MORGAN STANLEY ASIA INTERNATIONAL LIMITED

Reports and financial statements

31 December 2017

MORGAN STANLEY ASIA INTERNATIONAL LIMITED

REPORTS AND FINANCIAL STATEMENTS
Year ended 31 December 2017

CONTENTS **PAGE**

MORGAN STANLEY ASIA INTERNATIONAL LIMITED

DIRECTORS' REPORT

The Directors present the annual report and audited financial statements (which comprise the income statement, statement of comprehensive income, statement of changes in equity, statement of financial position, statement of cash flows and related notes 1 to 28) for Morgan Stanley Asia International Limited (the "Company" or "MSAIL") for the year ended 31 December 2017.

PRINCIPAL ACTIVITIES

The Company is a restricted licence bank under the Banking Ordinance in Hong Kong, regulated by the Hong Kong Monetary Authority ("HKMA"). It is also a registered institution under the Hong Kong Securities and Futures Ordinance. The Company is a private limited company incorporated in Hong Kong, with a head office in Hong Kong and a branch in Singapore ("Branch") which is regulated by the Monetary Authority of Singapore ("MAS").

The principal activities of the Company are to engage in the business of banking including deposit taking and lending. It also acts (a) as agent on behalf of its customers in connection with the provision of general investment, securities and futures dealing, as well as discretionary management and (b) as introducing broker to Morgan Stanley & Co. International plc for the provision of clearance, settlement and custody services in relation to the aforementioned transactions.

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

RESULTS AND APPROPRIATIONS

The results of the Company for the year ended 31 December 2017 are set out in the income statement on page 5.

No interim dividends were paid to the shareholder during the year. The Directors do not recommend the payment of a final dividend and propose that the profits be retained.

SHARE CAPITAL

Details of the Company's shares issued are set out in note 18 to the financial statements. There was no movement in the Company's share capital during the year.

DIRECTORS

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

Chui, Vincent Yik Chiu	
Clatworthy, David Peter	
Fung, Choi Cheung	
Kwan, Yin Ping	
Laroia, Gokul	
Ong, Whatt Soon Ronald	
Rajaram, Harish	(appointed on 11 September 2017)
Vazirani, Ravi Harish	(resigned on 13 June 2017)
Wraight, David John	

DIRECTORS' MATERIAL INTERESTS IN TRANSACTIONS, ARRANGEMENTS AND CONTRACTS THAT ARE SIGNIFICANT IN RELATION TO THE COMPANY'S BUSINESS

No transactions, arrangements and contracts of significance to which the Company, its holding companies or any subsidiaries of its holding companies were a party and in which a Director of the Company had a material interest, whether directly or indirectly, subsisted at the end of the year or at any time during the year.

DIRECTORS' RIGHTS TO ACQUIRE SHARES AND DEBENTURES

Morgan Stanley, the Company's ultimate holding company, has several senior executive incentive compensation programs under which senior executives receive, as part of their total compensation, incentive awards of restricted stock units and, in some cases, restricted stock options that in time are, or may be, converted into shares of Morgan Stanley. All Directors of the Company except independent non-executive directors, are eligible to participate in such incentive compensation programs and receive awards of restricted stock units and, in some cases, restricted stock options thereunder.

Details of the deferred stock awards of the ultimate holding company, in which the Directors of the Company are entitled to participate, are set out in note 26 to the financial statements.

Other than as disclosed above, at no time during the year was the Company, its holding companies or any subsidiaries of its holding companies a party to any arrangements to enable the Directors of the Company to acquire benefits by means of acquisition of shares in, or debentures of, the Company or any other body corporate.

PERMITTED INDEMNITY PROVISION

The Articles of Association of the Company provide that a director or former director of the Company may be indemnified out of the Company's assets against any liability incurred by the Director to a person other than the Company or an associated company of the Company in connection with any negligence, default, breach of duty or breach of trust in relation to the Company or associated company (as the case may be).

AUDITOR

A resolution will be submitted to the annual general meeting to re-appoint Messrs. Deloitte Touche Tohmatsu as auditor of the Company.

On behalf of the Board

CHUI, VINCENT YIK CHIU

DIRECTOR

12 April 2018

INDEPENDENT AUDITOR'S REPORT

TO THE SOLE MEMBER OF MORGAN STANLEY ASIA INTERNATIONAL LIMITED
(incorporated in Hong Kong with limited liability)

Opinion

We have audited the financial statements of Morgan Stanley Asia International Limited (the "Company") set out on pages 5 to 51, which comprise the statement of financial position as at 31 December 2017, and the income statement, statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the financial statements give a true and fair view of the financial position of the Company as at 31 December 2017, and of its financial performance and its cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards ("HKFRSs") issued by the Hong Kong Institute of Certified Public Accountants (the "HKICPA") and have been properly prepared in compliance with the Hong Kong Companies Ordinance.

Basis for Opinion

We conducted our audit in accordance with Hong Kong Standards on Auditing ("HKSAs") issued by the HKICPA. Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are independent of the Company in accordance with the HKICPA's Code of Ethics for Professional Accountants (the "Code"), and we have fulfilled our other ethical responsibilities in accordance with the Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Other Information

The Directors are responsible for the other information. The other information comprises the information included in the annual report, but does not include the financial statements and our auditor's report thereon.

Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of Directors and Those Charged with Governance for the Financial Statements

The Directors are responsible for the preparation of the financial statements that give a true and fair view in accordance with HKFRSs issued by the HKICPA and the Hong Kong Companies Ordinance, and for such internal control as the Directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

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

Those charged with governance are responsible for overseeing the Company's financial reporting process.

TO THE SOLE MEMBER OF MORGAN STANLEY ASIA INTERNATIONAL LIMITED
(incorporated in Hong Kong with limited liability)

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion solely to you in accordance with section 405 of the Hong Kong Companies Ordinance, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with HKSAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with HKSAs, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Directors.
- Conclude on the appropriateness of the Directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

Deloitte Touche Tohmatsu
Certified Public Accountants
Hong Kong

12 April 2018

MORGAN STANLEY ASIA INTERNATIONAL LIMITED

INCOME STATEMENT
Year ended 31 December 2017

	Note	2017 US$'000	2016 US$'000
Interest income	4	26,488	20,584
Interest expense	4	(33,570)	(27,141)
Net interest expense		(7,082)	(6,557)
Fee and commission income	5	214,535	197,232
Net (losses)/gains on financial instruments classified as held for trading		(108,093)	9,647
Net gains/(losses) on available-for-sale financial assets	6	136,283	(5,405)
Other income	7	3,429	12,052
Other expense	8	(209,711)	(203,544)
PROFIT BEFORE INCOME TAX		29,361	3,425
Income tax expense	9	(4,315)	(1,059)
PROFIT FOR THE YEAR		25,046	2,366

All operations were continuing in the current year and prior year.

The notes on pages 10 to 51 form an integral part of the financial statements.

MORGAN STANLEY ASIA INTERNATIONAL LIMITED

STATEMENT OF COMPREHENSIVE INCOME
Year ended 31 December 2017

	Note	2017 US$'000	2016 US$'000
PROFIT FOR THE YEAR		25,046	2,366
OTHER COMPREHENSIVE INCOME, NET OF TAX			
Items that may be reclassified subsequently to profit or loss:			
Available-for-sale reserve:			
Net change in fair value of available-for-sale financial assets	9	(572)	(61)
Net amount reclassified to income statement	9	297	40
OTHER COMPREHENSIVE LOSS AFTER INCOME TAX FOR THE YEAR		(275)	(21)
TOTAL COMPREHENSIVE INCOME FOR THE YEAR		24,771	2,345

The notes on pages 10 to 51 form an integral part of the financial statements.

STATEMENT OF CHANGES IN EQUITY
Year ended 31 December 2017

	Note	Share capital US$'000	Available-for-sale reserve US$'000	Retained earnings US$'000	Total equity US$'000
Balance at 1 January 2016		170,000	(400)	36,105	205,705
Profit for the year		-	-	2,366	2,366
Other comprehensive loss	9	-	(21)	-	(21)
Total comprehensive (loss)/ income		-	(21)	2,366	2,345
Transaction with owners:					
- Share-based payments		-	-	147	147
Balance at 31 December 2016		170,000	(421)	38,618	208,197
Profit for the year		-	-	25,046	25,046
Other comprehensive loss	9	-	(275)	-	(275)
Total comprehensive (loss)/ income		-	(275)	25,046	24,771
Balance at 31 December 2017		170,000	(696)	63,664	232,968

The notes on pages 10 to 51 form an integral part of the financial statements.

MORGAN STANLEY ASIA INTERNATIONAL LIMITED

STATEMENT OF FINANCIAL POSITION
As at 31 December 2017

	Note	2017 US$'000	2016 US$'000
ASSETS			
Loans and receivables:			
Cash and short-term deposits	19(a)	188,267	267,416
Trade receivables		15,314	3,123
Loans and advances to customers	10	1,430,416	1,257,791
Other receivables	11	3,467	2,365
		1,637,464	1,530,695
Financial assets classified as held for trading	12	2,813	35,047
Available-for-sale financial assets	13	2,410,435	3,099,511
Current tax asset		-	3,310
Deferred tax assets	14	6,452	5,406
Prepayments		215	108
TOTAL ASSETS		4,057,379	4,674,077
LIABILITIES AND EQUITY			
Financial liabilities at amortised cost:			
Deposits	15	3,686,326	4,330,912
Trade payables		254	45,424
Other payables	16	119,785	87,673
		3,806,365	4,464,009
Financial liabilities classified as held for trading	12	15,771	1,294
Current tax liabilities		1,667	-
Accruals		608	577
TOTAL LIABILITIES		3,824,411	4,465,880
EQUITY			
Share capital	18	170,000	170,000
Available-for-sale reserve	18	(696)	(421)
Retained earnings		63,664	38,618
Equity attributable to owners of the Company		232,968	208,197
TOTAL EQUITY		232,968	208,197
TOTAL LIABILITIES AND EQUITY		4,057,379	4,674,077

These financial statements were approved by the Board and authorised for issue on 12 April 2018:

Signed on behalf of the Board

Chui, Vincent Yik Chiu
Director

Wraight, David John
Director

The notes on pages 10 to 51 form an integral part of the financial statements.

STATEMENT OF CASH FLOWS
Year ended 31 December 2017

	Note	2017 US$'000	2016 US$'000
NET CASH FLOWS USED IN OPERATING ACTIVITIES	19(b)	(904,191)	(1,457,980)
INVESTING ACTIVITIES			
Purchase of available-for-sale financial assets	13	(9,753,551)	(10,994,445)
Proceeds from maturity/ sale of available-for-sale financial assets	13	10,576,343	11,912,101
Interest received from available-for-sale financial assets	13	2,250	8,797
NET CASH FLOWS FROM INVESTING ACTIVITIES		825,042	926,453
NET DECREASE IN CASH AND CASH EQUIVALENTS		(79,149)	(531,527)
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE YEAR		267,416	798,943
CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR	19(a)	188,267	267,416

The notes on pages 10 to 51 form an integral part of the financial statements.

1. CORPORATE INFORMATION

The Company is a private limited company with a head office in Hong Kong and a branch in Singapore ("Branch"). The Company was incorporated and is domiciled in Hong Kong, at the following principal place of business address: Level 31, International Commerce Centre, 1 Austin Road West, Kowloon, Hong Kong.

The Company is a restricted licence bank under the Banking Ordinance in Hong Kong, regulated by the HKMA, with its Branch regulated by the MAS. It is also a registered institution under the Hong Kong Securities and Futures Ordinance. The principal activities of the Company are to engage in the business of banking including deposit taking and lending. It also acts (a) as agent on behalf of its customers in connection with the provision of general investment, securities and futures dealing, as well as discretionary management and (b) as introducing broker to Morgan Stanley & Co. International plc for the provision of clearance, settlement and custody services in relation to the aforementioned transactions.

The Company's immediate parent undertaking is Morgan Stanley Hong Kong Limited, which was incorporated in Hong Kong.

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

2. BASIS OF PREPARATION

Statement of compliance

The Company has prepared its annual financial statements in accordance with Hong Kong Financial Reporting Standards ("HKFRS") and interpretations issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA") and the Hong Kong Companies Ordinance.

New standards and interpretations adopted during the year

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

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

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

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

New standards and interpretations not yet adopted

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

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

2. BASIS OF PREPARATION (CONTINUED)

New standards and interpretations not yet adopted (continued)

HKFRS 9 *'Financial instruments'* ("HKFRS 9") was issued by the HKICPA in November 2009, amended in December 2013, and revised and reissued by the HKICPA in September 2014. HKFRS 9 is applicable retrospectively, except where otherwise prescribed by transitional provisions of the standard, and is effective for annual periods beginning on or after 1 January 2018. Early application, either in full or relating to own credit in isolation, is permitted.

A further amendment to HKFRS 9, relating to the accounting treatment of financial instruments with prepayment features including negative compensation, was issued by the HKICPA in October 2017. The amendment is applicable retrospectively, expect where otherwise prescribed by transitional provisions of the amendment, and is effective for annual periods beginning on or after 1 January 2019.

The main aspects of HKFRS 9 which impact the Company are its requirements relating to:

- Classification and measurement of financial assets

  The classification and measurement of financial assets will depend on how these are managed (the Company's business model) and their contractual cash flow characteristics. Measurement will be at amortised cost, fair value through other comprehensive income ("FVOCI") or fair value through profit or loss ("FVPL").

- Impairment of financial assets

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

The Company has undertaken a project to implement HKFRS 9. As part of this project, the Company has completed an evaluation of its business models and a review of the contractual terms of financial assets measured at amortised cost or FVOCI under HKFRS 9 to ensure that they are compatible with such classifications.

As a result of this evaluation, debt investments currently held as available-for-sale will move to FVOCI with a consequent transfer of the accumulated Available-for-sale reserve to fair value reserve. The impact of this on retained earnings as at 1 January 2018 is not material to the Company.

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

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

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

2. BASIS OF PREPARATION (CONTINUED)

New standards and interpretations not yet adopted (continued)

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

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

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

HKFRS 15 *'Revenue from Contracts with Customers'* ("HKFRS 15") was issued by the HKICPA in July 2014 for retrospective application in annual periods beginning on or after 1 January 2018. In addition, amendments to HKFRS15 were issued by HKICPA in June 2016 requiring application in annual periods beginning on or after 1 January 2018. Early application of HKFRS15 and the amendments is permitted.

HK(IFRIC)-Int 22 '*Foreign Currency Transactions and Advance Consideration*' was issued by the HKICPA in June 2017 for application in annual periods beginning on or after 1 January 2018. The Company is currently assessing the impact of HK(IFRIC)-Int 22 on its financial statements.

HK(IFRIC)-Int 23 '*Uncertainty over Income Tax Treatments*' was issued by the HKICPA in July 2017 for application in annual periods beginning on or after 1 January 2019. The Company is currently assessing the impact of HK(IFRIC)-Int 23 on its financial statements.

As part of the 2015-2017 Annual Improvements Cycle published in February 2018, the HKICPA made amendments to the following standard that is relevant to the Company's operations: HKAS 12 *'Income Taxes'*, for application in accounting periods beginning on or after 1 January 2019.

Basis of measurement

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

Critical judgements in applying the Company's accounting policies

The preparation of the Company's financial statements requires management to make judgements regarding existence of impairment of assets. The Company believes that the judgements utilised in preparing the financial statements are reasonable, relevant and reliable.

For further details on the judgements used in determining impairment of assets, see note 3(f).

Key sources of estimation uncertainty

The preparation of the Company's financial statements requires management to make assumptions regarding the valuation of certain financial instruments.

For further details on the judgements used in determining fair value of certain assets and liabilities, see note 3(d) and 23.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

a. Functional currency

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

All currency amounts in the financial statements are rounded to the nearest thousand US dollars.

b. Foreign currencies

All monetary assets and liabilities denominated in currencies other than US dollars are translated into US dollars at the rates ruling at the reporting date. Transactions and non-monetary assets and liabilities denominated in currencies other than US dollars are recorded at the rates prevailing at the dates of the transactions. Foreign exchange differences on available-for-sale financial assets are recorded in the 'Available-for-sale reserve' in equity, with the exception of translation differences on the amortised cost of monetary available-for-sale financial assets, which are recognised through the income statement. All other translation differences are taken through the income statement. Exchange differences recognised in the income statement are presented in 'Other income' or 'Other expense', except where noted in 3(c) below.

c. Financial instruments

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

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

More information regarding these classifications is included below:

i) Financial instruments classified as held for trading

Financial instruments classified as held for trading, including all derivatives, are initially recorded on trade date at fair value (see note 3(d) below). All subsequent changes in fair value, foreign exchange differences, interest and dividends are reflected in the income statement in 'Net (losses)/gains on financial instruments classified as held for trading'.

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

ii) Available-for-sale financial assets

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

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

For debt instruments, interest calculated using the effective interest rate method (see note 3(c) (iii) below), impairment losses and reversals of impairment losses and foreign exchange differences on the amortised cost of the asset are recognised in the income statement in 'Net gains/ (losses) on available-for-sale financial assets'. All other gains and losses on debt instruments classified as available-for-sale are recognised in the 'Available-for-sale reserve' within equity.

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

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

c. Financial instruments (continued)

iii) Loans and receivables and financial liabilities at amortised cost

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

Financial assets classified as loans and receivables include cash and short-term deposits, trade receivables, loans and advances to customers and other receivables.

Financial liabilities at amortised cost are recognised when the Company becomes a party to the contractual provision of the instrument. They are initially measured at fair value (see note 3(d) below) and subsequently measured at amortised cost. Interest is recognised in the income statement in ‘Interest expense’ using the effective interest rate method as described below. Transaction costs that are directly attributable to the issue of the financial liability are added to or deducted from the fair value on initial recognition.

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

d. Fair value

Fair value measurement

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

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

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

d. Fair value (continued)

Fair value measurement (continued)

The hierarchy is broken down into three levels based on the observability of inputs as follows:

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

  Valuations based on quoted prices in active markets that the Morgan Stanley Group has the ability to access for identical assets or liabilities. Valuation adjustments and block discounts are not applied to Level 1 instruments. Since valuations are based on quoted prices that are readily and regularly available in an active market, valuation of these products does not entail a significant degree of judgement.

- Level 2 - Valuation techniques using observable inputs

  Valuations based on one or more quoted prices in markets that are not active or for which all significant inputs are observable, either directly or indirectly.

- Level 3 - Valuation techniques with significant unobservable inputs

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

The availability of observable inputs can vary from product to product and is affected by a wide variety of factors, including, for example, the type of product, whether the product is new and not yet established in the marketplace, the liquidity of markets and other characteristics particular to the product. To the extent that valuation is based on models or inputs that are less observable or unobservable in the market, the determination of fair value requires more judgement. Accordingly, the degree of judgement exercised by the Company in determining fair value is greatest for instruments categorised in Level 3 of the fair value hierarchy.

The Company considers prices and inputs that are current as of the measurement date, including during periods of market dislocation. In periods of market dislocation, the observability of prices and inputs may be reduced for many instruments. This condition could cause an instrument to be reclassified from Level 1 to Level 2 or Level 2 to Level 3 of the fair value hierarchy.

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

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

Valuation techniques

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

Fair value for many cash instruments and OTC derivative contracts is derived using pricing models. Pricing models take into account the contract terms, as well as multiple inputs including, where applicable, commodity prices, equity prices, interest rate yield curves, credit curves, correlation, creditworthiness of the counterparty, creditworthiness of the Company, option volatility and currency rates.

Where appropriate, valuation adjustments are made to account for various factors such as liquidity risk (bid-ask adjustments), credit quality, model uncertainty and concentration risk.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

d. Fair value (continued)

Valuation techniques (continued)

Adjustments for liquidity risk adjust model-derived mid-market levels of Level 2 and Level 3 financial instruments for the bid-mid or mid-ask spread required to properly reflect the exit price of a risk position. Bid-mid and mid-ask spreads are marked to levels observed in trade activity, broker quotes or other external third-party data. Where these spreads are unobservable for the particular position in question, spreads are derived from observable levels of similar positions.

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

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

Valuation process

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

> *Model Review.* VRG, in conjunction with the Model Risk Management Department ("MRM"), which report to the Chief Risk Officer of the Morgan Stanley Group ("CRO"), independently reviews valuation models' theoretical soundness, the appropriateness of the valuation methodology and calibration techniques developed by the business units using observable inputs. Where inputs are not observable, VRG reviews the appropriateness of the proposed valuation methodology to determine that it is consistent with how a market participant would arrive at the unobservable input. The valuation methodologies utilised in the absence of observable inputs may include extrapolation techniques and the use of comparable observable inputs. As part of the review, VRG develops a methodology to independently verify the fair value generated by the business unit's valuation models. The Company generally subjects valuations and models to a review process initially and on a periodic basis thereafter.
>
> *Independent Price Verification.* The business units are responsible for determining the fair value of financial instruments using approved valuation models and valuation methodologies. Generally on a monthly basis, VRG independently validates the fair values of financial instruments determined using valuation models by determining the appropriateness of the inputs used by the business units and by testing compliance with the documented valuation methodologies approved in the model review process described above.
>
> The results of this independent price verification and any adjustments made by VRG to the fair value generated by the business units are presented to management of the Morgan Stanley Group's three business segments (i.e. Institutional Securities, Wealth Management and Investment Management), the CFO and the CRO on a regular basis.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

d. Fair value (continued)

Valuation process (continued)

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

VRG reviews the models and valuation methodology used to price new material Level 2 and Level 3 transactions and both the FCG and MRM must approve the fair value of the trade that is initially recognised.

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

Gains and losses on inception

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

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

e. Derecognition of financial assets and liabilities

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

If the asset has been transferred, and the entity neither transfers nor retains substantially all of the risks and rewards of the asset, then the entity determines whether it has retained control of the asset.

If the entity has retained control of the asset, it shall continue to recognise the financial asset to the extent of its continuing involvement in the financial asset. If the entity has not retained control of the asset, it derecognises the asset and separately recognises any rights or obligation created or retained in the transfer.

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

f. Impairment of financial assets

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

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

f. Impairment of financial assets (continued)

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

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

For all financial assets, if in a subsequent year, the amount of the estimated impairment loss decreases because of an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed as described for the relevant categories of financial asset in note 3(c) (ii) and (iii). Any reversal is limited to the extent that the value of the asset may not exceed the original amortised cost of the asset had no impairment occurred.

g. Fees and commissions

Fee and commission income includes sales commissions, transaction and service fees. These amounts are recognised as the related services are performed or received.

h. Impairment of non-financial assets

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

i. Cash and cash equivalents

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

j. Income tax

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

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

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

j. Income tax (continued)

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

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

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

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

k. Provisions

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

The amount recognised as a provision is the best estimate of the consideration required to settle the present obligation at the year end date, taking into account the risks and uncertainties surrounding the obligation.

l. Employee compensation plans

i) Equity-settled share-based compensation plans

Morgan Stanley issues awards in the form of restricted stock units (“RSU”) to employees of Morgan Stanley Group for services rendered to the Company. Awards are classified as equity-settled and the cost of the equity-based transactions with employees is measured based on the fair value of the equity instruments at grant date. The fair value of RSUs is based on the market price of Morgan Stanley shares. Awards are amortised over the future service period.

Certain awards contain clawback provisions which permit the Company to cancel all or a portion of the award under specific circumstances. Compensation expense for those awards is adjusted to fair value based upon changes in the share price of Morgan Stanley’s common stock until grant date occurs.

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

Share-based compensation expense is recorded within ‘Staff costs’ and ‘Directors’ remuneration’ in ‘Other expense’ in the income statement.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

l. Employee compensation plans (continued)

ii) Deferred cash-based compensation plans

Morgan Stanley also maintains deferred compensation plans on behalf of the Company for the benefit of certain current and former employees that provide a return to the participating employees based upon the performance of various referenced investments. Liabilities for these awards, which are included within 'Other payables' in the statement of financial position, are measured at fair value and recognised over time in accordance with the awards' vesting conditions. The related expense is recorded within 'Staff costs' and 'Directors' remuneration' in 'Other expense'.

m. Post-employment benefits

The Company operates defined contribution post-employment plans. Additionally, the Branch of the Company participates in a defined contribution plan, the Singapore Central Provident Fund.

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

Details of the plans are given in note 27 to these financial statements.

n. Offsetting of financial assets and financial liabilities

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

4. INTEREST INCOME AND INTEREST EXPENSE

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

No other gains or losses have been recognised in respect of loans and receivables other than as disclosed as 'Interest income' and foreign exchange differences disclosed in 'Other income' (note 7).

No other gains or losses have been recognised in respect of financial liabilities at amortised cost other than as disclosed as "Interest expense" within the income statement and foreign exchange differences disclosed in "Other income" (note 7).

5. FEE AND COMMISSION INCOME

	2017 US$'000	2016 US$'000
Sales commissions and fees	214,520	197,194
Other fees	15	38
	214,535	197,232

6. NET GAINS/(LOSSES) ON AVAILABLE-FOR-SALE FINANCIAL ASSETS

	2017 US$'000	2016 US$'000
Interest income	25,696	19,754
Foreign exchange revaluation	110,925	(25,112)
Net fair value losses reclassified from the available-for-sale reserve on disposal of assets	(338)	(47)
	136,283	(5,405)

7. OTHER INCOME

	2017 US$'000	2016 US$'000
Net foreign exchange gains	1,408	5,817
Management charges to other Morgan Stanley Group undertakings	1,889	6,117
Other	132	118
	3,429	12,052

8. OTHER EXPENSE

	2017 US$'000	2016 US$'000
Staff costs	128,067	115,962
Directors' remuneration		
Fees	82	83
Contribution to defined contribution plan	71	52
Other	10,211	7,171
Auditors' remuneration:		
Fees payable to the Company's auditor for the audit of the Company's annual financial statements	579	549
Fees payable to the Company's auditor for other services to the Company	2	2
Non-audit professional services	10,049	7,179
Management charges from other Morgan Stanley Group undertakings relating to staff costs	128	590
Management charges from other Morgan Stanley Group undertakings relating to other services	57,010	68,405
Other	3,512	3,551
	209,711	203,544

Included within 'Staff costs', 'Directors' remuneration' and 'Management charges from other Morgan Stanley Group undertakings' is an amount of US$13,197,000 (2016: US$14,001,000) in relation to equity-settled share-based compensation plans, and US$14,008,000 (2016: US$12,094,000) in relation to awards of non-equity based deferred compensation plans, granted to employees of the Company. Previous years' awards were granted to the employees prior to their transfer to the Company. Refer to note 26 for more information about employee compensation plans.

For the years ended 31 December 2017 and 31 December 2016, the Company has not paid any (a) payments or benefits in respect of the termination of the service of directors whether in the capacity of directors or in any other capacity while being a director of the Company, and (b) consideration provided to or receivable by any third party for making available the services of a person as a director or in any other capacity while being a director of the Company.

During the year, the Company has not granted any loans, quasi-loans nor entered into any other dealings in favor of (a) the Directors, (b) entities controlled by the Directors; or (c) entities connected with the Directors (2016: Nil).

9. INCOME TAX EXPENSE

	2017 US$'000	2016 US$'000
Current tax expense		
Current year		
Hong Kong	4,638	3,773
Other jurisdiction	742	10
	5,380	3,783
Adjustments in respect of prior years		
Hong Kong	(43)	894
Other jurisdiction	(50)	-
	5,287	4,677
Deferred tax benefit		
Origination and reversal of temporary differences	(951)	(2,924)
Adjustments in respect of prior years	(21)	(694)
	(972)	(3,618)
Income tax expense	4,315	1,059

Reconciliation of effective tax rate

The current year income tax expense is lower (2016: higher) than that resulting from applying the standard rate of profits tax in Hong Kong for the year of 16.5% (2016:16.5%). The main differences are explained below:

	2017 US$'000	2016 US$'000
Profit before income tax	29,361	3,425
Income tax using the standard rate of profits tax in Hong Kong of 16.5%	4,845	565
Impact on tax of:		
Expenses not deductible for tax purposes	1,834	1,175
Recognition of previously unrecognised tax losses	(44)	-
Tax exempt income	(1,823)	(1,158)
Concessionary tax rate	(450)	347
Effect of tax rates in foreign jurisdiction	47	(36)
Tax (over)/under provided in prior years	(70)	200
Withholding tax expensed	6	10
Others	(30)	(44)
Total income tax expense in the income statement	4,315	1,059

9. INCOME TAX EXPENSE (CONTINUED)

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

	2017 Before tax US$'000	2017 Tax benefit/ (expense) US$'000	2017 Net of tax US$'000	2016 Before tax US$'000	2016 Tax benefit/ (expense) US$'000	2016 Net of tax US$'000
Available-for-sale reserve:						
Net change in fair value of available-for-sale financial assets	(655)	83	(572)	(69)	8	(61)
Net amount transferred to income statement	338	(41)	297	47	(7)	40
Other comprehensive (loss)/ income	(317)	42	(275)	(22)	1	(21)

10. LOANS AND ADVANCES TO CUSTOMERS

	2017 US$'000	2016 US$'000
Loans and advances to customers	1,430,416	1,257,791

There were no impaired loan and advances, collective and specific provisions, as at 31 December 2017 (31 December 2016: Nil).

11. OTHER RECEIVABLES

	2017 US$'000	2016 US$'000
Amounts due from other Morgan Stanley Group undertakings	633	416
Interest receivable	2,743	1,869
Other amounts receivable	91	80
	3,467	2,365

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

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

	2017 Notional amount US$'000	2017 Fair value Assets US$'000	2017 Fair value Liabilities US$'000	2016 Notional amount US$'000	2016 Fair value Assets US$'000	2016 Fair value Liabilities US$'000
Derivatives:						
Foreign exchange contracts	2,179,821	2,522	15,771	1,911,651	34,773	1,290
Interest rate contracts	1,050,000	291	-	2,150,000	274	4
	3,229,821	2,813	15,771	4,061,651	35,047	1,294

The derivatives are entered with other Morgan Stanley Group undertakings (see note 28).

13. AVAILABLE-FOR-SALE FINANCIAL ASSETS

Financial assets classified as available-for-sale are summarised as follows:

	2017 US$'000	2016 US$'000
Government debt securities:		
Singapore government treasury bills	1,287,352	1,501,304
US treasury bills and securities	1,123,083	1,598,207
	2,410,435	3,099,511

Movement in available-for-sale financial assets

	2017 US$'000	2016 US$'000
Fair value		
At 1 January	3,099,511	4,031,391
Additions	9,753,551	10,994,445
Changes in fair value recognised in the income statement	25,696	19,754
Changes in fair value recognised in the available-for-sale reserve	(655)	(69)
Foreign exchange revaluation recognised in the income statement	110,925	(25,112)
Disposals and other settlements	(10,578,593)	(11,920,898)
At 31 December	2,410,435	3,099,511

14. DEFERRED TAX ASSETS

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

	Deferred tax asset	
	2017 US$'000	2016 US$'000
At 1 January	5,406	1,868
Amount recognised in the income statement	972	3,618
Amount recognised in other comprehensive income:		
Available-for-sale financial assets	42	1
Foreign exchange revaluation	32	(81)
At 31 December	6,452	5,406

14. DEFERRED TAX ASSETS (CONTINUED)

The deferred tax included in the statement of financial position and changes recorded in the income statement in 'Income tax expense' and statement of comprehensive income are as follows:

	2017			2016		
	Deferred Tax Asset US$'000	Income statement US$'000	Other Comprehensive Income US$'000	Deferred tax asset US$'000	Income statement US$'000	Other Comprehensive Income US$'000
Deferred compensation	6,355	1,585	-	4,581	2,776	-
Available-for-sale financial assets	97	-	42	55	-	1
Tax losses (utilised)/ carried forward	-	(613)	-	770	842	-
	6,452	972	42	5,406	3,618	1

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

15. DEPOSITS

	2017 US$'000	2016 US$'000
Deposits of banks		
Current account balances	1,734	14,227
Deposits of non-bank customers		
Current account balances	2,644,840	2,323,846
Term deposits	254,478	949,333
Deposits of other Morgan Stanley Group undertakings	785,274	1,043,506
	3,686,326	4,330,912

16. OTHER PAYABLES

	2017 US$'000	2016 US$'000
Amounts due to other Morgan Stanley Group undertakings	13,520	13,501
Staff compensation and benefits accruals	81,502	64,664
Funds-in-transit	20,000	-
Interest payable	1,160	7,856
Other amounts payable	3,603	1,652
	119,785	87,673

17. COMMITMENTS AND CONTINGENCIES

At 31 December 2017, there are no commitments and contingencies (31 December 2016: Nil).

18. EQUITY

Ordinary share capital

	Ordinary shares Number	Ordinary shares US$'000
Issued and fully paid		
At 1 January 2016, 31 December 2016 and 31 December 2017	170,000,000	170,000

The holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at general meetings of the Company. All shares rank equally with regard to the Company's residual assets.

Available-for-sale reserve

The 'Available-for-sale reserve' of US$696,000 (2016: US$421,000) includes the cumulative net change in the fair value of available-for-sale financial assets held at the reporting date. The tax effect of these movements is also included in the 'Available-for-sale reserve'.

19. ADDITIONAL CASH FLOW INFORMATION

a. Cash and cash equivalents

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

	2017 US$'000	2016 US$'000
Cash with central bank	14,212	12,301
Cash at banks	162,968	161,095
Placements with banks	11,087	94,020
	188,267	267,416

19. ADDITIONAL CASH FLOW INFORMATION (CONTINUED)

b. Reconciliation of cash flows from operating activities

	2017 US$'000	2016 US$'000
Profit for the year	25,046	2,366
Adjustments for:		
Net (gains)/ losses on available-for-sale financial assets	(136,283)	5,405
Share-based payments	-	147
Interest income	(26,488)	(20,584)
Interest expense	33,570	27,141
Income tax expense	4,315	1,059
Operating cash flows before changes in operating assets and liabilities	(99,840)	15,534
Changes in operating assets		
Increase in loans and receivables, excluding cash and short-term deposits	(181,306)	(228,566)
Decrease/ (increase) in financial assets classified as held for trading	32,234	(25,489)
(Increase)/ decrease in prepayments	(107)	3
	(149,179)	(254,052)
Changes in operating liabilities		
Decrease in financial liabilities at amortised cost	(645,661)	(1,200,349)
Increase/ (decrease) in financial liabilities classified as held for trading	14,477	(6,569)
Increase/ (decrease) in accruals	31	(113)
	(631,153)	(1,207,031)
Interest received	21,876	20,291
Interest paid	(45,553)	(16,197)
Net income tax paid	(350)	(16,532)
Effect of foreign exchange movements	8	7
Net cash flows used in operating activities	(904,191)	(1,457,980)

20. EXPECTED MATURITY OF ASSETS AND LIABILITIES

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

At 31 December 2017	Less than or equal to twelve months US$'000	More than twelve months US$'000	Total US$'000
ASSETS			
Loans and receivables:			
Cash and short-term deposits	188,267	-	188,267
Trade receivables	15,314	-	15,314
Loans and advances to customers	1,430,416	-	1,430,416
Other receivables	3,467	-	3,467
	1,637,464	-	1,637,464
Financial assets classified as held for trading	2,813	-	2,813
Available-for-sale financial assets	2,410,435	-	2,410,435
Deferred tax assets	-	6,452	6,452
Prepayments	215	-	215
	4,050,927	6,452	4,057,379
LIABILITIES			
Financial liabilities at amortised cost:			
Deposits	3,686,326	-	3,686,326
Trade payables	254	-	254
Other payables	94,204	25,581	119,785
	3,780,784	25,581	3,806,365
Financial liabilities classified as held for trading	15,771	-	15,771
Current tax liabilities	1,667	-	1,667
Accruals	608	-	608
	3,798,830	25,581	3,824,411

20. EXPECTED MATURITY OF ASSETS AND LIABILITIES (CONTINUED)

At 31 December 2016	**Less than or equal to twelve months US$'000**	**More than twelve months US$'000**	**Total US$'000**
ASSETS			
Loans and receivables:			
Cash and short-term deposits	267,416	-	267,416
Trade receivables	3,123	-	3,123
Loans and advances to customers	1,257,791	-	1,257,791
Other receivables	2,365	-	2,365
	1,530,695	-	1,530,695
Financial assets classified as held for trading	35,047	-	35,047
Available-for-sale financial assets	3,099,511	-	3,099,511
Current tax assets	3,310	-	3,310
Deferred tax assets	-	5,406	5,406
Prepayments	108	-	108
	4,668,671	5,406	4,674,077
LIABILITIES			
Financial liabilities at amortised cost:			
Deposits	4,330,912	-	4,330,912
Trade payables	45,424	-	45,424
Other payables	65,198	22,475	87,673
	4,441,534	22,475	4,464,009
Financial liabilities classified as held for trading	1,294	-	1,294
Accruals	577	-	577
	4,443,405	22,475	4,465,880

21. FINANCIAL RISK MANAGEMENT

Risk management procedures

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

Significant risks faced by the Company resulting from its private wealth management and financing activities are set out below.

Credit risk

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

Credit risk management policies and procedures for the Company are consistent with those of the Morgan Stanley Group and include escalation to the Company's Board and appropriate key management personnel.

The Company's credit risk management policies and procedures establish the framework for ensuring transparency of material credit risks, ensuring compliance with established limits and escalation of risk concentrations to appropriate senior management.

The Company incurs credit risk exposure to institutions and sophisticated individuals mainly through its Wealth Management business segment. The Company incurs credit risk primarily through lending to individuals and entities, including, but not limited to, margin loans and other loans predominantly collateralised by cash and securities.

The Company also may incur credit risk through a variety of activities, including, but not limited to, the following:

- entering into derivative contracts with other Morgan Stanley Group undertakings under which counterparties have obligations to make payments to the Company;
- posting margin and/or collateral to banks and other financial counterparties;
- placing funds on deposit at other financial institutions; and
- entering into securities transactions, whereby the value of these assets may fluctuate based on realised or expected defaults on the underlying obligations.

Monitoring and Control

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

21. FINANCIAL RISK MANAGEMENT (CONTINUED)

Credit risk (continued)

Monitoring and Control (continued)

A comprehensive and global Credit Limits Framework is utilised to manage credit risk levels across the Morgan Stanley Group, including the Company. The Credit Limits Framework is calibrated within the Morgan Stanley Group's risk tolerance and includes single-name limits and portfolio concentration limits by country, industry and product type. The Credit Risk Management Department ensures transparency of material credit risks, compliance with established limits and escalation of risk concentrations to appropriate senior management. The Credit Risk Management Department also works closely with the Market Risk Department and applicable business units to monitor risk exposures and to perform stress tests to identify, analyse and control credit risk concentrations arising in the Morgan Stanley Group's lending and trading activities. Stress and scenario tests are conducted in accordance with established Morgan Stanley Group's policies and procedures and comply with methodologies outlined in the Basel regulatory framework.

Credit Evaluation

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

The Company's Wealth Management business segment generates minimal credit exposure given the collateralised nature of the business, as such the credit evaluation focuses on the counterparties' and borrowers' background, the purpose of the borrowing and collateral evaluation, to ensure the exposures are well-collateralised.

In addition to assessing and monitoring its credit exposure and risk at the individual obligor level, the Company also reviews its credit exposure and risk to geographic regions. As at 31 December 2017, credit exposure was concentrated in North American and Asian countries. In addition, the Company pays particular attention to smaller exposures in emerging markets given their unique risk profile. Sovereign ratings are derived using methodologies generally consistent with those employed by external rating agencies.

The Company also reviews its credit exposure and risk to types of customers. At 31 December 2017, the Company's material credit exposure was to sovereigns, sovereign related entities, corporate entities, financial institutions and individuals.

Risk Mitigation

The Morgan Stanley Group may seek to mitigate credit risk from its lending and trading activities in multiple ways, including collateral provisions, guarantees and hedges. In connection with its derivatives transactions with other Morgan Stanley Group undertakings, the Company generally enters into master netting agreements and collateral arrangements with counterparties. These agreements provide the Company with the ability to demand collateral, as well as to liquidate collateral and offset receivables and payables covered under the same master agreement in the event of a counterparty default.

21. FINANCIAL RISK MANAGEMENT (CONTINUED)

Credit risk (continued)

Risk Mitigation (continued)

In connection with securities purchased under agreements to resell transactions, the Company manages credit exposure arising from such transactions by, in appropriate circumstances, entering into Global Master Repurchase Agreements with counterparties that provide the Company, in the event of a counterparty default, with the right to net a counterparty's rights and obligations under such agreement and liquidate and set off collateral held by the Company against the net amount owed by the counterparty. Under these securities purchased under agreements to resell transactions, the Company receives collateral, including US government securities. The Company also monitors the fair value of the underlying securities as compared with the related receivable or payable, including accrued interest, and, as necessary, requests additional collateral to ensure such transactions are adequately collateralised. As at 31 December 2017 and 31 December 2016, there is no outstanding securities purchased under agreements to resell transaction.

In connection with the Company's Wealth Management business, the Company relies on the use of collateral to manage credit risk. The amount and type of collateral required by the Company depends on an assessment of the credit risk of the obligor. Collateral held is managed in accordance with the Company's guidelines and the relevant underlying agreements. Collateral is primarily publicly traded debt and equity securities, as well as a small amount of other collateral including unlisted securities, notes, mutual funds and insurance policies that fulfill the risk management requirement of being valuable and realisable at short notice. The market value of securities received as collateral is monitored on a daily basis and securities received as collateral generally are not recognised on the statement of financial position. The Company monitors the creditworthiness of counterparties to these transactions on an ongoing basis and requests additional collateral in accordance with collateral arrangements when deemed necessary.

Exposure to credit risk

The maximum exposure to credit risk ("gross credit exposure") of the Company as at 31 December 2017 and 31 December 2016 is disclosed below, based on the carrying amounts of the financial assets the Company believes are subject to credit risk. Where the Company enters into credit enhancements, including receiving cash and security as collateral and master netting agreements, to manage the credit exposure on these financial instruments the financial effect of the credit enhancements is also disclosed below. The net credit exposure represents the credit exposure remaining after the effect of the credit enhancements. The 'unrated' balance in the 'Maximum exposure to credit risk by credit rating' represents the pool of counterparties that either do not require a rating or are under review in accordance with the Morgan Stanley Group's rating policies. These counterparties individually generate no material credit exposure and this pool is highly diversified, monitored and subject to limits.

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

21. FINANCIAL RISK MANAGEMENT (CONTINUED)

Credit risk (continued)

Risk Mitigation (continued)

Exposure to credit risk by class:

Class	2017			2016		
	Gross credit exposure[1] US$'000	Credit Enhancements US$'000	Net Credit Exposure US$'000	Gross credit exposure[1] US$'000	Credit enhancements US$'000	Net Credit Exposure US$'000
Loans and receivables:						
Cash and short-term deposits	188,267	-	188,267	267,416	-	267,416
Trade receivables	15,314	-	15,314	3,123	(3,123)	-
Loans and advances to customers [2]	1,430,416	(1,430,416)	-	1,257,791	(1,257,791)	-
Other receivables	3,467	-	3,467	2,365	-	2,365
Financial assets classified as held for trading:						
Derivatives	2,813	(243)	2,570	35,047	(34,864)	183
Available-for-sale financial assets	2,410,435	-	2,410,435	3,099,511	-	3,099,511
	4,050,712	(1,430,659)	2,620,053	4,665,253	(1,295,778)	3,369,475

(1) The carrying amount recognised in the statement of financial position best represents the Company's maximum exposure to credit risk.
(2) The collateral held as security for loan and advances consists of cash of US$358,105,000 (2016: US$275,563,000), securities of US$647,222,000 (2016: US$634,667,000) and other collateral of US$425,089,000 (2016: US$347,561,000).

The impact of master netting arrangements and similar agreements on the Company's ability to offset financial assets and financial liabilities is disclosed in note 22.

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

Credit rating	Gross credit exposure 2017 US$'000	2016 US$'000
AAA	2,424,646	3,111,812
AA	42,387	59,676
A	148,974	233,704
BBB	54	35
BB	655	910
B	7,449	3,498
CCC/Unrated	1,426,547	1,255,618
Total	4,050,712	4,665,253

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

At 31 December 2017, there were no financial assets past due but not impaired or individually impaired (2016: Nil).

21. FINANCIAL RISK MANAGEMENT (CONTINUED)

Credit risk (continued)

Risk Mitigation (continued)

The main considerations for the impairment assessment include whether there are any known difficulties in the cash flows of counterparties, credit rating downgrades, or infringement of the original terms of the contract. For the Company's Wealth Management lending activities, which are collateralised by cash and securities, a loan is assessed for impairment when a counterparty fails to meet a margin call and there is a remaining uncollateralised shortfall after liquidating the underlying collateral. In addition, a collective impairment assessment is considered and a collective impairment allowance is established if necessary to cover estimated credit losses incurred in the lending portfolio that have not yet been specifically identified as impaired. The impairment losses are evaluated at least at each reporting date.

Liquidity risk

Liquidity risk refers to the risk that the Company will be unable to finance its operations due to a loss of access to the capital markets or difficulty in liquidating its assets. Liquidity risk encompasses the risk that the Company's financial condition or overall soundness is adversely affected by an inability or perceived inability to meet its financial obligations in a timely manner. Liquidity risk also encompasses the associated funding risks triggered by market or idiosyncratic stress events that may negatively affect the Company's liquidity and may impact its ability to raise new funding. Generally, the Company incurs liquidity risk as a result of its trading, lending, investing and client facilitation activities.

The Morgan Stanley Group's Liquidity Risk Management Framework is critical to helping ensure that the Company maintains sufficient liquidity reserves and durable funding sources to meet its daily obligations and to withstand unanticipated stress events. The Liquidity Risk Department is a distinct area in Risk Management, which oversees and monitors liquidity risk. The Liquidity Risk Department is independent of the business units and reports to the CRO. The Liquidity Risk Department ensures transparency of material liquidity risks, compliance with established risk limits and escalation of risk concentrations to appropriate senior management. To execute these responsibilities, the Liquidity Risk Department:

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

21. FINANCIAL RISK MANAGEMENT (CONTINUED)

Liquidity risk (continued)

The liquidity risks identified by these processes are summarised in reports produced by the Liquidity Risk Department that are circulated to and discussed with the Company's Assets & Liabilities Committee ("ALCO") and regional ALCO and risk committees, as appropriate.

The Treasury Department and applicable business units have primary responsibility for evaluating, monitoring and controlling the liquidity risks arising from the Morgan Stanley Group's business activities, and for maintaining processes and controls to manage the key risks inherent in their respective areas. The Liquidity Risk Department coordinates with the Treasury Department and these business units to help ensure a consistent and comprehensive framework for managing liquidity risk across the Morgan Stanley Group.

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

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

The following principles guide the Company's liquidity risk management framework:

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

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

Required Liquidity Framework

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

21. FINANCIAL RISK MANAGEMENT (CONTINUED)

Liquidity risk (continued)

Liquidity Stress Tests

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

The scenarios and assumptions used by the Company in its Liquidity Stress Tests include, but are not limited to, the following:

- withdrawal of customer deposits;
- no government support;
- no access to equity and unsecured debt markets;
- repayment of all unsecured debt maturing within the stress horizon;
- additional collateral that would be required by trading counterparties, certain exchanges and clearing organisations related to credit rating downgrades;
- drawdowns on unfunded commitments provided to customers; and
- limited access to the foreign exchange swap markets.

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

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

Liquidity Reserve

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

The Company holds its own Liquidity Reserve which is composed of diversified cash and cash equivalents and unencumbered highly liquid securities.

Eligible unencumbered highly liquid securities include primarily non-US government securities in addition to US government securities and other highly liquid investment grade securities.

Funding Management

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

The Company funds itself through diverse sources. These sources may include equity capital, long-term debt and deposits.

21. FINANCIAL RISK MANAGEMENT (CONTINUED)

Liquidity risk (continued)

Balance sheet management

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

Maturity analysis

In the following maturity analysis of financial assets and financial liabilities, derivatives not held as part of the Company's trading activities are disclosed according to their earliest contractual maturity; all such amounts are presented at their fair value, consistent with how these financial assets and liabilities are managed. All other amounts represent undiscounted cash flows receivable and payable by the Company arising from its financial assets and financial liabilities to earliest contractual maturities as at 31 December 2017 and 31 December 2016. Receipts of financial assets and repayments of financial liabilities that are subject to immediate notice are treated as if notice were given immediately and are classified as on demand. This presentation is considered by the Company to appropriately reflect the liquidity risk arising from those financial assets and financial liabilities, presented in a way that is consistent with how the liquidity risk on these financial assets and financial liabilities is managed by the Company.

31 December 2017	On demand US$'000	Not more than 1 month US$'000	More than 1 month but not more than 3 months US$'000	More than 3 months but not more than 1 year US$'000	More than 1 year but not more than 5 years US$'000	Total US$'000
Financial assets						
Loan and receivables:						
Cash and short-term deposits	177,179	11,088	-	-	-	188,267
Trade receivables	15,314	-	-	-	-	15,314
Loan and advances to customers	1,102,102	167,914	99,825	61,224	-	1,431,065
Other receivables	2,717	267	272	211	-	3,467
Financial assets classified as held for trading:						
Derivatives	-	1,945	868	-	-	2,813
Available-for-sale financial assets	-	566,987	1,444,752	398,696	-	2,410,435
Total financial assets	1,297,312	748,201	1,545,717	460,131	-	4,051,361
Financial liabilities						
Financial liabilities at amortised cost:						
Deposits of banks	1,734	-	-	-	-	1,734
Deposits of non-bank counterparties	2,644,840	79,651	90,976	886,121	-	3,701,588
Trade payables	254	-	-	-	-	254
Other payables	13,774	45,640	31,109	3,681	25,581	119,785
Financial liabilities classified as held for trading:						
Derivatives	-	4,224	7,576	3,971	-	15,771
Total financial liabilities	2,660,602	129,515	129,661	893,773	25,581	3,839,132

21. FINANCIAL RISK MANAGEMENT (CONTINUED)

Liquidity risk (continued)

Maturity analysis (continued)

31 December 2016	On demand US$'000	Not more than 1 month US$'000	More than 1 month but not more than 3 months US$'000	More than 3 months but not more than 1 year US$'000	More than 1 year but not more than 5 years US$'000	Total US$'000
Financial assets						
Loan and receivables:						
Cash and short-term deposits	173,396	94,029	-	-	-	267,425
Trade receivables	3,123	-	-	-	-	3,123
Loan and advances to customers	1,089,249	93,079	27,157	48,627	-	1,258,112
Other receivables	2,083	63	166	53	-	2,365
Financial assets classified as held for trading:						
Derivatives	-	21,797	11,697	1,553	-	35,047
Available-for-sale financial assets	-	829,437	1,203,262	1,066,812	-	3,099,511
Total financial assets	1,267,851	1,038,405	1,242,282	1,117,045	-	4,665,583
Financial liabilities						
Financial liabilities at amortised cost:						
Deposits of banks	14,227	-	-	-	-	14,227
Deposits of non-bank counterparties	2,323,846	352,441	216,415	1,438,219	-	4,330,921
Trade payables	45,424	-	-	-	-	45,424
Other payables	13,567	22,601	25,071	3,959	22,475	87,673
Financial liabilities classified as held for trading:						
Derivatives	-	627	116	551	-	1,294
Total financial liabilities	2,397,064	375,669	241,602	1,442,729	22,475	4,479,539

Market Risk

Market risk is defined by HKFRS 7 as the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices.

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

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

The Company is exposed to the following types of market risk under this definition: interest rate risk and currency risk.

21. FINANCIAL RISK MANAGEMENT (CONTINUED)

Market Risk (continued)

Interest rate risk

Interest rate risk is defined by HKFRS 7 as the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The Company is primarily exposed to interest rate risk under this definition as a result of changes in the future cash flows of floating rate deposits and loans, bank balance, changes in the fair value of fixed rate debt investments categorised as available-for-sale financial assets, and the basis swap which is paying out variable but earning fixed interest.

The application of a parallel shift in interest rates of 50 basis points increase or decrease to these positions, would result in a net gain or loss in price value of approximately US$3,093,000 (2016: US$5,751,000).

Currency risk

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

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

	2017			2016		
	Foreign currency exposure US$'000	Percentage change applied %	Sensitivity to applied percentage change in currency (+/-) profit or loss US$'000	Foreign currency exposure US$'000	Percentage change applied %	Sensitivity to applied percentage change in currency (+/-) profit or loss US$'000
Australian Dollar	1	8	-	-	11	-
Canadian Dollar	1	7	-	1	19	-
Sterling	4	16	1	2	16	-
Euro	21	14	3	5	10	1
Hong Kong Dollar	(7,344)	1	73	(4,416)	-	-
Japanese Yen	19	3	1	7	3	-
New Zealand Dollar	1	2	-	3	12	-
Singapore Dollar	(1,702)	8	136	(2,101)	7	147
Swiss Franc	1	4	-	-	-	-
Yuan Renminbi	(274)	6	16	(29)	6	2
	(9,272)			(6,528)		

The reasonably possible percentage change in the currency rate in relation to US dollars has been calculated based on the greatest annual percentage change over the 2 year period from 1 January 2016 to 31 December 2017 (2016: from 1 January 2015 to 31 December 2016). Thus, the percentage change applied may not be the same percentage as the actual change in the currency rate for year ended 31 December 2017, or for the year ended 31 December 2016.

21. FINANCIAL RISK MANAGEMENT (CONTINUED)

Operational risk

Operational risk refers to the risk of loss, or of damage to the Company's reputation, resulting from inadequate or failed processes, people and systems or from external events (e.g. fraud, theft, legal and compliance risks, cyber attacks or damage to physical assets). Operational risk relates to the following risk event categories as defined by Basel Capital Standards: internal fraud; external fraud; employment practices and workplace safety; clients, products and business practices; business disruption and system failure; damage to physical assets; and execution, delivery and process management.

The Company may incur operational risk across the full scope of its business activities, including revenue-generating activities (e.g., private wealth management) and support and control groups (e.g., information technology and trade processing).

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

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

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

21. FINANCIAL RISK MANAGEMENT (CONTINUED)

Operational risk (continued)

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

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

The Company maintains an information security programme that coordinates the management of information security risks and is designed to address regulatory requirements. Information security policies are designed to protect the Company's information assets against unauthorised disclosure, modification or misuse. These policies cover a broad range of areas, including: application entitlements, data protection, incident response, Internet and electronic communications, remote access and portable devices. The Company has also established policies, procedures and technologies to protect its computers and other assets from unauthorised access.

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

22. FINANCIAL ASSETS AND FINANCIAL LIABILITIES SUBJECT TO OFFSETTING

In order to manage credit exposure arising from its business activities, the Company applies various credit risk management policies and procedures, see note 21 for further details. Primarily in connection with derivative transactions, the Company enters into master netting arrangements and collateral arrangements with its counterparties. These agreements provide the Company with the right, in the ordinary course of business and/ or in the event of a counterparty default (such as bankruptcy or a counterparty's failure to pay or perform), to net a counterparty's rights and obligations under such agreement and, in the event of counterparty default, set off collateral held by the Company against the net amount owed by the counterparty. However, in certain circumstances, the Company may not have such an agreement in place; the relevant insolvency regime (which is based on type of counterparty entity and the jurisdiction of organisation of the counterparty) may not support the enforceability of the agreement; or the Company may not have sought legal advice to support the enforceability of the agreement. In cases where the Company has not determined an agreement to be enforceable, the related amounts are not offset in the narrative disclosures.

The Company's policy is generally to receive cash posted as collateral. In certain cases the Company may agree for such collateral to be posted to a third party custodian under a tri-party arrangement that enables the Company to take control of such collateral in the event of a counterparty default.

In the statement of financial position, financial assets and financial liabilities are offset and presented on a net basis only where there is a current legally enforceable right to set off the recognised amounts and an intention to either settle on a net basis or to realise the asset and the liability simultaneously. Due to the absence of such conditions, financial assets and financial liabilities are presented on a gross basis in the statement of financial position. Certain derivatives that are presented on a gross basis have associated enforceable master netting arrangements in place that allow US$2,522,000 (2016: US$1,294,000) of recognised assets and liabilities to be offset in the ordinary course of business and/ or in the event of default. An additional $13,249,000 (2016: Nil) of recognised financial liabilities is available to be set off against the cash collateral placed by the Company with a counterparty and $243,000 (2016: $33,573,000) of cash collateral received by the Company is available to be set off against the net recognised financial assets in the event of default.

The effect of master netting agreements, collateral agreements and other credit enhancements on the Company's exposure to credit risk is disclosed in note 21.

23. ASSETS AND LIABILITIES MEASURED AT FAIR VALUE

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

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

2017	Quoted prices in active market (Level 1) US$'000	Valuation techniques using observable inputs (Level 2) US$'000	Valuation techniques with significant unobservable inputs (Level 3) US$'000	Total US$'000
Financial assets classified as held for trading:				
- Derivatives	-	2,813	-	2,813
Available-for-sale financial assets:				
- Government debt securities	1,123,083	1,287,352	-	2,410,435
Total financial assets measured at fair value	1,123,083	1,290,165	-	2,413,248
Financial liabilities classified as held for trading:				
- Derivatives	-	15,771	-	15,771
Total financial liabilities measured at fair value	-	15,771	-	15,771

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

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

2016	Quoted prices in active market (Level 1) US$'000	Valuation techniques using observable inputs (Level 2) US$'000	Valuation techniques with significant unobservable inputs (Level 3) US$'000	Total US$'000
Financial assets classified as held for trading:				
- Derivatives	-	35,047	-	35,047
Available-for-sale financial assets:				
- Government debt securities	1,598,207	1,501,304	-	3,099,511
Total financial assets measured at fair value	1,598,207	1,536,351	-	3,134,558
Financial liabilities classified as held for trading:				
- Derivatives	-	1,294	-	1,294
Total financial liabilities measured at fair value	-	1,294	-	1,294

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

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

Asset and Liability / Valuation Technique	Valuation Hierarchy Classification
Government debt securities	
US treasury securities • Fair value is determined using quoted market prices; valuation adjustments are not applied.	• Generally Level 1
Non-US sovereign government obligations • Fair value is determined using quoted prices in active markets when available.	• Generally Level 1 • Level 2 - if the market is less active or prices are dispersed • Level 3 - in instances where the inputs are unobservable
Derivatives	
OTC derivative contracts (include swap contracts related to interest rates and foreign currencies) • Depending on the product and the terms of the transaction, the fair value of OTC derivative products can be modeled using a series of techniques, including closed-form analytic formulas, such as the Black-Scholes option-pricing model, simulation models or a combination thereof. Many pricing models do not entail material subjectivity as the methodologies employed do not necessitate significant judgement, since model inputs may be observed from actively quoted markets, as is the case for generic interest rate swaps. In the case of more established derivative products, the pricing models used by the Company are widely accepted by the financial services industry.	• Generally Level 2 - OTC derivative products valued using observable inputs, or where the unobservable input is not deemed significant • Level 3 - OTC derivative products for which the unobservable input is deemed significant

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

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

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

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

There were no transfers between Level 2 and Level 3 of the fair value hierarchy during the current year and prior year.

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

Non-recurring fair value measurements of assets or liabilities are those which are required or permitted in the statement of financial position in particular circumstances. There were no assets or liabilities measured at fair value on a non-recurring basis during the current year and prior year.

24. ASSETS AND LIABILITIES NOT MEASURED AT FAIR VALUE

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

25. CAPITAL MANAGEMENT

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

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

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

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

25. CAPITAL MANAGEMENT (CONTINUED)

The Company is regulated by the HKMA and as such is subject to minimum capital requirements. The Company’s capital is monitored on an ongoing basis to ensure compliance with these requirements. At a minimum, the Company must ensure that capital is greater than the capital requirement covering credit, market and operational risk.

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

The Company manages the following items as capital:

	2017	2016
	US$’000	US$’000
Ordinary share capital	170,000	170,000
Available-for-sale reserve	(696)	(421)
Retained earnings	63,664	38,618
	232,968	208,197

The Company has earmarked part of its retained earnings for maintaining its regulatory reserve for general banking risks to satisfy the provisions of the Banking Ordinance for prudential supervision purposes. At 31 December 2017, US$7,152,000 (2016: US$6,289,000) in the retained earnings was embarked for this purpose.

26. EMPLOYEE COMPENSATION PLANS

Morgan Stanley maintains various equity-settled share-based and cash-based deferred compensation plans for the benefit of certain current and former employees.

Equity-settled share-based compensation plans

- **Restricted stock units**

Morgan Stanley has granted restricted stock unit (“RSU”) awards pursuant to several equity-based compensation plans. The plans provide for the deferral of a portion of certain employees’ incentive compensation with awards made in the form of restricted common stock or in the right to receive unrestricted shares of common stock in the future. Awards under these plans are generally subject to vesting over time, generally three years from the date of grant, and are generally contingent upon continued employment and subject to restrictions on sale, transfer or assignment until the end of a specified period. All or a portion of an award may be cancelled if employment is terminated before the end of the relevant vesting period and after the vesting period in certain situation. Recipients of stock-based awards may have voting rights, at the Morgan Stanley Group’s discretion, and generally receive dividend equivalents.

During the year, Morgan Stanley granted 288,821 units (2016: 634,044 units) of restricted stock units to employees of the Company with a weighted average fair value per unit of US$42.71 (2016: US$25.21), based on the market value of Morgan Stanley shares at grant date.

Included within ‘Staff costs’, ‘Directors’ remuneration’ and ‘Management charges from other Morgan Stanley Group undertakings’ within the ‘Other expense’ note is an amount of US$13,197,000 (2016: US$14,001,000) in relation to restricted stock units equity based compensation plans, granted to employees of the Company.

26. EMPLOYEE COMPENSATION PLANS (CONTINUED)

Deferred cash-based compensation plans

The Company has granted deferred cash-based compensation awards to certain current and former employees which defer a portion of the employees' discretionary compensation. The plans generally provide a return based upon the performance of various referenced investments. Awards under these plans are generally subject to a sole vesting condition of service over time, which normally ranges from six months to three years from the date of grant. All or a portion of an award may be cancelled if employment is terminated before the end of the relevant vesting period. The awards are settled in cash at the end of the relevant vesting period.

Awards with a value of US$12,305,000 (2016: US$15,984,000) have been granted to employees of the Company during the year and an expense of US$14,008,000 (2016: US$12,094,000) has been recognised within 'Staff costs' and 'Directors' remuneration' in 'Other expense' in the income statement in relation to current and previous years' awards. The liability to employees at the end of the year, reported within 'Other payables' in the statement of financial position, is US$20,451,000 (2016: US$15,968,000).

27. POST-EMPLOYMENT BENEFITS

Defined contribution plans

The Morgan Stanley Group operates the Morgan Stanley Defined Contribution Plan (the "Plan"), which requires contributions to be made to funds held in trust, separate from the assets of the Company. The Plan is a defined contribution plan.

Additionally, the employees of the Branch are members of a state-managed retirement benefit plan, the Central Provident Board Fund, operated by the Government of Singapore. The Branch is required to contribute a specified percentage of payroll costs to the retirement benefit scheme to fund the benefits. The only obligation of the Branch with respect to the retirement plan is to make the specified contributions.

The defined contribution pension charge recognised within 'Staff costs' and 'Directors' remuneration' in 'Other expense' in the income statement was US$4,628,000 for the year (2016: US$4,467,000) of which US$193,000 was accrued at 31 December 2017 (2016: US$183,000).

28. RELATED PARTY DISCLOSURES

Parent and subsidiary relationships

Parent and ultimate controlling entity

The Company's immediate parent undertaking is Morgan Stanley Hong Kong Limited, which was incorporated in Hong Kong.

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

28. RELATED PARTY DISCLOSURES (CONTINUED)

Key management compensation

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

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

	2017 US$'000	2016 US$'000
Short-term employee benefits	4,385	3,540
Post-employment benefits	76	59
Share-based payments	5,709	4,002
Other long-term employee benefits	3,089	2,122
	13,259	9,723

The share-based payment costs disclosed above reflect the amortisation of equity-based awards granted to key management personnel over the last three years and are therefore not directly aligned with other staff costs in the current year.

In addition to the above, directors not in the Morgan Stanley Group provided key management personnel services to the Company for which a fee of US$82,000 was charged for the year (2016: US$83,000) and of which nil was accrued at 31 December 2017 (2016: Nil).

Transactions with related parties

The Morgan Stanley Group conducts business for clients globally through a combination of both functional and legal entity organisational structures. Accordingly, the Company is closely integrated with the operations of the Morgan Stanley Group and enters into transactions with other Morgan Stanley Group undertakings on an arm's length basis for the purposes of utilising financing, trading and risk management, and infrastructure services. The nature of these relationships along with information about the transactions and outstanding balances is given below. Settlement of the outstanding balances will be made in cash. The Company has not recognised any expense and has made no provision for impairment relating to the amount of outstanding balances from related parties (2016: Nil).

28. RELATED PARTY DISCLOSURES (CONTINUED)

Transactions with related parties (continued)

Cash

The Company receives deposits from other Morgan Stanley Group undertakings. All such transactions are entered into on an arm's length basis.

	2017		2016	
	Interest	Balance	Interest	Balance
	US$'000	US$'000	US$'000	US$'000
Amounts due to the Company's direct and indirect parent undertakings	10,490	473,139	77	80,174
Amounts due to other Morgan Stanley Group undertakings	16,332	312,135	8,508	963,332
	26,822	785,274	8,585	1,043,506

Trading and risk management

The Company enters into purchases and sales of securities and derivative transactions with other Morgan Stanley Group undertakings primarily to meet local regulatory requirements and to manage the market risks associated with such transactions. The Company also has a cash sweep service with other Morgan Stanley Group undertakings to facilitate provision of financial services to clients on a global basis. All such transactions are entered into on an arm's length basis. The total amounts receivable and payable on such securities transactions not yet settled and the fair value of such derivatives contracts outstanding at the year end were as follows:

	2017	2016
	US$'000	US$'000
Amounts due from other Morgan Stanley Group undertakings	4,833	38,170
Amounts due to other Morgan Stanley Group undertakings	15,778	1,294

The Company has received collateral of US$243,000 (2016: US$45,424,000) and incurred interest charges of US$8,000 (2016: Nil) to other Morgan Stanley Group undertakings and has pledged collateral of US$13,295,000 (2016: Nil) and received interest of US$118,000 (2016: Nil) from other Morgan Stanley Group undertakings to mitigate credit risk on exposures arising under derivatives contracts between the Company and other Morgan Stanley Group undertakings. This is reported in the statement of financial position in 'Trade receivables'/ 'Trade payables'.

28. RELATED PARTY DISCLOSURES (CONTINUED)

Transactions with related parties (continued)

Infrastructure services and fees and commissions

The Company receives and incurs management charges to and from other Morgan Stanley Group undertakings for infrastructure services, including the provision of staff, administrative support and office facilities. Management recharges received and incurred during the year are as follows:

	2017 US$'000	2016 US$'000
Amounts recharged from the Company's direct and indirect parent undertakings	168	125
Amounts recharged from other Morgan Stanley Group undertakings	56,970	68,870
	57,138	68,995
Amounts recharged to other Morgan Stanley Group undertakings	1,889	6,117

The management and execution of business strategies on a global basis results in many Morgan Stanley transactions impacting a number of Morgan Stanley Group undertakings. The Morgan Stanley Group operates a number of intra-group policies to ensure that, where possible, revenues and related costs are matched.

The Company earns fee and commission income from other Morgan Stanley Group undertakings for value added services which include sales commissions and fees arising from such policies. Fees and commissions received during the year are as follows:

	2017 US$'000	2016 US$'000
Fees and commissions received from the Company's direct and indirect parent undertakings	210,552	-
Fees and commissions received from other Morgan Stanley Group undertakings	-	195,552
	210,552	195,552

28. RELATED PARTY DISCLOSURES (CONTINUED)

Transactions with related parties (continued)

Infrastructure services and fees and commissions (continued)

Amounts arising from infrastructure services and fee and commission income outstanding at the reporting date are as follows:

	2017 US$'000	2016 US$'000
Amounts due from the Company's direct and indirect parent undertakings	29	35
Amounts due from other Morgan Stanley Group undertakings	604	381
	633	416

	2017 US$'000	2016 US$'000
Amounts due to the Company's direct and indirect parent undertakings	6,925	19
Amounts due to other Morgan Stanley Group undertakings	6,595	13,482
	13,520	13,501

These balances are undated, unsecured and non-interest bearing.

UNAUDITED SUPPLEMENTARY FINANCIAL INFORMATION
Year ended 31 December 2017

The following information is disclosed as part of the accompanying information to the financial statements to comply with the Banking (Disclosure) Rules and does not form part of the audited financial statements.

A. CORPORATE GOVERNANCE

Corporate Governance Practices

The Company and Morgan Stanley are committed to upholding high standards in its corporate governance practices. The HKMA has issued statutory guidelines on Corporate Governance of Locally Incorporated Authorised Institutions ("CG-1") under section 7(3) of the Banking Ordinance applicable to all locally incorporated Authorised Institutions ("AIs"). The Company has in place an effective framework which is consistent with the principles and best practices in corporate governance as set forth in the guidelines on CG-1.

Board of Directors

The Board of the Company currently comprises of eight members: two Executive Directors, four Non-Executive Directors, and two Independent Non-Executive Directors. All Directors have the appropriate experience, competence, personal and professional integrity to discharge their responsibilities effectively. The Directors have sufficient independence, expertise and experience to oversee the Company's operations and manage risks appropriately.

Board Practices

Board meetings are held at least four times a year, with one in each quarter. Notice of each Board meeting is given to all Directors in advance and the agenda is sent to the Directors before the date of each Board meeting. Minutes of each Board meeting are circulated to all Directors for their comments prior to confirmation of the minutes at the following Board meeting. Minutes of Board meetings are kept by the Company Secretary and are available for inspection by the Directors.

There are three Board level committees: (a) Audit Committee, (b) Remuneration Committee; and (c) Risk Committee. In addition, there are twelve Management level committees: (a) Management Committee, (b) Operating Committee, (c) Asset and Liability Committee, (d) Risk & Suitability Committee, (e) Operational Risk Committee, (f) Client Data Protection Committee, (g) New Product Approval Committee, (h) Product Governance Committee, (i) IT Steering Committee, (j) Best Execution Committee, (k) Anti-Money Laundering ("AML") Steering Committee and (l) Capital Adequacy Assessment Process ("CAAP") Steering Committee.

Key Board Level Committees

(a) Audit Committee

Three Board members sit on the Audit committee including the two Independent Non-Executive Directors. The Audit Committee is chaired by an Independent Non-Executive Director and expects to meet at least 4 times a year. The Audit Committee's mandate is to ensure that there is effective supervision of the Company's financial reporting processes, systems of internal controls and internal audit function. The Audit Committee also will review and endorse the recommendation on the appointment or re-appointment of external auditors and reviews the financial statements before recommending them to the Board for approval.

(b) Remuneration Committee

Three Board members sit on the Remuneration Committee including the two Independent Non-Executive Directors. The Remuneration Committee is chaired by an Independent Non-Executive Director and meets at least once a year. The Committee's responsibility is to assist the Board in discharging its responsibility for the design and operation of the Company's remuneration system, and to make recommendations in respect of remuneration policy and practices to the Board. It is responsible for reviewing and approving the remuneration of Directors who are also employees of the Morgan Stanley Group and Senior Management as defined by the Company's Remuneration Policy.

A. CORPORATE GOVERNANCE (CONTINUED)

Key Board Level Committees (continued)

(c) Risk Committee
The Risk Committee comprises of three Board members, including two Non-Executive Directors and one Executive Director. The Board Risk Committee meets at a minimum of 4 times a year and is chaired by a Non-Executive Director. The Risk Committee reviews annually the Company's risk management strategy and policy. It also reviews and ensures that the Company has appropriate manpower resources, infrastructure and other resources and systems to identify, assess, monitor, and manage risks.

Key Management Level Committees

(a) Management Committee
The Management Committee is chaired by the Chief Executive of the Company and meets monthly. The Committee oversees the operations of the Company and provides a regular forum for business leaders across the Company to identify and discuss key issues and actions that need to be taken to fulfill the Company's strategy.

(b) Operating Committee
The Operating Committee is chaired by the Company's Chief Operating Officer and meets monthly. The Operating Committee provides a regular forum for representatives from different functional infrastructure groups across the Company to identify, discuss and decide on key business, risk and operating issues.

(c) Asset & Liability Committee
The Asset & Liability Committee is chaired by the Company's Treasury Manager and meets at least monthly. The Asset & Liability Committee oversees the asset/liability risk management and capital adequacy of the Company.

(d) Risk & Suitability Committee
The Risk & Suitability Committee is chaired by the Company's Wealth Management Risk Management Officer and meets around monthly. The Risk & Suitability Committee assists the Board in its oversight and administration of the Company's credit, product risk, and client suitability risk management policies.

(e) Operational Risk Committee
The Operational Risk Committee is chaired by the Company's Chief Operating Officer and meets typically monthly. The Operational Risk Committee supervises operational risk exposures and the steps the Company takes to identify, measure, monitor, control and mitigate these risks.

(f) Client Data Protection Committee
The Client Data Protection Committee ("CDPC") meets typically monthly and oversees client data protection risk exposures and the steps the Company take to identify measure, monitor, control, and mitigate these risks.

(g) New Product Approval Committee
The New Product Approval Committee is chaired by the Company's Chief Operating Officer and meets typically monthly and no fewer than four times per annum. The New Product Approval Committee is appointed by the Company's Operating Committee to ratify new products to be offered by the Company.

(h) Product Governance Committee
The Product Governance Committee is appointed by the Risk and Suitability Committee of the Company. The purpose of the Product Governance Committee is to manage the product review framework including assessment and approval of the due diligence of various product types which are advised upon and distributed to clients.

A. CORPORATE GOVERNANCE (CONTINUED)

Key Management Level Committees (continued)

(i) IT Steering Committee
The IT Steering Committee is chaired by the Company's Technology Officer and meets typically monthly and no less than 9 times a year. The IT Steering Committee provides oversight and governance of key technology initiatives, risk and control that impact the Company's ability to comply with relevant rules and regulations.

(j) Best Execution Committee
The Best Execution Committee is chaired by the Company's Non-Market Risk Manager and meets quarterly. The Best Execution Committee is appointed by the Company's Operating Committee to oversee the Company's compliance with "best execution" obligations under applicable laws, rules and guidelines issued by relevant regulators.

(k) AML Steering Committee
The AML Steering Committee is chaired by the International Head of Global Financial Crimes Group of Morgan Stanley and meets quarterly. The AML Steering Committee is responsible for providing the necessary oversight and control of the Company's AML and Counter-Terrorist Financing Program ("AML/CTF Program").

(l) CAAP Steering Committee
The CAAP Steering Committee ("CSC") is chaired by the Treasurer of the Company. The CSC reports to the ALCO to oversee the Company's capital adequacy assessment framework and capital management process. It also performs annual review and evaluation of the capital management policy and capital adequacy assessment process ("CAAP") implemented by various departments including Risk and Financial Control Group.

Internal Audit
The Internal Audit Department ("IAD") is established to assist both senior management and the Audit Committee of the Board in the effective discharge of their legal, fiduciary, and oversight responsibilities. IAD provides independent assurance on the quality and effectiveness of the Company's internal control, risk management and governance systems and processes. IAD therefore operates as the third line of defense in the Company's internal control governance framework, after business operations and the Company's oversight functions, to protect the assets and reputation of the Company. IAD acts as an objective and independent function within the Company's risk management framework to promote an environment that fosters continual improvement of risk management processes. IAD identifies and assesses operating risks and evaluates the adequacy and effectiveness of the Company's system of internal control. Accordingly, IAD develops an independent and informed view of the risks faced by the Company and the risk management processes employed to manage those risks. Mr Chin Sim Gian has been the Internal Audit Manager of the Company since 19 April 2017, having succeeded Mr Pierre Herbst who held the same position from January 2015 to April 2017.

Compliance
The Company is committed to maintain and upholding high standards of corporate governance. The Company has been in material compliance with the HKMA Module on "Corporate Governance of Locally Incorporated Authorised institutions" ("CG-1") issued under the HKMA's Supervisory Policy Manual ("SPM"). The CG-1 was revised in October 2017, and the Company will be bringing its governance practices and policies into compliance with the revised requirements.

Financial disclosure policy
The Company has in place the financial disclosure policy which is reviewed and approved by the Board of the Company. It sets out (a) the process and approach in determining the content, appropriateness, frequency, relevance and adequacy of the information disclosed, and (b) governance and oversight of the Company's disclosures for verifying or reviewing the accuracy of the information disclosed.

B. REMUNERATION SYSTEM

(a) Design and Implementation of the Remuneration System

Governance structure

The Remuneration Committee appointed by the Board of Directors of the Company assists the Board of Directors in discharging its responsibility for the design and operation of the Company's remuneration system, and makes recommendation in respect of remuneration policy and practices to the Board of Directors. The Remuneration Committee comprises of three Board members, two of whom are independent non-executive directors of the Company. No external consultants have been engaged by the Company since the set up of the Remuneration Committee in 2017 and 2016.

The Board of Directors endorses and issues the remuneration policy for the Company and its branch. The remuneration policy takes into consideration the global practices of the Morgan Stanley Group on remuneration. In addition, local market and competitor practices are also taken into consideration in determining the Company's remuneration policy.

Senior management is defined as those persons who are responsible for oversight of the Company's strategy or activities and/or those of the Company's material business lines. Key personnel are defined as individual employees whose duties or activities in the course of their employment involve the assumption of material risk or taking on of material exposures on behalf of the Company. For the year ended 31 December 2017, the Company has 19 senior management and 1 key personnel (2016: 22 senior management and 1 key personnel). Quantitative information on the remuneration for senior management and key personnel is set out in note (b) below.

One meeting was held by the Remuneration Committee during the year ended 31 December 2017 (2016: Two). For the years ended 31 December 2017 and 31 December 2016, the remuneration paid to the Remuneration Committee members in the Morgan Stanley Group was borne by other Morgan Stanley Group undertakings; the remuneration paid to the Remuneration Committee members not in the Morgan Stanley Group by the Company was US$82,000 (2016: US$83,000).

Remuneration structure

The Company's remuneration policies and procedures are consistent with those of the Morgan Stanley Group. The Morgan Stanley Group is committed to responsible and effective compensation program, which is continually evaluated with a view toward balancing the following objectives, all of which support shareholders' interests:

<u>Deliver Pay for Sustainable Performance</u>
The Morgan Stanley Group applies "pay-for-performance" philosophy that pervades its culture and motivates the employees. The Morgan Stanley Group rewards employees by directly linking compensation to performance based on their annual objective setting and annual performance evaluation, taking account of the overall performance of the Company as a whole over the longer term; performance of the relevant business units; contribution of individual employees to the above performance; and outlook of the overall Morgan Stanley Group.

Compensation programs for the majority of employees comprised two key elements, including base salary and discretionary compensation which may be payable in cash or partially in cash and partially in deferred compensation awards depending on the level of total compensation, seniority and the role of the employees.

In addition, for employees in the most senior roles, a significant portion of compensation is delivered in the form of long-term incentive awards, which closely tie such employees' compensation to the Morgan Stanley Group's long-term performance.

B. REMUNERATION SYSTEM (CONTINUED)

(a) Design and Implementation of the Remuneration System (continued)

Remuneration structure (continued)

Deliver Pay for Sustainable Performance (continued)
Investment Representatives ("IRs") are also eligible to receive commissions, which are formulaically calculated based on predetermined production goals and also payable in cash or partially in cash and partially in deferred compensation awards.

Align Employees' Compensation with Shareholders' Interests
The Morgan Stanley Group links a significant portion of employees' incentive compensation to performance and delivers annual deferred compensation awards which helps motivate employees to achieve the Morgan Stanley Group's financial and strategic goals.

Compensation decisions for employees in risk control functions (including risk management, financial control, compliance, legal and internal audit functions) are determined by senior management of these divisions, wholly independent of the performance of the business units, and not by the management of the business units.

Attract and Retain Top Talent
The Morgan Stanley Group competes for talent globally with other banks and financial institutions. The Morgan Stanley Group continually monitors competitive pay levels and structures its incentive awards to attract and retain the most qualified employees.

Mitigate Excessive Risk-Taking
The Compensation, Management Development and Succession Committee (the "CMDS Committee") of the Morgan Stanley Group is advised by the Morgan Stanley Group's CRO and the CMDS Committee's independent compensation consultant to help ensure that the structure and design of compensation arrangements disincentivise unnecessary or excessive risk-taking that threatens the Morgan Stanley Group's interests or give rise to risks that could have a material adverse effect on the Morgan Stanley Group.

Remuneration process

In the first quarter of each year, senior management of the Morgan Stanley Group proposes and works with the members of the Morgan Stanley Group's Operating Committee (including the CRO of the Morgan Stanley Group) and the Board of Directors of the Morgan Stanley Group to establish financial and non-financial performance priorities that are aligned with the Morgan Stanley Group's business strategy and to incorporate risk-adjusted measures and objectives.

The CRO of the Morgan Stanley Group evaluates the Morgan Stanley Group's current compensation programs on annual basis and has determined that such programs do not encourage excessive risk-taking behavior, due in part to (i) the balance of fixed compensation and variable compensation; (ii) the balance between short-term and long-term incentives; (iii) mandatory deferrals into both equity-based and cash-based incentives programs; (iv) the governance procedures followed in making compensation decisions; and (v) the risk-mitigating features of the deferred incentive compensation awards, such as cancellation and clawback provisions. Details of the deferred compensation plans are set out in note 26 to the financial statements.

B. REMUNERATION SYSTEM (CONTINUED)

(a) Design and Implementation of the Remuneration System (continued)

Remuneration process (continued)

The overall discretionary bonus pool is established in consultation with the CMDS Committee. Risk-Adjusted Return on Equity is the primary quantitative metric reviewed with the CMDS Committee to determine the size of the bonus pool. Employee eligibility for bonus compensation is discretionary and bonus decisions are subject to a multi-dimensional process, which considers financial and non-financial individual, business unit and Morgan Stanley Group's performance measures.

Non-financial performance criteria that may be taken into account in deciding whether to award, and the amount of any bonus compensation, include (but are not limited to):

- Individual conduct, including but not limited to, adherence to the Morgan Stanley Group's Code of Conduct and policies and the Morgan Stanley Group's cultural values;
- Contribution to the performance and profitability of both the business unit and the Morgan Stanley Group and the strategic objectives of the Morgan Stanley Group, business unit and the team and the associated value attributed to the role;
- Commercial impact, including business/functional knowledge and judgment, client relationships, innovation and execution;
- Leadership skills, including teamwork, communication and management;
- Professional skills, including recruiting, diversity and inclusion; and
- Adherence to compliance and risk policies, including ethics, control and risk management.

Senior management of the Morgan Stanley Group and the CMDS Committee oversee the Morgan Stanley Group's controls regarding the year-end compensation process to help eliminate incentives for excessive risk-taking, including:

- Sizing the incentive compensation pool to more fully consider risk-adjusted returns, compliance with risk limits and the market and competitive environment;
- Allocating the incentive compensation pool among businesses after consideration of the business' returns on certain financial and return on capital metrics;
- Delivering a substantial portion of compensation in multi-year deferrals subject to malus/cancellation;
- Directing compensation managers to consider malus/cancellation events and an employee's risk management activities and outcomes in making compensation decisions; and
- Undertaking a rigorous review process by risk control functions to identify potential malus/cancellation situations.

In addition, on an annual basis, business heads and Operating Committee members representing the Morgan Stanley Group's revenue-generating divisions will prepare a Pay and Performance Analysis report that is presented to the CMDS Committee. This report sets the stage for the CMDS Committee to understand the outcomes of pay from the prior year relative to the market, and the linkage of prior year pay and performance. In turn, this enables the CMDS Committee to consider where the starting baseline of pay either trails or leads the market and whether such a position is warranted or should be rectified in light of current year known performance. Compensation outcomes are symmetric with risk outcomes at the Morgan Stanley Group level.

Compliance
To the extent applicable, the Company has complied with Part 3 of CG-5 "Guideline on a Sound Remuneration System" issued by the HKMA.

B. REMUNERATION SYSTEM (CONTINUED)

(b) Aggregate Quantitative Information on the Remuneration for Senior Management and Key Personnel

Quantitative information on the remuneration for senior management and key personnel is set out in the tables below. The Company has a small number of key personnel. The remuneration is disclosed for senior management and key personnel in aggregate to avoid the individual's remuneration being easily deduced.

(i) Analysis of remuneration awards split between fixed and variable compensation for the year

	Senior management and key personnel	
	2017	**2016**
	US$'000	**US$'000**
Fixed compensation		
Non-deferred cash	7,119	7,415
Variable compensation		
Non-deferred cash	6,854	5,592
Deferred cash	3,593	4,290
Deferred shares	3,593	4,290
	14,040	14,172
Total	21,159	21,587

B. REMUNERATION SYSTEM (CONTINUED)

(b) Aggregate Quantitative Information on Remuneration for Senior Management and Key Personnel (continued)

(ii) Analysis of deferred remuneration for the year

	Senior management and key personnel	
	2017	**2016**
	US$'000	**US$'000**
Awarded during the year	7,186	8,581
Paid out during the year	3,350	3,808
Reduced through performance adjustment	-	-

(iii) Analysis of total amount of outstanding deferred remuneration

	Senior management and key personnel	
	2017	**2016**
	US$'000	**US$'000**
At December 31,		
Vested	127	1,189
Unvested	20,081	17,663
At December 31,		
Cash	8,766	7,961
Shares	11,442	10,891

	Senior management and key personnel	
	2017	**2016**
	US$'000	**US$'000**
During the year:		
Amount of outstanding deferred remuneration and retained remuneration exposed to ex post explicit and/ or implicit adjustments	20,208	18,852
Reductions due to ex post explicit adjustments	-	168
Reductions due to ex post implicit adjustments	-	45

B. REMUNERATION SYSTEM (CONTINUED)

(b) Aggregate Quantitative Information on Remuneration for Senior Management and Key Personnel (continued)

(iv) Analysis of guaranteed bonus, sign-on payments and severance payments awarded during the year

	Senior management and key personnel	
	2017	**2016**
	US$'000	**US$'000**
Guaranteed bonus	-	-
Number of beneficiaries of guaranteed bonus	-	-
Sign-on awards	-	-
Number of beneficiaries of sign-on awards	-	-
Severance payments made	35	-
Number of beneficiaries of severance payments made	1	-
Severance payments awarded	35	-
Number of beneficiaries of severance payments awarded	1	-
Highest amount of severance payment to a single person	35	-

C. INTEREST RATE EXPOSURES IN BANKING BOOK

The Company is exposed to interest rate risk arising from banking book activities covering clients' deposits and loans, the Company's funding and liquidity investments. The financial assets and liabilities of the Company, which inherently have interest rate risk, are primarily driven by prevailing market rates.

The sensitivity analysis for the interest rate risk of the banking book is based on the difference in interest rate sensitivity of interest bearing assets and interest bearing liabilities. The Company uses an instantaneous parallel interest rate shock of 200 basis points (upward or downward) to evaluate the potential impact on its earnings, which was a gain or loss of approximately US$687,000 as at 31 December 2017 (2016: US$4,740,000). The Company also monitors the interest rate risk of the banking book daily based on price value per one basis point increase or decrease in interest rates, which was a gain or loss of approximately US$61,000 as at 31 December 2017 (2016: US$114,000).

D. SEGMENTAL INFORMATION

(a) By geographical area

The geographical segmental analysis for the years ended 31 December 2017 and 31 December 2016 is as follows:

2017	**Hong Kong (1)** US$'000	**Singapore (1)** US$'000	**Total** US$'000
Total operating income (net of interest expense)	166,187	72,885	239,072
(Loss)/ profit before income tax	(8,424)	37,785	29,361
Total assets	286,925	3,770,454	4,057,379
Total liabilities	1,053,360	2,771,051	3,824,411

2016	**Hong Kong (1)** US$'000	**Singapore (1)** US$'000	**Total** US$'000
Total operating income (net of interest expense)	176,299	30,670	206,969
Profit/ (loss) before income tax	7,209	(3,784)	3,425
Total assets	13,854	4,660,223	4,674,077
Total liabilities	891,583	3,574,297	4,465,880

(1) The amounts disclosed above are after elimination of interoffice balances or transactions between the head office in Hong Kong and the Branch.

There are no contingent liabilities and commitments as at 31 December 2017 (31 December 2016: Nil).

D. SEGMENTAL INFORMATION (CONTINUED)

(b) By class of business

The main business segments of the Company are as follows:

(i) Wealth Management: the Company engages in the business of banking including deposit taking and lending. It also acts (a) as agent on behalf of its customers in connection with the provision of general investment, securities dealing, as well as discretionary management and (b) as introducing broker to Morgan Stanley & Co. International plc for the provision of clearance, settlement and custody services in relation to the aforementioned transactions.

(ii) Treasury and others: includes treasury operations and back office activities.

The Company's business segment results for the years ended 31 December 2017 and 31 December 2016 are as follows:

2017	**Wealth Management (1) US$'000**	**Treasury and others (1) US$'000**	**Total US$'000**
Total operating income (net of interest expense)	235,877	3,195	239,072
Profit/ (loss) before income tax	63,545	(34,184)	29,361
Total assets	1,433,388	2,623,991	4,057,379

2016	**Wealth Management (1) US$'000**	**Treasury and others (1) US$'000**	**Total US$'000**
Total operating income (net of interest expense)	205,495	1,474	206,969
Profit/ (loss) before income tax	34,504	(31,079)	3,425
Total assets	1,259,760	3,414,317	4,674,077

(1) The amounts disclosed above are after elimination of interoffice balances or transactions between the head office in Hong Kong and the Branch.

There are no impairment losses, specific provision and collective provision for impaired assets for the year (2016: Nil).

During the year, there was no fee and commission income and expense arisen from financial assets or financial liabilities that has not been measured at fair value through profit or loss (2016: Nil).

During the year, there was no fee and commission income and expense on trust and other fiduciary activities where the Company holds or invests on behalf of its customers (2016: Nil).

E. LOAN AND ADVANCES – SECTOR INFORMATION

	As at 31 December 2017 US$'000	As at 31 December 2016 US$'000
Sector classification		
Loans and advances for use in Hong Kong		
Industrial, commercial and financial:		
- Others	463,374	443,866
Individuals		
- Others	148,296	94,515
Loans and advances for use outside Hong Kong	818,746	719,410
Total	1,430,416	1,257,791

The total loans are fully secured by collateral as at 31 December 2017 (31 December 2016: fully secured).

	As at 31 December 2017 US$'000	As at 31 December 2016 US$'000
Geographical Areas		
Hong Kong	611,670	538,381
Mainland China	205,766	218,384
Singapore	176,914	110,384
Taiwan	156,947	142,080
Others	279,119	248,562
Total	1,430,416	1,257,791

Loan and Advances are exposures of counterparties based on the location of the counterparties after taking into account any risk transfer. The risk transfers have been made if the claims are guaranteed by a party in a geographical area which is different from that of the counterparty or if the claims are on an overseas branch of a bank whose head office is located in another geographical area.

F. INTERNATIONAL CLAIMS

International claims are on-balance sheet exposures of counterparties based on the location of the counterparties after taking into account any risk transfer. The risk transfers have been made if the claims are guaranteed by a party in a geographical area which is different from that of the counterparty or if the claims are on an overseas branch of a bank whose head office is located in another geographical area.

			Non-bank private sector		
	Bank	Official sector	Non-bank financial institutions	Non-financial private sector	Total
31 December 2017	**US$'000**	**US$'000**	**US$'000**	**US$'000**	**US$'000**
Developed countries	150,693	1,121,974	2,850	1,847	1,277,364
United States	36,276	1,121,974	664	-	1,158,914
Offshore centres	39,216	-	19,537	822,813	881,566
Hong Kong	35,376	-	11,120	601,667	648,163
Developing Asia and Pacific	-	-	1	568,319	568,320

F. INTERNATIONAL CLAIMS (CONTINUED)

			Non-bank private sector		
	Bank	Official sector	Non-bank financial institutions	Non-financial private sector	Total
31 December 2016	**US$'000**	**US$'000**	**US$'000**	**US$'000**	**US$'000**
Developed countries	210,784	1,598,207	3,710	3,981	1,816,682
United States	79,424	1,598,207	406	-	1,678,037
Offshore centres	75,952	-	66,855	655,989	798,796
Hong Kong	25,201	-	42,654	496,619	564,474
Developing Asia and Pacific	-	-	670	526,363	527,033

G. OVERDUE AND RESCHEDULED ASSETS

There were no impaired, overdue or rescheduled assets as at 31 December 2017 and 31 December 2016.

H. MAINLAND ACTIVITIES

There were no mainland exposures on the Hong Kong office of the Company as at 31 December 2017 and 31 December 2016.

I. CURRENCY RISK

The currency risk arising from the Company's operation for those individual currencies which each constitutes more than 10% of the total net positions in all foreign currencies are as follows:

As at 31 December 2017	SGD (1) HK$'000	USD (1) HK$'000
Spot assets	11,520,307	19,908,294
Spot liabilities	(2,006,728)	(26,862,495)
Forward purchases	-	12,152,713
Forward sales	(9,526,798)	(5,126,082)
Net (short)/ long position	(13,219)	72,430

As at 31 December 2016	SGD (1) HK$'000	USD (1) HK$'000
Spot assets	11,933,955	27,704,572
Spot liabilities	(2,276,940)	(34,817,690)
Forward purchases	267,955	11,313,046
Forward sales	(9,941,119)	(4,149,444)
Net (short)/ long position	(16,149)	50,484

(1) Net (short)/ long positions in individual currencies of the Company are reported in gross, i.e. interoffice balances and transactions between the head office in Hong Kong and the Branch are not eliminated.

The Company had no option and structural positions in any particular foreign currency as at 31 December 2017 (31 December 2016: Nil).

J. LIQUIDITY

	For the year ended 31 December 2017	For the year ended 31 December 2016
Average liquidity maintenance ratio for the year	58%	58%

The average liquidity maintenance ratio is calculated as the arithmetic mean of each calendar month's average liquidity maintenance ratio. The liquidity maintenance ratio is computed in accordance with Banking (Liquidity) Rules.

K. CAPITAL CHARGE FOR CREDIT, MARKET AND OPERATIONAL RISKS

The capital adequacy ratios as at 31 December 2017 and 31 December 2016 were calculated in accordance with Banking (Capital) Rules of the Banking Ordinance. The Company uses the Standardised Approach ("STC approach") to calculate its credit risk.

Standard & Poor's Rating Services, Moody's Investors Service and Fitch Ratings are the external credit assessment institutions (the "ECAIs") that the Company has used to determine the risk weight of the exposures. The Company follows the process as prescribed in Part 4 of the Banking (Capital) Rules to map ECAI issuer ratings to exposures booked in its banking book.

The disclosure is made by multiplying the Company's risk-weighted amount derived from the relevant calculation approach by 8%, not the Company's actual "regulatory capital".

K. CAPITAL CHARGE FOR CREDIT, MARKET AND OPERATIONAL RISKS (CONTINUED)

(a) Capital charge for credit risk

		Exposures after Recognised Credit Risk Mitigation[1]		Risk-Weighted Amounts			
	Total exposures US$'000	Rated[2] US$'000	Unrated [3] US$'000	Rated[2] US$'000	Unrated [3] US$'000	Total Risk-Weighted Amounts US$'000	Capital Requirement US$'000
As at 31 December 2017							
On-balance sheet							
Sovereign exposures	2,424,646	2,424,646	-	-	-	-	-
Bank exposures	187,444	187,444	-	37,685	-	37,685	3,015
Securities firm exposures	4,112	3,754	-	1,877	-	1,877	150
Corporate exposures	1,126,026	-	373,100	-	373,100	373,100	29,848
Other exposures which are not past due exposures	307,454	-	109,314	-	109,314	109,314	8,745
	4,049,682	2,615,844	482,414	39,562	482,414	521,976	41,758
Off-balance sheet							
OTC derivative Transactions[4]	9,010	8,767	-	4,384	-	4,384	351
Credit valuation adjustments	8,767	8,767	-	1,992	-	1,992	159
	4,067,459	2,633,378	482,414	45,938	482,414	528,352	42,268

(1) As at 31 December 2017 and 31 December 2016, the amount and type of collateral required by the Company depends on an assessment of the credit risk of the obligor. Collateral held is managed in accordance with the Company's guidelines and the relevant underlying agreements. Collaterals are primarily publicly traded debt and equity securities, as well as other collaterals including unlisted securities, notes, mutual funds and insurance policies that fulfill the risk management requirement of being valuable and realisable at the earliest. The market value of securities received as collateral is monitored on a daily basis and securities received as collateral generally are not recognised in the statement of financial position. Haircuts are applied to the recognised collateral according to the Banking (Capital) Rules.

(2) Exposures with ECAI issue specific rating and exposures which have an inferred rating (i.e. exposures which do not have an issue-specific rating but whose risk-weights are determined under the Banking (Capital) Rules by reference to an ECAI issuer rating assigned to the obligor of the exposure or to an ECAI issue rating of any other exposures of the obligor).

(3) Exposures which do not have ECAI issue specific rating, nor inferred rating.

(4) The recognised collateral for the OTC derivative transactions consists of cash of US$243,000 as at 31 December 2017 (2016: 41,790,000).

K. CAPITAL CHARGE FOR CREDIT, MARKET AND OPERATIONAL RISKS (CONTINUED)

(a) Capital charge for credit risk (continued)

	Total exposures US$'000	Exposures after Recognised Credit Risk Mitigation[1] Rated[2] US$'000	Exposures after Recognised Credit Risk Mitigation[1] Unrated[3] US$'000	Risk-Weighted Amounts Rated[2] US$'000	Risk-Weighted Amounts Unrated[3] US$'000	Total Risk-Weighted Amounts US$'000	Capital Requirement US$'000
As at 31 December 2016							
On-balance sheet							
Sovereign exposures	3,115,122	3,115,122	-	-	-	-	-
Bank exposures	255,173	255,173	-	51,110	-	51,110	4,089
Securities firm exposures	3,744	621	-	311	-	311	25
Corporate exposures	1,030,906	-	307,860	-	307,860	307,860	24,629
Other exposures which are not past due exposures	228,989	-	59,109	-	59,109	59,109	4,729
	4,633,934	3,370,916	366,969	51,421	366,969	418,390	33,472
Off-balance sheet							
OTC derivative Transactions[4]	52,782	10,992	-	5,496	-	5,496	440
Credit valuation adjustments	10,992	10,992	-	2,499	-	2,499	200
	4,697,708	3,392,900	366,969	59,416	366,969	426,385	34,112

There were no exposures which were covered by recognised guarantees or recognised credit derivative contracts as at 31 December 2017 and 31 December 2016.

There were no credit exposures which were risk-weighted at 1250% as at 31 December 2017 and 31 December 2016.

There were no counterparty credit-risk related exposures for securities financing transactions as at 31 December 2017 and 31 December 2016.

(b) Capital charge for market risk

There was nil capital charge for market risk for the Company as at 31 December 2017 and 31 December 2016 because the Company was exempted by HKMA from the calculation of market risk.

(c) Capital charge for operational risk

The Company uses the Basic Indicator Approach ("BIA approach") to calculate its operational risk. The Company's capital charge for operational risk was US$34,119,000 as at 31 December 2017 (2016: US$33,642,000).

UNAUDITED SUPPLEMENTARY FINANCIAL INFORMATION
Year ended 31 December 2017

L. CAPITAL ADEQUACY RATIO

	At 31 December 2017	At 31 December 2016
Common Equity Tier 1 ("CET1") capital ratio	23%	23%
Tier 1 capital ratio	23%	23%
Total capital ratio	24%	24%

Component of capital base

Total capital after deductions used in the calculation of capital adequacy ratios as at 31 December 2017 and 31 December 2016 are analysed as follows:

	At 31 December 2017 US$'000	At 31 December 2016 US$'000
CET1 capital instruments		
Paid up ordinary share capital	170,000	170,000
Retained earnings	63,664	38,618
Available-for-sale reserve	(696)	(421)
CET1 capital before deductions	232,968	208,197
Deductions:		
Deferred tax assets net of deferred tax liabilities	(6,452)	(5,406)
Regulatory reserve for general banking risks[(1)]	(7,152)	(6,289)
Valuation adjustments	(128)	(91)
CET1 capital after deductions	219,236	196,411
Additional tier 1 capital	-	-
Tier 2 capital		
Regulatory reserve for general banking risks[(1)]	6,580	5,299
Total capital	225,816	201,710

(1) The Company has earmarked part of its retained earnings for maintaining its regulatory reserve for general banking risks to satisfy the provisions of the Banking Ordinance for prudential supervision purposes.

Information relating to the disclosure of the full terms and conditions of the Company's capital instruments can be viewed on the website: http://www.morganstanley.com/about-us/global-offices/hong-kong.

M. CAPITAL DISCLOSURE TEMPLATE

(a) Capital Disclosure Template

The following table shows the capital disclosure template specified by the HKMA in relation to the elements of the Company's regulatory capital.

(in thousands of US dollars)			Cross reference to Balance Sheet
	CET1 capital: instruments and reserves		
1	Directly issued qualifying CET1 capital instruments plus any related share premium	170,000	(1)
2	Retained earnings	63,664	(2)
3	Disclosed reserves	(696)	(3)
4	*Directly issued capital subject to phase out from CET1 capital (only applicable to non-joint stock companies)*	Not applicable	
5	Minority interests arising from CET1 capital instruments issued by consolidated bank subsidiaries and held by third parties (amount allowed in CET1 capital of the consolidation group)	0	
6	**CET1 capital before regulatory deductions**	232,968	
	CET1 capital: regulatory deductions		
7	Valuation adjustments	128	
8	Goodwill (net of associated deferred tax liability)	0	
#9	Other intangible assets (net of associated deferred tax liability)	0	
#10	Deferred tax assets net of deferred tax liabilities	6,452	(4)
11	Cash flow hedge reserve	0	
12	Excess of total EL amount over total eligible provisions under the IRB approach	0	
13	Gain-on-sale arising from securitisation transactions	0	
14	Gains and losses due to changes in own credit risk on fair valued liabilities	0	
15	Defined benefit pension fund net assets (net of associated deferred tax liabilities)	0	
16	Investments in own CET1 capital instruments (if not already netted off paid-in capital on reported balance sheet)	0	
17	Reciprocal cross-holdings in CET1 capital instruments	0	
#18	Insignificant capital investments in CET1 capital instruments issued by financial sector entities that are outside the scope of regulatory consolidation (amount above 10% threshold)	0	
#19	Significant capital investments in CET1 capital instruments issued by financial sector entities that are outside the scope of regulatory consolidation (amount above 10% threshold)	0	
20	Mortgage servicing rights (amount above 10% threshold)	Not applicable	
21	Deferred tax assets arising from temporary differences (amount above 10% threshold, net of related tax liability)	Not applicable	
22	Amount exceeding the 15% threshold	Not applicable	
23	of which: significant investments in the common stock of financial sector entities	Not applicable	
24	of which: mortgage servicing rights	Not applicable	
25	of which: deferred tax assets arising from temporary differences	Not applicable	
26	National specific regulatory adjustments applied to CET1 capital	0	
26a	Cumulative fair value gains arising from the revaluation of land and buildings (own-use and investment properties)	0	
26b	Regulatory reserve for general banking risks	7,152	
26c	Securitisation exposures specified in a notice given by the Monetary Authority	0	

M. CAPITAL DISCLOSURE TEMPLATE (CONTINUED)

(a) Capital Disclosure Template (continued)

(in thousands of US dollars)			Cross reference to Balance Sheet
26d	Cumulative losses below depreciated cost arising from the institution's holdings of land and buildings	0	
26e	Capital shortfall of regulated non-bank subsidiaries	0	
26f	Capital investment in a connected company which is a commercial entity (amount above 15% of the reporting institution's capital base)	0	
27	Regulatory deductions applied to CET1 capital due to insufficient AT1 capital and Tier 2 capital to cover deductions	0	
28	**Total regulatory deductions to CET1 capital**	13,732	
29	**CET1 capital**	219,236	
	AT1 capital: Instruments		
30	Qualifying AT1 capital instruments plus any related share premium	0	
31	of which: classified as equity under applicable accounting standards	0	
32	of which: classified as liabilities under applicable accounting standards	0	
33	*Capital instruments subject to phase out arrangements from AT1 capital*	0	
34	AT1 capital instruments issued by consolidated bank subsidiaries and held by third parties (amount allowed in AT1 capital of the consolidation group)	0	
35	*of which: AT1 capital instruments issued by subsidiaries subject to phase out arrangements*	0	
36	**AT1 capital before regulatory deductions**	0	
	AT1 capital: regulatory deductions		
37	Investments in own AT1 capital instruments	0	
38	Reciprocal cross-holdings in AT1 capital instruments	0	
#39	Insignificant capital investments in AT1 capital instruments issued by financial sector entities that are outside the scope of regulatory consolidation (amount above 10% threshold)	0	
40	Significant capital investments in AT1 capital instruments issued by financial sector entities that are outside the scope of regulatory consolidation	0	
41	National specific regulatory adjustments applied to AT1 capital	0	
42	Regulatory deductions applied to AT1 capital due to insufficient Tier 2 capital to cover deductions	0	
43	**Total regulatory deductions to AT1 capital**	0	
44	**AT1 capital**	0	
45	**Tier 1 capital (Tier 1 = CET1 + AT1)**	219,236	
	Tier 2 capital: instruments and provisions		
46	Qualifying Tier 2 capital instruments plus any related share premium	0	
47	*Capital instruments subject to phase out arrangements from Tier 2 capital*	0	
48	Tier 2 capital instruments issued by consolidated bank subsidiaries and held by third parties (amount allowed in Tier 2 capital of the consolidation group)	0	
49	*of which: capital instruments issued by subsidiaries subject to phase out arrangements*	0	
50	Collective impairment allowances and regulatory reserve for general banking risks eligible for inclusion in Tier 2 capital	6,580	
51	**Tier 2 capital before regulatory deductions**	**6,580**	

M. CAPITAL DISCLOSURE TEMPLATE (CONTINUED)

(a) Capital Disclosure Template (continued)

	(in thousands of US dollars)		Cross reference to Balance Sheet
	Tier 2 capital: regulatory deductions		
52	Investments in own Tier 2 capital instruments	0	
53	Reciprocal cross-holdings in Tier 2 capital instruments	0	
#54	Insignificant capital investments in Tier 2 capital instruments issued by financial sector entities that are outside the scope of regulatory consolidation (amount above 10% threshold)	0	
55	Significant capital investments in Tier 2 capital instruments issued by financial sector entities that are outside the scope of regulatory consolidation	0	
56	National specific regulatory adjustments applied to Tier 2 capital	0	
56a	Add back of cumulative fair value gains arising from the revaluation of land and buildings (own-use and investment properties) eligible for inclusion in Tier 2 capital	0	
57	**Total regulatory deductions to Tier 2 capital**	0	
58	**Tier 2 capital**	6,580	
59	**Total capital (Total capital = Tier 1 + Tier 2)**	225,816	
60	**Total risk weighted assets**	954,272	
	Capital ratios (as a percentage of risk weighted assets)		
61	CET1 capital ratio	23%	
62	Tier 1 capital ratio	23%	
63	Total capital ratio	24%	
64	Institution specific buffer requirement (minimum CET1 capital requirement as specified in s.3B of the BCR plus capital conservation buffer plus countercyclical buffer requirements plus G-SIB or D-SIB requirements)	6.278%	
65	*of which: capital conservation buffer requirement*	1.25%	
66	*of which: bank specific countercyclical buffer requirement*	0.528%	
67	*of which: G-SIB or D-SIB buffer requirements*	0%	
68	CET1 capital surplus over the minimum CET1 requirement and any CET1 capital used to meet the Tier 1 and Total capital requirement under s.3B of the BCR	16%	
	National minima (if different from Basel 3 minimum)		
69	National CET1 minimum ratio	Not applicable	
70	National Tier 1 minimum ratio	Not applicable	
71	National Total capital minimum ratio	Not applicable	
	Amounts below the thresholds for deduction (before risk weighting)		
72	Insignificant capital investments in CET1 capital instruments, AT1 capital instruments and Tier 2 capital instruments issued by financial sector entities that are outside the scope of regulatory consolidation	0	
73	Significant capital investments in CET1 capital instruments issued by financial sector entities that are outside the scope of regulatory consolidation	0	
74	Mortgage servicing rights (net of related tax liability)	Not applicable	
75	Deferred tax assets arising from temporary differences (net of related tax liability)	Not applicable	

M. CAPITAL DISCLOSURE TEMPLATE (CONTINUED)

(a) Capital Disclosure Template (continued)

(in thousands of US dollars)			Cross reference to Balance Sheet
Applicable caps on the inclusion of provisions in Tier 2 capital			
76	Provisions eligible for inclusion in Tier 2 in respect of exposures subject to the basic approach and the standardised (credit risk) approach (prior to application of cap)	0	
77	Cap on inclusion of provisions in Tier 2 under the basic approach and the standardised (credit risk) approach	0	
78	Provisions eligible for inclusion in Tier 2 in respect of exposures subject to the IRB approach (prior to application of cap)	0	
79	Cap for inclusion of provisions in Tier 2 under the IRB approach	0	
Capital instruments subject to phase-out arrangements (only applicable between 1 Jan 2018 and 1 Jan 2022)			
80	*Current cap on CET1 capital instruments subject to phase out arrangements*	Not applicable	
81	*Amount excluded from CET1 due to cap (excess over cap after redemptions and maturities)*	Not applicable	
82	*Current cap on AT1 capital instruments subject to phase out arrangements*	0	
83	*Amount excluded from AT1 capital due to cap (excess over cap after redemptions and maturities)*	0	
84	*Current cap on Tier 2 capital instruments subject to phase out arrangements*	0	
85	*Amount excluded from Tier 2 capital due to cap (excess over cap after redemptions and maturities)*	0	

Footnote:

# Indicates elements where a more conservative definition has been applied in the BCR relative to that set out in the Basel III capital standards.

M. CAPITAL DISCLOSURE TEMPLATE (CONTINUED)

(a) Capital Disclosure Template (continued)

Notes to the template

<table>
<tr><th>Row No.</th><th>Description</th><th>Hong Kong basis</th><th>Basel III basis</th></tr>
<tr><td rowspan="2">#9</td><td>Other intangible assets (net of associated deferred tax liability)</td><td>0</td><td>0</td></tr>
<tr><td colspan="3">Explanation
As set out in paragraph 87 of the Basel III text issued by the Basel Committee (December 2010), mortgage servicing rights (MSRs) may be given limited recognition in CET1 capital (and hence be excluded from deduction from CET1 capital up to the specified threshold). In Hong Kong, an AI is required to follow the accounting treatment of including MSRs as part of intangible assets reported in the AI's financial statements and to deduct MSRs in full from CET1 capital. Therefore, the amount to be deducted as reported in row 9 may be greater than that required under Basel III. The amount reported under the column "Basel III basis" in this box represents the amount reported in row 9 (i.e. the amount reported under the "Hong Kong basis") adjusted by reducing the amount of MSRs to be deducted to the extent not in excess of the 10% threshold set for MSRs and the aggregate 15% threshold set for MSRs, DTAs arising from temporary differences and significant investments in CET1 capital instruments issued by financial sector entities (excluding those that are loans, facilities or other credit exposures to connected companies) under Basel III.</td></tr>
<tr><td rowspan="2">#10</td><td>Deferred tax assets net of deferred tax liabilities</td><td>6,452</td><td>6,452</td></tr>
<tr><td colspan="3">Explanation
As set out in paragraphs 69 and 87 of the Basel III text issued by the Basel Committee (December 2010), DTAs that rely on future profitability of the bank to be realised are to be deducted, whereas DTAs which relate to temporary differences may be given limited recognition in CET1 capital (and hence be excluded from deduction from CET1 capital up to the specified threshold). In Hong Kong, an AI is required to deduct all DTAs in full, irrespective of their origin, from CET1 capital. Therefore, the amount to be deducted as reported in row 10 may be greater than that required under Basel III.

The amount reported under the column "Basel III basis" in this box represents the amount reported in row 10 (i.e. the amount reported under the "Hong Kong basis") adjusted by reducing the amount of DTAs to be deducted which relate to temporary differences to the extent not in excess of the 10% threshold set for DTAs arising from temporary differences and the aggregate 15% threshold set for MSRs, DTAs arising from temporary differences and significant investments in CET1 capital instruments issued by financial sector entities (excluding those that are loans, facilities and other credit exposures to connected companies) under Basel III.</td></tr>
<tr><td rowspan="2">#18</td><td>Insignificant capital investments in CET1 capital instruments issued by financial sector entities that are outside the scope of regulatory consolidation (amount above 10% threshold)</td><td>0</td><td>0</td></tr>
<tr><td colspan="3">Explanation
For the purpose of determining the total amount of insignificant capital investments in CET1 capital instruments issued by financial sector entities, an AI is required to aggregate any amount of loans, facilities or other credit exposures provided by it to any of its connected companies, where the connected company is a financial sector entity, as if such loans, facilities or other credit exposures were direct holdings, indirect holdings or synthetic holdings of the AI in the capital instruments of the financial sector entity, except where the AI demonstrates to the satisfaction of the Monetary Authority that any such loan was made, any such facility was granted, or any such other credit exposure was incurred, in the ordinary course of the AI's business.

Therefore, the amount to be deducted as reported in row 18 may be greater than that required under Basel III. The amount reported under the column "Basel III basis" in this box represents the amount reported in row 18 (i.e. the amount reported under the "Hong Kong basis") adjusted by excluding the aggregate amount of loans, facilities or other credit exposures to the AI's connected companies which were subject to deduction under the Hong Kong approach.</td></tr>
</table>

M. CAPITAL DISCLOSURE TEMPLATE (CONTINUED)

(a) Capital Disclosure Template (continued)

Notes to the template (continued)

<table>
<tr><th>Row No.</th><th>Description</th><th>Hong Kong basis</th><th>Basel III basis</th></tr>
<tr><td rowspan="2">#19</td><td>Significant capital investments in CET1 capital instruments issued by financial sector entities that are outside the scope of regulatory consolidation (amount above 10% threshold)</td><td>0</td><td>0</td></tr>
<tr><td colspan="3"><u>Explanation</u>
For the purpose of determining the total amount of significant capital investments in CET1 capital instruments issued by financial sector entities, an AI is required to aggregate any amount of loans, facilities or other credit exposures provided by it to any of its connected companies, where the connected company is a financial sector entity, as if such loans, facilities or other credit exposures were direct holdings, indirect holdings or synthetic holdings of the AI in the capital instruments of the financial sector entity, except where the AI demonstrates to the satisfaction of the Monetary Authority that any such loan was made, any such facility was granted, or any such other credit exposure was incurred, in the ordinary course of the AI's business.

Therefore, the amount to be deducted as reported in row 19 may be greater than that required under Basel III. The amount reported under the column "Basel III basis" in this box represents the amount reported in row 19 (i.e. the amount reported under the "Hong Kong basis") adjusted by excluding the aggregate amount of loans, facilities or other credit exposures to the AI's connected companies which were subject to deduction under the Hong Kong approach.</td></tr>
<tr><td rowspan="2">#39</td><td>Insignificant capital investments in AT1 capital instruments issued by financial sector entities that are outside the scope of regulatory consolidation (amount above 10% threshold)</td><td>0</td><td>0</td></tr>
<tr><td colspan="3"><u>Explanation</u>
The effect of treating loans, facilities or other credit exposures to connected companies which are financial sector entities as CET1 capital instruments for the purpose of considering deductions to be made in calculating the capital base (see note re row 18 to the template above) will mean the headroom within the threshold available for the exemption from capital deduction of other insignificant capital investments in AT1 capital instruments may be smaller. Therefore, the amount to be deducted as reported in row 39 may be greater than that required under Basel III. The amount reported under the column "Basel III basis" in this box represents the amount reported in row 39 (i.e. the amount reported under the "Hong Kong basis") adjusted by excluding the aggregate amount of loans, facilities or other credit exposures to the AI's connected companies which were subject to deduction under the Hong Kong approach.</td></tr>
<tr><td rowspan="2">#54</td><td>Insignificant capital investments in Tier 2 capital instruments issued by financial sector entities that are outside the scope of regulatory consolidation (amount above 10% threshold)</td><td>0</td><td>0</td></tr>
<tr><td colspan="3"><u>Explanation</u>
The effect of treating loans, facilities or other credit exposures to connected companies which are financial sector entities as CET1 capital instruments for the purpose of considering deductions to be made in calculating the capital base (see note re row 18 to the template above) will mean the headroom within the threshold available for the exemption from capital deduction of other insignificant capital investments in Tier 2 capital instruments may be smaller. Therefore, the amount to be deducted as reported in row 54 may be greater than that required under Basel III. The amount reported under the column "Basel III basis" in this box represents the amount reported in row 54 (i.e. the amount reported under the "Hong Kong basis") adjusted by excluding the aggregate amount of loans, facilities or other credit exposures to the AI's connected companies which were subject to deduction under the Hong Kong approach.</td></tr>
<tr><td colspan="4">Remarks:
The amount of 10% / 15% thresholds mentioned above is calculated based on the amount of CET1 capital determined under the Banking (Capital) Rules.</td></tr>
</table>

<u>Abbreviations</u>:

CET1: Common Equity Tier 1

AT1: Additional Tier 1

M. CAPITAL DISCLOSURE TEMPLATE (CONTINUED)

(b) Balance Sheet Reconciliation

The following table shows a reconciliation of amounts shown in the balance sheet of the Company to the capital components of regulatory capital:

	Balance sheet as in published financial statements	**Under regulatory scope of consolidation**	**Cross reference to Definition of Capital Components**
As at December 31, 2017	**US$'000**	**US$'000**	
ASSETS			
Cash and short-term deposits	188,267	188,267	
Trade receivables	15,314	15,314	
Loan and advances to customers	1,430,416	1,430,416	
Other receivables	3,467	3,467	
Financial assets classified as held for trading	2,813	2,813	
Available-for-sale financial assets	2,410,435	2,410,435	
Deferred tax assets	6,452	6,452	(4)
Prepayments	215	215	
TOTAL ASSETS	**4,057,379**	**4,057,379**	
LIABILITIES			
Deposits	3,686,326	3,686,326	
Trade payables	254	254	
Other payables	119,785	119,785	
Financial liabilities classified as held for trading	15,771	15,771	
Current tax liabilities	1,667	1,667	
Accruals	608	608	
TOTAL LIABILITIES	**3,824,411**	**3,824,411**	
SHAREHOLDERS' EQUITY			
Share capital	170,000	170,000	(1)
Available-for-sale reserves	(696)	(696)	(3)
Retained earnings	63,664	63,664	(2)
TOTAL SHAREHOLDERS' EQUITY	**232,968**	**232,968**	
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	**4,057,379**	**4,057,379**	

M. CAPITAL DISCLOSURE TEMPLATE (CONTINUED)

(c) Main Features of Capital Instruments

The following table shows the main features of outstanding capital instruments issued.

1	Issuer	Morgan Stanley Asia International Limited
2	Unique identifier (eg CUSIP, ISIN or Bloomberg identifier for private placement)	Not applicable
3	Governing law(s) of the instrument	Hong Kong Law
	Regulatory treatment	
4	Transitional Basel III rules#	Not applicable
5	Post-transitional Basel III rules+	Common Equity Tier 1
6	Eligible at solo*/group/group & solo	Solo
7	Instrument type (type to be specified by each jurisdiction)	Ordinary shares
8	Amount recognised in regulatory capital (Currency in million, as of most recent reporting date)	US$170 million
9	Par value instrument	Not applicable
10	Accounting classification	Shareholders’ equity
11	Original date of issuance	• 1 share issued on May 19, 2014 • 13,000,000 shares issued on July 11, 2014 • 156,999,998 shares issued on January 13, 2015 • 1 share issued on February 9, 2015
12	Perpetual or dated	Perpetual
13	Original maturity date	No maturity
14	Issuer call subject to prior supervisory approval	No
15	Optional call date, contingent call dates and redemption amount	Not applicable
16	Subsequent call dates, if applicable	Not applicable
	Coupons / dividends	
17	Fixed or floating dividend/coupon	Floating
18	Coupon rate and any related index	Not applicable
19	Existence of a dividend stopper	No
20	Fully discretionary, partially discretionary or mandatory	Fully discretionary
21	Existence of step up or other incentive to redeem	No
22	Noncumulative or cumulative	Noncumulative
23	Convertible or non-convertible	Non-convertible
24	If convertible, conversion trigger (s)	Not applicable
25	If convertible, fully or partially	Not applicable
26	If convertible, conversion rate	Not applicable
27	If convertible, mandatory or optional conversion	Not applicable
28	If convertible, specify instrument type convertible into	Not applicable
29	If convertible, specify issuer of instrument it converts into	Not applicable
30	Write-down feature	No
31	If write-down, write-down trigger(s)	Not applicable

UNAUDITED SUPPLEMENTARY FINANCIAL INFORMATION
Year ended 31 December 2017

M. CAPITAL DISCLOSURE TEMPLATE (CONTINUED)

(c) Main Features of Capital Instruments (continued)

32	If write-down, full or partial	Not applicable
33	If write-down, permanent or temporary	Not applicable
34	If temporary write-down, description of write-up mechanism	Not applicable
35	Position in subordination hierarchy in liquidation (specify instrument type immediately senior to instrument)	Not applicable
36	Non-compliant transitioned features	No
37	If yes, specify non-compliant features	Not applicable

Footnote:

Regulatory treatment of capital instruments subject to transitional arrangements provided for in Schedule 4H of the Banking (Capital) Rules.

+ Regulatory treatment of capital instruments not subject to transitional arrangements provided for in Schedule 4H of the Banking (Capital) Rules.

* Included solo-consolidated

N. COUNTERCYCLICAL CAPITAL BUFFER ("CCyB") RATIO

The geographical breakdown of risk-weighted amounts ("RWA") in relation to private section credit exposures is as follows:

As at 31 December 2017:

	Jurisdiction	**Applicable Jurisdictional CCyB ("JCCyB") ratio in effect**	**Total RWA used in computation of CCyB ratio of AI US$'000**	**CCyB ratio of AI**	**CcyB amount of AI US$'000**
1	Hong Kong	1.25%	204,494		
2	Mainland China	0%	74,981		
3	Australia	0%	70		
4	Cayman Islands	0%	7,838		
5	Chinese Taipei	0%	52,473		
6	Indonesia	0%	29,938		
7	Malaysia	0%	4,727		
8	Philippines	0%	1,677		
9	Singapore	0%	58,954		
10	Switzerland	0%	1		
11	Thailand	0%	46,451		
12	United Kingdom	0%	1,515		
13	United States	0%	1,196		
	Total		**484,315**	**0.528%**	**2,556**

N. COUNTERCYCLICAL CAPITAL BUFFER ("CCyB") RATIO (CONTINUED)

As at 31 December 2016:

	Jurisdiction	Applicable Jurisdictional CCyB ("JCCyB") ratio in effect	Total RWA used in computation of CCyB ratio of AI US$'000	CCyB ratio of AI	CcyB amount of AI US$'000
1	Hong Kong	0.625%	128,336		
2	Mainland China	0%	72,688		
3	Australia	0%	91		
4	Cayman Islands	0%	11,315		
5	Chinese Taipei	0%	69,106		
6	Indonesia	0%	18,343		
7	Jersey	0%	1,007		
8	Malaysia	0%	1,584		
9	Philippines	0%	15,821		
10	Singapore	0%	32,813		
11	Thailand	0%	15,357		
12	United Kingdom	0%	590		
13	United States	0%	229		
	Total		**367,280**	**0.218%**	**802**

The geographical allocation of private sector credit exposures to the various jurisdictions is based on "ultimate risk basis". "Ultimate risk basis" means the allocation of exposures to the jurisdictions where the risk ultimately lies, as defined as the location where the "ultimate obligor" resides.

O. CAPITAL CONSERVATION BUFFER RATIO

Under section 3M of the Banking (Capital) Rules, the capital conservation buffer ratio is 1.25% for 2017 (2016: 0.625%).

P. LEVERAGE RATIO DISCLOSURE TEMPLATE

	As at 31 December 2017	As at 31 December 2016
Leverage ratio	5.41%	4.20%

The increase in leverage ratio is due to decrease in total on-balance sheet exposures which is driven by decrease in customer deposits.

The leverage position is calculated according to the leverage ratio template submitted to the HKMA.

Summary Comparison Table

	Item	Leverage ratio framework US$'000
1	Total consolidated assets as per published financial statements	4,057,379
2	Adjustment for investments in banking, financial, insurance or commercial entities that are consolidated for accounting purposes but outside the scope of regulatory consolidation	-
3	Adjustment for fiduciary assets recognised on the balance sheet pursuant to the operative accounting framework but excluded from the leverage ratio exposure measure	-
4	Adjustments for derivative financial instruments	6,197
5	Adjustments for securities financing transactions (i.e. repos and similar secured lending)	-
6	Adjustments for off-balance sheet items (i.e. conversion to credit equivalent amounts of off-balance sheet exposures)	-
7	Other adjustments	(13,732)
8	**Leverage ratio exposure**	**4,049,844**

P. LEVERAGE RATIO DISCLOSURE TEMPLATE (CONTINUED)

Leverage Ratio Common Disclosure Template		
	Item	**Leverage ratio framework US$'000**
On-balance sheet exposures		
1	On-balance sheet items (excluding derivatives and SFTs, but including collateral)	4,054,566
2	Less: Asset amounts deducted in determining Basel III Tier 1 capital (reported as negative amounts)	(13,732)
3	Total on-balance sheet exposures (excluding derivatives and SFTs) (sum of lines 1 and 2)	4,040,834
Derivative exposures		
4	Replacement cost associated with all derivatives transactions (i.e. net of eligible cash variation margin)	291
5	Add-on amounts for PFE associated with all derivatives transactions	8,719
6	Gross-up for derivatives collateral provided where deducted from the balance sheet assets pursuant to the operative accounting framework	-
7	Less: Deductions of receivables assets for cash variation margin provided in derivatives transactions (reported as negative amounts)	-
8	Less: Exempted CCP leg of client-cleared trade exposures (reported as negative amounts)	-
9	Adjusted effective notional amount of written credit derivatives	-
10	Less: Adjusted effective notional offsets and add-on deductions for written credit derivatives (reported as negative amounts)	-
11	Total derivative exposures (sum of lines 4 to 10)	9,010
Securities financing transaction exposures		
12	Gross SFT assets (with no recognition of netting), after adjusting for sales accounting transactions	-
13	Less: Netted amounts of cash payables and cash receivables of gross SFT assets (reported as negative amounts)	-
14	CCR exposure for SFT assets	-
15	Agent transaction exposures	-
16	Total securities financing transaction exposures (sum of lines 12 to 15)	-
Other off-balance sheet exposures		
17	Off-balance sheet exposure at gross notional amount	-
18	Less: Adjustments for conversion to credit equivalent amounts (reported as negative amounts)	-
19	Off-balance sheet items (sum of lines 17 and 18)	-
Capital and total exposures		
20	Tier 1 capital	219,236
21	Total exposures (sum of lines 3, 11, 16 and 19)	4,049,844
Leverage ratio		
22	**Basel III leverage ratio**	**5.41%**

Q. PILLAR 3 DISCLOSURE

The capital adequacy ratios of the Company were calculated in accordance with Banking (Capital) Rules of the Banking Ordinance. The Company uses the following approaches to calculate its capital charge for:

(a) credit risk: STC approach; and
(b) operational risk: BIA approach.

There was no risk-weighted amount ("RWA") for market risk for the Company because the Company was exempted by the HKMA from the calculation of market risk.

The following templates and tables show the standard disclosure templates and tables specified by the HKMA in relation to the Pillar 3 disclosure required under the Banking (Disclosure) Rules. Other Pillar 3 templates or tables not disclosed below are either not applicable to the Company or having no reportable amount for the period.

Table OVA: Overview of risk management

Risk Management Framework

Risk is an inherent part of the Company's business and activities. The Board follows Morgan Stanley's firm-wide risk governance framework. The Company has policies and procedures in place to identify, assess, monitor and manage the significant risks involved in the activities of the Company. Although most risks are incurred and managed at the division level, risks should be independently monitored to assure the effectiveness and consistency of risk management across all divisions and risk categories.

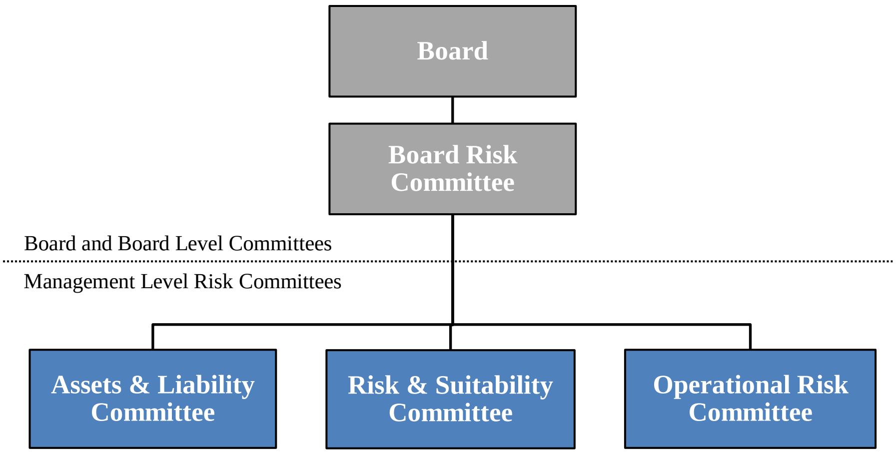
The Company's risk tolerance represents the amount of downside risk it is prepared to accept in pursuit of its business strategy in accordance with Board-level risk limits.

The Board Risk Committee reviews the risk profiles of the Company, including market, credit, liquidity and operational risks at least 4 times a year.

Risk Governance Structure

Risk management requires independent bank-level oversight, accountability of the Company's business segments, and effective communication of risk matters to senior management and across the Company. The nature of the Company's risks, coupled with this risk management philosophy, forms the Company's risk governance structure.

The Company's risk governance structure includes:



Above committees are further detailed in Section A of the Unaudited Supplementary Financial Information.

Q. PILLAR 3 DISCLOSURE (CONTINUED)

Table OVA: Overview of risk management (continued)

Risk Reporting and Measurement

- The Company has a suite of risk reporting across the main risk types - Credit Risk, Liquidity Risk, Market Risk (including Price Risk and Interest Rate Risk) and Operational Risk.
- The reporting includes quantitative measurements and qualitative assessments that enable a comparison of the Company's risk profile against risk limits and risk tolerance level as appropriate.
- Reporting identifies matters for escalation and highlights emerging risks. Material risk issues are investigated and escalated where appropriate, as per the specific escalation procedures set down by the Company.
- The Board Risk Committee has constituted delegated committees which provide senior management review of the risk reporting.
- The risk reporting capabilities are supported by a well-controlled infrastructure, including front office risk systems and the Company's risk management systems. Key risk data are subject to several control assessments, including: self-assessments, attestations, independent validation, reconciliation and internal audit reviews.
- Various policies and procedures are in place to support the systematic and regular review of risk management strategies inclusive of the risk frameworks covering independent identification, analysis, monitoring, reporting, and escalation of risks across the risk types, namely:
  - MSAIL Market Risk Management Policy;
  - MSAIL Credit Policy;
  - MSAIL Operational Risk Management Policy;
  - MSAIL Liquidity Risk Oversight Policy; and
  - MSAIL Risk Management Principles.

Legal and Compliance Department

The Company has established procedures based on legal and regulatory requirements that are designed to facilitate compliance with applicable statutory and regulatory requirements as well as Morgan Stanley's global standard relating to business conduct, ethics and practices.

Q. PILLAR 3 DISCLOSURE (CONTINUED)

Table OVA: Overview of risk management (continued)

Legal and Compliance Department (continued)

Compliance Department

- The Compliance Department maintains an enterprise-wide, independent compliance risk management program. The Compliance Department is responsible for promoting a strong culture of compliance; defining an operating model and setting standards for compliance risk management; identifying, measuring, mitigating and reporting on compliance risks; maintaining a risk-based program for monitoring and testing compliance risk management by the risk owners across the Company; providing management and staff with advice, guidance (including policies and, where appropriate, procedures) and training concerning the laws, regulations and policies associated with their responsibilities; managing a Company-wide compliance risk reporting framework; reviewing new products and business initiatives; and supporting and facilitating the framework for managing significant communications with regulators and regulatory relationships through oversight by the Regulatory Relations Group.

Legal Department

- The Legal Department provides legal and regulatory advice that protects the Company's financial well-being and reputation and assists the business in evaluating risks associated with completing transactions and other activities.

Global Financial Crimes

- The Company has adopted an AML policy which outlines the Company's anti-money laundering compliance program. This AML policy sets forth the guiding principles and consistent standards for best practices designed to protect the Company's business from being used to facilitate money laundering, terrorist financing, or other illicit activities.

- The Company is subject to risk of major regulatory sanctions and reputation damage if the Company significantly fails to comply with applicable AML, sanction screening laws, or Anti-Bribery and Corruption rules.

- AML related issues are reported as required to the Franchise Risk Officer, the Company's AML Steering Committee, Management Committee and the Board of Directors.

Internal Audit Department

IAD is established to assist both senior management and the Audit Committee of the Board in the effective discharge of their legal, fiduciary, and oversight responsibilities. It is further detailed in Section A of the Unaudited Supplementary Financial Information.

Risk Management Culture

Effective risk management is vital to the success of the Company. The Board oversees the establishment of risk governance to protect the interests of the Company's stakeholders and to ensure the safety and soundness of the Company's operations and its compliance with applicable laws and regulations. The Board follows Morgan Stanley's firm-wide risk governance framework.

The Company's risk management principles establish an enterprise risk management ("ERM") framework to integrate the diverse roles of the risk management functions into a holistic enterprise structure and to facilitate the incorporation of risk assessment into decision-making processes across the Company.

Q. PILLAR 3 DISCLOSURE (CONTINUED)

Table OVA: Overview of risk management (continued)

Risk Management Culture (continued)

The Company's risk management culture is based on the following five key principles:

- Integrity: critical to Morgan Stanley Group's approach to ERM is strong risk culture and risk governance. Developing the Morgan Stanley Group's risk culture is a continuous process and builds upon the Morgan Stanley Group's commitment to "doing the right thing" and its values that make managing risk each employee's responsibility;
- Comprehensiveness: a well-defined, comprehensive risk governance structure maintained by employees with appropriate risk management expertise that provides for periodic assessment of the efficacy of the Morgan Stanley Group's risk management framework;
- Independence: independent lines of reporting for risk managers in regard to identification, measurement, monitoring, escalation and mitigation of risk;
- Accountability: well-defined roles and responsibilities that establish clear accountability for risk management and are aligned with the Morgan Stanley Group's disciplinary and compensation structure;
- Transparency: strong risk culture that encourages open dialogue, effective challenge, escalation and appropriate reporting of risk to senior management, the Board (or a committee thereof) and the Company's regulators as well as external disclosures of risk matters.

The Company executes risk oversight through multiple lines of defense, which separately identify risk owners from independent risk control functions:

- Risk owners are organizational units or functions that have the ability to generate revenue or control expenses for the Company, or that provide certain operational or information technology support and services to units or functions within the Company. These groups include, for example, front-line business units, Operations and Information Technology, as well as certain functions performed by Finance. Risk owners are accountable for risks associated with their activities and are responsible for actively assessing and managing these risks.
- Independent risk management identify measure, monitor and control risks, and independently validate the effectiveness and consistency of risk management processes carried out by risk owners and across risk categories. Independent risk management includes, for example, functions performed by the Credit Risk Management Department, Liquidity Risk Department, Market Risk Department, Operational Risk Department, and Compliance Department, as well as certain functions performed by the Legal Department.
- Internal Audit independently assesses the Company's operating and control environment and control processes. The Internal Audit Manager of the Company reports to the Board Audit Committee and is independent of the business units and support and control functions and independent risk management. Internal Audit provides an independent assessment of the Company's control environment and risk management processes using a risk-based methodology developed from professional auditing standards.

Q. PILLAR 3 DISCLOSURE (CONTINUED)

Table OVA: Overview of risk management (continued)

Stress testing

Stress testing is one of the Company's principal risk management tools, which is used to identify and assess the impact of scenarios on its portfolios and capital, covering all products offered by the Company. Stress testing complements other company-wide risk metrics by providing a flexible approach to understanding risk and assessing the Company's resilience to different scenarios over a range of severities, relevant to current market conditions and forward looking macroeconomic views. Most notably, stress testing is used for:

- Risk Management: Identifying areas of potential weakness in Company's portfolio as a basis for senior management to take portfolio-level decisions, determining risk mitigation actions and set risk limits, and improving risk and control environment.
- Capital and Liquidity planning: Informing the proposed stressed capital and liquidity forecasts through severe but plausible stress tests.
- Others including business planning, new product evaluation and strategic business decision.

The MSAIL Stress Testing Framework utilises stress testing methodologies, including sensitivity tests and scenario analyses, to identify and assess Company's resilience to different stress conductions.

Risk Mitigation

Risk Mitigation is further detailed in the note 21 to the audited financial statements.

Adequacy of Risk Management Arrangements

The Company is satisfied that the risk management arrangements and systems, as described, are appropriate given the strategy and risk profile of the Company. These elements are reviewed at least annually and, where applicable, updated to reflect best practice, evolving market conditions and changing regulatory requirements.

Q. PILLAR 3 DISCLOSURE (CONTINUED)

Template OV1: Overview of risk-weighted amount ("RWA")

		RWA		Minimum capital requirements
		As at 31 December 2017 USD'000	As at 30 September 2017 USD'000	As at 31 December 2017 USD'000
1	Credit risk for non-securitization exposures	521,976	585,142	41,758
2	Of which Standardized (Credit Risk) Approach ("STC approach")	521,976	585,142	41,758
2a	Of which Basic Approach ("BSC approach")	-	-	-
3	Of which Internal Ratings-Based Approach ("IRB approach")	-	-	-
4	Counterparty credit risk	6,376	6,728	510
5	Of which Current Exposure Method ("CEM")	4,384	4,625	351
6	Of which Internal Models (Counterparty Credit Risk) Approach ("IMM(CCR) approach")	-	-	-
7	Equity exposures in banking book under the market-based approach	-	-	-
8	CIS exposures – Look-Through Approach ("LTA")	-	-	-
9	CIS exposures – Mandate-Based Approach ("MBA")	-	-	-
10	CIS exposures – Fall-Back Approach ("FBA")	-	-	-
11	Settlement risk	-	-	-
12	Securitization exposures in banking book	-	-	-
13	Of which Internal Ratings-Based (Securitization) Approach ("IRB(S) approach") – ratings-based method	-	-	-
14	Of which IRB(S) approach – supervisory formula method	-	-	-
15	Of which Standardized (Securitization) Approach ("STC(S) approach")	-	-	-
16	Market risk	-	-	-
17	Of which Standardized (Market Risk) Approach ("STM approach")	-	-	-
18	Of which Internal Models Approach ("IMM approach")	-	-	-
19	Operational risk	426,492	432,358	34,119
20	Of which Basic Indicator Approach ("BIA approach")	426,492	432,358	34,119
21	Of which Standardized (Operational Risk) Approach ("STO approach")	-	-	-
21a	Of which Alternative Standardized Approach ("ASA approach")	-	-	-
22	Of which Advanced Measurement Approach ("AMA approach")	N/A	N/A	N/A
23	Amounts below the thresholds for deduction (subject to 250% Risk-Weight ("RW"))	-	-	-
24	Capital floor adjustment	-	-	-
24a	Deduction to RWA	572	12	46
24b	Of which portion of regulatory reserve for general banking risks and collective provisions which is not included in Tier 2 Capital	572	12	46
24c	Of which portion of cumulative fair value gains arising from the revaluation of land and buildings which is not included in Tier 2 Capital	-	-	-
25	**Total**	**954,272**	**1,024,216**	**76,341**

N/A: Not applicable in the case of Hong Kong

The disclosure on minimum capital requirement is made by multiplying the Company's RWA derived from the relevant calculation approach by 8%, not the Company's actual "regulatory capital".

Decrease in total RWA during the fourth quarter in 2017 was US$69,944,000. The key driver of the decrease was due to decrease in RWA for credit risk for non-securitization exposures arising from loans and advances to customers.

Q. PILLAR 3 DISCLOSURE (CONTINUED)

Template LI1: Differences between accounting and regulatory scopes of consolidation and mapping of financial statement categories with regulatory risk categories

	Carrying values as reported in published financial statements/ under scope of regulatory consolidation	Carrying values of items:				
		subject to credit risk framework	subject to counterparty credit risk framework	subject to the securitization framework	subject to market risk framework	not subject to capital requirements or subject to deduction from capital
	USD'000	USD'000	USD'000	USD'000	USD'000	USD'000
Assets						
Loans and receivables:						
Cash and short-term deposits	188,267	188,267	-	-	-	-
Trade receivables	15,314	15,314	-	-	-	-
Loans and advances to customers	1,430,416	1,430,416	-	-	-	-
Other receivables	3,467	3,467	-	-	-	-
	1,637,464	1,637,464		-	-	-
Financial assets classified as held for trading	2,813	-	2,813	-	-	-
Available-for-sale financial assets	2,410,435	2,410,435	-	-	-	-
Current tax asset	-	-	-	-	-	-
Deferred tax assets	6,452	-	-	-	-	6,452
Prepayments	215	215	-	-	-	-
Total assets	**4,057,379**	**4,048,114**	**2,813**	**-**	**-**	**6,452**
Liabilities						
Financial liabilities at amortised cost:						
Deposits	3,686,326	-	-	-	-	3,686,326
Trade payables	254	-	-	-	-	254
Other payables	119,785	-	-	-	-	119,785
	3,806,365	-	-	-	-	3,806,365
Financial liabilities classified as held for trading	15,771	-	15,771	-	-	-
Current tax liabilities	1,667	-	-	-	-	1,667
Accruals	608	-	-	-	-	608
Total liabilities	**3,824,411**	**-**	**15,771**	**-**	**-**	**3,808,640**

The Company's scope of accounting consolidation and its scope of regulatory consolidation are the same.

Q. PILLAR 3 DISCLOSURE (CONTINUED)

Table CRA: General information about credit risk

Overview

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

The Company incurs credit risk primarily from margin loans to clients of the private wealth management business. Margin loans are asset-based in nature secured by marketable securities held with the Company as collateral. Credit risk from the margin loan portfolio is largely mitigated by the quality of the collateral held under a conservative margin policy.

The Company also incurs credit risk as part of its treasury activities from: (i) bank exposures with respect to agent banks; and (ii) sovereign exposures from the available-for-sale investment portfolio. The credit risk of these activities is mitigated by high credit quality of agent banks and the sovereign entities.

Credit Risk Management

The Company's credit risk management policies and procedures establish the framework for ensuring transparency of material credit risks, ensuring compliance with established limits and escalation of risk concentrations to appropriate senior management and the Board of Directors. A comprehensive Credit Limits Framework is utilised to manage credit risk levels across the Company. The Credit Limits Framework is calibrated within the Company's risk tolerance and includes single-name limits and portfolio concentration limits by country, counterparty type and product type.

The Company executes oversight of credit risk management through three lines of defense. The Company believes this structure creates clear delineation of responsibilities and facilitates effective implementation of the control framework.

(i) Wealth Management Risk Management Department ("BURM") – the first line of defense with decentralized ownership and business management accountability.

(ii) Credit Risk Management Department ("CRM") – the second line of defense providing independent risk oversight and challenges.

(iii) Internal Audit Department ("IAD") – the third line of defense independently assessing the Company's operating and control environment and control processes.

Credit risk exposure is actively managed by BURM, CRM and senior management. A variety of credit risk reports are distributed daily to BURM and CRM, monthly to Risk & Suitability Committee where membership includes senior management, and quarterly to Risk Committee and the Board of Directors.

Details of the Financial Risk Managements are further detailed in note 21 to the audited financial statements, and Table OVA of the Unaudited Supplementary Financial Information.

Q. PILLAR 3 DISCLOSURE (CONTINUED)

Template CR1: Credit quality of exposures

		Gross carrying amounts of		Allowances / impairments	Net values
		Defaulted exposures	Non-defaulted exposures		
		USD'000	USD'000	USD'000	USD'000
1	Loans	-	1,433,158	-	1,433,158
2	Debt securities	-	2,410,435	-	2,410,435
3	Off-balance sheet exposures	-	-	-	-
4	**Total at 31 December 2017**	**-**	**3,843,593**	**-**	**3,843,593**

Loans included loans and advances to customers and related accrued interest receivables.

There is no defaulted loans and debt securities as at 31 December 2017 and there is no movement between defaulted and non- defaulted exposures from 1 January 2017 to 31 December 2017.

Q. PILLAR 3 DISCLOSURE (CONTINUED)

Table CRB: Additional disclosure related to credit quality of exposures

A financial asset is considered past due when a counterparty has failed to make a payment when contractually due.

A financial asset is considered impaired if there is objective evidence of impairment resulting from an event occurring which will have an adverse impact on expected future cash flows of an asset and the expected impact can be reliably estimated.

For details of methods adopted for determining impairments, please refer to the note 3(f) and 21 to the audited financial statements.

As at 31 December 2017, the Company has no impaired exposures and no exposure which is past due for more than 90 days but is not impaired.

Restructured exposures refer to assets that have been restructured and renegotiated between the Company and the counterparties because of a deterioration in the financial position of the counterparties or of the inability of the counterparties to meet the original repayment schedule and for which the revised repayment terms, either of interest or of repayment period, are non-commercial to the Company. As at 31 December 2017, the company has no restructured exposures.

The following tables show the breakdown of the Company's exposures by geographical areas and industry as at 31 December 2017. These amounts do not include the effects of recognised credit risk mitigation. As at 31 December 2017, the residual maturities of all exposures are not more than 1 year.

Geographical areas	**USD'000**
Singapore	1,497,206
Hong Kong	649,815
Mainland China	206,089
Taiwan	157,290
Other [1]	1,539,282
Total at 31 December 2017	4,049,682

Industry	**USD'000**
Industrial, commercial and financial	1,126,026
Individuals	307,136
Others [1]	2,616,520
Total at 31 December 2017	4,049,682

(1) Any segment which constitutes less than 10% of the Company's total RWA for credit risk (after taking into account of any recognised credit risk mitigation) is not separately disclosed and grouped on an aggregated basis under the category "other".

Q. PILLAR 3 DISCLOSURE (CONTINUED)

Table CRC: Qualitative disclosures related to credit risk mitigation

In order to manage credit exposure arising from its business activities, the Company applies various credit risk management policies and procedures, see note 21 to the audited financial statements for further details.

The Company's primary method of mitigating credit risk is the use of eligible collateral for the margin loan portfolio. Eligible collaterals include marketable securities and other investment products. Majority of the Company's collaterals are marketable securities, including equity securities, bonds and mutual funds, where collateral values are being revaluated daily.

The Company maintains policies and procedures related to collateral management. It applies a conservative margin policy to ensure with a high degree of confidence that claims can be repaid in full through the liquidation of assets in the client portfolio securing the exposure.

The Company enters into valid bilateral netting agreements with Morgan Stanley affiliates which satisfied the conditions set out under section 2 of the Banking (Capital) Rules for recognised netting. As at 31 December 2017, minimal recognised netting is applied for both on- and off-balance sheet exposures.

Q. PILLAR 3 DISCLOSURE (CONTINUED)

Template CR3: Overview of recognised credit risk mitigation

		Exposures unsecured: carrying amount(1)	Exposures to be secured	Exposures secured by recognised collateral	Exposures secured by recognised guarantees	Exposures secured by recognised credit derivative contracts
		USD'000	USD'000	USD'000	USD'000	USD'000
1	Loans	481,734	951,424	951,424	-	-
2	Debt securities	2,410,435	-	-	-	-
3	**Total at 31 December 2017**	**2,892,169**	**951,424**	**951,424**	**-**	**-**
4	Of which defaulted	-	-	-	-	-

Loans included loans and advances to customers and related accrued interest receivables.

(1) All exposures arising from loans are fully secured by collateral as at 31 December 2017. Unsecured exposures disclosed in the above table are either because the relevant collateral is not considered as recognised collateral, or the carrying amount of such recognised collateral is subject to standard supervisory haircut in accordance with the Banking (Capital) Rules.

Table CRD: Qualitative disclosures on use of ECAI ratings under STC approach

The Company uses the STC approach to calculate its credit risk.

Standard & Poor's Rating Services, Moody's Investors Service and Fitch Ratings are the external credit assessment institutions (the "ECAIs") that the Company used to determine the risk weight of the exposure classes, including sovereign, bank, securities firm, corporate and other exposures which are not past due exposures. The Company follows the process as prescribed in Part 4 of the Banking (Capital) Rules to map ECAI issuer ratings to exposures booked in its banking book. If an exposure has only one ECAI issue specific rating, that rating is used to determine the risk weight of that exposure. In cases where there are two or more issue specific ratings assigned by different ECAIs to an exposure and these ratings map to different risk weights, any one of those ratings is used except the one or more of those ratings which map to the lowest of those different risk weights.

Q. PILLAR 3 DISCLOSURE (CONTINUED)

Template CR4: Credit risk exposures and effects of recognised credit risk mitigation – for STC approach

		Exposures pre-CCF and pre-CRM		Exposures post-CCF and post-CRM		RWA and RWA density	
		On-balance sheet amount	Off-balance sheet amount	On-balance sheet amount	Off-balance sheet amount	RWA	RWA density
	Exposure classes	**USD'000**	**USD'000**	**USD'000**	**USD'000**	**USD'000**	**%**
1	Sovereign exposures	2,424,646	-	2,424,646	-	-	-
2	PSE exposures	-	-	-	-	-	-
2a	Of which: domestic PSEs	-	-	-	-	-	-
2b	Of which: foreign PSEs	-	-	-	-	-	-
3	Multilateral development bank exposures	-	-	-	-	-	-
4	Bank exposures	187,444	-	187,444	-	37,685	20%
5	Securities firm exposures	4,112	-	3,754	-	1,877	50%
6	Corporate exposures	1,126,026	-	373,100	-	373,100	100%
7	CIS exposures	-	-	-	-	-	-
8	Cash items	-	-	-	-	-	-
9	Exposures in respect of failed delivery on transactions entered into on a basis other than a delivery-versus-payment basis	-	-	-	-	-	-
10	Regulatory retail exposures	-	-	-	-	-	-
11	Residential mortgage loans	-	-	-	-	-	-
12	Other exposures which are not past due exposures	307,454	-	109,314	-	109,314	100%
13	Past due exposures	-	-	-	-	-	-
14	Significant exposures to commercial entities	-	-	-	-	-	-
15	**Total at 31 December 2017**	**4,049,682**	**-**	**3,098,258**	**-**	**521,976**	**17%**

Q. PILLAR 3 DISCLOSURE (CONTINUED)

Template CR5: Credit risk exposures by asset classes and by risk weights – for STC approach

	Exposure class \ Risk Weight	0%	10%	20%	35%	50%	75%	100%	150%	250%	Others	Total credit risk exposures amount (post CCF and post CRM)
		USD'000	USD'000	USD'000	USD'000	USD'000	USD'000	USD'000	USD'000	USD'000	USD'000	USD'000
1	Sovereign exposures	2,424,646	-	-	-	-	-	-	-	-	-	2,424,646
2	PSE exposures	-	-	-	-	-	-	-	-	-	-	-
2a	Of which: domestic PSEs	-	-	-	-	-	-	-	-	-	-	-
2b	Of which: foreign PSEs	-	-	-	-	-	-	-	-	-	-	-
3	Multilateral development bank exposures	-	-	-	-	-	-	-	-	-	-	-
4	Bank exposures	-	-	186,789	-	655	-	-	-	-	-	187,444
5	Securities firm exposures	-	-	-	-	3,754	-	-	-	-	-	3,754
6	Corporate exposures	-	-	-	-	-	-	373,100	-	-	-	373,100
7	CIS exposures	-	-	-	-	-	-	-	-	-	-	-
8	Cash items	-	-	-	-	-	-	-	-	-	-	-
9	Exposures in respect of failed delivery on transactions entered into on a basis other than a delivery-versus-payment basis	-	-	-	-	-	-	-	-	-	-	-
10	Regulatory retail exposures	-	-	-	-	-	-	-	-	-	-	-
11	Residential mortgage loans	-	-	-	-	-	-	-	-	-	-	-
12	Other exposures which are not past due exposures	-	-	-	-	-	-	109,314	-	-	-	109,314
13	Past due exposures	-	-	-	-	-	-	-	-	-	-	-
14	Significant exposures to commercial entities	-	-	-	-	-	-	-	-	-	-	-
15	**Total at 31 December 2017**	**2,424,646**	**-**	**186,789**	**-**	**4,409**	**-**	**482,414**	**-**	**-**	**-**	**3,098,258**

Q. PILLAR 3 DISCLOSURE (CONTINUED)

Table CCRA: Qualitative disclosures related to counterparty credit risk (including those arising from clearing through CCPs)

Counterparty credit risk refers to the risk of loss associated with the failure by one or more sales and trading counterparties to perform against its contractual obligations. The Company's counterparty credit risk arises from securities purchased under agreements to resell with external counterparties and derivative transactions with Morgan Stanley affiliates in relation to treasury activities. Counterparty credit exposure is managed by eligible collateral with daily margining between the Company and counterparties and the collateral requirement is not linked to credit rating. Given the nature of such transactions, there is no general wrong-way-risk and specific wrong-way risk. Operating limits in relation to exposures arising from the derivative transactions with Morgan Stanley affiliates are set as a percentage of the Company's capital based on historical usage of such activities.

Details of such transactions are further detailed in note 21 and note 22 to the audited financial statements.

Template CCR1: Analysis of counterparty default risk exposures (other than those to CCPs) by approaches

		Replacement cost (RC)	PFE	Effective EPE	Alpha (α) used for computing default risk exposure	Default risk exposure after CRM	RWA
		USD'000	USD'000	USD'000	USD'000	USD'000	USD'000
1	CEM	291	8,719		1	8,767	4,384
2	IMM (CCR) approach			-	-	-	-
3	Simple Approach (for SFTs)					-	-
4	Comprehensive Approach (for SFTs)					-	-
5	Value-at-risk ("VaR") (for SFTs)					-	-
6	**Total at 31 December 2017**						**4,384**

Q. PILLAR 3 DISCLOSURE (CONTINUED)

Template CCR2: Credit Valuation Adjustment ("CVA") capital charge

		Exposure at default ("EAD") post CRM	**RWA**
		USD'000	**USD'000**
	Netting sets for which CVA capital charge is calculated by the advanced CVA method	-	-
1	(i) VaR (after application of multiplication factor if applicable)		-
2	(ii) Stressed VaR (after application of multiplication factor if applicable)		-
3	Netting sets for which CVA capital charge is calculated by the standardized CVA method	8,767	1,992
4	**Total at 31 December 2017**	**8,767**	**1,992**

Q. PILLAR 3 DISCLOSURE (CONTINUED)

Template CCR3: Counterparty default risk exposures (other than those to CCPs) by asset classes and by risk weights – for STC approach

	Exposure class \ Risk Weight	0%	10%	20%	35%	50%	75%	100%	150%	250%	Others	Total default risk exposure after CRM
		USD '000	USD '000	USD '000	USD '000	USD '000	USD '000	USD '000	USD '000	USD '000	USD '000	USD '000
1	Sovereign exposures	-	-	-	-	-	-	-	-	-	-	-
2	PSE exposures	-	-	-	-	-	-	-	-	-	-	-
2a	Of which: domestic PSEs	-	-	-	-	-	-	-	-	-	-	-
2b	Of which: foreign PSEs	-	-	-	-	-	-	-	-	-	-	-
3	Multilateral development bank exposures	-	-	-	-	-	-	-	-	-	-	-
4	Bank exposures	-	-	-	-	8,767	-	-	-	-	-	8,767
5	Securities firm exposures	-	-	-	-	-	-	-	-	-	-	-
6	Corporate exposures	-	-	-	-	-	-	-	-	-	-	-
7	CIS exposures	-	-	-	-	-	-	-	-	-	-	-
8	Regulatory retail exposures	-	-	-	-	-	-	-	-	-	-	-
9	Residential mortgage loans	-	-	-	-	-	-	-	-	-	-	-
10	Other exposures which are not past due exposures	-	-	-	-	-	-	-	-	-	-	-
11	Significant exposures to commercial entities	-	-	-	-	-	-	-	-	-	-	-
12	**Total at 31 December 2017**	**-**	**-**	**-**	**-**	**8,767**	**-**	**-**	**-**	**-**	**-**	**8,767**

Q. PILLAR 3 DISCLOSURE (CONTINUED)

Template CCR5: Composition of collateral for counterparty default risk exposures (including those for contracts or transactions cleared through CCPs)

	Derivative contracts				SFTs	
	Fair value of recognised collateral received		Fair value of posted collateral		Fair value of recognised collateral received	Fair value of posted collateral
	Segregated	Unsegregated	Segregated	Unsegregated		
	USD'000	USD'000	USD'000	USD'000	USD'000	USD'000
Cash - domestic currency	-	243	-	12,231	-	-
Total at 31 December 2017	**-**	**243**	**-**	**12,231**	**-**	**-**

Domestic currency refers to the reporting currency of the Company, i.e. USD.