assets designated at fair value through profit or loss	381	7	-	15	(236)	-	11	178	7
Available-for-sale financial assets:									
Corporate equities	34	-	(8)	1	-	-	-	27	(8)
Total financial assets measured at fair value	1,223	2	(8)	121	(673)	-	(177)	488	(6)
Financial liabilities classified as held for trading:									
Corporate and other debt	5	-	-	(1)	1	-	-	5	-
Corporate equities	15	12	-	(3)	24	-	4	28	-
Net derivative contracts (3)(4)	1,006	212	-	(355)	543	301	(479)	804	13
Total financial liabilities classified as held for trading	1,026	224	-	(359)	568	301	(475)	837	13
Financial liabilities designated at fair value through profit or loss	160	8	-	-	251	(88)	(18)	297	8
Total financial liabilities measured at fair value	1,186	232	-	(359)	819	213	(493)	1,134	21

(1) The total gains or (losses) are recognised in the income statement and the statement of comprehensive income as detailed in the financial instruments accounting policy (note 3c) of the consolidated financial statements.
(2) For financial assets and financial liabilities that were transferred into and out of Level 3 during the year, gains or (losses) are presented as if the assets or liabilities had been transferred into or out of Level 3 as at the beginning of the year.
(3) Amounts represent unrealised gains or (losses) for the year ended 31 December 2016 related to assets and liabilities still outstanding at 31 December 2016. The unrealised gains or (losses) are recognised in the income statement or statement of comprehensive income as detailed in the financial instruments accounting policy (note 3c) of the consolidated financial statements.
(4) Net derivative contracts represent Financial liabilities classified as held for trading – derivative contracts net of Financial assets classified as held for trading – derivative contracts.

There were no material transfers from Level 2 to Level 3 or from Level 3 to Level 2 of the fair value hierarchy during the year (2016: $nil).

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

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

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

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

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

The level of aggregation and breadth of products cause the range of inputs to be wide and not evenly distributed across the inventory. Further, the range of unobservable inputs may differ across companies in the financial services industry because of diversity in the types of products included in each company's inventory. The following disclosures also include qualitative information on the sensitivity of the fair value measurements to changes in the significant unobservable inputs. There are no predictable relationships between multiple significant unobservable inputs attributable to a given valuation technique. A single amount is disclosed when there is no significant difference between the minimum, maximum and average (weighted average or similar average / median).

31 December 2017	Fair value $millions	Predominant valuation techniques/ Significant unobservable inputs	Range [2] (Weighted averages or simple averages/median)[3]
ASSETS			
Financial assets classified as held for trading:			
- Corporate and other debt:			
- Mortgage- and asset-backed securities	151	Comparable pricing	
		Comparable bond price	0 to 100 pts (35 pts)
- Corporate bonds	214	Comparable pricing	
		Comparable bond price	65 to 134 pts (70 pts)
- Loans and lending commitments	36	Comparable pricing	
		Comparable loan price	79 to 100 pts (93 pts)
- Corporate equities	77	Comparable pricing	
		Comparable equity price	100% (100%)
Financial assets designated at fair value through profit or loss:			
- Customer loans	229	Option Model	
		Volatility skew	-1% (-1%)
- Prepaid OTC contracts	106	Discounted Cash Flow	
		Recovery rate	15% (15%)
Available-for-sale financial assets:			
- Corporate equities	92	Comparable pricing	
		Comparable equity price	100%(100%)

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

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

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

31 December 2017	Fair value	Predominant valuation techniques/ Significant unobservable inputs	Range (2) (Weighted averages or simple averages/median)(3)
	$millions		
LIABILITIES			
Financial liabilities classified as held for trading:			
- Net derivatives contracts:(1)(4) (5)			
- Interest rate	511	Option Model	
		Inflation Volatility	23% to 63% (44%/41%)
		Interest rate - Foreign exchange correlation	54% to 57% (56%/56%)
		Interest Rate Curve Correlation	55% to 90% (75%/76%)
		Inflation Curve	2% to 2% (2%/2%)
		Interest rate volatility skew	31% to 99% (42%/45%)
- Credit	(21)	Comparable pricing	
		Funding spreads	93 bp to 96 bp (96bp)
		Comparable bond price	1 to 140 pts (40 pts)
		Credit spreads	150 bp (150 bp)
- Foreign exchange and gold	(21)	Option Model	
		Interest rate - Foreign exchange correlation	54% to 57% (56%/56%)
		Interest rate volatility skew	31% to 99% (42%/45%)
		Deal Execution Probability	95% to 100% (96%/95%)
- Equity	(568)	Option Model	
		At the money volatility	5% to 53% (23%)
		Volatility skew	-2% to 0% (-1%)
		Equity-equity correlation	25% to 99% (73%)
		Equity-foreign exchange correlation	-60% to 40% (26%)
- Commodity	4	Comparable pricing	
		Comparable price	$557 to $1,552 ($1,233)
Financial liabilities designated at fair value through profit or loss:			
- Issued structured notes	(361)	Option Model	
		At the money volatility	5% to 35% (25%)
		Volatility skew	-1% to 0% (0%)
		Equity-equity correlation	46% to 86% (68%)
		Equity-foreign exchange correlation	-60% to 10% (4%)
- Prepaid OTC contracts	(169)	Discounted Cash Flow	
		Recovery Rate	15% (15%)

(1) Net derivative contracts represent financial liabilities classified as held for trading – derivative contracts net of financial assets classified as held for trading – derivative contracts.
(2) The ranges of significant unobservable inputs are represented in points, percentages, basis points or times. Points are a percentage of par; for example, 100 points would be 100% of par. A basis point equals 1/100th of 1%; for example, 353 basis points would equal 3.53%.
(3) Amounts represent weighted averages except where simple averages and the median of the inputs are provided when more relevant.
(4) CVA and FVA are included in fair value, but excluded from the valuation techniques and significant unobservable inputs in the previous table. CVA is a Level 3 input when the underlying counterparty credit curve is unobservable. FVA is a Level 3 input in its entirety given the lack of observability of funding spreads in the principal market.
(5) Includes derivative contracts with multiple risks (i.e. hybrid products).

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

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

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

31 December 2016	Fair value $millions	Predominant valuation techniques/ Significant unobservable inputs	Range [2] (Weighted averages or simple averages/median)[3]
ASSETS			
Financial assets classified as held for trading:			
- Corporate and other debt:			
- Mortgage- and asset-backed securities	104	Comparable pricing	
		Comparable bond price	2 to 100 pts (40 pts)
- Corporate bonds	91	Comparable pricing	
		Comparable bond price	5 to 130 pts (99 pts)
- Corporate equities	61	Comparable pricing	
		Comparable equity price	100% (100%)
Financial assets designated at fair value through profit or loss:			
- Customer loans	152	Margin loan model	
		Discount rate	9% (9%)
		Option model	
		Volatility skew	-1% (-1%)
Available-for-sale financial assets:			
- Corporate equities	27	Comparable pricing	
		Comparable equity price	100%(100%)
LIABILITIES			
Financial liabilities classified as held for trading:			
- Corporate equities	(28)	Comparable pricing	
		Comparable equity price	100%(100%)
- Net derivatives contracts:[(1)(4) (5)]			
- Interest rate	(177)	Option model	
		Inflation volatility	24% to 55% (40%/39%)
		Interest rate-foreign exchange correlation	28% to 58% (44%/43%)
		Interest rate curve correlation	28% to 98% (67%/69%)
		Interest rate quanto correlation	-8% to 37% (6%/-7%)
		Inflation rate curve	1.5% to 1.6% (1.5%/1.5%)
		Interest rate volatility skew	31% to 116% (47%/50%)
- Credit	(5)	Correlation model	
		Credit correlation	35% to 59% (44%)
		Comparable pricing	
		Comparable bond price	2 to 100 pts (39 pts)
- Foreign exchange and gold	14	Option model	
		Interest rate-foreign exchange correlation	28% to 58% (44%/43%)
		Interest rate volatility skew	31% to 116% (47%/50%)
		Credit-foreign exchange correlation	0% (0%)

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

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

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

31 December 2016

	Fair value $millions	Predominant valuation techniques/ Significant unobservable inputs	Range (2) (Weighted averages or simple averages/median)(3)
LIABILITIES			
Financial liabilities classified as held for trading:			
- Equity	(633)	Option model	
		At the money volatility	16% to 66% (32%)
		Volatility skew	-2% to 0% (-1%)
		Equity-equity correlation	35% to 99% (74%)
		Equity-foreign exchange correlation	-63% to -5% (-41%)
- Commodity	(3)	Comparable pricing	
		Comparable price	\$508 to \$1,626 (\$829)
Financial liabilities designated at fair value through profit or loss:			
- Issued structured notes	(270)	Option model	
		At the money volatility	7% to 34% (29%)
		Volatility skew	-1% to 0% (-1%)
		Equity-equity correlation	46% to 98% (82%)
		Equity-foreign exchange correlation	-55% to -6% (-41%)

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

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

(3) Amounts represent weighted averages except where simple averages and the median of the inputs are provided when more relevant.

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

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

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

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

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

For the descriptions of the Significant Unobservable Inputs and their sensitivity, refer to note 31.d.i. to the consolidated financial statements.

- Sensitivity of fair values to changing significant assumptions to reasonably possible alternatives

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

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

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

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

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

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

31 December 2017	Fair value $millions	Effect of reasonably possible alternative assumptions Increase in fair value $millions	Decrease in fair value $millions
Financial assets classified as held for trading:			
Corporate and other debt:	401	15	(19)
Corporate equities	77	5	(15)
Financial assets designated at fair value through profit or loss:			
Prepaid OTC contracts	106	135	(58)
Customer loans	229	-	-
Available-for-sale financial assets:			
Corporate equities	92	32	(45)
Financial liabilities classified as held for trading:			
Net derivatives contracts:(1)(2)	95	9	(5)
Financial liabilities designated at fair value through profit or loss:			
Prepaid OTC contracts	169	135	(58)
Issued structured notes	361	2	(1)

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

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

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

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

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

2016	Fair value $millions	Effect of reasonably possible alternative assumptions: Increase in fair value $millions	Effect of reasonably possible alternative assumptions: Decrease in fair value $millions
Financial assets classified as held for trading:			
Corporate and other debt	218	10	(10)
Corporate equities	61	10	(13)
Financial assets designated at fair value through profit or loss:			
Customer loans	152	1	(1)
Available-for-sale financial assets:			
Corporate equities	27	6	(10)
Financial liabilities classified as held for trading:			
Corporate Equities	28	-	(4)
Net derivatives contracts (1)(2)	804	37	(57)
Financial liabilities designated at fair value through profit or loss:			
Issued structured notes	270	2	(2)

(1) Net derivative contracts represent financial liabilities classified as held for trading – derivative contracts net of financial assets classified as held for trading – derivative contracts.
2) CVA and FVA are included in the fair value, but excluded from the effect of reasonably possible alternative assumptions in the table above. CVA is deemed to be a Level 3 input when the underlying counterparty credit curve is unobservable. FVA is deemed to be a Level 3 input in its entirety given the lack of observability of funding spreads in the principle market

e. Financial instruments valued using unobservable market data

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

	2017 $millions	2016 $millions
At 1 January	245	216
New transactions	211	70
Amounts recognised in the income statement during the year	(126)	(41)
At 31 December	330	245

The balance above predominately relates to derivatives.

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

e. Financial instruments valued using unobservable market data (continued)

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

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

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

27. ASSETS AND LIABILITIES NOT MEASURED AT FAIR VALUE

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

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

			Fair value measurements using:		
	Carrying value $millions	Fair value $millions	Quoted prices in active market (Level 1) $millions	Valuation techniques using observable inputs (Level 2) $millions	Valuation techniques with significant unobservab inputs (Level 3) $millions
Financial liabilities at 31 December 2017					
Subordinated loans	7,000	7,310	-	7,310	-
Financial liabilities at 31 December 2016					
Other payables	7,240	7,069	-	7,069	-
Subordinated loans	7,906	8,004	-	8,004	-

Also included in the statement of financial position is $30,278 million of other payables where the carrying value is a reasonable approximation of fair value (2016: $3,531 million). Refer to note 32 of the consolidated financial statements for further information related to the fair value of other payables and subordinated loans.

28. CAPITAL MANAGEMENT

The Company views capital as an important source of financial strength. Capital management procedures of the Company are consistent with those of the Group as detailed in the Strategic report.

The capital managed by the Company broadly includes share capital, Additional Tier 1 capital instruments, subordinated loans and reserves, as outlined below:

	2017 $millions	2016 $millions
Ordinary share capital	12,465	11,465
Share premium	513	513
Additional Tier 1 capital	1,300	1,300
Subordinated debt	7,000	7,906
Reserves	4,256	3,495
Total capital	25,534	24,679
Less: Current year unaudited profit as at 31 December	(199)	(513)
Regulatory Deductions	(1,364)	(1,075)
Own Funds	23,971	23,091

Pillar 3 disclosures and Country-by-Country Reporting

The Company is included in the MSI Group Pillar 3 disclosures which allow investors and other market participants to understand capital adequacy, particular risk exposures and risk management processes of individual firms required by the EU implementation of Basel capital standards.

The Company is also included in the MSI consolidated disclosure in order to comply with the provisions of Statutory Instrument 2013 No.3118 Capital Requirements (Country-by-Country Reporting) Regulations 2013, which implements in the UK the requirements set out in Article 89 of the Capital Requirements Directive (Directive 2013/36/EU).

The Pillar 3 disclosures and the Country-by-Country Reporting for the MSI Group for the year ended 31 December 2017 will be made available on the Morgan Stanley website at www.morganstanley.com/investorrelations.

29. EMPLOYEE COMPENSATION PLANS

Morgan Stanley maintains various equity-settled share-based and cash-based deferred compensation plans for the benefit of certain current and former employees.

Equity-settled share-based compensation plans

- **Restricted stock units**

Morgan Stanley has granted restricted stock unit ("RSU") awards pursuant to several equity-based compensation plans. The plans provide for the deferral of a portion of certain employees' incentive compensation with awards made in the form of restricted common stock or in the right to receive unrestricted shares of common stock in the future. Awards under these plans are generally subject to vesting over time, generally three years from the date of award, and are generally contingent upon continued employment and subject to restrictions on sale, transfer or assignment until the end of a specified period. All or a portion of an award may be cancelled if employment is terminated before the end of the relevant vesting period and after the vesting period in certain situations. Recipients of stock-based awards may have voting rights, at the Morgan Stanley Group's discretion, and generally receive dividend equivalents if the awards vest.

29. EMPLOYEE COMPENSATION PLANS (CONTINUED)

Equity-settled share-based compensation plans (continued)

- **Restricted stock units (continued)**

During the year, Morgan Stanley granted 127,710 units (2016: 246,134 units) of restricted stock units to employees of the Company with a weighted average fair value per unit of $42.64 (2016: $25.25), based on the market value of Morgan Stanley shares at grant date.

An expense of $7 million (2016: $9 million) was incurred through the Company's total profit for the year in relation to restricted stock units equity based compensation plans, granted to employees of the Company.

The Company has no options outstanding at 31 December 2017 (2016: nil) and Morgan Stanley has not granted stock options in 2017 or 2016.

Deferred cash-based compensation plans

Morgan Stanley has granted deferred cash-based compensation awards to certain employees which defer a portion of the employees' discretionary compensation. The plans generally provide a return based upon the performance of various referenced investments. Awards under these plans are generally subject to a sole vesting condition of service over time, which normally ranges from one to three years from the date of grant. All or a portion of an award may be cancelled if employment is terminated before the end of the relevant vesting period. The awards are settled in cash at the end of the relevant vesting period.

Awards with a value of $4 million (2016: $5 million) have been granted to employees of the Company during the year. The liability to employees at the end of the year, reported within 'Accruals and deferred income' in the statement of financial position, is $12 million (2016: $13 million).

The Company economically hedges the exposure created by these deferred compensation schemes by entering into derivative transactions with other Morgan Stanley Group undertakings. The derivative balance at the end of the year, recognised within 'Financial liabilities classified as held for trading' in relation to these deferred compensation schemes is $nil (2016: $2 million). The related profit recorded within 'Net gains/ (losses) on financial instruments classified as held for trading' for the year is $nil (2016: $nil).

30. POST-EMPLOYMENT BENEFITS

Defined contribution plans

The Company operates four Morgan Stanley defined contribution plans, which require contributions to be made to funds held in trust, separate from the assets of the Company.

The defined contribution plans are as follows:

- Morgan Stanley Flexible Company Pension Plan (Amsterdam);
- MSII Offshore Retirement Benefit Plan IV, Dubai Section; and
- Morgan Stanley & Co. International plc, Seoul Branch Defined Contribution Plan
- Morgan Stanley & Co. International plc Zurich Branch Top-up Plan

The Company pays fixed contributions to the funds, with no legal or constructive obligation to pay further contributions.

Following a legislative change in Switzerland during 2017, a benefit guarantee was removed from the Morgan Stanley & Co. International plc Zurich Branch Top-up Plan. As a result a credit of $1.8 million has been recognised in the Company's total profit reflecting the settlement of the defined benefit obligation under the plan. The Group has no further legal or constructive obligations under the plan which is now recognised as a defined contribution scheme.

The defined contribution pension charge recognised in total profit was $4 million for the year (2016: $3 million) of which $nil was accrued at 31 December 2017 (2016: $nil).

Defined benefit plans

The Company also operates several defined benefit plans, which provides post-employment benefits that are based on length of service and salary. The Company's policy is to fund at least the amounts sufficient to meet minimum funding requirements under applicable employee benefit and tax regulations.

The defined benefit plans are as follows:

- Morgan Stanley & Co. International plc Zurich Branch Base Plan; and
- Morgan Stanley & Co. International plc Dubai Branch End of Service Gratuity

On 1 February 2017, obligations of the Morgan Stanley & Co. International plc Paris Branch IFC (Indemnites de Fin de Carriere) plan were transferred to Morgan Stanley (France) S.A..

A net liability of $4 million (2016: $4 million) is recognised in the statement of financial position in respect of the above plans.

31. PARENT UNDERTAKINGS

Refer to note 35 of the consolidated financial statements for information on the Company's immediate and ultimate parent undertaking.

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 & Co. International plc, 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, Cardiff CF14 3UZ.

APPENDIX TO THE COMPANY FINANCIAL STATEMENTS

List of subsidiaries, including indirect subsidiaries, as at 31 December 2017 and 31 December 2016:

		Proportion of shares held by the Group [(1)(3)]		
Name of Company	**Address of undertaking's registered office/ principal place of business** [(2)]	**2017**	**2016**	**Nature of Business**
Morgan Stanley (France) S.A.	61 Rue De Monceau, 75008, Paris, France	100%	100%	Financial Services
Morgan Stanley Taiwan Limited	14th & 22nd Floors, Taipei Metro, 207 Tun Hwa South Road, Sec. 2, Taipei, 106, Taiwan	100%	100%	Financial Services
Morgan Stanley Strategic Investments Limited		100%	100%	Financial Services
Morgan Stanley Turnberry Limited		100%	100%	Holding company
Morgan Stanley Mallard Investments Limited		100%	100%	Holding company
Morgan Stanley Montgomerie Investments Limited		100%	100%	Holding company
Morgan Stanley Northcote Investments Limited		100%	100%	Holding company
Morgan Stanley Silvermere Limited		100%	100%	Holding company
Morgan Stanley Equity Trading (DIFC) Limited	Level 7, The Gate, Dubai International Financial Centre, Sheik Zayed Road, PO Box 506501, Dubai, United Arab Emirates	N/A [(4)]	100%	Financial Services
Shavano Cooperatieve U.A. (3)		100%	100%	Financial Services
Morgan Stanley Humboldt Investments Limited		100%	100%	Financial Services
Morgan Stanley Equity Finance (Denmark) ApS	Bech-Bruun Dragsted, Langelinie Alle 35, 2100 , Kobenhavn, Denmark	100%	100%	Financial Services
Morgan Stanley Rivelino Investments Limited		100%	100%	Holding company
Morgan Stanley Dolor Limited	Maples Corporate Services Limited, PO Box 309, Ugland House, Grand Cayman, KY1-1104, Cayman Islands	100%	100%	Holding company
Morgan Stanley Tostao Limited	Maples Corporate Services Limited, PO Box 309, Ugland House, Grand Cayman, KY1-1104, Cayman Islands	100%	100%	Financial Services
Morgan Stanley Equity Financing Services (Sweden) AB	Hovslagargatan 5 A, 111 48 , Stockholm, Sweden	100%	100%	Financial Services
Morgan Stanley Havel GmbH	Junghofstrasse 13-15, 60311, Frankfurt am Main, Germany	100%	100%	Holding company
Morgan Stanley Cooper Investments Limited		100%	100%	Holding company
Morgan Stanley Montrose Investments Limited		100%	100%	Financial Services
Morgan Stanley Langtree Investments B.V.		100%	100%	Financial Services
Morgan Stanley Equity Investments (UK) Limited	Maples Corporate Services Limited, PO Box 309, Ugland House, Grand Cayman, KY1-1104, Cayman Islands	100%	100%	Financial Services
Clearcreek, S.L.U.	Calle Aribau 171, 8036, Barcelona, Spain	100%	100%	Financial Services
Cabot 38 Limited		100%	100%	Financial Services
Morgan Stanley Maple Investments Limited	Baker Tilly, 25 Farringdon Street, London, EC4A 4AD	100%	100%	Financial Services
Morgan Stanley Millbrae Investments B.V. (3)		100%	100%	Financial Services
Morgan Stanley Derivative Products (Netherlands) B.V.	Luna Arena, Herikerbergweg 238, 1101 CM, Amsterdam , Netherlands	100%	100%	Financial Services
Morgan Stanley Longcross Limited		100%	100%	Holding company
Morgan Stanley Derivative Products Spain S.L.	Serrano 55, 28006, Madrid, Spain	100%	100%	Financial Services
Morgan Stanley Equity Investments (Luxembourg)	Custom House, Plaza Block 6, , International Financial Services Centre, Dublin, DUBLIN 1, Ireland	99%	99%	Holding company

APPENDIX TO THE COMPANY FINANCIAL STATEMENTS (CONTINUED)

List of subsidiaries, including indirect subsidiaries, as at 31 December 2017 and 31 December 2016 (continued):

		Proportion of shares held by the Group (1)(3)		
Name of Company	**Address of undertaking's registered office/ principal place of business (2)**	**2017**	**2016**	**Nature of Business**
Morgan Stanley Langton Limited		100%	100%	Holding company
Morgan Stanley Bowline Limited	Baker Tilly, 25 Farringdon Street, London, EC4A 4AD	100%	100%	Holding company
Morgan Stanley Equity Finance (Malta) Limited	SmartCity Malta, SCM 01 TMF Group (Malta) 401, Ricasoli, Kalkara SCM 1001, Malta	100%	100%	Financial Services
Morgan Stanley Equity Derivative Services (Luxembourg) S.a r.l	20, rue de la Poste, L-2346, Luxembourg	100%	100%	Financial Services
Morgan Stanley Equity Financing Limited		100%	100%	Financial Services
Drake II Investments Limited	Maples Corporate Services Limited, PO Box 309, Ugland House, Grand Cayman, KY1-1104, Cayman Islands	100%	100%	Financial Services
Morgan Stanley Grund S.a.r.L	46A, Avenue J.F. Kennedy, L-1855, Luxembourg	100%	100%	Financial Services
Morgan Stanley Kochi Limited	Maples Corporate Services Limited, PO Box 309, Ugland House, Grand Cayman, KY1-1104, Cayman Islands	100%	100%	Holding company
Morgan Stanley Derivative Products (Portugal), Unipessoal LDA	Rua Duque de Palmela, No. 23, 1250-097 , Lisbon, Portugal	100%	100%	Financial Services
Morgan Stanley Corporate Holdings (Luxembourg)	Custom House, Plaza Block 6, International Financial Services Centre, Dublin, DUBLIN 1, Ireland	100%	100%	Holding company
Morgan Stanley Heythorp Investments	Custom House, Plaza Block 6, International Financial Services Centre, Dublin, DUBLIN 1, Ireland	100%	100%	Holding company
Morgan Stanley Equity Holding (Netherlands) B.V.	Luna Arena, Herikerbergweg 238, 1101 CM, Amsterdam, Netherlands	100%	100%	Financial Services
Morgan Stanley Waterloo Limited	Maples Corporate Services Limited, PO Box 309, Ugland House, Grand Cayman, KY1-1104, Cayman Islands	100%	100%	Financial Services
Morstan Nominees Limited	25 Cabot Square, Canary Wharf, London, E14 4QA	100%	100%	Nominee company
Global Equity High Yield Fund B.V.	Weena 210-212, 3012NJ, Rotterdam, Netherlands	100%	100%	Financial Services
Morgan Stanley Client Securities Nominees Limited	25 Cabot Square, Canary Wharf, London, E14 4QA	100%	100%	Nominee company
Morgan Stanley France Holdings I S.A.S	61 Rue De Monceau, 75008, Paris, France	100%	100%	Holding company
Morgan Stanley France Holdings II S.A.S	61 Rue De Monceau, 75008, Paris, France	100%	100%	Holding company
Morgan Stanley Europe Holding SE	Junghofstrasse 13-15, 60311, Frankfurt am Main, Germany	100%	N/A	Holding company
Morgan Stanley Europe SE	Junghofstrasse 13-15, 60311, Frankfurt am Main, Germany	100%	N/A	Financial Services
Morgan Stanley EU Trading Services SAS	61 Rue De Monceau, 75008, Paris, France	100%	N/A	Financial Services
Morgan Stanley Investment Management (Ireland) Limited	The Observatory, 7-11, Sir John Rogerson's Quay, Dublin, Dublin 2, Ireland	100%	N/A	Financial Services

(1) The proportion of voting rights held by the Group is the same as the proportion of shares held by the Group unless otherwise stated

(2) All entities have a registered address of 20 Bank Street, Canary Wharf, London, E14 4AD, United Kingdom, unless otherwise stated.

(3) All shares held in each Company are ordinary shares with the exception of Shavano Cooperative U.A where €1 C membership shares are held and Morgan Stanley Millbrae Investments B.V. where ordinary and preference shares are held.

(4) During 2017, Morgan Stanley Equity Trading (DIFC) Limited merged with Morgan Stanley Equity Derivative Services (Luxembourg) S.a r.l and subsequently legally closed.