

Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.  
Form N-CSR  
January 08, 2009

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

**FORM N-CSR**

**CERTIFIED SHAREHOLDER REPORT OF REGISTERED  
MANAGEMENT INVESTMENT COMPANIES**

Investment Company Act file number 811-22011

MORGAN STANLEY EMERGING MARKETS DOMESTIC DEBT FUND, INC.  
(Exact name of registrant as specified in charter)

522 FIFTH AVENUE NEW YORK, NY  
(Address of principal executive offices)

10036  
(Zip code)

RANDY TAKIAN

522 FIFTH AVENUE NEW YORK, NY 10036  
(Name and address of agent for service)

Registrant's telephone number, including area code: 1-800-231-2608

Date of fiscal year end: 10/31

Date of reporting period: 10/31/08

Form N-CSR is to be used by management investment companies to file reports with the Commission not later than 10 days after the transmission to stockholders of any report that is required to be transmitted to stockholders under Rule 30e-1 under the Investment Company Act of 1940 (17 CFR 270.30e-1). The Commission may use the information provided on Form N-CSR in its regulatory, disclosure review, inspection, and policymaking roles.

A registrant is required to disclose the information specified by Form N-CSR, and the Commission will make this information public. A registrant is not required to respond to the collection of information contained in Form N-CSR unless the Form displays a currently valid Office of Management and Budget ("OMB") control number. Please direct comments concerning the accuracy of the information collection burden estimate and any suggestions for reducing the burden to Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609. The OMB has reviewed this collection of information under the clearance requirements of 44 U.S.C. Section 3507.



ITEM 1. REPORTS TO STOCKHOLDERS.

The Fund's annual report transmitted to shareholders pursuant to Rule 30e-1 under the Investment Company Act of 1940 is as follows:

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**2008 Annual Report**

October 31, 2008

Morgan Stanley  
Emerging Markets  
Domestic Debt Fund, Inc.  
(EDD)

Morgan Stanley

Investment Management Inc.

Investment Adviser

**Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.**

Overview (unaudited)

## Letter to Stockholders

### Performance

For the year ended October 31, 2008, the Morgan Stanley Emerging Markets Domestic Debt Fund, Inc. (the Fund) had total returns of -27.22%, based on net asset value and -39.43% based on market value per share (including reinvestment of distributions), compared to its benchmark, the JPMorgan Government Bond Index - Emerging Markets Global Diversified Index (the Index) which returned -15.16%. On October 31, 2008, the closing price of the Fund's shares on the New York Stock Exchange was \$9.70, representing a 23.1% discount to the Fund's net asset value per share. Past performance is no guarantee of future results.

### Factors Affecting Performance

- Deleveraging, manic risk aversion and capitulation (that is, panic selling) drove the turmoil in emerging markets (EM) debt markets during the latter part of the 12-month review period. While the economic fundamentals of most EM countries were quite solid coming into the latter part of the measurement period, the shock emanating from the developed world proved too big to escape. The credit crunch, with its roots in the U.S., took on a more disorderly and global footprint over the last few months, infecting economies both developed and emerging.
- Nearly all financial markets sold off in a chaotic fashion during the month of October with record high levels of volatility, illiquidity and contagion. The strong balance sheets, favorable external balances, high liquidity and low leverage in EM economies proved insufficient to fend off this more aggressive strain of the global financial crisis. Expectations for global growth collapsed during the month of October, as did commodity prices and most financial assets. In this environment, EM local currency debt markets suffered sharp declines.
- Positive contributors to relative performance versus the Index included an overweight exposure to Nigeria, Kazakhstan and Venezuela; security selection in Chile and Peru also aided relative returns.
- The Nigerian Naira, despite the marked sell-off in several EM currencies, remained firm versus the U.S. Dollar during the period. In addition, the Nigerian government lowered its 2009 budget oil price assumption to \$45 per barrel, a prudent move that was lauded by markets and supportive of asset prices.
- In mid-October, the Fund accumulated a position in dollar-denominated Venezuelan bonds yielding more than 24%. We believe Venezuelan bonds came under pressure due more to forced selling by leveraged investors at fire sale prices than to fundamental factors. Although an element of this forced selling occurred throughout EM debt markets, it was especially acute in Venezuela, where prices have since recovered.

- Detractors from relative gains included overweights in Argentina, Egypt, and Indonesia. The Fund's below-Index exposure to Malaysia also detracted from relative returns.

#### **Management Strategies**

- We believe that most emerging economies can navigate through the current financial crisis and the widely expected global recession in 2009. Lower global growth would undoubtedly reduce global trade, impairing both emerging countries' export volumes and commodity prices. At the same time, tighter global financial conditions will likely reduce capital inflows to emerging countries. We believe EM countries—especially those in need of significant external funding—are likely to adjust to more hostile global conditions through lower domestic growth and weaker real exchange rates (to reduce imports).

**Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.**

Overview (cont d)

## Letter to Stockholders (cont d)

- However, the relative stability of the systemically important EM economies that account for the vast majority of EM demand should lessen the overall impact on EM growth relative to earlier crises. In contrast to the situation in 1997-1998, a majority of emerging economies today enjoy ample reserves and lower external debt, along with greater policymaking flexibility. A recession in developed countries would definitely take its toll on EM growth prospects but would not necessarily cause a collapse, in our opinion.
- Undoubtedly, a low global growth environment is negative for emerging economies. In our opinion, the wild gyrations in developed financial markets and risk aversion have overwhelmed the role that fundamentals usually play in anchoring asset prices. On purely fundamental metrics, we find significant pockets of value in the emerging debt markets. We believe sovereign risk premiums are too high relative to the economies' debt servicing capacity and yields in domestic fixed income markets are too high relative to the expected inflation and growth dynamics in most of the emerging economies. However, the picture on the foreign exchange side of the story is more mixed, as there is greater risk of an overshoot relative to fundamental valuations as these economies adjust.
- Unfortunately, it is difficult to imagine a convergence to fair value without financial markets in the developed world normalizing and the recent bout of extreme risk aversion dissipating. Furthermore, the longer the financial crisis lingers the higher the risk that economic fundamentals in emerging markets – and hence EM fundamental asset valuations – will likely weaken. However, we believe that the risk of a very negative outcome has become less likely in our view due to the magnitude of the policy response in both the developed and emerging world. As markets work through the deleveraging process they will eventually normalize. Now, most EM assets are declining in tandem, creating good opportunities to add exposures to those EM countries that we believe to be best positioned to weather the financial storm.

Sincerely,

Randy Takian





**Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.**

October 31, 2008

## Investment Advisory Agreement Approval (unaudited)

### **Nature, Extent and Quality of Services**

The Board reviewed and considered the nature and extent of the investment advisory services provided by the Adviser under the Advisory Agreement, including portfolio management, investment research and equity and fixed income securities trading. The Board also reviewed and considered the nature and extent of the non-advisory, administrative services provided by the Adviser under the Administration Agreement, including accounting, clerical, bookkeeping, compliance, business management and planning, and the provision of supplies, office space and utilities at the Adviser's expense. (The Advisory and Administration Agreements together are referred to as the Management Agreement.) The Board also compared the nature of the services provided by the Adviser with similar services provided by non-affiliated advisers as reported to the Board by Lipper Inc. (Lipper).

The Board reviewed and considered the qualifications of the portfolio managers, the senior administrative managers and other key personnel of the Adviser who provide the advisory and administrative services to the Fund. The Board determined that the Adviser's portfolio managers and key personnel are well qualified by education and/or training and experience to perform the services in an efficient and professional manner. The Board concluded that the nature and extent of the advisory and administrative services provided were necessary and appropriate for the conduct of the business and investment activities of the Fund. The Board also concluded that the overall quality of the advisory and administrative services was satisfactory.

### **Performance Relative to Comparable Funds Managed by Other Advisers**

On a regular basis, the Board reviews the performance of all funds in the Morgan Stanley Fund Complex, including the Fund, compared to their peers, paying specific attention to the underperforming funds. In addition, the Board specifically reviewed the Fund's performance for the one-year period ended April 30, 2008, as shown in a report provided by Lipper (the Lipper Report), compared to the performance of comparable funds selected by Lipper (the performance peer group). The Board also discussed with the Adviser the performance goals and the actual results achieved in managing the Fund. The Board concluded that the Fund's performance was competitive with that of its performance peer group.

### **Fees Relative to Other Proprietary Funds Managed by the Adviser with Comparable Investment Strategies**

The Board noted that the Adviser did not manage any other proprietary funds with investment strategies comparable to those of the Fund.

### **Fees and Expenses Relative to Comparable Funds Managed by Other Advisers**

The Board reviewed the advisory and administrative fee (together, the management fee ) rate and total expense ratio of the Fund as compared to the average management fee rate and average total expense ratio for funds, selected by Lipper (the expense peer group ), managed by other advisers with investment strategies comparable to those of the Fund, as shown in the Lipper Report. The Board concluded that the Fund's management fee rate and total expense ratio were acceptable given the services provided.

**Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.**

October 31, 2008

## Investment Advisory Agreement Approval (cont'd)

### **Breakpoints and Economies of Scale**

The Board reviewed the structure of the Fund's management fee schedule under the Management Agreement and noted that it does not include breakpoints. The Board considered that the Fund is a closed-end fund and, therefore, that the Fund's assets are not likely to grow with new sales or grow significantly as a result of capital appreciation. The Board concluded that economies of scale for the Fund were not a factor that needed to be considered at the present time.

### **Profitability of the Adviser and Affiliates**

The Board considered information concerning the costs incurred and profits realized by the Adviser and affiliates during the last year from their relationship with the Fund and during the last two years from their relationship with the Morgan Stanley Fund Complex and reviewed with the Adviser the cost allocation methodology used to determine the profitability of the Adviser and affiliates. Based on its review of the information it received, the Board concluded that the profits earned by the Adviser and affiliates were not excessive in light of the advisory, administrative and other services provided to the Fund.

### **Fall-Out Benefits**

The Board considered so-called "fall-out benefits" derived by the Adviser and affiliates from their relationship with the Fund and the Morgan Stanley Fund Complex, such as commissions on the purchase and sale of Fund shares and "float" benefits derived from handling of checks for purchases and sales of Fund shares, through a broker-dealer affiliate of the Adviser. The Board also considered that, from time to time, the Adviser may, directly or indirectly, effect trades on behalf of certain Morgan Stanley Funds through various electronic communications networks or other alternative trading systems in which the Adviser's affiliates have ownership interests and/or board seats. The Board concluded that the sales commissions were competitive with those of other broker-dealers and the fall-out benefits were relatively small.

### **Soft Dollar Benefits**

The Board considered whether the Adviser realizes any benefits from commissions paid to brokers who execute securities transactions for the Fund ("soft dollars"). The Board noted that the Fund invests only in fixed income securities, which do not generate soft dollars.

**Adviser Financially Sound and Financially Capable of Meeting the Fund's Needs**

The Board considered whether the Adviser is financially sound and has the resources necessary to perform its obligations under the Management Agreement. The Board concluded that the Adviser has the financial resources necessary to fulfill its obligations under the Management Agreement.

**Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.**

October 31, 2008

## Investment Advisory Agreement Approval (cont'd)

### **Historical Relationship Between the Fund and the Adviser**

The Board also reviewed and considered the historical relationship between the Fund and the Adviser, including the organizational structure of the Adviser, the policies and procedures formulated and adopted by the Adviser for managing the Fund's operations and the Board's confidence in the competence and integrity of the senior managers and key personnel of the Adviser. The Board concluded that it is beneficial for the Fund to continue its relationship with the Adviser.

### **Other Factors and Current Trends**

The Board considered the controls and procedures adopted and implemented by the Adviser and monitored by the Fund's Chief Compliance Officer and concluded that the conduct of business by the Adviser indicates a good faith effort on its part to adhere to high ethical standards in the conduct of the Fund's business.

### **General Conclusion**

After considering and weighing all of the above factors, the Board concluded that it would be in the best interest of the Fund and its shareholders to approve renewal of the Management Agreement for another year.

## Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.

October 31, 2008

## Portfolio of Investments

(Showing Percentage of Total Value of Investments)

|   |     | Face Amount<br>(000) | Value<br>(000) |
|---|-----|----------------------|----------------|
| <b>Debt Instruments (95.7%)</b>   |     |                      |                |
| <b>Brazil (17.8%)</b>   |     |                      |                |
| <b>Sovereign (17.8%)</b>  |     |                      |                |
| Brazil Notas do Tesouro Nacional,<br>10.00%, 7/1/10   | BRL | 109,030              | \$ 45,782      |
| Brazil Notas do Tesouro Nacional, Series F,<br>10.00%, 1/1/14                                 |     | 494,989              | 172,408        |
|   |     |                      | 218,190        |
| <b>Colombia (2.8%)</b>  |     |                      |                |
| <b>Sovereign (2.8%)</b>   |     |                      |                |
| Jupiter, S.p.V., Colombian Peso Linked Bonds,<br>13.50%, 9/15/14                              | \$  | 75,000               | 33,857         |
| <b>Egypt (3.6%)</b>   |     |                      |                |
| <b>Sovereign (3.6%)</b>   |     |                      |                |
| Arab Republic of Egypt,<br>8.75%, 7/18/12   | EGP | 332,700              | 44,819         |
| <b>Hungary (7.0%)</b>   |     |                      |                |
| <b>Sovereign (7.0%)</b>   |     |                      |                |
| Republic of Hungary,<br>6.25%, 8/24/10  | HUF | 10,750,000           | 46,944         |
| 6.75%, 2/24/17  |     | 4,834,840            | 18,880         |
| 7.25%, 6/12/12  |     | 4,776,500            | 19,915         |
|   |     |                      | 85,739         |
| <b>Indonesia (7.7%)</b>   |     |                      |                |
| <b>Corporate (0.9%)</b>   |     |                      |                |
| Pindo Deli Finance Mauritius,<br>Tranche A, 5.43%, 4/28/15 - 4/28/18(c)(d)                    | \$  | 9,727                | 3,967          |
| Tranche B, 5.43%, 4/28/15(c)  |     | 137                  | 99             |
| Tranche C, Zero Coupon, 4/28/25   |     | 2,227                | 167            |
| Tjiwi Kimia Finance Mauritius Ltd., Tranche A, 5.53%, 4/28/15 - 4/28/18(c)(d)                 |     | 13,512               | 6,469          |
| Tranche B, 5.43%, 4/28/15(c)  |     | 627                  | 461            |
| Tranche C, Zero Coupon, 4/28/27(d)  |     | 998                  | 80             |
|   |     |                      | 11,243         |
| <b>Sovereign (6.8%)</b>   |     |                      |                |
| Barclays Bank plc, Indonesian Government Bond Linked Notes,<br>10.00%, 7/17/17                | IDR | 750,000,000          | 47,060         |
| Citigroup, Inc., Indonesian Indexed Credit Linked Unsecured Notes,<br>Zero Coupon, 7/19/17    | \$  | 28,828               | 14,432         |
| Credit Suisse, Republic of Indonesia Government Bonds Credit Linked Notes,<br>10.00%, 7/17/17 | IDR | 154,683,530          | 9,706          |
| JPMorgan Chase & Co., London, Indonesian Treasury Bill Linked Notes,<br>10.00%, 7/15/17       |     | 192,525,000          | 11,788         |

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|  |     |           |         |
|--|-----|-----------|---------|
|  |     |           | 82,986  |
|  |     |           | 94,229  |
| <b>Malaysia (2.4%)</b>                                   |     |           |         |
| <b>Sovereign (2.4%)</b>                                  |     |           |         |
| Government of Malaysia, 3.72%, 6/15/12                   | MYR | 105,000   | 29,258  |
| <b>Mexico (16.7%)</b>                                    |     |           |         |
| <b>Sovereign (16.7%)</b>                                 |     |           |         |
| Mexican Bonos,   |     |           |         |
| 7.75%, 12/14/17  |     | 1,561,924 | 114,078 |
| 8.00%, 12/17/15  |     | 101,200   | 7,547   |
| 9.50%, 12/18/14  |     | 360,000   | 28,982  |
| 10.00%, 11/20/36   | MXN | 620,000   | 54,710  |
|  |     |           | 205,317 |
| <b>Multi-Country (2.1%)</b>                              |     |           |         |
| <b>Sovereign (2.1 %)</b>                                 |     |           |         |
| Standard Bank plc, African Currency Basket Linked Bonds, |     |           |         |
| Zero Coupon, 12/15/08                                    | \$  | 30,000    | 25,545  |

The accompanying notes are an integral part of the financial statements.

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## Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.

October 31, 2008

## Portfolio of Investments (cont d)

(Showing Percentage of Total Value of Investments)

|  |     | Face Amount<br>(000) | Value<br>(000)   |
|--|-----|----------------------|------------------|
| <b>Nigeria (2.0%)</b>  |     |                      |                  |
| <b>Corporate (2.0%)</b>  |     |                      |                  |
| Shell Petroleum Development Co., Credit Linked Notes,<br>Zero Coupon, 11/19/08 - 5/15/09 | \$  | 28,201               | \$ 24,402        |
| <b>South Africa (10.2%)</b>  |     |                      |                  |
| <b>Sovereign (10.2%)</b>   |     |                      |                  |
| Republic of South Africa,<br>13.00%, 8/31/10   | ZAR | 1,159,000            | 124,947          |
| <b>Thailand (9.7%)</b>   |     |                      |                  |
| <b>Sovereign (9.7%)</b>  |     |                      |                  |
| Kingdom of Thailand,<br>4.25%, 3/13/13   | THB | 2,203,720            | 64,860           |
| 5.25%, 7/13/13   |     | 1,766,120            | 54,177           |
|  |     |                      | 119,037          |
| <b>Turkey (12.5%)</b>  |     |                      |                  |
| <b>Sovereign (12.5%)</b>   |     |                      |                  |
| Republic of Turkey,<br>Zero Coupon, 8/5/09 - 4/14/10                                     | TRY | 292,424              | 140,435          |
| 16.00%, 3/7/12   |     | 24,060               | 12,828           |
|  |     |                      | 153,263          |
| <b>Venezuela (1.2%)</b>  |     |                      |                  |
| <b>Sovereign (1.2%)</b>  |     |                      |                  |
| Government of Venezuela,<br>9.25%, 5/7/28  | \$  | 32,000               | 14,880           |
| <b>Total Debt Instruments (Cost \$1,530,811)</b>   |     |                      | <b>1,173,483</b> |
| <b>Loans (2.8%)</b>  |     |                      |                  |
| <b>Colombia (1.0%)</b>   |     |                      |                  |
| <b>Corporate (1.0%)</b>  |     |                      |                  |
| MFI WWB Cali,<br>12.50%, 2/28/11 (a)(b)  | COP | 15,103,760           | 6,333            |
| MFI WWB Popoyan,<br>12.50%, 2/28/11 (a)(b)   |     | 13,215,790           | 5,541            |
|  |     |                      | 11,874           |
| <b>Kazakhstan (0.6%)</b>   |     |                      |                  |
| <b>Corporate (0.6%)</b>  |     |                      |                  |
| MFI KMF,<br>15.50%, 2/28/11 (a)(b)   | KZT | 905,197              | \$ 7,548         |
| <b>Mexico (1.0%)</b>   |     |                      |                  |
| <b>Corporate (1.0%)</b>  |     |                      |                  |
| MFI Finsol,  |     |                      |                  |



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|                                      |     |         |               |
|--------------------------------------|-----|---------|---------------|
| 14.00%, 2/28/11 (a)(b)               | MXN | 161,685 | 12,565        |
| <b>Peru (0.2%)</b>                   |     |         |               |
| <b>Corporate (0.2%)</b>              |     |         |               |
| MFI Confranz, 10.40%, 2/28/11 (a)(b) | PEN | 8,672   | 2,820         |
| <b>Total Loans (Cost \$40,569)</b>   |     |         | <b>34,807</b> |

|  |                        | Shares                  | Value<br>(000) |
|--|------------------------|-------------------------|----------------|
| <b>Short-Term Investments (1.5%)</b>         |                        |                         |                |
| <b>United States (1.5%)</b>                  |                        |                         |                |
| <b>Investment Company (0.4%)</b>             |                        |                         |                |
| Morgan Stanley Institutional Liquidity Funds | Money Market Portfolio | Institutional Class (e) | 4,745,897      |
|  |                        |                         | 4,746          |

|  |    | Face Amount<br>(000) | Value<br>(000)    |
|--|----|----------------------|-------------------|
| <b>U.S. Treasury Security (1.1%)</b>                 |    |                      |                   |
| U.S. Treasury Bill, 0.35%, 1/15/09 (f)(g)            | \$ | 13,055               | 13,046            |
| <b>Total Short-Term Investments</b>                  |    |                      | <b>17,792</b>     |
| <b>(Cost \$17,781)</b>                               |    |                      |                   |
| <b>Total Investments (100.0%) (Cost \$1,589,161)</b> |    |                      | <b>1,226,082</b>  |
| <b>Liabilities in Excess of Other Assets</b>         |    |                      | <b>(302,120)</b>  |
| <b>Net Assets</b>                                    |    |                      | <b>\$ 923,962</b> |

- (a) Security has been deemed illiquid at October 31, 2008.
- (b) Securities were valued at fair value. At October 31, 2008, the Fund held approximately \$34,807,000 of fair valued securities, representing 3.8% of net assets.
- (c) Variable/Floating Rate Security. Interest rate changes on these instruments are based on changes in a designated base rate. The rates shown are those in effect on October 31, 2008.

8 The accompanying notes are an integral part of the financial statements.

## Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.

October 31, 2008

## Portfolio of Investments (cont d)

- (d) 144A security Certain conditions for public sale may exist. Unless otherwise noted, these securities are deemed to be liquid.
- (e) See Note G within the Notes to Financial Statements regarding investment in Morgan Stanley Institutional Liquidity Funds Money Market Portfolio Institutional Class.
- (f) Rate shown is the yield to maturity at October 31, 2008.
- (g) All or a portion of the security was pledged as collateral for swap agreements.

## Foreign Currency Exchange Contract Information:

The Fund had the following foreign currency exchange contract(s) open at period end:

| Currency to Deliver (000) | Value (000) | Settlement Date | In Exchange For (000) | Value (000) | Net Unrealized Appreciation (Depreciation) (000) |
|---------------------------|-------------|-----------------|-----------------------|-------------|--|
| BRL 169,900               | \$ 78,421   | 11/4/08         | USD 87,645            | \$ 87,645   | \$ 9,224   |
| BRL 169,900               | 77,530      | 12/2/08         | USD 79,244            | 79,244      | 1,714  |
| BRL 98,775                | 45,592      | 11/4/08         | USD 50,983            | 50,983      | 5,391  |
| BRL 30,705                | 14,172      | 11/4/08         | USD 13,909            | 13,909      | (263)  |
| BRL 33,330                | 15,385      | 11/4/08         | USD 14,429            | 14,429      | (956)  |
| BRL 43,465                | 20,063      | 11/4/08         | USD 20,649            | 20,649      | 586  |
| BRL 55,310                | 25,239      | 12/2/08         | USD 25,973            | 25,973      | 734  |
| COP 80,000,000            | 33,543      | 11/4/08         | USD 36,563            | 36,563      | 3,020  |
| COP 33,300,000            | 13,962      | 11/4/08         | USD 15,219            | 15,219      | 1,257  |
| COP 33,300,000            | 13,896      | 11/28/08        | USD 13,783            | 13,783      | (113)  |
| COP 80,000,000            | 33,385      | 11/28/08        | USD 33,466            | 33,466      | 81   |
| MXN 250,365               | 19,376      | 11/18/08        | USD 18,877            | 18,877      | (499)  |
| USD 80,142                | 80,142      | 11/4/08         | BRL 169,900           | 78,422      | (1,720)  |
| USD 21,099                | 21,099      | 11/4/08         | BRL 43,465            | 20,062      | (1,037)  |
| USD 13,617                | 13,617      | 11/4/08         | BRL 30,705            | 14,173      | 556  |
| USD 13,549                | 13,549      | 11/4/08         | BRL 33,330            | 15,384      | 1,835  |
| USD 46,924                | 46,924      | 11/4/08         | BRL 98,775            | 45,592      | (1,332)  |
| USD 33,684                | 33,684      | 11/4/08         | COP 80,000,000        | 33,543      | (141)  |
| USD 13,875                | 13,875      | 11/4/08         | COP 33,300,000        | 13,962      | 87   |
| USD 74,643                | 74,643      | 11/14/08        | EUR 54,616            | 69,585      | (5,058)  |
| USD 6,105                 | 6,105       | 11/10/08        | MXN 79,565            | 6,172       | 67   |
| USD 18,433                | 18,433      | 11/18/08        | MXN 250,365           | 19,377      | 944  |
| USD 20,981                | 20,981      | 11/28/08        | MXN 271,238           | 20,927      | (54)   |
|                           | \$ 733,616  |                 |                       | \$ 747,939  | \$ 14,323  |

BRL Brazilian Real  
COP Colombian Peso  
EGP Egyptian Pound  
EUR Euro  
HUF Hungarian Forint

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|     |                      |
|-----|----------------------|
| IDR | Indonesian Rupiah    |
| KZT | Kazakhstan Tenge     |
| MXN | Mexican Peso         |
| MYR | Malaysian Ringgit    |
| PEN | Peruvian Sol         |
| THB | Thailand Baht        |
| TRY | Turkish Lira         |
| USD | United States Dollar |
| ZAR | South African Rand   |

### Portfolio Composition

| <b>Classification</b>  | <b>Percentage<br/>of Total<br/>Investments</b> |
|------------------------|--|
| Sovereign              | 92.8%  |
| Corporate              | 5.7  |
| Short-Term Investments | 1.5  |
| Total Investments      | 100.0%   |

The accompanying notes are an integral part of the financial statements. 9

## Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.

October 31, 2008

## Portfolio of Investments (cont d)

## Interest Rate Swap Contracts

The Fund had the following interest rate swap agreement(s) open at period end:

| Swap Counterparty | Floating Rate Index | Pay/Receive Floating Rate | Fixed Rate | Termination Date | Notional Amount (000) | Net Unrealized Appreciation (Depreciation) (000) |
|-------------------|---------------------|---------------------------|------------|------------------|-----------------------|--|
| JPMorgan Chase    | 3 Month JIBAR       | Pay                       | 10.93%     | 8/26/10          | \$ 256,600            | \$ 94  |
|                   | MXN-TIE-Banxico     | Pay                       | 9.41       | 7/8/13           | 259,500               | 231  |
|                   | 3 Month JIBAR       | Receive                   | 9.67       | 8/27/18          | 71,600                | (285)  |
|                   |                     |                           |            |                  |                       | \$ 40  |

JIBAR Johannesburg Interbank Agreed Rate

MXN-TIE Mexican Inter Bank Equilibrium Interest Rate

## Total Return Swap Contract

The Fund had the following total return swap agreement(s) open at period end:

| Swap Counterparty | Pay                   | Receive | Termination Date | Notional Amount (000) | Net Unrealized Appreciation (Depreciation) (000) |
|-------------------|-----------------------|---------|------------------|-----------------------|--|
| Citigroup         | USD-LIBOR-BBA + 0.20% | 7.34%   | 02/13/17         | RUB 982,224           | \$ (7,949)                                       |

BBA British Bankers Association

LIBOR London Inter Bank Offer Rate

RUB Russian Ruble

10 The accompanying notes are an integral part of the financial statements.

## Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.

## Financial Statements

## Statement of Assets and Liabilities

October 31, 2008  
(000)

|   |                   |
|---|-------------------|
| <b>Assets:</b>  |                   |
| Investments in Securities of Unaffiliated Issuers, at Value (Cost \$1,584,415)                          | \$ 1,221,336      |
| Investment in Security of Affiliated Issuer, at Value (Cost \$4,746)                                    | 4,746             |
| Total Investments in Securities, at Value (Cost \$1,589,161)  | 1,226,082         |
| Cash  | 313               |
| Receivable for Investments Sold   | 135,473           |
| Interest Receivable   | 34,985            |
| Unrealized Appreciation on Foreign Currency Exchange Contracts  | 25,496            |
| Foreign Currency, at Value (Cost \$2,601)   | 2,675             |
| Unrealized Appreciation on Swap Agreements  | 325               |
| Dividends Receivable  | 181               |
| Receivable from Affiliate   | 8                 |
| Other Assets  | 51                |
| <b>Total Assets</b>   | <b>1,425,589</b>  |
| <b>Liabilities:</b>   |                   |
| Payable For:  |                   |
| Line of Credit  | 345,149           |
| Investments Purchased   | 134,107           |
| Investment Advisory Fees  | 1,106             |
| Due to Broker   | 994               |
| Custodian Fees  | 310               |
| Lehman Brothers Closed Reverse Repurchase Transactions  | 266               |
| Administration Fees   | 90                |
| Unrealized Depreciation on Foreign Currency Exchange Contracts  | 11,173            |
| Unrealized Depreciation on Swap Agreements  | 8,234             |
| Other Liabilities   | 198               |
| <b>Total Liabilities</b>  | <b>501,627</b>    |
| <b>Net Assets</b>   |                   |
| Applicable to 73,284,736 Issued and Outstanding \$0.01 Par Value Shares (100,000,000 Shares Authorized) | \$ 923,962        |
| <b>Net Asset Value Per Share</b>  | <b>\$ 12.61</b>   |
| <b>Net Assets Consist of:</b>   |                   |
| Common Stock  | \$ 733            |
| Paid-in Capital   | 1,394,082         |
| Undistributed (Distributions in Excess of) Net Investment Income  | (29,481)          |
| Accumulated Net Realized Loss   | (81,227)          |
| Unrealized Appreciation (Depreciation) on:  |                   |
| Investments   | (363,079)         |
| Foreign Currency Exchange Contracts and Translations  | 10,843            |
| Swap Agreements   | (7,909)           |
| <b>Net Assets</b>   | <b>\$ 923,962</b> |

The accompanying notes are an integral part of the financial statements.

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## Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.

## Financial Statements

|   | <b>Year Ended<br/>October 31, 2008<br/>(000)</b> |
|---|--|
| <b>Statement of Operations</b>  |  |
| <b>Investment Income:</b>   |  |
| Interest from Securities of Unaffiliated Issuers (Net of \$1 of Foreign Taxes Withheld) | \$ 191,126                                       |
| Dividends from Securities of Affiliated Issuer  | 947  |
| <b>Total Investment Income</b>  | <b>192,073</b>                                   |
| <b>Expenses:</b>  |  |
| Investment Advisory Fees (Note B)   | 17,042   |
| Administration Fees (Note C)  | 1,364  |
| Custodian Fees (Note D)   | 1,127  |
| Commitment Fee  | 169  |
| Professional Fees   | 156  |
| Stockholder Reporting Expenses  | 150  |
| Maintenance Fees on Line of Credit  | 26   |
| Directors Fees and Expenses   | 21   |
| Stockholder Servicing Agent Fees  | 6  |
| Other Expenses  | 745  |
| <b>Expenses Before Non Operating Expenses</b>   | <b>20,806</b>                                    |
| Interest Expense on Line of Credit (Note H)   | 10,359   |
| Interest Expense on Reverse Repurchase Agreements                                       | 5,401  |
| Country Tax Expense#  | 83   |
| Bank Overdraft Expense  | 9  |
| <b>Total Expenses</b>   | <b>36,658</b>                                    |
| Rebate from Morgan Stanley Affiliated Cash Sweep (Note G)                               | (33)   |
| Expense Offset (Note D)   | (1)  |
| <b>Net Expenses</b>   | <b>36,624</b>                                    |
| <b>Net Investment Income</b>  | <b>155,449</b>                                   |
| <b>Net Realized Gain (Loss) on:</b>   |  |
| Investments   | (109,753)  |
| Foreign Currency Transactions   | (20,103)   |
| Swap Agreements   | 1,677  |
| <b>Net Realized Loss</b>  | <b>(128,179)</b>                                 |
| <b>Change in Unrealized Appreciation (Depreciation) on:</b>                             |  |
| Investments   | (422,168)  |
| Foreign Currency Exchange Contracts and Translations                                    | 10,024   |
| Swap Agreements   | (9,572)  |
| <b>Change in Unrealized Appreciation (Depreciation)</b>                                 | <b>(421,716)</b>                                 |
| <b>Net Realized Loss and Change in Unrealized Appreciation (Depreciation)</b>           | <b>(549,895)</b>                                 |
| <b>Net Decrease in Net Assets Resulting from Operations</b>                             | <b>\$ (394,446)</b>                              |

# CPMF (Provisional Contribution on Financial Transactions) is a Brazilian federal tax imposed on certain banking transactions and account withdrawals. The tax is charged based on the value of the transaction.

12 The accompanying notes are an integral part of the financial statements.

## Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.

## Financial Statements

| Statements of Changes in Net Assets  | Year Ended<br>October 31,<br>2008<br>(000) | Period Ended<br>October 31,<br>2007 <sup>^</sup><br>(000) |
|--|--|---|
| <b>Increase (Decrease) in Net Assets</b>   |  |   |
| Operations:  |  |   |
| Net Investment Income  | \$ 155,449                                 | \$ 65,321   |
| Net Realized Gain (Loss)   | (128,179)                                  | 18,444  |
| Net Change in Unrealized Appreciation (Depreciation)   | (421,716)                                  | 61,571  |
| <b>Net Increase (Decrease) in Net Assets Resulting from Operations</b>   | <b>(394,446)</b>                           | <b>145,336</b>  |
| Distributions from and/or in Excess of:  |  |   |
| Net Investment Income  | (175,774)                                  | (43,991)  |
| Net Realized Gain  | (6,283)                                    |   |
| Total Distributions  | (182,057)                                  | (43,991)  |
| Capital Share Transactions:  |  |   |
| Fund Shares Sold (0 and 73,317,736 shares, Net of Expenses of \$651,000 in 2007)   |  | 1,399,618   |
| Additional Expenses Incurred from the 2007 Initial Offering  | (16)                                       |   |
| Repurchase of Shares (33,000 and 0 shares, respectively)   | (582)                                      |   |
| <b>Net Increase (Decrease) in Net Assets Resulting from Capital Share Transactions</b>   | <b>(598)</b>                               | <b>1,399,618</b>  |
| <b>Total Increase (Decrease)</b>   | <b>(577,101)</b>                           | <b>1,500,963</b>  |
| Net Assets:  |  |   |
| Beginning of Period  | 1,501,063                                  | 100   |
| <b>End of Period (Including Undistributed (Distributions in Excess of) Net Investment Income of \$(29,481) and \$36,010, respectively)</b> | <b>\$ 923,962</b>                          | <b>\$ 1,501,063</b>                                       |

<sup>^</sup> For the period April 24, 2007 (commencement of operations) to October 31, 2007.

The accompanying notes are an integral part of the financial statements.

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## Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.

## Financial Statements

|  | <b>Year Ended<br/>October 31, 2008<br/>(000)</b> |
|--|--|
| <b>Statement of Cash Flows</b>   |  |
| <b>Cash Flows From Operating Activities:</b>   |  |
| Proceeds from Sales and Maturities of Long-Term Investments  | \$ 2,160,110                                     |
| Purchase of Long-Term Investments  | (1,999,786)                                      |
| Net (Increase) Decrease in Short-Term Investments  | 5,446  |
| Net (Increase) Decrease in Foreign Currency Holdings   | (1,326)  |
| Net Realized Gain (Loss) for Foreign Currency Transactions   | (20,103)   |
| Net Realized Gain (Loss) on Swap Agreements  | 1,677  |
| Net Investment Income  | 155,449  |
| <b>Adjustments to Reconcile Net Investment Income to Net Cash Provided (Used) by Operating Activities:</b> |  |
| Net (Increase) Decrease in Receivables Related to Operations   | 8,799  |
| Net (Increase) Decrease in Payables Related to Operations  | (665)  |
| Accretion/Amortization of Discounts and Premiums   | (28,534)   |
| Net Cash Provided (Used) by Operating Activities   | 281,067  |
| <b>Cash Flows From Financing Activities:</b>   |  |
| Cash Received for Reverse Repurchase Agreements  | 5,395,579  |
| Cash Paid for Reverse Repurchase Agreements  | (5,624,105)                                      |
| Cash Received for Line of Credit   | 128,700  |
| Payment for Fund Shares Repurchased  | (582)  |
| Cash Distribution Paid   | (182,057)  |
| Net Cash Provided (Used) for Financing Activities  | (282,465)  |
| Net Increase(Decrease) in Cash   | (1,398)  |
| <b>Cash at Beginning of Period</b>   | <b>1,711</b>                                     |
| <b>Cash at End of Period</b>   | <b>\$ 313</b>                                    |
| <b>Supplemental Disclosure of Cash Flow Information:</b>   |  |
| Interest Paid on Line of Credit during the Period  | \$ 9,846   |
| Interest Paid on Reverse Repurchase Agreements during the Period   | 6,574  |

14 The accompanying notes are an integral part of the financial statements.



## Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.

## Financial Highlights

## Selected Per Share Data and Ratios

|  | Year<br>Ended<br>October 31,<br>2008 | Period from<br>April 24,<br>2007 <sup>^</sup> to<br>October 31,<br>2007 |
|--|--------------------------------------|---|
| <b>Net Asset Value, Beginning of Period</b>                              | \$ 20.47                             | \$ 19.10  |
| Net Investment Income  | 2.12                                 | 0.90  |
| Net Realized and Unrealized Gain (Loss) on Investments                   | (7.49)                               | 1.07  |
| Total from Investment Operations   | (5.37)                               | 1.97  |
| Distributions from and/or in excess of:                                  |                                      |   |
| Net Investment Income  | (2.40)                               | (0.60)  |
| Net Realized Gain  | (0.09)                               |   |
| Total Distributions  | (2.49)                               | (0.60)  |
| Anti-Dilutive Effect of Share Repurchase Program                         | 0.00 @                               |   |
| <b>Net Asset Value, End of Period</b>                                    | \$ 12.61                             | \$ 20.47  |
| <b>Per Share Market Value, End of Period</b>                             | \$ 9.70                              | \$ 18.93  |
| <b>TOTAL INVESTMENT RETURN:</b>  |                                      |   |
| Market Value   | (39.43)%                             | (2.46)%#  |
| Net Asset Value (1)  | (27.22)%                             | 10.77%#   |
| <b>RATIOS, SUPPLEMENTAL DATA:</b>  |                                      |   |
| <b>Net Assets, End of Period (Thousands)</b>                             | \$ 923,962                           | \$ 1,501,063  |
| Ratio of Expenses to Average Net Assets                                  | 2.80%+                               | 3.24%*+   |
| Ratio of Expenses to Average Net Assets Excluding Non Operating Expenses | 1.59%+                               | 2.21%*+   |
| Ratio of Net Investment Income to Average Net Assets                     | 11.90%+                              | 8.88%*+   |
| Portfolio Turnover Rate  | 130%                                 | 58%#  |

<sup>^</sup> Commencement of Operations

Per share amount is based on average shares outstanding.

@ Amount is less than \$0.005 per share.

# Not Annualized

(1) Total investment return based on net asset value per share reflects the effects of changes in net asset value on the performance of the Fund during each period, and assumes dividends and distributions, if any, were reinvested. This percentage is not an indication of the performance of a stockholder's investment in the Fund based on market value due to differences between the market price of the stock and the net asset value per share of the Fund.

+ Reflects rebate of certain Fund expenses in connection with the investments in Morgan Stanley Institutional Liquidity Funds Money Market Portfolio Institutional Class during the period. As a result of such rebate, the expenses as a percentage of its net assets were effected by less than 0.005% and approximately 0.01% for the years ended October 31, 2008 and 2007, respectively.

\* Annualized

The accompanying notes are an integral part of the financial statements. 15

**Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.**

October 31, 2008

## Notes to Financial Statements

The Morgan Stanley Emerging Markets Domestic Debt Fund, Inc. (the Fund) was incorporated in Maryland on January 25, 2007 and is registered as a non-diversified, closed-end management investment company under the Investment Company Act of 1940, as amended (the 1940 Act). The Fund's primary investment objective is to seek a high level of current income, with a secondary investment objective of long-term capital appreciation. The Fund seeks to achieve its investment objectives by investing, under normal circumstances, at least 80% of its managed assets in emerging markets domestic debt.

The Fund is authorized to issue 100,000,000 shares of \$0.01 par value common stock and 50,000,000 shares of \$0.01 par value preferred stock. The Fund had no operations until April 24, 2007, other than matters relating to its organization and registration and sale and issuance to Morgan Stanley Investment Management Inc. (the Adviser or MS Investment Management) of 5,236 shares of common stock at an aggregate purchase price of \$100,000. The Adviser, on behalf of the Fund, will incur all of the Fund's organizational costs, estimated at \$10,000. The Adviser also has agreed to pay the amount by which the offering costs of the Fund (other than the sales load) exceed \$0.04 per share of the Fund's common shares. The aggregate offering expenses (other than the sales load) were \$667,000 (including amounts to be paid by the Adviser). On April 24, 2007, the Fund sold 63,750,000 common shares in an initial public offering. Proceeds to the Fund were \$1,217,025,000 after deducting underwriting commissions and \$600,000 of offering expenses. On May 7, 15 and 29, 2007 the Fund sold 6,000,000, 2,000,000 and 1,562,500 common shares, respectively, pursuant to an over allotment agreement with the underwriters for net proceeds of \$182,643,750 after deducting underwriting commissions and \$16,000 of additional expenses incurred in 2008 related to the 2007 offering.

**A. Accounting Policies:** The following significant accounting policies are in conformity with U.S. generally accepted accounting principles. Such policies are consistently followed by the Fund in the preparation of its financial statements. U.S. generally accepted accounting principles may require management to make estimates and assumptions that affect the reported amounts and disclosures in the financial statements. Actual results may differ from those estimates.

**1. Security Valuation:** Bonds and other fixed income securities may be valued according to the broadest and most representative market. In addition, bonds and other fixed income securities may be valued on the basis of prices provided by a pricing service. The prices provided by a pricing service take into account broker dealer market price quotations for institutional size trading in similar groups of securities, security quality, maturity, coupon and other security characteristics as well as any developments related to the specific securities. Securities listed on a foreign exchange are valued at their closing price. Unlisted securities and listed securities not traded on the valuation date for which market quotations are readily available are valued at the mean between the current bid and ask prices obtained from reputable brokers. Equity securities listed on a U.S. exchange are valued at the latest quoted sales price on the valuation date. Equity securities listed or traded on NASDAQ, for which market quotations are available, are valued at the NASDAQ Official Closing Price. Debt securities purchased with remaining maturities of 60 days or less are valued at amortized cost, if it approximates market value.

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All other securities and investments for which market values are not readily available, including restricted securities, and those securities for which it is inappropriate to determine prices in accordance with the aforementioned procedures, are valued at fair value as determined in good faith under procedures adopted by the Board of Directors (the Director ), although the actual calculations may be done by others. Factors considered in making this determination may include, but are not limited to, information obtained by contacting the issuer, analysts, or the appropriate stock exchange (for exchange-traded securities), analysis of the issuer's financial statements or other available documents and, if necessary, available information concerning other securities in similar circumstances.

Most foreign markets close before the New York Stock Exchange (NYSE). Occasionally, developments that could affect the closing prices of securities and other assets may occur between the times at which valuations of such securities are determined (that is, close of the foreign market on which the securities trade) and the close of business on the NYSE. If these developments are expected to materially affect the value of the securities, the valuations may be adjusted to reflect the estimated fair value as of the close of the NYSE, as determined in good faith under procedures established by the Directors.

**2. Reverse Repurchase Agreements:** The Fund may enter into reverse repurchase agreements with institutions that the Fund's investment adviser has determined are

**Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.**

October 31, 2008

## Notes to Financial Statements (cont d)

creditworthy. Under a reverse repurchase agreement, the Fund sells securities and agrees to repurchase them at a mutually agreed upon date and price. Reverse repurchase agreements involve the risk that the market value of the securities purchased with the proceeds from the sale of securities received by the Fund may decline below the price of the securities the Fund is obligated to repurchase. Reverse repurchase agreements also involve credit risk with the counterparty to the extent that the value of securities subject to repurchase exceed the Fund's liability under the reverse repurchase agreement. Securities subject to repurchase under reverse repurchase agreements, if any, are designated as such in the Portfolio of Investments.

At October 31, 2008, the Fund did not have any outstanding reverse repurchase agreements.

**3. Foreign Currency Translation:** The books and records of the Fund are maintained in U.S. dollars. Foreign currency amounts are translated into U.S. dollars at the mean of the bid and asked prices of such currencies against U.S. dollars last quoted by a major bank as follows:

investments, other assets and liabilities at the prevailing rate of exchange on the valuation date;

investment transactions and investment income at the prevailing rate of exchange on the dates of such transactions.

Although the net assets of the Fund are presented at the foreign exchange rates and market values at the close of the period, the Fund does not isolate that portion of the results of operations arising as a result of changes in the foreign exchange rates from the fluctuations arising from changes in the market prices of the securities held at period end. Similarly, the Fund does not isolate the effect of changes in foreign exchange rates from the fluctuations arising from changes in the market prices of securities sold during the period. Accordingly, realized and unrealized foreign currency gains (losses) due to securities transactions are included in the reported net realized and unrealized gains (losses) on investment transactions and balances.

Net realized gains (losses) on foreign currency transactions represent net foreign exchange gains (losses) from sales and maturities of foreign currency exchange contracts, disposition of foreign currencies, currency gains or losses realized between the trade and settlement dates on securities transactions, and the difference between the amount of investment income and foreign withholding taxes recorded on the Fund's books and the U.S. dollar equivalent amounts actually received or paid. Net unrealized currency gains (losses) from valuing foreign currency denominated assets and liabilities at period end exchange rates are reflected as a component of unrealized appreciation (depreciation) on investments and foreign currency translations in the Statement of Assets and Liabilities. The change in net unrealized currency gains (losses) on foreign currency translations for the period is reflected in the Statement of Operations.

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A significant portion of the Fund's managed assets consist of securities of issuers located in emerging markets or which are denominated in foreign currencies. Such investments may be concentrated in a limited number of countries and regions and may vary throughout the year. Changes in currency exchange rates will affect the value of and investment income from foreign currency denominated securities. Emerging market securities are often subject to greater price volatility, limited capitalization and liquidity, and higher rates of inflation than U.S. securities. In addition, emerging market securities may be subject to substantial governmental involvement in the economy and greater social, economic and political uncertainty.

**4. Derivatives:** The Fund may use derivatives to achieve its investment objectives. The Fund may engage in transactions in futures contracts on foreign currencies, securities or stock indices, as well as in options, swaps and structured products. Consistent with the Fund's investment objectives and policies, the Fund may use derivatives for non-hedging as well as hedging purposes.

Following is a description of derivative instruments that the Fund has utilized and their associated risks:

**Foreign Currency Exchange Contracts:** The Fund may enter into foreign currency exchange contracts to attempt to protect securities and related receivables and payables against changes in future foreign exchange rates and, in certain situations, to gain exposure to a foreign currency. A foreign currency exchange contract is an agreement between two parties to buy or sell currency at a set price on a future date. The market value of the contract will fluctuate with changes in currency exchange rates. The contract is marked-to-market daily and the change in market value is recorded by the Fund as unrealized gain or loss. The Fund records realized gains or losses when

**Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.**

October 31, 2008

## Notes to Financial Statements (cont d)

the contract is closed equal to the difference between the value of the contract at the time it was opened and the value at the time it was closed. Risk may arise upon entering into these contracts from the potential inability of counterparties to meet the terms of their contracts and is generally limited to the amount of unrealized gain on the contracts, if any, at the date of default. Risks may also arise from unanticipated movements in the value of a foreign currency relative to the U.S. dollar.

**Purchased & Written Options:** The Fund may write covered call and put options on portfolio securities and other financial instruments. Premiums are received and are recorded as liabilities. The liabilities are subsequently adjusted to reflect the current value of the options written. Premiums received from writing options which expire are treated as realized gains. Premiums received from writing options which are exercised or are closed are added to or offset against the proceeds or amount paid on the transaction to determine the net realized gain or loss. By writing a covered call option, the Fund, in exchange for the premium, foregoes the opportunity for capital appreciation above the exercise price should the market price of the underlying security increase. By writing a put option, the Fund, in exchange for the premium, accepts the risk of having to purchase a security at an exercise price that is above the current market price.

The Fund may purchase call and put options on its securities or other financial instruments. The Fund may purchase call options to protect against an increase in the price of the security or financial instrument it anticipates purchasing. The Fund may purchase put options on securities which it holds or other financial instruments to protect against a decline in the value of the security or financial instrument or to close out covered written put positions. Risks may arise from an imperfect correlation between the change in market value of the securities purchased or sold by the Fund and from the possible lack of a liquid secondary market for an option. The maximum exposure to loss for any purchased option is limited to the premium initially paid for the option.

At October 31, 2008, the Fund did not have any outstanding options written.

**Securities Sold Short:** The Fund may sell securities short. A short sale is a transaction in which the Fund sells securities it may or may not own, but has borrowed, in anticipation of a decline in the market price of the securities. The Fund is obligated to replace the borrowed securities at their market price at the time of replacement. The Fund may have to pay a premium to borrow the securities as well as pay any dividends or interest payable on the securities until they are replaced. The Fund's obligation to replace the securities borrowed in connection with a short sale will generally be secured by collateral deposited with the broker that consists of cash, U.S. government securities or other liquid, high grade debt obligations. In addition, the Fund will either place in a segregated account with its custodian or denote on its custody records an amount of cash, U.S. government securities or other liquid high grade debt obligations equal to the difference, if any, between (1) the market value of the securities sold at the time they were sold short and (2) any cash, U.S. government securities or other liquid high grade debt obligations deposited as collateral with the broker in connection with the short sale (not including the proceeds of the short sale). Short sales by the Fund involve certain risks and special considerations. Possible losses from short sales differ from losses that could be incurred from a purchase of a security because losses from short sales may be unlimited, whereas losses from purchases cannot exceed the total amount invested.

**Structured Securities:** The Fund may invest in interests in entities organized and operated solely for the purpose of restructuring the investment characteristics of sovereign debt obligations. This type of restructuring involves the deposit with or purchase by an entity of specified

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instruments and the issuance by that entity of one or more classes of securities ( Structured Securities ) backed by, or representing interests in, the underlying instruments. Structured Securities generally will expose the Fund to credit risks of the underlying instruments as well as of the issuer of the Structured Security. Structured Securities are typically sold in private placement transactions with no active trading market. Investments in Structured Securities may be more volatile than their underlying instruments, however, any loss is limited to the amount of the original investment.

Over-the-Counter Trading: Securities and other derivative instruments that may be purchased or sold by the Fund may consist of instruments not traded on an exchange. The risk of nonperformance by the obligor on such an instrument may be greater, and the ease with which the Fund can dispose of or enter into closing transactions with respect to such an instrument may be



**Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.**

October 31, 2008

## Notes to Financial Statements (cont d)

less, than in the case of an exchange-traded instrument. In addition, significant spreads may exist between bid and ask prices for derivative instruments that are not traded on an exchange. Derivative instruments not traded on exchanges are also not subject to the same type of government regulation as exchange traded instruments, and many of the protections afforded to participants in a regulated environment may not be available in connection with such transactions.

**Swap Agreements:** The Fund may enter into swap agreements to exchange the interest rate on, or return generated by, one nominal instrument for the return generated by another nominal instrument. Securities designated as collateral for swap agreements, if any, are designated as such in the Portfolio of Investments. Cash collateral for swap agreements, if applicable, is deposited with the broker serving as counterparty to the agreement, and is included in Due from (to) Broker on the Statement of Assets and Liabilities. The following summarizes swaps entered into by the Fund:

*Credit Default Swaps:* Credit default swaps involve commitments to pay a fixed rate in exchange for payment if a credit event affecting a third party (the referenced company) occurs. Credit events may include a failure to pay interest, bankruptcy, or restructuring. The Fund accrues for interim payments on swap contracts on a daily basis, with the net amount recorded within unrealized appreciation (depreciation) of swap contracts on the Statement of Assets and Liabilities. Once interim payments are settled in cash, the net amount is recorded within realized gain (loss) on swaps in the Statement of Operations. Credit default swaps are marked-to-market daily based upon quotations from market makers and the change, if any, is recorded as unrealized appreciation or depreciation in the Statement of Operations.

*Interest Rate Swaps:* Interest rate swaps involve the exchange of commitments to pay and receive interest based on a notional principal amount. The Fund accrues for interim payments on swap contracts on a daily basis, with the net amount recorded within unrealized appreciation (depreciation) of swap contracts on the Statement of Assets and Liabilities. Once interim payments are settled in cash, the net amount is recorded within realized gain (loss) on swaps on the Statement of Operations. In a zero-coupon interest rate swap, payments only occur at maturity, at which time one counterparty pays the total compounded fixed rate over the life of the swap and the other pays the total compounded floating rate that would have been earned had a series of LIBOR investments been rolled over through the life of the swap. The Fund amortizes its interest payment obligation over the life of the swap. The amortized portion of this payment is recorded in the Statement of Operations as an adjustment to interest income. The unamortized portion of this payment is included in Due from (to) Broker on the Statement of Assets and Liabilities. Interest rate swaps are marked-to market daily based upon quotations from market makers and the change, if any, is recorded as unrealized appreciation or depreciation in the Statement of Operations.

*Total Return Swaps:* Total return swaps involve commitments to pay interest in exchange for a market-linked return based on a notional amount. To the extent the total return of the security or index underlying the transaction exceeds or falls

short of the offsetting interest rate obligation, the Fund will receive a payment from or make a payment to the counterparty, respectively. Total return swaps are marked-to-market daily based upon quotations from market makers and the change, if any, is recorded as unrealized appreciation or depreciation in the Statement of Operations. Periodic payments received or made at the end of each measurement period, but prior to termination, are recorded as realized gains or losses in the Statement of Operations.

Realized gains or losses on maturity or termination of swaps are presented in the Statement of Operations. Because there is no organized market for these swap agreements, the unrealized gain (loss) reported in the Statement of Assets and Liabilities may differ from that which would be realized in the event the Fund terminated its position in the agreement. Risks may arise upon entering into these agreements from the potential inability of the counterparties to meet the terms of the agreements and are generally limited to the amount of net interest payments to be received, if any, at the date of default. Risks also arise from potential losses from adverse market movements and such losses could exceed the related amounts shown in the Statement of Assets and Liabilities.

**5. New Accounting Pronouncements:** In September 2006, Statement of Financial Accounting Standards No. 157, Fair Value Measurements ( SFAS 157 ), was issued and is effective for fiscal years beginning after November

**Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.**

October 31, 2008

## Notes to Financial Statements (cont d)

15, 2007. SFAS 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. As of October 31, 2008, the Adviser does not believe the adoption of SFAS 157 will impact the amounts reported in the financial statements, however, additional disclosures will be required about the inputs used to develop the measurements of fair value and the effect of certain measurements reported in the Statement of Operations for a fiscal period.

On March 19, 2008, Financial Accounting Standards Board released Statement of Financial Accounting Standards No. 161, Disclosures about Derivative Instruments and Hedging Activities ( SFAS 161 ). SFAS 161 requires qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair value amounts of and gains and losses on derivative instruments, and disclosures about credit-risk-related contingent features in derivative agreements. The application of SFAS 161 is required for fiscal years and interim periods beginning after November 15, 2008. At this time, management is evaluating the implications of SFAS 161 and its impact on the financial statements has not yet been determined.

**6. Other:** Security transactions are accounted for on the date the securities are purchased or sold. Realized gains (losses) on the sale of investment securities are determined on the specific identified cost basis. Interest income is recognized on the accrual basis and discounts and premiums on investments purchased are accreted or amortized in accordance with the effective yield method over their respective lives, except where collection is in doubt.

**B. Investment Advisory Fees:** MS Investment Management provides investment advisory services to the Fund under the terms of an Investment Advisory and Management Agreement (the Agreement ). Under the Agreement, the Adviser is paid a fee computed weekly and payable monthly at an annual rate of 1.00% of the Fund's average weekly managed assets.

**C. Administration Fees:** MS Investment Management also serves as Administrator to the Fund pursuant to an Administration Agreement. Under the Administration Agreement, the administration fee is 0.08% of the Fund's average weekly managed assets. Under a sub-administration agreement between the Administrator and JPMorgan Investor Services Co. ( JPMIS ), a corporate affiliate of JPMorgan Chase Bank, N.A., JPMIS provides certain administrative services to the Fund. For such services, the Administrator pays JPMIS a portion of the fee the Administrator receives from the Fund. Administration costs (including out-of-pocket expenses) incurred in the ordinary course of providing services under the Administration Agreement, except pricing services and extraordinary expenses, are covered under the administration fee.

**D. Custodian Fees:** JPMorgan Chase Bank, N.A., (the Custodian ) and its affiliates serve as Custodian for the Fund. The Custodian holds cash, securities, and other assets of the Fund as required by the 1940 Act. Custody fees are payable monthly based on assets held in custody, investment purchases and sales activity and account maintenance fees, plus reimbursement for certain out-of-pocket expenses.

The Fund has entered into an arrangement with its Custodian whereby credits realized on uninvested cash balances were used to offset a portion of the Fund's expenses. These custodian credits are shown as Expense Offset in the Statement of Operations.

**E. Federal Income Taxes:** It is the Fund's intention to continue to qualify as a regulated investment company and distribute all of its taxable income. Accordingly, no provision for Federal income taxes is required in the financial statements. Distributions to stockholders are recorded on the ex-dividend date.

The Fund may be subject to taxes imposed by countries in which it invests. Such taxes are generally based on income and/or capital gains earned or repatriated. Taxes are accrued and applied to net investment income, net realized gains and net unrealized appreciation as such income and/or gains are earned.

The Fund adopted the provisions of the FASB Interpretation number 48 *Accounting for Uncertainty in Income Taxes* ( *the Interpretation* ), on April 30, 2008. At October 31, 2008, the Fund did not have any liabilities for unrecognized tax benefits. The Fund recognizes interest and penalties, if any, related to unrecognized tax benefits as income tax expense in the Statement of Operations. During the period, the Fund did not incur any interest or penalties.

The tax year ended October 31, 2008 and the tax period ended October 31, 2007 remain subject to examination by the Internal Revenue Service and state taxing authorities. The

**Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.**

October 31, 2008

**Notes to Financial Statements (cont d)**

adoption of FIN 48 had no impact on the operations of the Fund for the year ended October 31, 2008.

The tax character of distributions paid may differ from the character of distributions shown on the Statement of Changes in Net Assets due to short-term capital gains being treated as ordinary income for tax purposes. The tax character of distributions paid during fiscal 2008 and 2007 was as follows:

|                            | <b>2008 Distributions<br/>Paid From:<br/>(000)</b> |                                       | <b>2007 Distributions<br/>Paid From:<br/>(000)</b> |                                       |
|----------------------------|--|---------------------------------------|--|---------------------------------------|
| <b>Ordinary<br/>Income</b> |  | <b>Long-term<br/>Capital<br/>Gain</b> | <b>Ordinary<br/>Income</b>                         | <b>Long-term<br/>Capital<br/>Gain</b> |
| \$182,057                  |  | \$                                    | \$43,991   | \$                                    |

The amount and character of income and capital gain distributions to be paid by the Fund are determined in accordance with federal income tax regulations, which may differ from U.S. generally accepted accounting principles. The book/tax differences are considered either temporary or permanent in nature.

Temporary differences are attributable to differing book and tax treatments for the timing of the recognition of gains and losses on certain investment transactions and the timing of the deductibility of certain expenses.

Permanent differences, primarily due to differing treatment of gains (losses) related to foreign currency transactions, foreign options, foreign futures and swap transactions, resulted in the following reclassifications among the components of net assets at October 31, 2008:

|  | <b>Increase (Decrease)</b>                                    |                                      |
|--|---|--------------------------------------|
| <b>Undistributed<br/>(Distributions in<br/>Excess of)<br/>Net Investment<br/>Income (Loss)<br/>(000)</b> | <b>Accumulated<br/>Net Realized<br/>Gain (Loss)<br/>(000)</b> | <b>Paid-in<br/>Capital<br/>(000)</b> |
| \$(45,166)   | \$49,889  | \$(4,723)                            |

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At October 31, 2008, the components of distributable earnings on a tax basis were as follows:

| <b>Undistributed Ordinary<br/>Income<br/>(000)</b> | <b>Undistributed<br/>Long-term Capital Gain<br/>(000)</b> |
|--|---|
| \$17,666   | \$  |

At October 31, 2008, the U.S. Federal income tax cost basis of investments was \$1,645,476,000 and, accordingly, net unrealized depreciation for U.S. Federal income tax purposes was \$419,394,000 of which \$5,474,000 related to appreciated securities and \$424,868,000 related to depreciated securities.

At October 31, 2008, the Fund had a capital loss carryforward for U.S. Federal income tax purposes of approximately \$65,470,000 available to offset future capital gains which will expire October 31, 2016.

**F. Contractual Obligations:** The Fund enters into contracts that contain a variety of indemnifications. The Fund's maximum exposure under these arrangements is unknown. However, the Fund has not had prior claims or losses pursuant to these contracts and expects the risk of loss to be remote.

**G. Security Transactions and Transactions with Affiliates:** The Fund invests in the Institutional Class of the Morgan Stanley Institutional Liquidity Funds Money Market Portfolio, an open-ended management investment company managed by the Adviser. Investment in Advisory fees paid by the Fund are reduced by an amount equal to its pro-rata share of advisory and administration fees paid by the Morgan Stanley Institutional Liquidity Funds Money Market Portfolio. For the year ended October 31, 2008, advisory fees paid were reduced by approximately \$33,000 relating to the Fund's investment in the Morgan Stanley Institutional Liquidity Money Market Portfolio.

A summary of the Fund's transactions in shares of the affiliated issuer during the year ended October 31, 2008 is as follows:

| Market<br>Value<br>October<br>31, 2007<br>(000) | Purchases<br>at Cost<br>(000) | Sales<br>Proceeds<br>(000) | Dividend<br>Income<br>(000) | Market<br>Value<br>October<br>31, 2008<br>(000) |
|---|-------------------------------|----------------------------|-----------------------------|---|
| \$21,731  | \$1,152,889                   | \$1,169,874                | \$947                       | \$4,746   |

**Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.**

October 31, 2008

## Notes to Financial Statements (cont d)

During the year ended October 31, 2008, the Fund made purchases and sales totaling approximately \$2,132,397,000 and \$2,294,018,000, respectively, of investment securities other than long-term U.S. Government securities and short-term investments. There were no purchases or sales of long-term U.S. Government securities.

During the year ended October 31, 2008, the Fund incurred no brokerage commissions with Morgan Stanley & Co., Incorporated, an affiliate of the Adviser.

**H. Credit Facility:** The Fund will use the proceeds from the use of leverage to purchase additional securities consistent with the Fund's investment objectives, policies and strategies. The Fund has engaged JPMorgan Securities Inc. to arrange a syndicate of lenders to provide a revolving line of credit facility in the amount of up to \$475,000,000. Pursuant to the agreement among the parties, JPMorgan Chase Bank, N.A., as lender (the Lender) has agreed to commit up to \$75,000,000 of the facility amount. The facility is expected to have the following terms and conditions, among others: The term of the facility is 364 days, which term may be extended under certain conditions. The loans under the facility will bear interest at a rate per annum, at the election of the Fund, equal to (a) the higher of (i) the Conduit Lender's prime rate and (ii) the Federal Funds Effective Rate or (b) the rate of LIBOR for the applicable interest period plus a spread of 0.30%. The loans will be secured by a fully perfected first priority lien on all of the assets of the Fund capable of being pledged. There will be a commitment fee on the unused portion of the facility in the amount of 0.08% of the average daily unused portion of the credit facility. Effective May 1, 2008 the credit facility has been amended. The Fund has engaged JPMorgan Securities Inc. to arrange a syndicate of lenders to provide a revolving line of credit facility in an amount up to \$375,000,000. The loans under the facility will bear interest at a rate per annum, at the election of the Fund, equal to (a) the higher of (i) the Conduit Lender's prime rate and (ii) the Federal Funds Effective Rate or (b) the rate of LIBOR for the applicable interest period plus a spread of 1.00%. The loans will be secured by a fully perfected first priority lien on all of the assets of the Fund capable of being pledged. There will be a commitment fee on the unused portion of the facility in the amount of 0.20% of the average daily unused portion of the credit facility. The average borrowings and interest rate for the year ended October 31, 2008 were approximately \$259,787,000 and 3.98%, respectively, during a period of 366 days. During the same period, the Fund incurred approximately \$10,359,000 in interest expense associated with the outstanding balances.

**I. Other:** On June 20, 2007, the Fund commenced a share repurchase program for purposes of enhancing stockholder value and reducing the discount at which the Fund's shares trade from their net asset value. For the year ended October 31, 2008, the Fund repurchased 33,000 of its shares at an average discount of 7.42% from the net asset value per share. Since the inception of the program, the Fund has repurchased 33,000 of its shares at an average discount of 7.42% from net asset value per share. The Fund expects to continue to repurchase its outstanding shares at such time and in such amounts as it believes will further the accomplishment of the foregoing objectives, subject to review by the Directors.

**J. Supplemental Proxy Information (unaudited):** On June 19, 2008, an annual meeting of the Fund's stockholders was held for the purpose of voting on the following matter, the results of which were as follows:

Election of Directors by all stockholders:

|                    | <b>For</b> | <b>Withhold</b> |
|--------------------|------------|-----------------|
| Frank L. Bowman    | 64,653,807 | 1,796,938       |
| Michael Bozic      | 64,595,114 | 1,855,631       |
| Kathleen A. Dennis | 64,600,677 | 1,850,068       |
| James F. Higgins   | 64,646,952 | 1,803,793       |
| Manuel H. Johnson  | 64,655,019 | 1,795,726       |
| Joseph J. Kearns   | 64,639,253 | 1,811,492       |
| Michael F. Klein   | 64,608,183 | 1,842,562       |
| Michael E. Nugent  | 64,611,901 | 1,838,844       |
| W. Allen Reed      | 64,658,875 | 1,791,870       |
| Fergus Reid        | 64,615,445 | 1,835,300       |



**Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.**

October 31, 2008

## Notes to Financial Statements (cont d)

### **For More Information About Portfolio Holdings (unaudited)**

The Fund provides a complete schedule of portfolio holdings in its semi-annual and annual reports within 60 days of the end of the Fund's second and fourth fiscal quarters. The semi-annual reports and the annual reports are filed electronically with the SEC on Form N-CSRS and Form N-CSR, respectively. Morgan Stanley also delivers the semi-annual and annual reports to Fund stockholders and makes these reports available on its public website, [www.morganstanley.com/msim](http://www.morganstanley.com/msim). Each Morgan Stanley fund also files a complete schedule of portfolio holdings with the SEC for the Fund's first and third fiscal quarters on Form N-Q. Morgan Stanley does not deliver the reports for the first and third fiscal quarters to stockholders, nor are the reports posted to the Morgan Stanley public website. You may, however, obtain the Form N-Q filings (as well as the Form N-CSR and N-CSRS filings) by accessing the SEC's website, [www.sec.gov](http://www.sec.gov). You may also review and copy them at the SEC's public reference room in Washington, DC. Information on the operation of the SEC's Public Reference Room may be obtained by calling the SEC at 1(800) SEC-0330. You can also request copies of these materials, upon payment of a duplicating fee, by electronic request at the SEC's e-mail address ([publicinfo@sec.gov](mailto:publicinfo@sec.gov)) or by writing the public reference section of the SEC, Washington, DC 20549-0102.

In addition to filing a complete schedule of portfolio holdings with the SEC each fiscal quarter, the Fund makes portfolio holdings information available by periodically providing the information on its public website, [www.morganstanley.com/msim](http://www.morganstanley.com/msim).

The Fund provides a complete schedule of portfolio holdings on the public website on a calendar-quarter basis approximately 31 calendar days after the close of the calendar quarter. The Fund also provides Top 10 holdings information on the public website approximately 15 business days following the end of each month. You may obtain copies of the Fund's monthly or calendar-quarter website postings, by calling 1(800) 231-2608.

### **Proxy Voting Policy and Procedures and Proxy Voting Record (unaudited)**

A copy of (1) the Fund's policies and procedures with respect to the voting of proxies relating to the Fund's portfolio securities; and (2) how the Fund voted proxies relating to portfolio securities during the most recent twelve-month period ended June 30, is available without charge, upon request, by calling 1 (800) 548-7786 or by visiting our website at [www.morganstanley.com/msim](http://www.morganstanley.com/msim). This information is also available on the SEC's web site at [www.sec.gov](http://www.sec.gov).

**Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.**

October 31, 2008

## Report of Independent Registered Public Accounting Firm

**To the Stockholders and Board of Directors of  
Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.:**

We have audited the accompanying statement of assets and liabilities of Morgan Stanley Emerging Markets Domestic Debt Fund, Inc., (the Fund ), including the portfolio of investments, as of October 31, 2008, and the related statements of operations and cash flows for the year then ended and the statements of changes in net assets and the financial highlights for each of the periods indicated therein. These financial statements and financial highlights are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements and financial highlights based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements and financial highlights are free of material misstatement. We were not engaged to perform an audit of the Fund's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Fund's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements and financial highlights, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our procedures included confirmation of securities owned as of October 31, 2008 by correspondence with the custodian and brokers or by other appropriate auditing procedures where replies from brokers were not received. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements and financial highlights referred to above present fairly, in all material respects, the financial position of Morgan Stanley Emerging Markets Domestic Debt Fund, Inc. at October 31, 2008, the results of its operations and cash flows for the year then ended and the changes in its net assets and the financial highlights for each of the periods indicated therein, in conformity with U.S. generally accepted accounting principles.

Boston, Massachusetts  
December 19, 2008



**Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.**

October 31, 2008

## Dividend Reinvestment Plan (unaudited)

Pursuant to the Dividend Reinvestment Plan (the "Plan"), each stockholder will be deemed to have elected, unless Computershare Trust Company, N.A. (the "Plan Agent") is otherwise instructed by the stockholder in writing, to have all distributions automatically reinvested in Fund shares.

Dividend and capital gain distributions will be reinvested on the reinvestment date in full and fractional shares. If the market price per share equals or exceeds net asset value per share on the reinvestment date, the Fund will issue shares to participants at net asset value or, if net asset value is less than 95% of the market price on the reinvestment date, shares will be issued at 95% of the market price. If net asset value exceeds the market price on the reinvestment date, participants will receive shares valued at market price. The Fund may purchase shares of its Common Stock in the open market in connection with dividend reinvestment requirements at the discretion of the Board of Directors. Should the Fund declare a dividend or capital gain distribution payable only in cash, the Plan Agent will purchase Fund shares for participants in the open market as agent for the participants.

The Plan Agent's fees for the reinvestment of dividends and distributions will be paid by the Fund. However, each participant's account will be charged a pro rata share of brokerage commissions incurred on any open market purchases effected on such participant's behalf. Although stockholders in the Plan may receive no cash distributions, participation in the Plan will not relieve participants of any income tax which may be payable on such dividends or distributions.

In the case of stockholders, such as banks, brokers or nominees, that hold shares for others who are the beneficial owners, the Plan Agent will administer the Plan on the basis of the number of shares certified from time to time by the stockholder as representing the total amount registered in the stockholder's name and held for the account of beneficial owners who are participating in the Plan.

Stockholders who do not wish to have distributions automatically reinvested should notify the Plan Agent in writing. There is no penalty for non-participation or withdrawal from the Plan, and stockholders who have previously withdrawn from the Plan may rejoin at any time. Requests for additional information or any correspondence concerning the Plan should be directed to the Plan Agent at:

Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.  
Computershare Trust Company, N.A.  
P.O. Box 43078  
Providence, Rhode Island 02940-3078  
1(800) 231-2608

**Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.**

October 31, 2008

## Morgan Stanley Institutional Closed End Funds

### An Important Notice Concerning Our

### U.S. Privacy Policy (unaudited)

We are required by federal law to provide you with a copy of our Privacy Policy annually.

The following Policy applies to current and former individual investors in Morgan Stanley Institutional closed end funds. This Policy is not applicable to partnerships, corporations, trusts or other non-individual clients or account holders. Please note that we may amend this Policy at any time, and will inform you of any changes to this Policy as required by law.

#### **We Respect Your Privacy**

We appreciate that you have provided us with your personal financial information. We strive to maintain the privacy of such information while we help you achieve your financial objectives. This Policy describes what non-public personal information we collect about you, why we collect it, and when we may share it with others. We hope this Policy will help you understand how we collect and share non-public personal information that we gather about you. Throughout this Policy, we refer to the non-public information that personally identifies you or your accounts as personal information.

#### **1. What Personal Information Do We Collect About You?**

To serve you better and manage our business, it is important that we collect and maintain accurate information about you. We may obtain this information from applications and other forms you submit to us, from your dealings with us, from consumer reporting agencies, from our Web sites and from third parties and other sources.

For example:

- We may collect information such as your name, address, e-mail address, telephone/fax numbers, assets, income and investment objectives through applications and other forms you submit to us.

- We may obtain information about account balances, your use of account(s) and the types of products and services you prefer to receive from us through your dealings and transactions with us and other sources.
- We may obtain information about your creditworthiness and credit history from consumer reporting agencies.
- We may collect background information from and through third-party vendors to verify representations you have made and to comply with various regulatory requirements.
- If you interact with us through our public and private Web sites, we may collect information that you provide directly through online communications (such as an e-mail address). We may also collect information about your Internet service provider, your domain name, your computer's operating system and Web browser, your use of our Web sites and your product and service preferences, through the use of cookies. Cookies recognize your computer each time you return to one of our sites, and help to improve our sites' content and personalize your experience on our sites by, for example, suggesting offerings that may interest you. Please consult the Terms of Use of these sites for more details on our use of cookies.

## **2. When Do We Disclose Personal Information We Collect About You?**

To provide you with the products and services you request, to serve you better and to manage our business, we may disclose personal information we collect about you to our affiliated companies and to non-affiliated third parties as required or permitted by law.

Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.

October 31, 2008

## Morgan Stanley Institutional Closed End Funds

### An Important Notice Concerning Our

### U.S. Privacy Policy (cont d)

**A. Information We Disclose to Our Affiliated Companies.** We do not disclose personal information that we collect about you to our affiliated companies except to enable them to provide services on our behalf or as otherwise required or permitted by law.

**B. Information We Disclose to Third Parties.** We do not disclose personal information that we collect about you to nonaffiliated third parties except to enable them to provide services on our behalf, to perform joint marketing agreements with other financial institutions, or as otherwise required or permitted by law. For example, some instances where we may disclose information about you to nonaffiliated third parties include: for servicing and processing transactions, to offer our own products and services, to protect against fraud, for institutional risk control, to respond to judicial process or to perform services on our behalf. When we share personal information with these companies, they are required to limit their use of personal information to the particular purpose for which it was shared and they are not allowed to share personal information with others except to fulfill that limited purpose.

### 3. How Do We Protect the Security and Confidentiality of Personal Information We Collect About You?

We maintain physical, electronic and procedural security measures to help safeguard the personal information we collect about you. We have internal policies governing the proper handling of client information. Third parties that provide support or marketing services on our behalf may also receive personal information, and we require them to adhere to confidentiality standards with respect to such information.

## Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.

October 31, 2008

## Director and Officer Information (unaudited)

## Independent Directors:

| Name, Age and Address of Independent Director  | Position(s) Held with Registrant | Length of Time Served*  | Principal Occupation(s) During Past 5 Years   | Number of Portfolios in Fund Complex Overseen by Independent Director** | Other Directorships Held by Directors   |
|--|----------------------------------|-------------------------|---|---|---|
| Frank L. Bowman (64)<br>c/o Kramer Levin<br>Naftalis & Frankel LLP<br>Counsel to the Independent<br>Directors<br>1177 Avenue of the<br>Americas<br>New York, NY 10036    | Director                         | Since<br>August<br>2006 | Formerly, President and Chief Executive Officer, Nuclear Energy Institute (policy organization) (February 2005 - November 2008); Director or Trustee of various Retail Funds and Institutional Funds (since August 2006); Chairperson of the Insurance Sub-Committee of the Insurance, Valuation and Compliance Committee (since February 2007); formerly, variously, Admiral in the U.S. Navy, Director of Naval Nuclear Propulsion Program and Deputy Administrator - Naval Reactors in the National Nuclear Security Administration at the U.S. Department of Energy (1996-2004). Honorary Knight Commander of the Most Excellent Order of the British Empire.   | 180   | Director of the National Energy Foundation, the U.S. Energy Association, the American Council for Capital Formation and the Armed Services YMCA of the USA. |
| Michael Bozic (67)<br>c/o Kramer Levin<br>Naftalis & Frankel LLP<br>Counsel to the Independent<br>Directors<br>1177 Avenue of the<br>Americas<br>New York, NY 10036      | Director                         | Since<br>April<br>1994  | Private investor; Chairperson of the Insurance, Valuation and Compliance Committee (since October 2006); Director or Trustee of the Retail Funds (since April 1994) and Institutional Funds (since July 2003); formerly, Chairperson of the Insurance Committee (July 2006-September 2006), Vice Chairman of Kmart Corporation (December 1998-October 2000), Chairman and Chief Executive Officer of Levitz Furniture Corporation (November 1995-November 1998) and President and Chief Executive Officer of Hills Department Stores (May 1991-July 1995); variously Chairman, Chief Executive Officer, President and Chief Operating Officer (1987-1991) of the Sears Merchandise Group of Sears Roebuck & Co. | 182   | Director of various business organizations.   |
| Kathleen A. Dennis (55)<br>c/o Kramer Levin<br>Naftalis & Frankel LLP<br>Counsel to the Independent<br>Directors<br>1177 Avenue of the<br>Americas<br>New York, NY 10036 | Director                         | Since<br>August<br>2006 | President, Cedarwood Associates (mutual fund and investment management) (since July 2006); Chairperson of the Money Market and Alternatives Sub-Committee of the Investment Committee (since October 2006) and Director or Trustee of various Retail Funds and Institutional Funds (since August 2006); formerly, Senior Managing Director of Victory Capital Management (1993-2006).   | 180   | Director of various non- profit organizations.  |



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|  |                 |                                |   |            |   |
|--|-----------------|--------------------------------|---|------------|---|
| <p>Dr. Manuel H. Johnson (59)<br/>c/o Johnson Smick<br/>Group, Inc.<br/>888 16th Street, N.W.<br/>Suite 740<br/>Washington, D.C. 20006</p> | <p>Director</p> | <p>Since<br/>July<br/>1991</p> | <p>Senior Partner, Johnson Smick International, Inc. (consulting firm); Chairperson of the Investment Committee (since October 2006) and Director or Trustee of the Retail Funds (since July 1991) and Institutional Funds (since July 2003); Co-Chairman and a founder of the Group of Seven Council (G7C) (international economic commission); formerly, Chairperson of the Audit Committee (July 1991-September 2006); Vice Chairman of the Board of Governors of the Federal Reserve System and Assistant Secretary of the U.S. Treasury.</p> | <p>182</p> | <p>Director of NVR, Inc. (home construction); Director of Evergreen Energy.</p> |
|--|-----------------|--------------------------------|---|------------|---|

## Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.

October 31, 2008

## Director and Officer Information (cont d)

## Independent Directors (cont d):

| Name, Age and Address of Independent Director   | Position(s) Held with Registrant      | Length of Time Served*   | Principal Occupation(s) During Past 5 Years  | Number of Portfolios in Fund Complex Overseen by Independent Director** | Other Directorships Held by Independent Director   |
|---|---------------------------------------|--|--|---|--|
| Joseph J. Kearns (66)<br>c/o Kearns & Associates LLC<br>PMB754<br>23852 Pacific Coast Highway<br>Malibu, CA 90265   | Director                              | Since August 1994  | President, Kearns & Associates LLC (investment consulting); Chairperson of the Audit Committee (since October 2006) and Director or Trustee of the Retail Funds (since July 2003) and the Institutional Funds (since August 1994); formerly Deputy Chairperson of the Audit Committee (July 2003-September 2006) and Chairperson of the Audit Committee of the Institutional Funds (October 2001- July 2003); CFO of the J. Paul Getty Trust.  | 183   | Director of Electro Rent Corporation (equipment leasing) and The Ford Family Foundation.   |
| Michael F. Klein (50)<br>c/o Kramer Levin Naftalis & Frankel LLP<br>Counsel to the Independent Directors<br>1177 Avenue of the Americas<br>New York, NY 10036 | Director                              | Since August 2006  | Managing Director, Aetos Capital, LLC (since March 2000) and Co-President, Aetos Alternatives Management, LLC (since January 2004); Chairperson of the Fixed Income Sub-Committee of the Investment Committee (since October 2006) and Director or Trustee of various Retail Funds and Institutional Funds (since August 2006); formerly, Managing Director, Morgan Stanley & Co. Inc. and Morgan Stanley Dean Witter Investment Management, President, Morgan Stanley Institutional Funds (June 1998-March 2000) and Principal, Morgan Stanley & Co. Inc. and Morgan Stanley Dean Witter Investment Management (August 1997-December 1999). | 180   | Director of certain investment funds managed or sponsored by Aetos Capital LLC; Director of Sanitized AG and Sanitized Marketing AG (specialty chemicals). |
| Michael E. Nugent (72)<br>c/o Triumph Capital, L.P.<br>445 Park Avenue<br>New York, NY 10022  | Chairperson of the Board and Director | Chairperson of the Boards since July 2006 and Director since July 1991 | General Partner of Triumph Capital, L.P. (private investment partnership); Chairman of the Boards of the Retail Funds and Institutional Funds (since July 2006); Director or Trustee of the Retail Funds (since July 1991) and Institutional Funds (since July 2001); formerly, Chairperson of the Insurance Committee (until July 2006).  | 182   | None.  |
| W. Allen Reed (61)<br>c/o Kramer Levin Naftalis & Frankel LLP<br>Counsel to the Independent Directors<br>1177 Avenue of the                                   | Director                              | Since August 2006  | Chairperson of the Equity Sub-Committee of the Investment Committee (since October 2006) and Director or Trustee of various Retail and Institutional Funds (since August 2006); formerly, President and CEO of General Motors Asset Management; Chairman and Chief   | 180   | Director of Temple-Inland Industries (packaging and forest products); Director of Legg Mason, Inc. and   |

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|  |  |   |
|--|--|---|
| Americas<br>New York, NY 10036   | Executive Officer of the GM Trust Bank and Corporate Vice President of General Motors Corporation (July 1994-December 2005).       | Director of the Auburn University Foundation.   |
| Fergus Reid (76)<br>c/o Lumelite Plastics Corporation<br>85 Charles Coleman Blvd.<br>Pawling, NY 12564 | Director<br><br>Since June 1992  | Chairman of Lumelite Plastics Corporation; Chairperson of the Governance Committee and Director or Trustee of the Retail Funds (since July 2003) and Institutional Funds (since June 1992). |
| 183  | Trustee and Director of certain investment companies in the JPMorgan Funds complex managed by JP Morgan Investment Management Inc. |   |

**Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.**

October 31, 2008

**Director and Officer Information (cont d)**

Interested Directors:

| Name, Age and Address of Interested Director   | Position(s) Held with Registrant | Term of Office and Length of Time Served* | Principal Occupation(s) During Past 5 Years  | Number of Portfolios in Fund Complex Overseen by Interested Director** | Other Directorships Held by Interested Director   |
|--|----------------------------------|---|--|--|---|
| James F. Higgins (60)<br>c/o Morgan Stanley Trust<br>Harborside Financial Center<br>Plaza Two<br>Jersey City, NJ 07311 | Director                         | Since June 2000                           | Director or Trustee of the Retail Funds (since June 2000) and Institutional Funds (since July 2003); Senior Advisor of Morgan Stanley (since August 2000). | 181  | Director of AXA Financial, Inc. and The Equitable Life Assurance Society of the United States (financial services). |

\* This is the earliest date the Directors began serving the Retail Funds or Institutional Funds. Each Director serves an indefinite term, until his or her successor is elected.

\*\* The Fund Complex includes all funds advised by Morgan Stanley Investment Management Inc. ( MSIM ) that have an investment advisor that is an affiliated entity of MSIM (including but not limited to, Morgan Stanley Investment Advisors Inc. ( MSIA ) and Morgan Stanley AIP GP LP). The Retail Funds are those funds advised by MSIA. The Institutional Funds are certain U.S. registered funds advised by MSIM and Morgan Stanley AIP GP LP.

**Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.**

October 31, 2008

**Director and Officer Information (cont d)**

## Officers:

| Name, Age and Address of Executive Officer   | Position(s) Held with Registrant          | Term of Office and Length of Time Served* | Principal Occupation(s) During Past 5 Years   |
|--|---|---|---|
| Randy Takian (34)<br>Morgan Stanley Investment Management Inc.<br>522 Fifth Avenue<br>New York, NY 10036   | President and Principal Executive Officer | Since September 2008                      | President and Principal Executive Officer (since September 2008) of funds in the Fund Complex; President and Chief Executive Officer of Morgan Stanley Services Company Inc. (since September 2008). President of Morgan Stanley Investment Advisors Inc. (since July 2008). Head of the Retail and Intermediary business within Morgan Stanley Investment Management (since July 2008). Head of Liquidity and Bank Trust business (since July 2008) and the Latin American franchise (since July 2008) at Morgan Stanley Investment Management. Managing Director, Director and/or Officer of the Adviser and various entities affiliated with the Adviser. Formerly, Head of Strategy and Product Development for the Alternatives Group and Senior Loan Investment Management. Formerly with Bank of America (July 1996-March 2006), most recently as Head of the Strategy, Mergers and Acquisitions team for Global Wealth and Investment Management. |
| Kevin Klingert (46)<br>Morgan Stanley Investment Management Inc.<br>522 Fifth Avenue<br>New York, NY 10036 | Vice President                            | Since June 2008                           | Chief Operating Officer of the Global Fixed Income Group of the Adviser and Morgan Stanley Investment Advisors Inc. (since March 2008). Head of Global Liquidity Portfolio Management and co-Head of Liquidity Credit Research of Morgan Stanley Investment Management (since December 2007). Managing Director of the Adviser and Morgan Stanley Investment Advisors Inc. (since December 2007). Previously, Managing Director on the Management Committee and head of Municipal Portfolio Management and Liquidity at BlackRock (October 1991 to January 2007).   |
| Dennis F. Shea (55)<br>Morgan Stanley Investment Management Inc.<br>522 Fifth Avenue<br>New York, NY 10036 | Vice President                            | Since February 2006                       | Managing Director and (since February 2006) Chief Investment Officer Global Equity of Morgan Stanley Investment Management; Vice President of the Retail Funds and Institutional Funds (since February 2006). Formerly, Managing Director and   |

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|  |                          |                     |  |
|--|--------------------------|---------------------|--|
|  |                          |                     | Director of Global Equity Research at Morgan Stanley.  |
| Amy R. Doberman (46)<br>Morgan Stanley Investment Management Inc.<br>522 Fifth Avenue<br>New York, NY 10036      | Vice President           | Since July 2004     | Managing Director and General Counsel, U.S. Investment Management of Morgan Stanley Investment Management (since July 2004); Vice President of the Retail Funds and Institutional Funds (since July 2004); Vice President of the Van Kampen Funds (since August 2004); Secretary (since February 2006) and Managing Director (since July 2004) of the Adviser and various entities affiliated with the Adviser. Formerly, Managing Director and General Counsel Americas, UBS Global Asset Management (July 2000-July 2004). |
| Carsten Otto (45)<br>Morgan Stanley Investment Management Inc.<br>522 Fifth Avenue<br>New York, NY 10036         | Chief Compliance Officer | Since October 2004  | Managing Director and Global Head of Compliance for Morgan Stanley Investment Management (since April 2007) and Chief Compliance Officer of the Retail Funds and Institutional Funds (since October 2004). Formerly, U.S. Director of Compliance (October 2004 - April 2007) and Assistant Secretary and Assistant General Counsel of the Retail Funds.  |
| Stefanie V. Chang Yu (42)<br>Morgan Stanley Investment Management Inc.<br>522 Fifth Avenue<br>New York, NY 10036 | Vice President           | Since December 1997 | Managing Director of the Adviser and various entities affiliated with the Adviser; Vice President of the Retail Funds (since July 2002) and Institutional Funds (since December 1997). Formerly, Secretary of various entities affiliated with the Adviser.  |
| Mary E. Mullin (41)<br>Morgan Stanley Investment Management Inc.<br>522 Fifth Avenue<br>New York, NY 10036       | Secretary                | Since June 1999     | Executive Director of the Adviser and various entities affiliated with the Adviser; Secretary of the Retail Funds (since July 2003) and Institutional Funds (since June 1999).   |

**Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.**

October 31, 2008

**Director and Officer Information (cont d)**

Officers (cont d):

| <b>Name, Age and Address of Executive Officer</b>  | <b>Position(s) Held with Registrant</b> | <b>Term of Office and Length of Time Served*</b>                          | <b>Principal Occupation(s) During Past 5 Years</b>   |
|--|---|---|--|
| James W. Garrett (40)<br>Morgan Stanley Investment Management Inc.<br>522 Fifth Avenue<br>New York, NY 10036 | Treasurer and Chief Financial Officer   | Treasurer since February 2002 and Chief Financial Officer since July 2003 | Head of Global Fund Administration; Managing Director of the Adviser and various entities affiliated with the Adviser; Treasurer and Chief Financial Officer of the Institutional Funds. |

\* This is the earliest date the Officer began serving the Retail Funds or Institutional Funds. Each Officer serves an indefinite term, until his or her successor is elected.

In accordance with Section 303A. 12(a) of the New York Stock Exchange Listed Company Manual, the Fund's Annual CEO Certification certifying as to compliance with NYSE's Corporate Governance Listing Standards was submitted to the Exchange on October 3, 2008.

The Fund's Principal Executive Officer and Principal Financial Officer Certifications required by Section 302 of the Sarbanes-Oxley Act of 2002 were filed with the Fund's N-CSR and are available on the Securities and Exchange Commission's Website at <http://www.sec.gov>.

**Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.**

**Directors**

|                       |  |
|-----------------------|--|
| Michael E. Nugent     | Kevin Klingert                                   |
| Frank L. Bowman       | <i>Vice President</i>                            |
| Michael Bozic         | Dennis F. Shea                                   |
| Kathleen A. Dennis    | <i>Vice President</i>                            |
| James F. Higgins      | Amy R. Doberman                                  |
| Dr. Manuel H. Johnson | <i>Vice President</i>                            |
| Joseph J. Kearns      | Stefanie V. Chang Yu                             |
| Michael F. Klein      | <i>Vice President</i>                            |
| W. Allen Reed         | James W. Garrett                                 |
| Fergus Reid           | <i>Treasurer and Chief<br/>Financial Officer</i> |

**Officers**

|  |                                 |
|--|---------------------------------|
| Michael E. Nugent                                    | Carsten Otto                    |
| <i>Chairman of the Board and<br/>Director</i>        | <i>Chief Compliance Officer</i> |
| Randy Takian   | Mary E. Mullin                  |
| <i>President and Principal<br/>Executive Officer</i> | <i>Secretary</i>                |

**Investment Adviser and Administrator**

Morgan Stanley Investment Management Inc.

522 Fifth Avenue

New York, New York 10036

**Custodian**

JPMorgan Chase Bank, N.A.  
270 Park Avenue  
New York, New York 10017

**Stockholder Servicing Agent**

Computershare Trust Company, N.A.  
250 Royall Street  
Canton, Massachusetts 02021

**Legal Counsel**

Clifford Chance US LLP  
31 West 52nd Street  
New York, New York 10019-6131

**Independent Registered Public Accounting Firm**

Ernst & Young LLP  
200 Clarendon Street  
Boston, Massachusetts 02116

For additional Fund information, including the Fund's net asset value per share and information regarding the investments comprising the Fund's portfolio, please call



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1(800) 231-2608 or visit our website at  
[www.morganstanley.com/msim](http://www.morganstanley.com/msim). All investments involve  
risks, including the possible loss of principal.

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MSITFANN IU08-061221-Y10/08

Item 2. Code of Ethics.

(a) The Fund has adopted a code of ethics (the Code of Ethics ) that applies to its principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions, regardless of whether these individuals are employed by the Fund or a third party.

(b) No information need be disclosed pursuant to this paragraph.

(c) Not applicable.

(d) Not applicable.

(e) Not applicable.

(f)

(1) The Fund's Code of Ethics is attached hereto as Exhibit 12 A.

(2) Not applicable.

(3) Not applicable.

Item 3. Audit Committee Financial Expert.

The Fund's Board of Trustees has determined that Joseph J. Kearns, an independent Trustee, is an audit committee financial expert serving on its audit committee. Under applicable securities laws, a person who is determined to be an audit committee financial expert will not be deemed an expert for any purpose, including without limitation for the purposes of Section 11 of the Securities Act of 1933, as a result of being designated or identified as an audit committee financial expert. The designation or identification of a person as an audit committee financial expert does not impose on such person any duties, obligations, or liabilities that are greater than the duties, obligations, and liabilities imposed on such person as a member of the audit committee and Board of Trustees in the absence of such designation or identification.



Item 4. Principal Accountant Fees and Services.

(a)(b)(c)(d) and (g). Based on fees billed for the periods shown:

| <b>2008</b>                 | <b>Registrant</b> | <b>Covered Entities(1)</b> |
|-----------------------------|-------------------|----------------------------|
| <b>Audit Fees</b>           | \$ 86,800         | N/A                        |
| <b>Non-Audit Fees</b>       |                   |                            |
| <b>Audit-Related Fees</b>   |                   | \$ 742,276(2)              |
| <b>Tax Fees</b>             | \$ 3,380(3)       | \$ 99,522(4)               |
| <b>All Other Fees</b>       |                   | \$ 205,436(5)              |
| <b>Total Non-Audit Fees</b> | \$ 3,380          | \$ 1,047,234               |
| <b>Total</b>                | \$ 90,180         | \$ 1,047,234               |
| <br>                        |                   |                            |
| <b>2007</b>                 | <b>Registrant</b> | <b>Covered Entities(1)</b> |
| <b>Audit Fees</b>           | \$ 75,000         | N/A                        |
| <b>Non-Audit Fees</b>       |                   |                            |
| <b>Audit-Related Fees</b>   |                   | \$ 781,800(2)              |
| <b>Tax Fees</b>             | \$ 3,100(3)       | \$ 59,185(4)               |
| <b>All Other Fees</b>       |                   | \$ 74,100(5)               |
| <b>Total Non-Audit Fees</b> | \$ 3,100          | \$ 915,085                 |
| <b>Total</b>                | \$ 78,100         | \$ 915,085                 |

N/A- Not applicable, as not required by Item 4.

(1) Covered Entities include the Adviser (excluding sub-advisors) and any entity controlling, controlled by or under common control with the Adviser that provides ongoing services to the Registrant.

(2) Audit-Related Fees represent assurance and related services provided that are reasonably related to the performance of the audit of the financial statements of the Covered Entities and funds advised by the Adviser or its affiliates, specifically attestation services provided in connection with a SAS 70 Report and advisory consulting work.

(3) Tax Fees represent tax advice and compliance services provided in connection with the review of the Registrant's tax returns.

(4) Tax Fees represent tax advice services provided to Covered Entities, including research and identification of PFIC entities.



(5) All Other Fees represent attestation services provided in connection with performance presentation standards and a compliance review project performed.

(e)(1) The audit committee's pre-approval policies and procedures are as follows:

**APPENDIX A**

**AUDIT COMMITTEE  
AUDIT AND NON-AUDIT SERVICES  
PRE-APPROVAL POLICY AND PROCEDURES  
OF THE  
MORGAN STANLEY RETAIL AND INSTITUTIONAL FUNDS**

**AS ADOPTED AND AMENDED JULY 23, 2004,(1)**

**1. Statement of Principles**

The Audit Committee of the Board is required to review and, in its sole discretion, pre-approve all Covered Services to be provided by the Independent Auditors to the Fund and Covered Entities in order to assure that services performed by the Independent Auditors do not impair the auditor's independence from the Fund.

The SEC has issued rules specifying the types of services that an independent auditor may not provide to its audit client, as well as the audit committee's administration of the engagement of the independent auditor. The SEC's rules establish two different approaches to pre-approving services, which the SEC considers to be equally valid. Proposed services either: may be pre-approved without consideration of specific case-by-case services by the Audit Committee (general pre-approval); or require the specific pre-approval of the Audit Committee or its delegate (specific pre-approval). The Audit Committee believes that the combination of these two approaches in this Policy will result in an effective and efficient procedure to pre-approve services performed by the Independent Auditors. As set forth in this Policy, unless a type of service has received general pre-approval, it will require specific pre-approval by the Audit Committee (or by any member of the Audit Committee to which pre-approval authority has been delegated) if it is to be provided by the Independent Auditors. Any proposed services exceeding pre-approved cost levels or budgeted amounts will also require specific pre-approval by the Audit Committee.

The appendices to this Policy describe the Audit, Audit-related, Tax and All Other services that have the general pre-approval of the Audit Committee. The term of any general pre-approval is 12 months from the date of pre-approval, unless the Audit Committee considers and provides a different period and states otherwise. The Audit Committee will annually review and pre-approve the services that may be provided

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by the Independent Auditors without obtaining specific pre-approval from the Audit Committee. The Audit Committee will add to or subtract from the list of general pre-approved services from time to time, based on subsequent determinations.

---

(1) This Audit Committee Audit and Non-Audit Services Pre-Approval Policy and Procedures (the Policy ), adopted as of the date above, supersedes and replaces all prior versions that may have been adopted from time to time.

The purpose of this Policy is to set forth the policy and procedures by which the Audit Committee intends to fulfill its responsibilities. It does not delegate the Audit Committee's responsibilities to pre-approve services performed by the Independent Auditors to management.

The Fund's Independent Auditors have reviewed this Policy and believes that implementation of the Policy will not adversely affect the Independent Auditors' independence.

## **2. Delegation**

As provided in the Act and the SEC's rules, the Audit Committee may delegate either type of pre-approval authority to one or more of its members. The member to whom such authority is delegated must report, for informational purposes only, any pre-approval decisions to the Audit Committee at its next scheduled meeting.

## **3. Audit Services**

The annual Audit services engagement terms and fees are subject to the specific pre-approval of the Audit Committee. Audit services include the annual financial statement audit and other procedures required to be performed by the Independent Auditors to be able to form an opinion on the Fund's financial statements. These other procedures include information systems and procedural reviews and testing performed in order to understand and place reliance on the systems of internal control, and consultations relating to the audit. The Audit Committee will approve, if necessary, any changes in terms, conditions and fees resulting from changes in audit scope, Fund structure or other items.

In addition to the annual Audit services engagement approved by the Audit Committee, the Audit Committee may grant general pre-approval to other Audit services, which are those services that only the Independent Auditors reasonably can provide. Other Audit services may include statutory audits and services associated with SEC registration statements (on Forms N-1A, N-2, N-3, N-4, etc.), periodic reports and other documents filed with the SEC or other documents issued in connection with securities offerings.

The Audit Committee has pre-approved the Audit services in Appendix B.1. All other Audit services not listed in Appendix B.1 must be specifically pre-approved by the Audit Committee (or by any member of the Audit Committee to which pre-approval has been delegated).

## **4. Audit-related Services**

Audit-related services are assurance and related services that are reasonably related to the performance of the audit or review of the Fund's financial statements and, to the extent they are Covered Services, the Covered Entities or that are traditionally performed by the Independent Auditors. Because the Audit Committee believes that the provision of





Audit-related services does not impair the independence of the auditor and is consistent with the SEC's rules on auditor independence, the Audit Committee may grant general pre-approval to Audit-related services. Audit-related services include, among others, accounting consultations related to accounting, financial reporting or disclosure matters not classified as Audit services; assistance with understanding and implementing new accounting and financial reporting guidance from rulemaking authorities; agreed-upon or expanded audit procedures related to accounting and/or billing records required to respond to or comply with financial, accounting or regulatory reporting matters; and assistance with internal control reporting requirements under Forms N-SAR and/or N-CSR.

The Audit Committee has pre-approved the Audit-related services in Appendix B.2. All other Audit-related services not listed in Appendix B.2 must be specifically pre-approved by the Audit Committee (or by any member of the Audit Committee to which pre-approval has been delegated).

## **5. Tax Services**

The Audit Committee believes that the Independent Auditors can provide Tax services to the Fund and, to the extent they are Covered Services, the Covered Entities, such as tax compliance, tax planning and tax advice without impairing the auditor's independence, and the SEC has stated that the Independent Auditors may provide such services.

Pursuant to the preceding paragraph, the Audit Committee has pre-approved the Tax Services in Appendix B.3. All Tax services in Appendix B.3 must be specifically pre-approved by the Audit Committee (or by any member of the Audit Committee to which pre-approval has been delegated).

## **6. All Other Services**

The Audit Committee believes, based on the SEC's rules prohibiting the Independent Auditors from providing specific non-audit services, that other types of non-audit services are permitted. Accordingly, the Audit Committee believes it may grant general pre-approval to those permissible non-audit services classified as All Other services that it believes are routine and recurring services, would not impair the independence of the auditor and are consistent with the SEC's rules on auditor independence.

The Audit Committee has pre-approved the All Other services in Appendix B.4. Permissible All Other services not listed in Appendix B.4 must be specifically pre-approved by the Audit Committee (or by any member of the Audit Committee to which pre-approval has been delegated).

## **7. Pre-Approval Fee Levels or Budgeted Amounts**

Pre-approval fee levels or budgeted amounts for all services to be provided by the Independent Auditors will be established annually by the Audit Committee. Any proposed services exceeding these levels or amounts will require specific pre-approval by the Audit Committee. The Audit Committee is mindful of the overall relationship of fees for audit and non-audit services in determining whether to pre-approve any such

services.

## 8. Procedures

All requests or applications for services to be provided by the Independent Auditors that do not require specific approval by the Audit Committee will be submitted to the Fund's Chief Financial Officer and must include a detailed description of the services to be rendered. The Fund's Chief Financial Officer will determine whether such services are included within the list of services that have received the general pre-approval of the Audit Committee. The Audit Committee will be informed on a timely basis of any such services rendered by the Independent Auditors. Requests or applications to provide services that require specific approval by the Audit Committee will be submitted to the Audit Committee by both the Independent Auditors and the Fund's Chief Financial Officer, and must include a joint statement as to whether, in their view, the request or application is consistent with the SEC's rules on auditor independence.

The Audit Committee has designated the Fund's Chief Financial Officer to monitor the performance of all services provided by the Independent Auditors and to determine whether such services are in compliance with this Policy. The Fund's Chief Financial Officer will report to the Audit Committee on a periodic basis on the results of its monitoring. Both the Fund's Chief Financial Officer and management will immediately report to the chairman of the Audit Committee any breach of this Policy that comes to the attention of the Fund's Chief Financial Officer or any member of management.

## 9. Additional Requirements

The Audit Committee has determined to take additional measures on an annual basis to meet its responsibility to oversee the work of the Independent Auditors and to assure the auditor's independence from the Fund, such as reviewing a formal written statement from the Independent Auditors delineating all relationships between the Independent Auditors and the Fund, consistent with Independence Standards Board No. 1, and discussing with the Independent Auditors its methods and procedures for ensuring independence.

## 10. Covered Entities

Covered Entities include the Fund's investment adviser(s) and any entity controlling, controlled by or under common control with the Fund's investment adviser(s) that provides ongoing services to the Fund(s). Beginning with non-audit service contracts entered into on or after May 6, 2003, the Fund's audit committee must pre-approve non-audit services provided not only to the Fund but also to the Covered Entities if the engagements relate directly to the operations and financial reporting of the Fund. This list of Covered Entities would include:

### Morgan Stanley Retail Funds

Morgan Stanley Investment Advisors Inc.

Morgan Stanley & Co. Incorporated

Morgan Stanley DW Inc.

Morgan Stanley Investment Management Inc.

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Morgan Stanley Investment Management Limited

Morgan Stanley Investment Management Private Limited

Morgan Stanley Asset & Investment Trust Management Co., Limited

Morgan Stanley Investment Management Company

Van Kampen Asset Management

Morgan Stanley Services Company, Inc.

Morgan Stanley Distributors Inc.

Morgan Stanley Trust FSB

Morgan Stanley Institutional Funds

Morgan Stanley Investment Management Inc.

Morgan Stanley Investment Advisors Inc.

Morgan Stanley Investment Management Limited

Morgan Stanley Investment Management Private Limited

Morgan Stanley Asset & Investment Trust Management Co., Limited

Morgan Stanley Investment Management Company

Morgan Stanley & Co. Incorporated

Morgan Stanley Distribution, Inc.

Morgan Stanley AIP GP LP

Morgan Stanley Alternative Investment Partners LP

(e)(2) Beginning with non-audit service contracts entered into on or after May 6, 2003, the audit committee also is required to pre-approve services to Covered Entities to the extent that the services are determined to have a direct impact on the operations or financial reporting of the Registrant. 100% of such services were pre-approved by the audit committee pursuant to the Audit Committee's pre-approval policies and procedures (attached hereto).

(f) Not applicable.

(g) See table above.

(h) The audit committee of the Board of Trustees has considered whether the provision of services other than audit services performed by the auditors to the Registrant and Covered Entities is compatible with maintaining the auditors' independence in performing audit services.

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Item 5. Audit Committee of Listed Registrants.

(a) The Fund has a separately-designated standing audit committee established in accordance with Section 3(a)(58)(A) of the Exchange Act whose members are: Frank Joseph Kearns, Michael Nugent and Allen Reed.

(b) Not applicable.

Item 6. Schedule of Investments

(a) Refer to Item 1.

(b) Not used.

Item 7. Disclosure of Proxy Voting Policies and Procedures for Closed-End Management Investment Companies.

*APPROVED FEBRUARY 28, 2008*

**MORGAN STANLEY INVESTMENT MANAGEMENT**

**PROXY VOTING POLICY AND PROCEDURES**





I. **POLICY STATEMENT**

Introduction - Morgan Stanley Investment Management's (MSIM) policy and procedures for voting proxies (Policy) with respect to securities held in the accounts of clients applies to those MSIM entities that provide discretionary investment management services and for which an MSIM entity has authority to vote proxies. This Policy is reviewed and updated as necessary to address new and evolving proxy voting issues and standards.

The MSIM entities covered by this Policy currently include the following: Morgan Stanley Investment Advisors Inc., Morgan Stanley AIP GP LP, Morgan Stanley Investment Management Inc., Morgan Stanley Investment Management Limited, Morgan Stanley Investment Management Company, Morgan Stanley Asset & Investment Trust Management Co., Limited, Morgan Stanley Investment Management Private Limited, Van Kampen Asset Management, and Van Kampen Advisors Inc. (each an MSIM Affiliate and collectively referred to as the MSIM Affiliates or as we below).

Each MSIM Affiliate will use its best efforts to vote proxies as part of its authority to manage, acquire and dispose of account assets. With respect to the MSIM registered management investment companies (Van Kampen, Institutional and Advisor Funds collectively referred to herein as the MSIM Funds), each MSIM Affiliate will vote proxies under this Policy pursuant to authority granted under its applicable investment advisory agreement or, in the absence of such authority, as authorized by the Board of Directors/Trustees of the MSIM Funds. An MSIM Affiliate will not vote proxies if the named fiduciary for an ERISA account has reserved the authority for itself, or in the case of an account not governed by ERISA, the investment management or investment advisory agreement does not authorize the MSIM Affiliate to vote proxies. MSIM Affiliates will vote proxies in a prudent and diligent manner and in the best interests of clients, including beneficiaries of and participants in a client's benefit plan(s) for which the MSIM Affiliates manage assets, consistent with the objective of maximizing long-term investment returns (Client Proxy Standard). In certain situations, a client or its fiduciary may provide an MSIM Affiliate with a proxy voting policy. In these situations, the MSIM Affiliate will comply with the client's policy.

Proxy Research Services - RiskMetrics Group ISS Governance Services (ISS) and Glass Lewis (together with other proxy research providers as we may retain from time to time, the Research Providers) are independent advisers that specialize in providing a

variety of fiduciary-level proxy-related services to institutional investment managers, plan sponsors, custodians, consultants, and other institutional investors. The services provided include in-depth research, global issuer analysis, and voting recommendations. While we may review and utilize the recommendations of the Research Providers in making proxy voting decisions, we are in no way obligated to follow such recommendations. In addition to research, ISS provides vote execution, reporting, and recordkeeping.

Voting Proxies for Certain Non-U.S. Companies - Voting proxies of companies located in some jurisdictions, particularly emerging markets, may involve several problems that can restrict or prevent the ability to vote such proxies or entail significant costs. These problems include, but are not limited to: (i) proxy statements and ballots being written in a language other than English; (ii) untimely and/or inadequate notice of shareholder meetings; (iii) restrictions on the ability of holders outside the issuer's jurisdiction of organization to exercise votes; (iv) requirements to vote proxies in person; (v) the imposition of restrictions on the sale of the securities for a period of time in proximity to the shareholder meeting; and (vi) requirements to provide local agents with power of attorney to facilitate our voting instructions. As a result, we vote clients' non-U.S. proxies on a best efforts basis only, after weighing the costs and benefits of voting such proxies, consistent with the Client Proxy Standard. ISS has been retained to provide assistance in connection with voting non-U.S. proxies.

## II. **GENERAL PROXY VOTING GUIDELINES**

To promote consistency in voting proxies on behalf of its clients, we follow this Policy (subject to any exception set forth herein), including the guidelines set forth below. These guidelines address a broad range of issues, and provide general voting parameters on proposals that arise most frequently. However, details of specific proposals vary, and those details affect particular voting decisions, as do factors specific to a given company. Pursuant to the procedures set forth herein, we may vote in a manner that is not in accordance with the following general guidelines, provided the vote is approved by the Proxy Review Committee (see Section III for description) and is consistent with the

Client Proxy Standard. Morgan Stanley AIP GP LP will follow the procedures as described in Appendix A.

We endeavor to integrate governance and proxy voting policy with investment goals and to follow the Client Proxy Standard for each client. At times, this may result in split votes, for example when different clients have varying economic interests in the outcome of a particular voting matter (such as a case in which varied ownership interests in two companies involved in a merger result in different stakes in the outcome). We also may split votes at times based on differing views of portfolio managers, but such a split vote must be approved by the Proxy Review Committee.

We may abstain on matters for which disclosure is inadequate.

**A. Routine Matters.** We generally support routine management proposals. The following are examples of routine management proposals:

- Approval of financial statements and auditor reports.
  
- General updating/corrective amendments to the charter, articles of association or bylaws.
  
- Most proposals related to the conduct of the annual meeting, with the following exceptions. We generally oppose proposals that relate to the transaction of such other business which may come before the meeting, and open-ended requests for adjournment. However, where management specifically states the reason for requesting an adjournment and the requested adjournment would facilitate passage of a proposal that would otherwise be supported under this Policy (i.e. an uncontested corporate transaction), the adjournment request will be supported.

We generally support shareholder proposals advocating confidential voting procedures and independent tabulation of voting results.

**B. Board of Directors**

1. Election of directors: In the absence of a proxy contest, we generally support the board's nominees for director except as follows:

a. We consider withholding support from or voting against interested directors if the company's board does not meet market standards for director independence, or if otherwise we believe board independence is insufficient. We refer to prevalent market standards as promulgated by a stock exchange or other authority within a given market (e.g., New York Stock Exchange or Nasdaq rules for most U.S. companies, and The Combined Code on Corporate Governance in the United Kingdom). Thus, for an NYSE company with no controlling shareholder, we would expect that at a minimum a majority of directors should be independent as

defined by NYSE. Where we view market standards as inadequate, we may withhold votes based on stronger independence standards. Market standards notwithstanding, we generally do not view long board tenure alone as a basis to classify a director as non-independent, although lack of board turnover and fresh perspective can be a negative factor in voting on directors.

i. At a company with a shareholder or group that controls the company by virtue of a majority economic interest in the company, we have a reduced expectation for board independence, although we believe the presence of independent directors can be helpful, particularly in staffing the audit committee, and at times we may withhold support from or vote against a nominee on the view the board or its committees are not sufficiently independent.

ii. We consider withholding support from or voting against a nominee if he or she is affiliated with a major shareholder that has representation on a board disproportionate to its economic interest.

b. Depending on market standards, we consider withholding support from or voting against a nominee who is interested and who is standing for election as a member of the company's compensation, nominating or audit committee.

c. We consider withholding support from or voting against a nominee if we believe a direct conflict exists between the interests of the nominee and the public shareholders, including failure to meet fiduciary standards of care and/or loyalty. We may oppose directors where we conclude that actions of directors are unlawful, unethical or negligent. We consider opposing individual board members or an entire slate if we believe the board is entrenched and/or dealing inadequately with performance problems, and/or acting with insufficient independence between the board and management.

d. We consider withholding support from or voting against a nominee standing for election if the board has not taken action to implement generally accepted governance practices for which there is a "bright line" test. For example, in the context of the U.S. market, failure to eliminate a dead hand or slow hand poison pills would be seen as a basis for opposing one or more incumbent nominees.

e. In markets that encourage designated audit committee financial experts, we consider voting against members of an audit committee if no members are designated as such.

f. We consider withholding support from or voting against a nominee who has failed to attend at least 75% of board meetings within a given year without a reasonable excuse.

g. We consider withholding support from or voting against a nominee who serves on the board of directors of more than six companies (excluding investment companies). We also consider voting against a director who otherwise appears to have too many commitments to serve adequately on the board of the company.

2. Board independence: We generally support U.S. shareholder proposals requiring that a certain percentage (up to 66 $\frac{2}{3}$ %) of the company's board members be independent directors, and promoting all-independent audit, compensation and nominating/governance committees.

3. Board diversity: We consider on a case-by-case basis shareholder proposals urging diversity of board membership with respect to social, religious or ethnic group.

4. Majority voting: We generally support proposals requesting or requiring majority voting policies in election of directors, so long as there is a carve-out for plurality voting in the case of contested elections.

5. Proxy access: We consider on a case-by-case basis shareholder proposals to provide procedures for inclusion of shareholder nominees in company proxy statements.

6. Proposals to elect all directors annually: We generally support proposals to elect all directors annually at public companies (to declassify the Board of Directors) where such action is supported by the board, and otherwise consider the issue on a case-by-case basis based in part on overall takeover defenses at a company.

7. Cumulative voting: We generally support proposals to eliminate cumulative voting in the U.S. market context. (Cumulative voting provides that shareholders may concentrate their votes for one or a handful of candidates, a system that can enable a minority bloc to place representation on a board). U.S. proposals to establish cumulative voting in the election of directors generally will not be supported.

8. Separation of Chairman and CEO positions: We vote on shareholder proposals to separate the Chairman and CEO positions and/or to appoint a non-executive Chairman based in part on prevailing practice in particular markets, since the context for such a practice varies. In many non-U.S. markets, we view separation of the roles as a market standard practice, and support division of the roles in that context.





9. Director retirement age and term limits: Proposals recommending set director retirement ages or director term limits are voted on a case-by-case basis.

10. Proposals to limit directors liability and/or broaden indemnification of directors. Generally, we will support such proposals provided that the officers and directors are eligible for indemnification and liability protection if they have acted in good faith on company business and were found innocent of any civil or criminal charges for duties performed on behalf of the company.

**C. Corporate transactions and proxy fights.** We examine proposals relating to mergers, acquisitions and other special corporate transactions (i.e., takeovers, spin-offs, sales of assets, reorganizations, restructurings and recapitalizations) on a case-by-case basis. However, proposals for mergers or other significant transactions that are friendly and approved by the Research Providers generally will be supported and in those instances will not need to be reviewed by the Proxy Review Committee, where there is no portfolio manager objection and where there is no material conflict of interest. We also analyze proxy contests on a case-by-case basis.

**D. Changes in capital structure.**

1. We generally support the following:

- Management and shareholder proposals aimed at eliminating unequal voting rights, assuming fair economic treatment of classes of shares we hold.
- Management proposals to increase the authorization of existing classes of common stock (or securities convertible into common stock) if: (i) a clear business purpose is stated that we can support and the number of shares requested is reasonable in relation to the purpose for which authorization is requested; and/or (ii) the authorization does not exceed 100% of shares currently authorized and at least 30% of the total new authorization will be outstanding.
- Management proposals to create a new class of preferred stock or for issuances of preferred stock up to 50% of issued capital, unless we have concerns about use of the authority for anti-takeover purposes.
- Management proposals to authorize share repurchase plans, except in some cases in which we believe there are insufficient protections against use of an authorization for anti-takeover purposes.

- Management proposals to reduce the number of authorized shares of common or preferred stock, or to eliminate classes of preferred stock.
  
- Management proposals to effect stock splits.

- Management proposals to effect reverse stock splits if management proportionately reduces the authorized share amount set forth in the corporate charter. Reverse stock splits that do not adjust proportionately to the authorized share amount generally will be approved if the resulting increase in authorized shares coincides with the proxy guidelines set forth above for common stock increases.

- Management proposals for higher dividend payouts.

2. We generally oppose the following (notwithstanding management support):

- Proposals to add classes of stock that would substantially dilute the voting interests of existing shareholders.

- Proposals to increase the authorized or issued number of shares of existing classes of stock that are unreasonably dilutive, particularly if there are no preemptive rights for existing shareholders.

- Proposals that authorize share issuance at a discount to market rates, except where authority for such issuance is de minimis, or if there is a special situation that we believe justifies such authorization (as may be the case, for example, at a company under severe stress and risk of bankruptcy).

- Proposals relating to changes in capitalization by 100% or more.

We consider on a case-by-case basis shareholder proposals to increase dividend payout ratios, in light of market practice and perceived market weaknesses, as well as individual company payout history and current circumstances. For example, currently we perceive low payouts to shareholders as a concern at some Japanese companies, but may deem a low payout ratio as appropriate for a growth company making good use of its cash, notwithstanding the broader market concern.

#### **E. Takeover Defenses and Shareholder Rights**

1. Shareholder rights plans: We generally support proposals to require shareholder approval or ratification of shareholder rights plans (poison pills). In voting on rights plans or similar takeover defenses, we consider on a case-by-case basis whether the company has demonstrated a need for the defense in the context of promoting long-term share value; whether provisions of the defense are in line with generally accepted governance principles; and the specific context if the proposal is made in the midst of a takeover bid or contest for control.

2. Supermajority voting requirements: We generally oppose requirements for supermajority votes to amend the charter or bylaws, unless the provisions protect

minority shareholders where there is a large shareholder. In line with this view, in the absence of a large shareholder we support reasonable shareholder proposals to limit such supermajority voting requirements.

3. Shareholder rights to call meetings: We consider proposals to enhance shareholder rights to call meetings on a case-by-case basis.

4. Reincorporation: We consider management and shareholder proposals to reincorporate to a different jurisdiction on a case-by-case basis. We oppose such proposals if we believe the main purpose is to take advantage of laws or judicial precedents that reduce shareholder rights.

5. Anti-greenmail provisions: Proposals relating to the adoption of anti-greenmail provisions will be supported, provided that the proposal: (i) defines greenmail; (ii) prohibits buyback offers to large block holders (holders of at least 1% of the outstanding shares and in certain cases, a greater amount, as determined by the Proxy Review Committee) not made to all shareholders or not approved by disinterested shareholders; and (iii) contains no anti-takeover measures or other provisions restricting the rights of shareholders.

6. Bundled proposals: We may consider opposing or abstaining on proposals if disparate issues are bundled and presented for a single vote.

**F. Auditors.** We generally support management proposals for selection or ratification of independent auditors. However, we may consider opposing such proposals with reference to incumbent audit firms if the company has suffered from serious accounting irregularities and we believe rotation of the audit firm is appropriate, or if fees paid to the auditor for non-audit-related services are excessive. Generally, to determine if non-audit fees are excessive, a 50% test will be applied (i.e., non-audit-related fees should be less than 50% of the total fees paid to the auditor). We generally vote against proposals to indemnify auditors.

**G. Executive and Director Remuneration.**

1. We generally support the following proposals:

- Proposals for employee equity compensation plans and other employee ownership plans, provided that our research does not indicate that approval of the plan would be against shareholder interest. Such approval may be against shareholder interest if it authorizes excessive dilution and shareholder cost, particularly in the context of high usage (run rate) of equity compensation in the recent past; or if there are objectionable plan design and provisions.



- Proposals relating to fees to outside directors, provided the amounts are not excessive relative to other companies in the country or industry, and provided that the structure is appropriate within the market context. While stock-based compensation to outside directors is positive if moderate and appropriately structured, we are wary of significant stock option awards or other performance-based awards for outside directors, as well as provisions that could result in significant forfeiture of value on a director's decision to resign from a board (such forfeiture can undercut director independence).

- Proposals for employee stock purchase plans that permit discounts up to 15%, but only for grants that are part of a broad-based employee plan, including all non-executive employees.

- Proposals for the establishment of employee retirement and severance plans, provided that our research does not indicate that approval of the plan would be against shareholder interest.

2. Shareholder proposals requiring shareholder approval of all severance agreements will not be supported, but proposals that require shareholder approval for agreements in excess of three times the annual compensation (salary and bonus) generally will be supported. We generally oppose shareholder proposals that would establish arbitrary caps on pay. We consider on a case-by-case basis shareholder proposals that seek to limit Supplemental Executive Retirement Plans (SERPs), but support such proposals where we consider SERPs to be excessive.

3. Shareholder proposals advocating stronger and/or particular pay-for-performance models will be evaluated on a case-by-case basis, with consideration of the merits of the individual proposal within the context of the particular company and its labor markets, and the company's current and past practices. While we generally support emphasis on long-term components of senior executive pay and strong linkage of pay to performance, we consider whether a proposal may be overly prescriptive, and the impact of the proposal, if implemented as written, on recruitment and retention.

4. We consider shareholder proposals for U.K.-style advisory votes on pay on a case-by-case basis.

5. We generally support proposals advocating reasonable senior executive and director stock ownership guidelines and holding requirements for shares gained in option exercises.

6. Management proposals effectively to re-price stock options are considered on a case-by-case basis. Considerations include the company's reasons and justifications for a re-pricing, the company's competitive position, whether senior executives and outside directors are excluded, potential cost to shareholders, whether the re-pricing or share exchange is on a value-for-value basis, and whether vesting requirements are extended.

**H. Social, Political and Environmental Issues.** We consider proposals relating to social, political and

environmental issues on a case-by-case basis to determine whether they will have a financial impact on shareholder value. However, we generally vote



against proposals requesting reports that are duplicative, related to matters not material to the business, or that would impose unnecessary or excessive costs. We may abstain from voting on proposals that do not have a readily determinable financial impact on shareholder value. We generally oppose proposals requiring adherence to workplace standards that are not required or customary in market(s) to which the proposals relate.

**I. Fund of Funds.** Certain Funds advised by an MSIM Affiliate invest only in other MSIM Funds. If an underlying fund has a shareholder meeting, in order to avoid any potential conflict of interest, such proposals will be voted in the same proportion as the votes of the other shareholders of the underlying fund, unless otherwise determined by the Proxy Review Committee.

### **III. ADMINISTRATION OF POLICY**

The MSIM Proxy Review Committee (the Committee) has overall responsibility for creating and implementing the Policy, working with an MSIM staff group (the Corporate Governance Team). The Committee, which is appointed by MSIM's Chief Investment Officer of Global Equities (CIO), consists of senior investment professionals who represent the different investment disciplines and geographic locations of the firm. Because proxy voting is an investment responsibility and impacts shareholder value, and because of their knowledge of companies and markets, portfolio managers and other members of investment staff play a key role in proxy voting, although the Committee has final authority over proxy votes.

The Committee Chairperson is the head of the Corporate Governance Team, and is responsible for identifying issues that require Committee deliberation or ratification. The Corporate Governance Team, working with advice of investment teams and the Committee, is responsible for voting on routine items and on matters that can be addressed in line with these Policy guidelines. The Corporate Governance Team has responsibility for voting case-by-case where guidelines and precedent provide adequate guidance, and to refer other case-by-case decisions to the Proxy Review Committee.

The Committee will periodically review and have the authority to amend, as necessary, the Policy and establish and direct voting positions consistent with the Client Proxy Standard.

#### **A. Committee Procedures**

The Committee will meet at least monthly to (among other matters) address any outstanding issues relating to the Policy or its implementation. The Corporate

Governance Team will timely communicate to ISS MSIM's Policy (and any amendments and/or any additional guidelines or procedures the Committee may adopt).

The Committee will meet on an ad hoc basis to (among other matters): (1) authorize split voting (i.e., allowing certain shares of the same issuer that are the subject of the same proxy solicitation and held by one or more MSIM portfolios to be voted differently than other shares) and/or override voting (i.e., voting all MSIM portfolio shares in a manner contrary to the Policy); (2) review and approve upcoming votes, as appropriate, for matters for which specific direction has been provided in this Policy; and (3) determine how to vote matters for which specific direction has not been provided in this Policy.

Members of the Committee may take into account Research Providers' recommendations and research as well as any other relevant information they may request or receive, including portfolio manager and/or analyst research, as applicable. Generally, proxies related to securities held in accounts that are managed pursuant to quantitative, index or index-like strategies ( Index Strategies ) will be voted in the same manner as those held in actively managed accounts, unless economic interests of the accounts differ. Because accounts managed using Index Strategies are passively managed accounts, research from portfolio managers and/or analysts related to securities held in these accounts may not be available. If the affected securities are held only in accounts that are managed pursuant to Index Strategies, and the proxy relates to a matter that is not described in this Policy, the Committee will consider all available information from the Research Providers, and to the extent that the holdings are significant, from the portfolio managers and/or analysts.

**B. Material Conflicts of Interest**

In addition to the procedures discussed above, if the Committee determines that an issue raises a material conflict of interest, the Committee will request a special committee to review, and recommend a course of action with respect to, the conflict(s) in question ( Special Committee ).

The Special Committee shall be comprised of the Chairperson of the Proxy Review Committee, the Chief Compliance Officer or his/her designee, a senior portfolio manager (if practicable, one who is a member of the Proxy Review Committee) designated by the Proxy Review Committee, and MSIM's relevant Chief Investment Officer or his/her designee, and any other persons deemed necessary by the Chairperson. The Special Committee may request the assistance of MSIM's General Counsel or his/her designee who will have sole discretion to cast a vote. In addition to the research provided by Research Providers, the Special Committee may request analysis from MSIM Affiliate investment professionals and outside sources to the extent it deems appropriate.

**C. Identification of Material Conflicts of Interest**

A potential material conflict of interest could exist in the following situations, among others:

1. The issuer soliciting the vote is a client of MSIM or an affiliate of MSIM and the vote is on a material matter affecting the issuer.
2. The proxy relates to Morgan Stanley common stock or any other security issued by Morgan Stanley or its affiliates except if echo voting is used, as with MSIM Funds, as described herein.
3. Morgan Stanley has a material pecuniary interest in the matter submitted for a vote (e.g., acting as a financial advisor to a party to a merger or acquisition for which Morgan Stanley will be paid a success fee if completed).

If the Chairperson of the Committee determines that an issue raises a potential material conflict of interest, depending on the facts and circumstances, the Chairperson will address the issue as follows:

1. If the matter relates to a topic that is discussed in this Policy, the proposal will be voted as per the Policy.
2. If the matter is not discussed in this Policy or the Policy indicates that the issue is to be decided case-by-case, the proposal will be voted in a manner consistent with the Research Providers, provided that all the Research Providers have the same recommendation, no portfolio manager objects to that vote, and the vote is consistent with MSIM's Client Proxy Standard.
3. If the Research Providers' recommendations differ, the Chairperson will refer the matter to the Committee to vote on the proposal. If the Committee determines that an issue raises a material conflict of interest, the Committee will request a Special Committee to review and recommend a course of action, as described above. Notwithstanding the above, the Chairperson of the Committee may request a Special Committee to review a matter at any time as he/she deems necessary to resolve a conflict.

**D. Proxy Voting Reporting**

The Committee and the Special Committee, or their designee(s), will document in writing all of their decisions and actions, which documentation will be maintained by the Committee and the Special Committee, or their designee(s), for a period of at least 6 years. To the extent these decisions relate to a security held by an MSIM Fund, the Committee and Special Committee, or their designee(s), will report their decisions to each applicable Board of Trustees/Directors of those Funds at each Board's next regularly scheduled Board meeting. The report will

contain information concerning decisions made by the Committee and Special Committee during the most recently ended calendar quarter immediately preceding the Board meeting.

The Corporate Governance Team will timely communicate to applicable portfolio managers and to ISS, decisions of the Committee and Special Committee so that, among other things, ISS will vote proxies consistent with their decisions.

MSIM will promptly provide a copy of this Policy to any client requesting it. MSIM will also, upon client request, promptly provide a report indicating how each proxy was voted with respect to securities held in that client's account.

MSIM's Legal Department is responsible for filing an annual Form N-PX on behalf of each MSIM Fund for which such filing is required, indicating how all proxies were voted with respect to such Fund's holdings.

#### **APPENDIX A**

The following procedures apply to accounts managed by Morgan Stanley AIP GP LP ( "AIP" ).

Generally, AIP will follow the guidelines set forth in Section II of MSIM's Proxy Voting Policy and Procedures. To the extent that such guidelines do not provide specific direction, or AIP determines that consistent with the Client Proxy Standard, the guidelines should not be followed, the Proxy Review Committee has delegated the voting authority to vote securities held by accounts managed by AIP to the Liquid Markets investment team and the Private Markets investment team of AIP. A summary of decisions made by the investment teams will be made available to the Proxy Review Committee for its information at the next scheduled meeting of the Proxy Review Committee.

In certain cases, AIP may determine to abstain from determining (or recommending) how a proxy should be voted (and therefore abstain from voting such proxy or recommending how such proxy should be voted), such as where the expected cost of giving due consideration to the proxy does not justify the potential benefits to the affected account(s) that might result from adopting or rejecting (as the case may be) the measure in question.

#### **Waiver of Voting Rights**

For regulatory reasons, AIP may either 1) invest in a class of securities of an underlying fund (the "Fund" ) that does not provide for voting rights; or 2) waive 100% of its voting rights with respect to the following:

1. Any rights with respect to the removal or replacement of a director, general partner, managing member or other person acting in a similar capacity for or on behalf of the Fund (each individually a "Designated Person," and collectively, the "Designated Persons" ), which may include, but are not limited to, voting on the election or removal of a Designated Person in the event of such Designated



Person's death, disability, insolvency, bankruptcy, incapacity, or other event requiring a vote of interest holders of the Fund to remove or replace a Designated Person; and

2. Any rights in connection with a determination to renew, dissolve, liquidate, or otherwise terminate or continue the Fund, which may include, but are not limited to, voting on the renewal, dissolution, liquidation, termination or continuance of the Fund upon the occurrence of an event described in the Fund's organizational documents; provided, however, that, if the Fund's organizational documents require the consent of the Fund's general partner or manager, as the case may be, for any such termination or continuation of the Fund to be effective, then AIP may exercise its voting rights with respect to such matter.

## **APPENDIX B**

The following procedures apply to the portion of the Van Kampen Dynamic Credit Opportunities Fund ( VK Fund ) sub advised by Avenue Europe International Management, L.P. ( Avenue ). (The portion of the VK Fund managed solely by Van Kampen Asset Management will continue to be subject to MSIM's Policy.)

1. Generally: With respect to Avenue's portion of the VK Fund, the Board of Trustees of the VK Fund will retain sole authority and responsibility for proxy voting. The Adviser's involvement in the voting process of Avenue's portion of the VK Fund is a purely administrative function, and serves to execute and deliver the proxy voting decisions made by the VK Fund Board in connection with the Avenue portion of the VK Fund, which may, from time to time, include related administrative tasks such as receiving proxies, following up on missing proxies, and collecting data related to proxies. As such, the Adviser shall not be deemed to have voting power or shared voting power with Avenue with respect to Avenue's portion of the Fund.

2. Voting Guidelines: All proxies, with respect to Avenue's portion of the VK Fund, will be considered by the VK Fund Board or such subcommittee as the VK Fund Board may designate from time to time for determination and voting approval. The VK Board or its subcommittee will timely communicate to MSIM's Corporate Governance Group its proxy voting decisions, so that among other things the votes will be effected consistent with the VK Board's authority.

3. Administration: The VK Board or its subcommittee will meet on an adhoc basis as may be required from time to time to review proxies that require its review and determination. The VK Board or its subcommittee will document

in writing all of its decisions and actions which will be maintained by the VK Fund, or its designee(s), for a period of at least 6 years. If a subcommittee is designated, a summary of decisions made by such subcommittee will be made available to the full VK Board for its information at its next scheduled respective meetings.

Item 8. Portfolio Managers of Closed-End Management Investment Companies

**Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.**

**FUND MANAGEMENT**

**PORTFOLIO MANAGEMENT.** As of the date of this report, the Fund is managed by members of the Emerging Markets Debt team. The team consists of portfolio managers and analysts. Current members of the team jointly and primarily responsible for the day-to-day management of the Fund's portfolio are Abigail McKenna, Eric J. Baurmeister, Managing Director and Federico L. Kaune, Executive Director of the Adviser.

Ms. McKenna has been associated with the Adviser in an investment management capacity since August 1996 and began managing the Fund at its inception. Mr. Baurmeister has been associated with the Adviser in an investment management capacity since October 1997 and began managing the Fund at its inception. Mr. Kaune has been associated with the Adviser in an investment management capacity since April 2003 and began managing the Fund at its inception. Ms. McKenna, Mr. Baurmeister and Mr. Kaune are co-portfolio managers. Certain other members of the team collaborate to manage the assets of the Fund, but are not primarily responsible for the day-to-day management of the Fund.

The composition of the team may change from time to time.

**OTHER ACCOUNTS MANAGED BY THE PORTFOLIO MANAGERS**

As of October 31, 2008:

Ms. McKenna managed nine registered investment companies with a total of approximately \$1.6 billion in assets; eight pooled investment vehicles other than registered investment companies with a total of approximately \$586.0 million in assets; and six other accounts with a total of approximately \$1.7 billion in assets.

Mr. Baurmeister managed nine registered investment companies with a total of approximately \$1.6 billion in assets; eight pooled investment vehicles other than registered investment companies with a total of approximately \$586.0 million in assets; and six other accounts with a total of approximately \$1.7 billion in assets.



Mr. Kaune managed nine registered investment companies with a total of approximately \$1.6 billion in assets; eight pooled investment vehicles other than registered investment companies with a total of approximately \$586.0 million in assets; and six other accounts with a total of approximately \$1.7 billion in assets.

Because the portfolio managers manage assets for other investment companies, pooled investment vehicles and/or other accounts (including institutional clients, pension plans and certain high net worth individuals), there may be an incentive to favor one client over another resulting in conflicts of interest. For instance, the Investment Adviser may receive fees from certain accounts that are higher than the fee it receives from the Fund, or it may receive a performance-based fee on certain accounts. In those instances, the portfolio managers may have an incentive to favor the higher and/or performance-based fee accounts over the Fund. In addition, a conflict of interest could exist to the extent the Investment Adviser has proprietary investments in certain accounts, where portfolio managers have personal investments in certain accounts or when certain accounts are investment options in the Investment Adviser's employee benefits and/or deferred compensation plans. The portfolio manager may have an incentive to favor these accounts over others. If the Investment Adviser manages accounts that engage in short sales of securities of the type in which the Fund invests, the Investment Adviser could be seen as harming the performance of the Fund for the benefit of the accounts engaging in short sales if the short sales cause the market value of the securities to fall. The Investment Adviser have adopted trade allocation and other policies and procedures that it believes are reasonably designed to address these and other conflicts of interest.

#### PORTFOLIO MANAGER COMPENSATION STRUCTURE

Portfolio managers receive a combination of base compensation and discretionary compensation, comprising a cash bonus and several deferred compensation programs described below. The methodology used to determine portfolio manager compensation is applied across all funds/accounts managed by the portfolio managers.

**BASE SALARY COMPENSATION.** Generally, portfolio managers receive base salary compensation based on the level of their position with the Investment Adviser.

**DISCRETIONARY COMPENSATION.** In addition to base compensation, portfolio managers may receive discretionary compensation.

Discretionary compensation can include:

- Cash Bonus.
- Morgan Stanley's Long Term Incentive Compensation awards - a mandatory program that defers a portion of discretionary year-end compensation into restricted stock units or other awards based on Morgan Stanley common stock or other investments that are subject to vesting and other conditions.
- Investment Management Alignment Plan (IMAP) awards - a mandatory program that defers a portion of discretionary year-end compensation and notionally invests it in designated funds advised by the Investment Adviser or its affiliates. The award is subject to vesting and other conditions. Portfolio managers must notionally invest a minimum of 25% to a maximum of 100% of the IMAP deferral into a combination of the designated funds they manage that are included in the IMAP fund menu, which may or may not include the Fund..

- Voluntary Deferred Compensation Plans - voluntary programs that permit certain employees to elect to defer a portion of their discretionary year-end compensation and directly or notionally invest the deferred amount: (1) across a range of designated investment funds, including funds advised by the Investment Adviser or its affiliates; and/or (2) in Morgan Stanley stock units.

Several factors determine discretionary compensation, which can vary by portfolio management team and circumstances. In order of relative importance, these factors include:

- Investment performance. A portfolio manager's compensation is linked to the pre-tax investment performance of the funds/accounts managed by the portfolio manager. Investment

performance is calculated for one-, three- and five-year periods measured against a fund's/account's primary benchmark, indices and/or peer groups where applicable. Generally, the greatest weight is placed on the three- and five-year periods.

- Revenues generated by the investment companies, pooled investment vehicles and other accounts managed by the portfolio manager.
- Contribution to the business objectives of the Investment Adviser.
- The dollar amount of assets managed by the portfolio manager.
- Market compensation survey research by independent third parties.
- Other qualitative factors, such as contributions to client objectives.
- Performance of Morgan Stanley and Morgan Stanley Investment Management, and the overall performance of the investment team(s) of which the portfolio manager is a member.

#### SECURITIES OWNERSHIP OF PORTFOLIO MANAGERS

As of October 31, 2008, the portfolio managers did not own any share of the Fund.

#### Item 9. Closed-End Fund Repurchases

None

#### Item 10. Submission of Matters to a Vote of Security Holders

Not applicable.

Item 11. Controls and Procedures

(a) The Fund's principal executive officer and principal financial officer have concluded that the Fund's disclosure controls and procedures are sufficient to ensure that information required to be disclosed by the Fund in this Form N-CSR was recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, based upon such officers' evaluation of these controls and procedures as of a date within 90 days of the filing date of the report.

(b) There were no changes in the registrant's internal control over financial reporting that occurred during the second fiscal quarter of the period covered by this report that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting.

Item 12. Exhibits

(a) The Code of Ethics for Principal Executive and Senior Financial Officers is attached hereto.

(b) A separate certification for each principal executive officer and principal financial officer of the registrant are attached hereto as part of EX-99.CERT.

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934 and the Investment Company Act of 1940, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Morgan Stanley Emerging Markets Domestic Debt Fund, Inc.

/s/ Randy Takian  
Randy Takian  
Principal Executive Officer  
December 17, 2008

Pursuant to the requirements of the Securities Exchange Act of 1934 and the Investment Company Act of 1940, this report has been signed by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

/s/ Randy Takian  
Randy Takian  
Principal Executive Officer  
December 17, 2008

/s/ James Garrett  
James Garrett  
Principal Financial Officer  
December 17, 2008

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