MORGAN STANLEY ASIA INTERNATIONAL LIMITED

Reports and financial statements

31 December 2016

MORGAN STANLEY ASIA INTERNATIONAL LIMITED

REPORTS AND FINANCIAL STATEMENTS
Year ended 31 December 2016

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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") for the year ended 31 December 2016.

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 as introducing broker for other subsidiaries of the Morgan Stanley group of companies in connection with the provision of general investment, securities and futures dealing, and custody services, as well as discretionary management.

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 2016 are set out in the income statement on page 5.

No interim dividends were paid to the shareholders 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	(appointed on 22 April 2016)
Fung, Choi Cheung	
Kwan, Yin Ping	
Laroia, Gokul	
Ong, Whatt Soon Ronald	
Vazirani, Ravi Harish	(appointed on 25 August 2016)
Wraight, David John	(appointed on 15 November 2016)
Jesse Jr, James William	(resigned on 15 November 2016)
Kohli, Arun	(resigned on 22 April 2016)
Sim, Hwee Hoon	(resigned on 25 August 2016)

All existing Directors continue in office except Wraight, David John who will retire at the forthcoming Annual General Meeting by virtue of Article 24.5.1 of the Company's Articles of Association and will be eligible for re-appointment to the office.

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

19 April 2017

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 50, which comprise the statement of financial position as at 31 December 2016, 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 2016, 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 ("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

19 April 2017

MORGAN STANLEY ASIA INTERNATIONAL LIMITED

INCOME STATAMENT
Year ended 31 December 2016

	Note	2016 US$'000	2015 US$'000
Interest income	4	20,584	17,866
Interest expense	4	(27,141)	(19,658)
Net interest expense		(6,557)	(1,792)
Fee and commission income	5	197,232	218,350
Net gains on financial instruments classified as held for trading		9,647	50,922
Net losses on available-for-sale financial assets	6	(5,405)	(62,514)
Other income	7	12,052	17,833
Other expense	8	(203,544)	(180,218)
PROFIT BEFORE INCOME TAX		3,425	42,581
Income tax expense	9	(1,059)	(6,838)
PROFIT FOR THE YEAR		2,366	35,743

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

The notes on pages 10 to 50 form an integral part of the financial statements.

STATEMENT OF COMPREHENSIVE INCOME
Year ended 31 December 2016

	Note	2016 US$'000	2015 US$'000
PROFIT FOR THE YEAR		2,366	35,743
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	(61)	(407)
Net amount reclassified to income statement	9	40	7
OTHER COMPREHENSIVE LOSS AFTER INCOME TAX FOR THE YEAR		(21)	(400)
TOTAL COMPREHENSIVE INCOME FOR THE YEAR		2,345	35,343

The notes on pages 10 to 50 form an integral part of the financial statements.

MORGAN STANLEY ASIA INTERNATIONAL LIMITED

STATEMENT OF CHANGES IN EQUITY
Year ended 31 December 2016

	Note	Share capital US$'000	Available-for-sale reserve US$'000	(Accumulated losses)/ retained earnings US$'000	Total equity US$'000
Balance at 1 January 2015		13,000	-	(20)	12,980
Profit for the year		-	-	35,743	35,743
Other comprehensive loss	9	-	(400)	-	(400)
Total comprehensive (loss)/ income		-	(400)	35,743	35,343
Transaction with owners:					
- Issue of capital	18	157,000	-	-	157,000
- Share-based payments		-	-	382	382
Balance at 31 December 2015		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
Transactions with owners:					
- Share-based payments		-	-	147	147
Balance at 31 December 2016		170,000	(421)	38,618	208,197

The notes on pages 10 to 50 form an integral part of the financial statements.

MORGAN STANLEY ASIA INTERNATIONAL LIMITED

STATEMENT OF FINANCIAL POSITION
As at 31 December 2016

	Note	2016 US$'000	2015 US$'000
ASSETS			
Loans and receivables:			
Cash and short-term deposits	19(a)	267,416	798,943
Trade receivables		3,123	553
Loans and advances to customers	10	1,257,791	1,031,953
Other receivables	11	2,365	1,914
		1,530,695	1,833,363
Financial assets classified as held for trading	12	35,047	9,558
Available-for-sale financial assets	13	3,099,511	4,031,391
Current tax asset		3,310	-
Deferred tax assets	14	5,406	1,868
Prepayments		108	111
TOTAL ASSETS		4,674,077	5,876,291
LIABILITIES AND EQUITY			
Financial liabilities at amortised cost:			
Deposits	15	4,330,912	5,439,241
Trade payables		45,424	150,770
Other payables	16	87,673	63,403
		4,464,009	5,653,414
Financial liabilities classified as held for trading	12	1,294	7,863
Current tax liabilities		-	8,619
Accruals		577	690
TOTAL LIABILITIES		4,465,880	5,670,586
EQUITY			
Share capital	18	170,000	170,000
Available-for-sale reserve	18	(421)	(400)
Retained earnings		38,618	36,105
Equity attributable to owners of the Company		208,197	205,705
TOTAL EQUITY		208,197	205,705
TOTAL LIABILITIES AND EQUITY		4,674,077	5,876,291

These financial statements were approved by the Board and authorised for issue on 19 April 2017:

Signed on behalf of the Board

Chui, Vincent Yik Chiu
Director

Wraight, David John
Director

The notes on pages 10 to 50 form an integral part of the financial statements.

STATEMENT OF CASH FLOWS
Year ended 31 December 2016

	Note	2016 US$'000	2015 US$'000
NET CASH FLOWS (USED IN)/ FROM OPERATING ACTIVITIES	19(b)	(1,457,980)	1,352,953
INVESTING ACTIVITIES			
Purchase of available-for-sale financial assets	13	(10,994,445)	(13,092,050)
Proceeds from maturity/ sale of available-for-sale financial assets	13	11,912,101	11,165,234
Interest received from available-for-sale financial assets	13	8,797	9,172
Net cash flow arising from business combination		-	1,193,634
NET CASH FLOWS FROM/ (USED IN) INVESTING ACTIVITIES		926,453	(724,010)
FINANCING ACTIVITY			
Issue of ordinary share capital	18	-	157,000
NET CASH FLOWS FROM FINANCING ACTIVITY		-	157,000
NET (DECREASE)/ INCREASE IN CASH AND CASH EQUIVALENTS		(531,527)	785,943
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE YEAR		798,943	13,000
CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR	19(a)	267,416	798,943

The notes on pages 10 to 50 form an integral part of the financial statements.

NOTES TO THE FINANCIAL STATEMENTS
Year ended 31 December 2016

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 as introducing broker for other subsidiaries of the Morgan Stanley Group in connection with the provision of general investment, securities and futures dealing, and custody services, as well as discretionary management.

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 1 'Presentation of financial statements' was issued by the HKICPA in January 2015, as part of the Disclosure Initiative project. The amendment is applicable in annual periods beginning on or after 1 January 2016.

As part of the 2012 – 2014 Annual Improvements Cycle published in October 2014, the HKICPA made amendments to the following standards that are relevant to the Company's operations: HKFRS 7 'Financial instruments: Disclosures', HKAS 19 'Employee benefits' and HKAS 34 'Interim financial reporting', for application in accounting periods beginning on or after 1 January 2016.

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

2. BASIS OF PREPARATION (CONTINUED)

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 yet mandatory. 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 HKAS 7 '*Statement of Cash Flows*' was issued by the HKICPA in June 2016, as part of the Disclosure Initiative project. The amendment is applicable for annual periods beginning on or after 1 January 2017. Early application is permitted.

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

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

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 July 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 adoption, either in full or relating to own credit in isolation, is permitted. The Company is currently assessing the impact of HKFRS 9 on its financial statements.

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. The Company is currently assessing the impact of HKFRS 15 on its financial statements.

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.

Use of estimates and sources of uncertainty

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

For further details on the judgements used in determining fair value of certain assets and liabilities, see notes 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 gains/ (losses) 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 for identical assets or liabilities that the Morgan Stanley Group has the ability to access. Valuation adjustments and block discounts are not applied to Level 1 instruments. Since valuations are based on quoted prices that are readily and regularly available in an active market, valuation of these products does not entail a significant degree of judgement.

- 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 to validate the fair value of the Company's financial instruments measured at fair value including those derived from pricing models. These control processes are designed to assure that the values used for financial reporting are based on observable inputs wherever possible. In the event that observable inputs are not available, the control processes are designed to ensure the valuation approach utilised is appropriate and consistently applied and that the assumptions are reasonable.

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

> *Model Review.* VRG, in conjunction with the Market Risk Department ('MRD') and, where appropriate, the Credit Risk Management Department, both of which report to the Chief Risk Officer of the Morgan Stanley Group ('CRO'), independently review valuation models' theoretical soundness, the appropriateness of the valuation methodology and calibration techniques developed by the business units using observable inputs. Where inputs are not observable, VRG reviews the appropriateness of the proposed valuation methodology to ensure it is consistent with how a market participant would arrive at the unobservable input. The valuation methodologies utilised in the absence of observable inputs may include extrapolation techniques and the use of comparable observable inputs. As part of the review, VRG develops a methodology to independently verify the fair value generated by the business unit's valuation models. All of the Company's valuation models are subject to an independent annual review.
>
> *Independent Price Verification.* The business units are responsible for determining the fair value of financial instruments using approved valuation models and valuation methodologies. Generally on a monthly basis, VRG independently validates the fair values of financial instruments determined using valuation models by determining the appropriateness of the inputs used by the business units and by testing compliance with the documented valuation methodologies approved in the model review process described above.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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

For financial instruments categorised within Level 3 of the fair value hierarchy, VRG reviews the business unit's valuation techniques to ensure these are consistent with market participant assumptions.

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

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

Gains and losses on inception

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

When 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.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

f. Impairment of financial assets

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

Impairment losses on available-for-sale financial assets are measured as the difference between cost (net of any principal repayment and amortisation) and the current fair value (see note 3(d) above). Where there is evidence that 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 and introductory brokerage 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 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 operates equity-based compensation plans on behalf of the Company in relation to which, the Company pays Morgan Stanley in consideration of the procurement of the transfer of shares to employees. The cost of equity-based transactions with employees is measured based on the fair value of the equity instruments at grant date. Fair value of stock unit awards is based on the market price of Morgan Stanley shares. Non-market vesting conditions are not taken into account when measuring fair value, but are reflected by adjusting over time the number of equity instruments included in the measurement of the transaction such that the amount ultimately recognised reflects the number that actually vest. The expense is recorded within ‘Staff costs’, ‘Directors’ remuneration’ and ‘Management charges from other Morgan Stanley Group undertakings’ in ‘Other expense’ in the income statement; the corresponding credit to retained earnings is reduced to the extent that payments are due to Morgan Stanley in respect of these awards.

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’.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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

	2016 US$'000	2015 US$'000
Sales commissions and introductory brokerage fees	197,194	218,342
Other fees	38	8
	197,232	218,350

6. NET LOSSES ON AVAILABLE-FOR-SALE FINANCIAL ASSETS

	2016 US$'000	2015 US$'000
Interest income	19,754	20,725
Foreign exchange revaluation	(25,112)	(83,231)
Net fair value losses reclassified from the available-for-sale reserve on disposal of asset	(47)	(8)
	(5,405)	(62,514)

7. OTHER INCOME

	2016 US$'000	2015 US$'000
Net foreign exchange gains	5,817	16,766
Management charges to other Morgan Stanley Group undertakings	6,117	1,002
Other	118	65
	12,052	17,833

8. OTHER EXPENSE

	2016 US$'000	2015 US$'000
Staff costs	115,962	95,688
Directors' remuneration		
Fees	83	83
Contribution to defined contribution plan	52	41
Other	7,171	4,684
Auditors' remuneration:		
Fees payable to the Company's auditor for the audit of the Company's annual financial statements	549	532
Fees payable to the Company's auditor for other services to the Company	2	-
Non-audit professional services	7,179	10,572
Management charges from other Morgan Stanley Group undertakings relating to staff costs	590	1,743
Management charges from other Morgan Stanley Group undertakings relating to other services	68,405	62,539
Other	3,551	4,336
	203,544	180,218

Included within 'Staff costs', 'Directors' remuneration' and 'Management charges from other Morgan Stanley Group undertakings' is an amount of US$14,001,000 (2015: US$12,651,000) in relation to equity-settled share-based compensation plans, and US$12,094,000 (2015: US$7,835,000) 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 year ended 31 December 2016 and 31 December 2015, 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 (2015: Nil).

9. INCOME TAX EXPENSE

	2016 US$'000	2015 US$'000
Current tax expense		
Current year		
Hong Kong	3,773	8,551
Other jurisdiction	10	109
	3,783	8,660
Adjustments in respect of prior years		
Hong Kong	894	-
	4,677	8,660
Deferred tax benefit		
Origination and reversal of temporary differences	(2,924)	(1,822)
Adjustments in respect of prior years	(694)	-
	(3,618)	(1,822)
Income tax expense	1,059	6,838

Reconciliation of effective tax rate

The current year income tax expense is higher (2015: lower) than that resulting from applying the standard rate of profits tax in Hong Kong for the year of 16.5% (2015:16.5%). The main differences are explained below:

	2016 US$'000	2015 US$'000
Profit before income tax	3,425	42,581
Income tax using the standard rate of profits tax in Hong Kong of 16.5%	565	7,026
Impact on tax of:		
Expenses not deductible for tax purposes	1,175	1,484
Utilisation of tax losses	-	(4)
Tax exempt income	(1,158)	(1,765)
Concessionary tax rate	347	88
Effect of tax rates in foreign jurisdiction	(36)	(12)
Tax under provided in prior years	200	-
Withholding tax expensed	10	20
Others	(44)	1
Total income tax expense in the income statement	1,059	6,838

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:

	2016			2015		
	Before tax US$'000	Tax benefit/ (expense) US$'000	Net of tax US$'000	Before tax US$'000	Tax benefit/ (expense) US$'000	Net of tax US$'000
Available-for-sale reserve:						
Net change in fair value of available-for-sale financial assets	(69)	8	(61)	(463)	56	(407)
Net amount transferred to income statement	47	(7)	40	8	(1)	7
Other comprehensive (loss)/ income	(22)	1	(21)	(455)	55	(400)

10. LOANS AND ADVANCES TO CUSTOMERS

	2016 US$'000	2015 US$'000
Loans and advances to customers	1,257,791	1,031,953

There were no impaired loan and advances, collective and specific provisions, as at 31 December 2016 (31 December 2015: Nil).

11. OTHER RECEIVABLES

	2016 US$'000	2015 US$'000
Amounts due from other Morgan Stanley Group undertakings	416	185
Interest receivable	1,869	1,576
Other amounts receivable	80	153
	2,365	1,914

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:

	2016			2015		
	Notional amount US$'000	Fair value Assets US$'000	Fair value Liabilities US$'000	Notional amount US$'000	Fair value Assets US$'000	Fair value Liabilities US$'000
Derivatives:						
Foreign exchange contracts	1,911,651	34,773	1,290	2,874,841	9,036	7,197
Interest rate contracts	2,150,000	274	4	3,300,000	522	666
	4,061,651	35,047	1,294	6,174,841	9,558	7,863

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:

	2016 US$'000	2015 US$'000
Government debt securities:		
Singapore government treasury bills	1,501,304	1,927,296
US treasury bills and securities	1,598,207	2,104,095
	3,099,511	4,031,391

Movement in available-for-sale financial assets

	2016 US$'000	2015 US$'000
Fair value		
At 1 January	4,031,391	-
Additions through business combination	-	2,176,716
Additions	10,994,445	13,092,050
Changes in fair value recognised in the income statement	19,754	20,725
Changes in fair value recognised in the available-for-sale reserve	(69)	(463)
Foreign exchange revaluation recognised in the income statement	(25,112)	(83,231)
Disposals and other settlements	(11,920,898)	(11,174,406)
At 31 December	3,099,511	4,031,391

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	
	2016 US$'000	2015 US$'000
At 1 January	1,868	4
Amount recognised in the income statement	3,618	1,822
Amount recognised in other comprehensive income:		
Available-for-sale financial assets	1	55
Foreign exchange revaluation	(81)	(13)
At 31 December	5,406	1,868

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:

	2016			2015		
	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	4,581	2,776	-	1,813	1,826	-
Available-for-sale financial assets	55	-	1	55	-	55
Tax losses carried forward/ (utilised)	770	842	-	-	(4)	-
	5,406	3,618	1	1,868	1,822	55

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

	2016 US$'000	2015 US$'000
Deposits of banks		
Current account balances	14,227	6,854
Deposits of non-bank customers		
Current account balances	2,323,846	3,799,197
Term deposits	949,333	1,287,227
Deposits of other Morgan Stanley Group undertakings	1,043,506	345,963
	4,330,912	5,439,241

16. OTHER PAYABLES

	2016 US$'000	2015 US$'000
Amounts due to other Morgan Stanley Group undertakings	13,501	10,101
Staff compensation and benefits accruals	64,664	46,604
Interest payable	7,856	4,175
Other amounts payable	1,652	2,523
	87,673	63,403

17. COMMITMENTS AND CONTINGENCIES

At 31 December 2016, there are no commitments and contingencies (31 December 2015: Nil).

18. EQUITY

Ordinary share capital

	Ordinary shares Number	Ordinary shares US$'000
Issued and fully paid		
At 1 January 2015	13,000,001	13,000
Issued in the year: 13 January 2015	156,999,998	157,000
Issued in the year: 9 February 2015	1	-
At 31 December 2015 and 31 December 2016	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' 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:

	2016 US$'000	2015 US$'000
Cash with central bank	12,301	10,513
Cash at banks	161,095	345,180
Placements with banks	94,020	443,250
	267,416	798,943

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Year ended 31 December 2016

19. ADDITIONAL CASH FLOW INFORMATION (CONTINUED)

b. Reconciliation of cash flows from operating activities

	2016 US$'000	2015 US$'000
Profit for the year	2,366	35,743
Adjustments for:		
Net losses on available-for-sale financial assets	5,405	62,514
Share-based payments	147	382
Interest income	(20,584)	(17,866)
Interest expense	27,141	19,658
Income tax expense	1,059	6,838
Operating cash flows before changes in operating assets and liabilities	15,534	107,269
Changes in operating assets		
Increase in loans and receivables, excluding cash and short-term deposits	(228,566)	(49,931)
Increase in financial assets classified as held for trading	(25,489)	(9,558)
Decrease in prepayments	3	526
	(254,052)	(58,963)
Changes in operating liabilities		
(Decrease)/ increase in financial liabilities at amortised cost	(1,200,349)	1,292,391
(Decrease)/ increase in financial liabilities classified as held for trading	(6,569)	7,863
(Decrease)/ increase in accruals	(113)	690
	(1,207,031)	1,300,944
Interest received	20,291	16,290
Interest paid	(16,197)	(12,559)
Income tax paid	(16,532)	(20)
Effect of foreign exchange movements	7	(8)
Net cash flows (used in)/ from operating activities	(1,457,980)	1,352,953

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 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

20. EXPECTED MATURITY OF ASSETS AND LIABILITIES (CONTINUED)

At 31 December 2015	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	798,943	-	798,943
Trade receivables	553	-	553
Loans and advances to customers	1,031,953	-	1,031,953
Other receivables	1,914	-	1,914
	1,833,363	-	1,833,363
Financial assets classified as held for trading	9,558	-	9,558
Available-for-sale financial assets	4,031,391	-	4,031,391
Deferred tax assets	55	1,813	1,868
Prepayments	111	-	111
	5,874,478	1,813	5,876,291
LIABILITIES			
Financial liabilities at amortised cost:			
Deposits	5,439,241	-	5,439,241
Trade payables	150,770	-	150,770
Other payables	51,772	11,631	63,403
	5,641,783	11,631	5,653,414
Financial liabilities classified as held for trading	7,863	-	7,863
Current tax liabilities	8,619	-	8,619
Accruals	690	-	690
	5,658,955	11,631	5,670,586

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, measure, monitor, assess, challenge 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 2016, 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 2016, 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 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 2016 and 31 December 2015 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.

Exposure to credit risk by class:

Class	2016			2015		
	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	267,416	-	267,416	798,943	-	798,943
Trade receivables	3,123	(3,123)	-	553	-	553
Loans and advances to customers [(2)]	1,257,791	(1,257,791)	-	1,031,953	(1,031,953)	-
Other receivables	2,365	-	2,365	1,914	-	1,914
Financial assets classified as held for trading:						
Derivatives	35,047	(34,864)	183	9,558	-	9,558
Available-for-sale financial assets	3,099,511	-	3,099,511	4,031,391	-	4,031,391
	4,665,253	(1,295,778)	3,369,475	5,874,312	(1,031,953)	4,842,359

(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$275,563,000 (2015: US$271,570,000), securities of US$634,667,000 (2015: US$498,144,000) and other collateral of US$347,561,000 (2015: US$262,239,000).

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.

21. FINANCIAL RISK MANAGEMENT (CONTINUED)

Credit risk (continued)

Risk Mitigation (continued)

Exposure to credit risk by class (continued)

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

	Gross credit exposure	
Credit rating	**2016**	**2015**
	US$'000	**US$'000**
AAA	3,111,812	4,121,910
AA	59,676	398,632
A	233,704	319,907
BBB	35	10
BB	910	1,447
B	3,498	-
CCC	992,488	496,693
Unrated	263,130	535,713
Total	4,665,253	5,874,312

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

At 31 December 2016, there were no financial assets past due but not impaired or individually impaired (2015: Nil).

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 Company's ability (or perceived ability) to meet its financial obligations without experiencing significant business disruption or reputational damage that may threaten the Company's viability as a going concern. 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.

21. FINANCIAL RISK MANAGEMENT (CONTINUED)

Liquidity risk (continued)

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. In 2015, the Morgan Stanley Group established the Liquidity Risk Department as a distinct area in Risk Management to oversee and monitor liquidity risk. The Liquidity Risk Department is independent of the business units and reports to the Chief Risk Officer. 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 and funding under a range of adverse scenarios. The liquidity risks identified by these processes are summarised in reports produced by the Liquidity Risk Department that are circulated to and discussed with senior management, 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 maintain 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. 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 Contingency Funding Plan ("CFP"), Liquidity Stress Tests and the Liquidity Reserve (as defined below), which support the Company's target liquidity profile.

Contingency Funding Plan

CFP describes the data and information flows, limits, targets, operating environment indicators, escalation procedures, roles and responsibilities, and available mitigating actions in the event of a liquidity stress. The CFP also sets forth the principal elements of the liquidity stress testing which identifies stress events of different severity and duration, assesses current funding sources and uses and establishes a plan for monitoring and managing a potential liquidity stress event.

21. FINANCIAL RISK MANAGEMENT (CONTINUED)

Liquidity risk (continued)

Liquidity Stress Tests

The Company uses Liquidity Stress Tests to model liquidity inflows and outflows 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 assumptions underpinning the 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 2016 and 31 December 2015, 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 CFP and Liquidity Stress Tests. The size of the Liquidity Reserve is actively managed by the Company. The following components are considered in sizing the Liquidity Reserve: unsecured debt maturity profile, balance sheet size and composition, funding needs in a stressed environment inclusive of contingent cash outflows; 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 its Institutional Securities business segment's sales and trading activities. The liquid nature of these assets provides the Morgan Stanley Group and the Company with flexibility in 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 2016 and 31 December 2015. 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 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

21. FINANCIAL RISK MANAGEMENT (CONTINUED)

Liquidity risk (continued)

Maturity analysis (continued)

31 December 2015	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	355,693	443,268	-	-	-	798,961
Trade receivables	553	-	-	-	-	553
Loan and advances to customers	1,006,730	14,782	10,528	-	-	1,032,040
Other receivables	1,670	33	211	-	-	1,914
Financial assets classified as held for trading:						
Derivatives	-	7,921	1,115	522	-	9,558
Available-for-sale financial assets	-	994,011	1,585,215	1,452,165	-	4,031,391
Total financial assets	1,364,646	1,460,015	1,597,069	1,452,687	-	5,874,417
Financial liabilities						
Financial liabilities at amortised cost:						
Deposits of banks	6,854	-	-	-	-	6,854
Deposits of non-bank counterparties	3,799,197	176,780	295,981	1,172,585	-	5,444,543
Trade payables	150,770	-	-	-	-	150,770
Other payables	10,303	11,619	23,287	6,563	11,631	63,403
Financial liabilities classified as held for trading:						
Derivatives	-	5,299	2,520	44	-	7,863
Total financial liabilities	3,967,124	193,698	321,788	1,179,192	11,631	5,673,433

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 of approximately US$5,751,000 (2015: US$13,273,000).

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.

	2016			2015		
	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	-	11	-	(3)	11	-
Canadian Dollar	1	19	-	-	19	-
Euro	5	10	1	3	12	-
Hong Kong Dollar	(4,416)	-	-	(6,852)	-	-
Japanese Yen	7	3	-	1	14	-
New Zealand Dollar	3	12	-	3	12	-
Singapore Dollar	(2,101)	7	147	(2,045)	7	143
Sterling	2	16	-	1	6	-
Yuan Renminbi	(29)	6	2	(152)	6	9
	(6,528)			(9,044)		

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 2015 to 31 December 2016 (2015: from 1 January 2014 to 31 December 2015). Thus, the percentage change applied may not be the same percentage as the actual change in the currency rate for year ended 31 December 2016, or for the year ended 31 December 2015.

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 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. Legal, regulatory and compliance risk is discussed below under "Legal, regulatory and compliance risk".

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. 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 unit, 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. The business unit has a designated operational risk coordinator. The operational risk coordinator regularly reviews operational risk issues and reports to the Company's senior management. 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 Committee and senior management. In the event of reorganisation; or creation of 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 Chief Risk Officer. 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) 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.

Legal, regulatory and compliance risk

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

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

21. FINANCIAL RISK MANAGEMENT (CONTINUED)

Operational risk (continued)

Legal, regulatory and compliance risk (continued)

In addition, the Company has established procedures to mitigate the risk that a counterparty's performance obligations will be unenforceable, including consideration of counterparty legal authority and capacity, adequacy of legal documentation, the permissibility of a transaction under applicable law and whether applicable bankruptcy or insolvency laws limit or alter contractual remedies. The heightened legal and regulatory focus on the financial services industry presents a continuing business challenge for the Company.

Culture, values and conduct of employees

All employees of the Morgan Stanley Group are accountable for conducting themselves in accordance with the Morgan Stanley Group's core values Putting Clients First, Doing the Right Thing, Leading with Exceptional Ideas, and Giving Back. The Morgan Stanley Group is committed to establishing a strong culture anchored in these core values, and in its governance framework, which includes management oversight, effective risk management and controls, training and development programmes, policies, procedures, and defined roles and responsibilities. The Morgan Stanley Group's Code of Conduct (the "Code") establishes standards for employee conduct that further reinforce the Morgan Stanley Group's commitment to integrity and ethical conduct. Every new hire and every employee annually must attest to their understanding of and adherence to the Code. The annual employee performance appraisal process includes an evaluation of adherence to the Code and the Morgan Stanley Group's core values. The Global Incentive Compensation Discretion Policy sets forth standards that specifically provide that managers must consider whether their employees effectively managed and/or supervised risk control practices during the performance year. The Morgan Stanley Group also has several mutually reinforcing processes to identify employee conduct that may have an impact on employment status, current year compensation and/or prior year compensation. The Morgan Stanley Group's clawback and cancellation provisions permit recovery of deferred incentive compensation where an employee's act or omission (including with respect to direct supervisory responsibilities) causes a restatement of the Morgan Stanley Group's consolidated financial results, constitutes a violation of the Morgan Stanley Group's global risk management principles, policies and standards, or causes a loss of revenues associated with a position on which the employee was paid and the employee operated outside of internal control policies.

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 only offset and presented on a net basis where there is a current legally enforceable right to set off the recognised amounts and an intention to either settle on a net basis or to realise the asset and the liability simultaneously. 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$1,294,000 (2015: US$7,719,000) of recognised assets and liabilities to be offset in the ordinary course of business and/ or in the event of default and an additional US$33,573,000 of associated cash to be set off against the net amount in the event of default (2015: US$144,000 of recognised financial liabilities available to be set off against the cash collateral placed by the Company with a counterparty).

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.

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

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

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

2015

	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	-	9,558	-	9,558
Available-for-sale financial assets:				
- Government debt securities	2,104,095	1,927,296	-	4,031,391
Total financial assets measured at fair value	2,104,095	1,936,854	-	4,040,949
Financial liabilities classified as held for trading:				
- Derivatives	-	7,863	-	7,863
Total financial liabilities measured at fair value	-	7,863	-	7,863

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/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 either observed or modeled using a series of techniques and model inputs from comparable benchmarks, including closed-form analytic formulas, such as the Black-Scholes option-pricing model, and simulation models or a combination thereof. Many pricing models do not entail material subjectivity because the methodologies employed do not necessitate significant judgement, and the pricing inputs are observed from actively quoted markets, 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 pricing models; • Level 3 - OTC derivative products with significant unobservable inputs;

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 shareholders, 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:

	2016 US$'000	2015 US$'000
Ordinary share capital	170,000	170,000
Available-for-sale reserve	(421)	(400)
Retained earnings	38,618	36,105
	208,197	205,705

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 2016, US$6,289,000 (2015: US$5,160,000) in the retained earnings was embarked for this purpose.

26. EMPLOYEE COMPENSATION PLANS

Morgan Stanley maintains various deferred compensation plans for the benefit of certain current and former employees. The two principal forms of deferred compensation are granted under equity-settled share-based compensation and deferred cash based compensation plans.

Equity-settled share-based compensation plans

- **Restricted stock units**

Morgan Stanley has granted restricted stock unit 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 one to three years from the date of grant, and are generally contingent upon continued employment and 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 634,044 units (2015:10,679 units) of restricted stock units to employees of the Company with a weighted average fair value per unit of US$25.21 (2015: US$36.88), 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$14,001,000 (2015: US$12,651,000) 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$15,984,000 (2015: US$469,000) have been granted to employees during the year and an expense of US$12,094,000 (2015: US$7,835,000) 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$15,968,000 (2015: US$10,952,000).

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$4,467,000 for the year (2015: US$3,315,000) of which US$183,000 was accrued at 31 December 2016 (2015: US$192,000).

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:

	2016 US$'000	2015 US$'000
Short-term employee benefits	3,540	2,880
Post-employment benefits	59	29
Share-based payments	4,002	1,148
Other long-term employee benefits	2,122	294
Termination benefits	-	-
	9,723	4,351

The share-based payment costs disclosed above reflect the amortisation of equity-based awards granted to key management personnel over the last three years, prior to their transfer to the Company 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$83,000 was charged for the year (2015: US$83,000) and of which nil was accrued at 31 December 2016 (2015: 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 (2015: 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.

	2016		2015	
	Interest	Balance	Interest	Balance
	US$'000	US$'000	US$'000	US$'000
Amounts due to the Company's direct and indirect parent undertakings	77	80,174	74	-
Amounts due to other Morgan Stanley Group undertakings	8,508	963,332	7,953	345,963
	8,585	1,043,506	8,027	345,963

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:

	2016	2015
	US$'000	US$'000
Amounts due from other Morgan Stanley Group undertakings	38,170	9,558
Amounts due to other Morgan Stanley Group undertakings	1,294	158,633

The Company has received collateral of US$45,424,000 (2015: Nil) from other Morgan Stanley Group undertakings and has pledged nil collateral (2015: US$553,000) to 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:

	2016 US$'000	2015 US$'000
Amounts recharged from the Company's direct and indirect parent undertakings	125	148
Amounts recharged from other Morgan Stanley Group undertakings	68,870	64,134
	68,995	64,282
Amounts recharged to other Morgan Stanley Group undertakings	6,117	1,002

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 introductory brokerage fees arising from such policies. Fees and commissions received during the year are as follows:

	2016 US$'000	2015 US$'000
Fees and commissions received from other Morgan Stanley Group undertakings	195,552	218,342

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:

	2016 US$'000	2015 US$'000
Amounts due from the Company's direct and indirect parent undertakings	35	16
Amounts due from other Morgan Stanley Group undertakings	381	169
	416	185

	2016 US$'000	2015 US$'000
Amounts due to the Company's direct and indirect parent undertakings	19	109
Amounts due to other Morgan Stanley Group undertakings	13,482	9,992
	13,501	10,101

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

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, last revised in August 2012, 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 ten Management level committees: (a) Management Committee, (b) Operating Committee, (c) Asset and Liability Committee, (d) Risk & Suitability Committee, (e) Operational Risk Committee, (f) New Product Approval Committee, (g) IT Steering Committee, (h) Best Execution Committee, (i) Anti-Money Laundering ("AML") Steering Committee and (j) 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 biweekly. 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 ("ALCO") 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) 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.

(g) 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.

A. CORPORATE GOVERNANCE (CONTINUED)

Key Management Level Committees (continued)

(h) 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.

(i) 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").

(j) 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 Bank's oversight functions, to protect the assets and reputation of the Bank. 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.

Compliance
To the extent applicable, the Company has complied with the requirements set out in the guideline CG-1 "Corporate Governance of Locally Incorporated Authorised Institutions" issued by the HKMA.

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 2016 and 2015.

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.

B. REMUNERATION SYSTEM (CONTINUED)

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

Governance structure (continued)

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 2016, the Company has 22 senior management and 1 key personnel (2015: 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.

Two meetings were held by the Remuneration Committee during the year ended 31 December 2016 (2015: Two). For the year ended 31 December 2016 and 31 December 2015, 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$83,000 (2015: 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.

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.

B. REMUNERATION SYSTEM (CONTINUED)

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

Remuneration structure (continued)

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.

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.

B. REMUNERATION SYSTEM (CONTINUED)

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

Remuneration process (continued)

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	
	2016	**2015**
	US$'000	**US$'000**
Fixed compensation		
Non-deferred cash	7,415	6,409
Variable compensation		
Non-deferred cash	5,592	5,015
Deferred cash	4,290	3,304
Deferred shares	4,290	3,536
	14,172	11,855
Total	21,587	18,264

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	
	2016	**2015**
	US$'000	**US$'000**
Transferred in on 9 February 2015	-	14,943
Awarded during the year	8,581	6,840
Paid out during the year	3,808	348
Reduced through performance adjustment	-	-

(iii) Analysis of total amount of outstanding deferred remuneration

	Senior management and key personnel	
	2016	**2015**
	US$'000	**US$'000**
At December 31,		
Vested	1,189	2,906
Unvested	17,663	19,658
At December 31,		
Cash	7,961	9,539
Shares	10,891	13,025

	Senior management and key personnel	
	2016	**2015**
	US$'000	**US$'000**
During the year:		
Amount of outstanding deferred remuneration and retained remuneration exposed to ex post explicit and/ or implicit adjustments	18,852	22,564
Reductions due to ex post explicit adjustments	168	259
Reductions due to ex post implicit adjustments	45	220

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	
	2016	**2015**
	US$'000	**US$'000**
Guaranteed bonus	-	41
Number of beneficiaries of guaranteed bonus	-	1
Sign-on awards	-	34
Number of beneficiaries of sign-on awards	-	1
Severance payments made	-	356
Number of beneficiaries of severance payments made	-	1
Severance payments awarded	-	527
Number of beneficiaries of severance payments awarded	-	2
Highest amount of severance payment to a single person	-	356

C. RISK MANAGEMENT

Risk Governance Structure

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.

The cornerstone of the Company's risk management philosophy is the pursuit of risk-adjusted returns through prudent risk-taking that protects the Company's capital base and franchise. The Company's risk management philosophy is based on the following key principles:

- Integrity: critical to Morgan Stanley's approach to ERM is a 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 managing risk is each employee's responsibility;

- Comprehensiveness: a well-defined, comprehensive risk governance structure with appropriate risk management expertise, including a process for periodically assessing the efficacy of the Company's risk management program;

C. RISK MANAGEMENT (CONTINUED)

Risk Governance Structure (continued)

- Independence: independent lines of reporting relationships for risk managers and an appropriate compensation structure help ensure the independent oversight of risk;

- Accountability: well-defined roles and responsibilities that establish clear accountability for risk management; and are aligned with the disciplinary and compensation structure;

- Transparency: appropriate measurement and reporting of risk to senior management, the Board, regulatory entities and other external reporting and disclosure requirements.

The Board members possess adequate knowledge and understanding of the material risks faced by the Company. The Board of the Company has put in place a corporate and risk governance framework consisting of Board and management level committees to effectively oversee the operations of the Company, including risk management. The committees and their roles and functions are stated in the "Corporate Governance" section.

The Board and the Risk Committee are responsible for overseeing the risk management activities and the related strategies and policies.

Details of the Financial Risk Management are disclosed in note 21 to the audited financial statements.

Interest Rate Exposure in the Banking Books

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$4,740,000 as at 31 December 2016 (2015: US$14,270,000). 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$114,000 as at 31 December 2016 (2015: US$265,000).

New Product Approval

The Company has established its own New Product Approval Policy which follows Morgan Stanley's Global New Product Approval Policy and Procedures; and includes additional procedures in line with regulatory requirements.

The Global New Product Approval Policy establishes a framework for managing the new product approval ("NPA") processes and related risks on an aggregated basis at the firm-wide level which also applies to the Company. The implementation of this policy and the addendum enables the Company's management to monitor the NPA process and related risks and ensure its consistent and effective application.

All new products approved under the Global NPA Policy framework will be ratified by the Company's New Product Approval Committee ("the NPA Committee"). The NPA Committee is appointed by the Operating Committee which in turns reports into the Management Committee which derives its delegated authority from the Board. The NPA Committee is charged with the responsibility for approving new products for the Company.

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Year ended 31 December 2016

D. SEGMENTAL INFORMATION

(a) By geographical area

The geographical segmental analysis for the year ended 31 December 2016 and 31 December 2015 is as follows:

2016	**Hong Kong US$'000**	**Singapore US$'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

2015	**Hong Kong US$'000**	**Singapore US$'000**	**Total US$'000**
Total operating income (net of interest expense)	182,242	40,557	222,799
Profit before income tax	35,631	6,950	42,581
Total assets	6,271	5,870,020	5,876,291
Total liabilities	280,984	5,389,602	5,670,586

There are no contingent liabilities and commitments as at 31 December 2016 (31 December 2015: 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 as introducing broker for other Morgan Stanley subsidiaries in connection with the provision of general investment, securities dealing, and custody services, as well as discretionary management.

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

The Company's business segment results for the year ended 31 December 2016 and 31 December 2015 are as follows:

2016	**Wealth Management US$'000**	**Treasury and others US$'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

2015	**Wealth Management US$'000**	**Treasury and others US$'000**	**Total US$'000**
Total operating income/ (loss) (net of interest expense)	225,654	(2,855)	222,799
Profit/ (loss) before income tax	55,761	(13,180)	42,581
Total assets	1,033,622	4,842,669	5,876,291

There are no impairment losses, specific provision and collective provision for impaired assets for the year (2015: 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 (2015: 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 (2015: Nil).

E. LOAN AND ADVANCES – SECTOR INFORMATION

	As at 31 December 2016 US$'000	As at 31 December 2015 US$'000
Sector classification		
Loans and advances for use in Hong Kong		
Industrial, commercial and financial:		
- Others	443,866	345,930
Individuals		
- Others	94,515	86,346
Loans and advances for use outside Hong Kong	719,410	599,677
Total	1,257,791	1,031,953

The total loans are fully secured by collateral as at 31 December 2016 (31 December 2015: fully secured).

	As at 31 December 2016 US$'000	As at 31 December 2015 US$'000
Geographical Areas		
Hong Kong	538,381	432,276
Mainland China	218,384	214,851
Taiwan	142,080	144,528
Others	358,946	240,298
Total	1,257,791	1,031,953

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 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

F. INTERNATIONAL CLAIMS (CONTINUED)

			Non-bank private sector		
	Bank	Official sector	Non-bank financial institutions	Non-financial private sector	Total
31 December 2015	**US$'000**	**US$'000**	**US$'000**	**US$'000**	**US$'000**
Developed countries	715,900	2,104,095	858	11,233	2,832,086
United States	107,457	2,104,095	756	-	2,212,308
Offshore centres	79,019	-	37,992	456,721	573,732
Hong Kong	35,716	-	30,556	402,382	468,654
Developing Asia and Pacific	-	-	1,934	519,281	521,215

G. OVERDUE AND RESCHEDULED ASSETS

There were no impaired, overdue or rescheduled assets as at 31 December 2016 and 31 December 2015.

H. MAINLAND ACTIVITIES

There were no mainland exposures on the Hong Kong office of the Company as at 31 December 2016 and 31 December 2015.

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 2016	SGD HK$'000	USD HK$'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

As at 31 December 2015	SGD HK$'000	USD HK$'000
Spot assets	15,190,282	28,378,991
Spot liabilities	(2,080,798)	(37,049,729)
Forward purchases	1,093,764	16,160,422
Forward sales	(14,218,935)	(7,419,766)
Net (short)/ long position	(15,687)	69,918

The Company had no option and structural positions in any particular foreign currency as at 31 December 2016 (31 December 2015: Nil).

J. LIQUIDITY

	For the year ended 31 December 2016	For the period from 9 February 2015 (date of business commencement) to 31 December 2015
Average liquidity maintenance ratio for the year/period	58%	66%

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. DERIVATIVE TRANSACTIONS

	2016			
		Fair Value		
	Notional Amount US$'000	Assets US$'000	Liabilities US$'000	Risk-weighted amount US$'000
Exchange rate swap contracts	1,911,651	34,773	1,290	5,403
Interest rate swap contracts	2,150,000	274	4	93
	4,061,651	35,047	1,294	5,496

	2015			
		Fair Value		
	Notional Amount US$'000	Assets US$'000	Liabilities US$'000	Risk-weighted amount US$'000
Exchange rate swap contracts	2,874,841	9,036	7,197	8,793
Interest rate swap contracts	3,300,000	522	666	-
	6,174,841	9,558	7,863	8,793

The notional amounts of these instruments indicate the volume of outstanding transactions and do not represent amounts at risk.

The above derivative assets and liabilities are computed at a transaction level and shown on a gross basis with no offsetting presentation due to bilateral netting agreements (31 December 2015: Nil). The risk-weighted amount has taken into account the effect of valid bilateral netting agreement.

L. CAPITAL CHARGE FOR CREDIT, MARKET AND OPERATIONAL RISKS

The capital adequacy ratios as at 31 December 2016 and 31 December 2015 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".

(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 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

(1) As at 31 December 2016 and 31 December 2015, 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$41,790,000 as at 31 December 2016 (2015: Nil).

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

(a) Capital charge for credit risk (continued)

		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 2015							
On-balance sheet							
Sovereign exposures	4,035,816	4,035,816	-	-	-	-	-
Bank exposures	788,851	788,851	-	157,827	-	157,827	12,626
Securities firm exposures	443	434	-	217	-	217	17
Corporate exposures	886,002	-	266,701	-	266,701	266,701	21,336
Other exposures which are not past due exposures	153,884	-	26,896	-	26,896	26,896	2,152
	5,864,996	4,825,101	293,597	158,044	293,597	451,641	36,131
Off-balance sheet							
OTC derivative Transactions[4]	17,585	17,585	-	8,793	-	8,793	703
Credit valuation adjustments	17,585	17,585	-	3,997	-	3,997	320
	5,900,166	4,860,271	293,597	170,834	293,597	464,431	37,154

There were no exposures which were covered by recognised guarantees or recognised credit derivative contracts for the year ended 31 December 2016 and 31 December 2015.

There were no credit exposures which were risk-weighted at 1250% for the year ended 31 December 2016 and 31 December 2015.

There were no counterparty credit-risk related exposures for securities financing transactions for the year ended 31 December 2016 and 31 December 2015.

(b) Capital charge for market risk

There was nil capital charge for market risk for the Company as at 31 December 2016 because the Company was exempted by HKMA from the calculation of market risk in 2016. As at 31 December 2015, the Company used the Standardised Approach ("STM approach") to calculate its capital charge for market risk, which included currency risk of US$174,000.

(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$33,642,000 as at 31 December 2016 (2015: US$29,937,000).

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M. CAPITAL ADEQUACY RATIO

	At 31 December 2016	At 31 December 2015
Common Equity Tier 1 ("CET1") capital ratio	23%	24%
Tier 1 capital ratio	23%	24%
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 2016 and 31 December 2015 are analysed as follows:

	At 30 December 2016 US$'000	At 30 December 2015 US$'000
CET1 capital instruments		
Paid up ordinary share capital	170,000	170,000
Retained earnings/(accumulated losses)	38,618	36,105
Available-for-sale assets reserve	(421)	(400)
CET1 capital before deductions	208,197	205,705
Deductions:		
Deferred tax assets net of deferred tax liabilities	(5,406)	(1,868)
Regulatory reserve for general banking risks(1)	(6,289)	(5,160)
Valuation adjustments	(91)	(222)
CET1 capital after deductions	196,411	198,455
Additional tier 1 capital	-	-
Tier 2 capital		
Regulatory reserve for general banking risks(1)	5,299	5,160
Total capital	201,710	203,615

(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.

N. 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	38,618	(2)
3	Disclosed reserves	(421)	(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**	208,197	
	CET1 capital: regulatory deductions		
7	Valuation adjustments	91	
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	5,406	(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	6,289	
26c	Securitisation exposures specified in a notice given by the Monetary Authority	0	

N. 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**	11,786	
29	**CET1 capital**	196,411	
	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)**	196,411	
	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	5,299	
51	**Tier 2 capital before regulatory deductions**	**5,299**	

N. 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**	5,299	
59	**Total capital (Total capital = Tier 1 + Tier 2)**	201,710	
60	**Total risk weighted assets**	845,914	
	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)	0.843%	
65	*of which: capital conservation buffer requirement*	0.625%	
66	*of which: bank specific countercyclical buffer requirement*	0.218%	
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	11.845%	
	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	

N. 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.

N. CAPITAL DISCLOSURE TEMPLATE (CONTINUED)

(a) Capital Disclosure Template (continued)

Notes to the template

Row No.	Description	Hong Kong basis	Basel III basis
#9	**Other intangible assets (net of associated deferred tax liability)**	0	0
	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.		
#10	**Deferred tax assets net of deferred tax liabilities**	5,406	5,406
	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.		
#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	0
	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.		

N. CAPITAL DISCLOSURE TEMPLATE (CONTINUED)

(a) Capital Disclosure Template (continued)

Notes to the template (continued)

Row No.	Description	Hong Kong basis	Basel III basis
#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	0
	Explanation 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.		
#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	0
	Explanation 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.		
#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	0
	Explanation 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.		
Remarks: The amount of 10% / 15% thresholds mentioned above is calculated based on the amount of CET1 capital determined under the Banking (Capital) Rules.			

Abbreviations:

CET1: Common Equity Tier 1

AT1: Additional Tier 1

N. 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, 2016	**US$'000**	**US$'000**	
ASSETS			
Cash and short-term deposits	267,416	267,416	
Trade receivables	3,123	3,123	
Loan and advances to customers	1,257,791	1,257,791	
Other receivables	2,365	2,365	
Financial assets classified as held for trading	35,047	35,047	
Available-for-sale financial assets	3,099,511	3,099,511	
Current tax asset	3,310	3,310	
Deferred tax assets	5,406	5,406	(4)
Prepayments	108	108	
TOTAL ASSETS	**4,674,077**	**4,674,077**	
LIABILITIES			
Deposits	4,330,912	4,330,912	
Trade payables	45,424	45,424	
Other payables	87,673	87,673	
Financial liabilities classified as held for trading	1,294	1,294	
Accruals	577	577	
TOTAL LIABILITIES	**4,465,880**	**4,465,880**	
SHAREHOLDERS' EQUITY			
Share capital	170,000	170,000	(1)
Available-for-sale reserves	(421)	(421)	(3)
Retained earnings	38,618	38,618	(2)
TOTAL SHAREHOLDERS' EQUITY	**208,197**	**208,197**	
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	**4,674,077**	**4,674,077**	

N. 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

N. 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

O. COUNTERCYCLICAL CAPITAL BUFFER ("CCyB") RATIO

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

	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.

There is no information disclosed relating to the CCyB ratio pursuant to section 24B of the Banking (Disclosure) Rules for the year ended 31 December 2015 since the applicable JCCyB ratios for Hong Kong and for jurisdictions outside Hong Kong are at 0% before 1 January 2016.

P. CAPITAL CONSERVATION BUFFER RATIO

Under section 3M of the Banking (Capital) Rules, the capital conservation buffer ratio is 0.625% for 2016 (2015: 0%).

Q. LEVERAGE RATIO DISCLOSURE TEMPLATE

	As at 31 December 2016	As at 31 December 2015
Leverage ratio	4.20%	3.38%

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	4,674,077
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	17,735
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	(11,786)
8	**Leverage ratio exposure**	**4,680,026**

O. 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)	4,639,030
2	Less: Asset amounts deducted in determining Basel III Tier 1 capital (reported as negative amounts)	(11,786)
3	Total on-balance sheet exposures (excluding derivatives and SFTs) (sum of lines 1 and 2)	4,627,244
	Derivative exposures	
4	Replacement cost associated with all derivatives transactions (i.e. net of eligible cash variation margin)	33,753
5	Add-on amounts for PFE associated with all derivatives transactions	19,029
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)	52,782
	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	196,411
21	Total exposures (sum of lines 3, 11, 16 and 19)	4,680,026
	Leverage ratio	
22	**Basel III leverage ratio**	**4.20%**