

Registered number: 01281415

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Canary Wharf
London
E14 4QA
United Kingdom

MORGAN STANLEY UK GROUP

Report and financial statements

31 December 2018

THURSDAY



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MORGAN STANLEY UK GROUP

CONTENTS	PAGE
Strategic report	1
Directors' report	3
Independent auditor's report	5
Income statement	8
Statement of comprehensive income	9
Statement of changes in equity	10
Statement of financial position	11
Notes to the financial statements	12

MORGAN STANLEY UK GROUP

STRATEGIC REPORT

The Directors present their Strategic report for Morgan Stanley UK Group (the "Company") for the year ended 31 December 2018.

PRINCIPAL ACTIVITY

The Company's principal activity is to provide property services to other Morgan Stanley Group undertakings and acts as an intermediate holding company.

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 Company's immediate parent undertaking is Morgan Stanley International Limited, which, together with its subsidiaries forms the "MSI Group".

The Company is designated a material service entity in the recovery and/or resolution plans of the Morgan Stanley Group and the MSI Group.

Further information on the Morgan Stanley Group is available in the public documents available at www.morganstanley.com/investorrelations.

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

BUSINESS REVIEW

The Company provides support services to Morgan Stanley Group's operating undertakings. The scope of services provided and contractual arrangements of the Company may continue to evolve as a normal consequence of changes to the recovery and resolution planning requirements or other regulatory changes impacting the Morgan Stanley Group or the MSI Group (including but not limited to the impact of United Kingdom's (the "UK") decision to leave the European Union (the "EU") of which a thorough assessment has been made of various Brexit scenarios. The Company manages these potential impacts on its business by maintaining a constant planning dialogue with all Morgan Stanley Group undertakings supported and accordingly management does not expect any significant impact on the operations and business of the Company arising from these external factors.

Overview of 2018 performance

The income statement for the year is set out on page 8. The Company generated a profit before tax for the financial year of \$2,000,000 compared with \$360,182,000 in the prior year. Results of both years are impacted by the Company's investing activities, which generated returns of \$609,000 in the current year and \$359,428,000 in the prior year. Modified for the impact of these investing activities, the Company generated pre-tax profits of \$1,391,000 for the current year and \$754,000 for the prior year, primarily representing government grant income for capital expenditure. Fee income comprises of management charges to other Morgan Stanley Group undertakings for costs incurred in the provision of property services, which decreased from \$229,087,000 in the prior year to \$201,482,000 as a result of lower operating lease rental charges and depreciation on property, plant and equipment in 2018.

The statement of financial position is set out on page 11. Liquid assets held for compliance with recovery and resolution requirements increased from \$51,242,000 in the prior year to \$69,392,000 in 2018, which is now comprised of secured funding as well as cash held in bank. The Company sourced financing for liquid assets from a Morgan Stanley Group undertaking.

The performance of the Company is included in the results of the Morgan Stanley Group. The Company's Directors believe that providing further performance indicators for the Company itself would not enhance an understanding of the development, performance or position of the business of the Company.

MORGAN STANLEY UK GROUP

STRATEGIC REPORT (CONTINUED)

BUSINESS REVIEW (CONTINUED)

Risk management

The key risk of the Company is its exposure to other Morgan Stanley Group undertakings. In 2017 the Morgan Stanley Group established a global network of material service entities, and as a material service entity, the Company is subject to additional operational oversight and governance. This additional governance is designed to support the continuity of support services in business as usual and recovery and resolution scenarios. The risks of the Company, expressed in terms of the Morgan Stanley Group risk categories are set out below. Further information on how the Morgan Stanley Group manages these risks is available in the public documents available at www.morganstanley.com/investorrelations.

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 includes the risk that economic, social and political conditions and events in a foreign country will adversely affect an obligor's ability and willingness to fulfil their obligations.

As noted above, the primary credit risk of the entity is the concentration of exposure to other Morgan Stanley Group undertakings.

Liquidity risk

Liquidity and funding risk refers to the risk that the Company will be unable to finance its operations. The company sources its financing from other Morgan Stanley Group undertakings.

As a material service entity the Company maintains minimum liquidity, which is monitored on an ongoing basis to ensure compliance with recovery and resolution requirements as established by Morgan Stanley Group's regulators as described above.

Operational risk

Operational risk refers to the risk of loss, or of damage to the Company's reputation, resulting from inadequate or failed processes, people and systems, or from external events (e.g. fraud, theft, legal and compliance risks, cyber attacks or damage to physical assets).

The Company acknowledges its responsibility in the management of its own and its customer's operational risks to comply with the contractual provisions of its services. The Company applies the Morgan Stanley Group's globally established procedures which are based on legal and regulatory requirements on a worldwide basis 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.

GOING CONCERN

Retaining sufficient liquidity and capital to withstand market pressures remains central to the Company's strategy. Additionally, the Company has access to Morgan Stanley Group capital and liquidity as required.

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

Approved by the Board and signed on its behalf by



A P Mullineaux - Director

16 April 2019

MORGAN STANLEY UK GROUP

DIRECTORS' REPORT

The Directors present their report and financial statements (which comprise the income statement, the statement of comprehensive income, the statement of changes in equity, the statement of financial position and the related notes, 1 to 25) for the Company for the year ended 31 December 2018.

RESULTS AND DIVIDENDS

The profit for the year, after tax, was \$2,805,000 (2017: \$331,089,000). During the year, no dividends were paid or proposed (2017: \$14,877,224,000). (See note 22).

RISK MANAGEMENT AND FUTURE DEVELOPMENTS

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

DIRECTORS

The following Directors held office throughout the year and to the date of approval of this report:

A P Mullineaux	(appointed 23 January 2019)
J D Bendall	
K M Lazaroo	(resigned 24 January 2019)
S E Watts	

DIRECTORS' AND OFFICERS' LIABILITY INSURANCE

Directors' and Officers' Liability Insurance is taken out by Morgan Stanley, the Company's ultimate parent undertaking, for the benefit of the Directors and Officers of the Company and its subsidiary undertakings.

DIRECTORS' INDEMNITY

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

EVENTS AFTER THE REPORTING DATE

There have been no significant events since the reporting date.

MORGAN STANLEY UK GROUP

DIRECTORS' REPORT (CONTINUED)

AUDITOR

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

Statement as to disclosure of information to the auditor

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

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

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

DIRECTORS' RESPONSIBILITIES STATEMENT

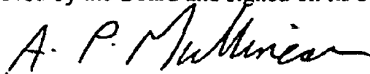
The Directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare financial statements for each financial year. Under that law the Directors have elected to prepare the financial statements in accordance with UK Generally Accepted Accounting Practice (UK Accounting Standards and applicable law), including Financial Reporting Standard ("FRS") 101 *Reduced disclosure framework* ("FRS 101"). Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing these financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent;
- state whether applicable UK Accounting Standards, including FRS 101, have been followed; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Approved by the Board and signed on its behalf by



A P Mullineaux - Director

16 April 2019

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF MORGAN STANLEY UK GROUP

Opinion

In our opinion the financial statements:

- give a true and fair view of the state of the Company's affairs as at 31 December 2018 and of its profit for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice including Financial Reporting Standard 101 "Reduced disclosure framework"; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements of Morgan Stanley UK Group which comprise:

- the income statement;
- the statement of comprehensive income;
- the statement of changes in equity;
- the statement of financial position; and
- the related notes 1 to 25.

The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards, including Financial Reporting Standard 101 "Reduced disclosure framework" (United Kingdom Generally Accepted Accounting Practice).

Basis for opinion

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

We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the Financial Reporting Council's Ethical Standard, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Conclusions relating to going concern

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

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

We have nothing to report in respect of these matters.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF MORGAN STANLEY UK GROUP (CONTINUED)

Other information

The Directors are responsible for the other information. The other information comprises the information included in the annual report, other than the financial statements and our auditor's report thereon. Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, 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 we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

We have nothing to report in respect of these matters.

Responsibilities of Directors

As explained more fully in the Directors' responsibilities statement, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the Directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Directors are responsible for assessing the 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.

Auditor's responsibilities for the audit of the financial statements

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

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

Report on other legal and regulatory requirements

Opinions on other matters prescribed by the Companies Act 2006

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

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

In the light of the knowledge and understanding of the Company and its environment obtained in the course of the audit, we have not identified any material misstatements in the Strategic Report or the Directors' Report.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF MORGAN STANLEY UK GROUP (CONTINUED)

Matters on which we are required to report by exception

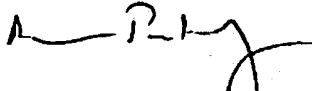
Under the Companies Act 2006 we are required to report in respect of the following matters if, in our opinion:

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of Directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

We have nothing to report in respect of these matters.

Use of our report

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.



Andrew Partridge, C.A. (Senior Statutory Auditor)
for and on behalf of Deloitte LLP
Statutory Auditor
Glasgow, United Kingdom

30/4/19

MORGAN STANLEY UK GROUP

INCOME STATEMENT

Year ended 31 December 2018

	Note	2018 \$'000	2017 \$'000
Fee income	4	201,482	229,087
Net gains on derecognition of financial assets measured at fair value through other comprehensive income	5	-	10,803
Other revenue	6	1,070	494
Total non-interest revenues		<u>202,552</u>	<u>240,384</u>
Interest income		13,000	74,518
Interest expense		(23,599)	(90,294)
Net interest expense	7	<u>(10,599)</u>	<u>(15,776)</u>
Net revenues		<u>191,953</u>	<u>224,608</u>
Net gains on investments in subsidiaries	8	609	348,625
Non-interest expense			
Other expense	9	(190,562)	(213,051)
PROFIT BEFORE TAXATION		<u>2,000</u>	<u>360,182</u>
Income tax benefit / (expense)	10	805	(29,093)
PROFIT FOR THE YEAR		<u>2,805</u>	<u>331,089</u>

All operations were continuing in the current and prior year.

The notes on pages 12 to 31 form an integral part of the financial statements.

MORGAN STANLEY UK GROUP

STATEMENT OF COMPREHENSIVE INCOME
Year ended 31 December 2018

	Note	2018 \$'000	2017 \$'000
PROFIT FOR THE YEAR		2,805	331,089
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		-	550
Net amount reclassified to income statement	5	-	(10,803)
OTHER COMPREHENSIVE INCOME AFTER INCOME TAX		-	(10,253)
TOTAL COMPREHENSIVE INCOME FOR THE YEAR ATTRIBUTABLE TO OWNERS OF THE COMPANY		<u>2,805</u>	<u>320,836</u>

The notes on pages 12 to 31 form an integral part of the financial statements.

MORGAN STANLEY UK GROUP

STATEMENT OF CHANGES IN EQUITY Year ended 31 December 2018

Note	Share capital \$'000	Share premium \$'000	Available-for-sale reserve \$'000	Capital contribution reserve \$'000	Capital redemption reserve \$'000	Retained earnings \$'000	Total equity \$'000
Balance at 1 January 2017	7,138,796	304,218	10,253	6,064,670	250,000	2,336,824	16,104,761
Profit for the year	-	-	-	-	-	331,089	331,089
Other comprehensive income	-	-	(10,253)	-	-	-	(10,253)
Total comprehensive income for the year	-	-	(10,253)	-	-	331,089	320,836
Transactions with owners:							
Dividends	22	-	-	-	-	(14,877,224)	(14,877,224)
Cancellation of A preference shares	21	(200,000)	-	-	-	-	(200,000)
Issue of capital	21	6,314,670	-	(6,064,670)	(250,000)	-	-
Cancellation of Additional Tier 1 capital	21	(1,300,000)	-	-	-	-	(1,300,000)
Reduction of capital	21	(11,943,466)	(304,218)	-	-	12,247,684	-
Balance at 31 December 2017	10,000	-	-	-	-	38,373	48,373
Profit and total comprehensive income for the year	-	-	-	-	-	2,805	2,805
Balance at 31 December 2018	10,000	-	-	-	-	41,178	51,178

The notes on pages 12 to 31 form an integral part of the financial statements.

MORGAN STANLEY UK GROUP

Registered number: 01281415

STATEMENT OF FINANCIAL POSITION

As at 31 December 2018

	Note	2018 \$'000	2017 \$'000
ASSETS			
Cash and short-term deposits		18,397	51,242
Secured financing	11	50,995	-
Loans and advances	12	371,750	342,342
Trade and other receivables	13	13,059	21,304
Current tax assets		933	980
Prepayments and accrued income		23,365	23,446
Investments in subsidiaries	14	78	78
Property, plant and equipment	15	267,405	306,257
TOTAL ASSETS		<u>745,982</u>	<u>745,649</u>
LIABILITIES AND EQUITY			
Trade and other payables	16	1,815	764
Debt and other borrowings	17	493,331	481,268
Provisions	18	111,885	118,861
Current tax liabilities		7,252	8,037
Deferred tax liabilities	19	6,588	7,575
Accruals and deferred income		73,933	80,771
TOTAL LIABILITIES		<u>694,804</u>	<u>697,276</u>
EQUITY			
Share capital	21	10,000	10,000
Retained earnings		41,178	38,373
Equity attributable to owners of the Company		<u>51,178</u>	<u>48,373</u>
TOTAL EQUITY		<u>51,178</u>	<u>48,373</u>
TOTAL LIABILITIES AND EQUITY		<u>745,982</u>	<u>745,649</u>

These financial statements were approved by the Board and authorised for issue on 16 April 2019.

Signed on behalf of the Board



A P Mullineaux – Director

The notes on pages 12 to 31 form an integral part of the financial statements.

MORGAN STANLEY UK GROUP

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2018

1. CORPORATE INFORMATION

The Company is incorporated and domiciled in England and Wales, UK, at the following registered address: 25 Cabot Square, Canary Wharf, London, E14 4QA, UK. The Company is a private company and is unlimited by shares. The registered number of the Company is 01281415.

The Company's immediate parent undertaking is Morgan Stanley International Limited, which has its registered office at 25 Cabot Square, Canary Wharf, London, E14 4QA and is registered in England and Wales, UK. Copies of its financial statements can be obtained from the Registrar of Companies for England and Wales, Companies House, Crown Way, Cardiff, CF14 3UZ.

The Company's ultimate parent undertaking and controlling entity and the largest and smallest group of which the Company is a member and for which group financial statements are prepared is Morgan Stanley which, together with the Company and Morgan Stanley's other subsidiary undertakings, form the Morgan Stanley Group. Morgan Stanley has its registered office c/o The Corporation Trust Company, The Corporation Trust Center, 1209 Orange Street, Wilmington, DE 19801, United States of America and is incorporated in the state of Delaware, in the United States of America. Copies of its financial statements can be obtained from www.morganstanley.com/investorrelations.

2. BASIS OF PREPARATION

The Company is not required to prepare consolidated financial statements by virtue of the exemption under Section 401 of the Companies Act 2006. The results of the Company are included within the financial statements of Morgan Stanley, which has prepared consolidated financial statements for the year ended 31 December 2018. The financial statements therefore present information about the Company as an individual entity and not about its group.

Statement of compliance

These financial statements are prepared in accordance with UK Generally Accepted Accounting Practice (UK Accounting Standards and applicable law), including FRS 101.

The Company meets the definition of a qualifying entity as defined in FRS 100 *Application of Financial Reporting Requirements*. The Company has taken advantage of the disclosure exemptions available under FRS 101 in relation to financial instruments, fair value measurement, revenue from contracts with customers, capital management, presentation of comparative information in respect of certain assets and shares outstanding, presentation of a cash-flow statement, accounting standards not yet effective and related party transactions.

Where relevant, equivalent disclosures have been provided in the group accounts of Morgan Stanley, in which the Company is consolidated. Copies of Morgan Stanley's accounts can be obtained as detailed at note 1.

New standards and interpretations adopted during the year

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

International Financial Reporting Standard 9 '*Financial instruments*' ("IFRS 9") was issued by the IASB in November 2009, reissued in October 2010, amended in November 2013, and revised and reissued by the IASB in July 2014. IFRS 9 is applicable retrospectively, except where otherwise prescribed by transitional provisions of the standard, and is effective for accounting periods beginning on or after 1 January 2018. The standard was endorsed by the EU in November 2016.

MORGAN STANLEY UK GROUP

NOTES TO THE FINANCIAL STATEMENTS Year ended 31 December 2018

2. BASIS OF PREPARATION (CONTINUED)

New standards and interpretations adopted during the year (continued)

The main aspects of IFRS 9 which are relevant to the Company are its requirements relating to:

- Classification and measurement of financial assets

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

- Impairment of financial instruments

The impairment requirements are based on expected credit losses ("ECL") and apply to financial assets measured at amortised cost.

As part of the implementation of IFRS 9, the Company performed an evaluation of its business models and a review of the contractual terms of financial assets. There was no impact to the retained earnings of the Company as at 1 January 2018 as a result of the implementation of IFRS 9.

Under the transitional provisions of the standard, the Company's opening balance sheet at the date of initial application (1 January 2018) has been restated. Financial assets classified as loans and receivables up to 31 December 2017 were reclassified to financial assets at amortised cost. The Company has updated the presentation of its primary statements on transition to IFRS 9 to provide more relevant information to the users of the financial statements. The comparative period has been re-presented to align to the new-format in the annual financial statements.

Note 3 provides the new accounting policies under IFRS 9 applicable from 1 January 2018, alongside the accounting policies applicable to 31 December 2017 under IAS 39.

IFRS 15 '*Revenue from Contracts with Customers*' ("IFRS 15") was issued by the IASB in May 2014 for retrospective application in accounting periods beginning on or after 1 January 2018. In addition, amendments relating to clarifications to IFRS 15 were issued by the IASB in April 2016 requiring application in accounting periods beginning on or after 1 January 2018. The standard and amendments were endorsed by the EU in October 2016. There was no impact to the retained earnings of the Company as at 1 January 2018 as a result of the implementation of IFRS 15.

IFRIC 22 '*Foreign Currency Transactions and Advance Consideration*' was issued by the IASB in December 2016 for application in accounting periods beginning on or after 1 January 2018 and was endorsed by the EU in April 2018.

Amendments to FRS 100 and FRS 101 '*Triennial review 2017 amendments*' were issued by the Financial Reporting Council in December 2017 for application in accounting periods beginning on or after 1 January 2019. The Company has early adopted all these amendments from 1 January 2018.

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

International Financial Reporting Standards 16 '*Leases*' ("IFRS 16")

IFRS 16 was issued by the IASB in January 2016. IFRS 16 is applicable on a modified retrospective basis, and is effective for accounting periods beginning on or after 1 January 2019. The standard was endorsed by the EU in November 2017.

The main aspect of IFRS 16 which impacts the Company is the requirement relating to the recognition of right of use ("ROU") assets and lease liabilities for leases existing at, or entered into after, 1 January 2019, that were previously accounted for as operating leases under IAS 17 '*Leases*' ("IAS 17").

Under the transitional provisions of the Standard, the Company will apply the following practical expedients at the date of initial application:

- application of IFRS 16 only to contracts that were previously identified as leases. Contracts that were not previously identified as leases will not be reassessed for the existence of a lease;

MORGAN STANLEY UK GROUP

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2018

2. BASIS OF PREPARATION (CONTINUED)

IFRS 16 'Leases' ("IFRS 16") (continued)

- reduction of the opening ROU asset by the carrying amount of the IAS 37 onerous lease provision existing before the date of initial application. Opening ROU assets will not be subject to an impairment review at the time of adoption;

As a result of the transition to IFRS 16, ROU assets of \$594,936,000 and lease liabilities of \$712,764,000 will be recognised as at 1 January 2019. There will be no impact to net assets or retained earnings as a result of the implementation of IFRS 16 at the date of initial application.

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, and in accordance with applicable UK Accounting Standards, including FRS 101, and UK company law.

Critical judgements in applying the Company's accounting policies

No judgements have been made in the process of applying the Company's accounting policies that have had a significant effect on the amounts recognised in the financial statements.

The going concern assumption

The Company's business activities, together with the factors likely to affect its future development, performance and position, are reflected in the Business Review section of the Strategic report on pages 1 to 2.

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

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

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 and Strategic and Directors' reports 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. Until 31 December 2017, foreign exchange differences on available-for-sale financial assets were recorded in the 'Available-for-sale reserve' in equity. All other translation differences are taken through the income statement. Exchange differences recognised in the income statement are presented in 'Other revenue' or 'Other expense', except where noted in 3(c) below.

c. Financial instruments

i) Financial instruments mandatorily at fair value through profit and loss

Non-trading financial assets at fair value through profit or loss

Non-trading financial assets at FVPL include secured financing transactions related to securities purchased under agreements to resell.

MORGAN STANLEY UK GROUP

NOTES TO THE FINANCIAL STATEMENTS Year ended 31 December 2018

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

c. Financial instruments (continued)

i) Financial instruments mandatorily at fair value through profit and loss (continued)

Non-trading financial assets at fair value through profit or loss (continued)

Non-trading financial assets at FVPL are principally financial assets where the Company makes decisions based upon the assets' fair values and are generally recognised on settlement date at fair value (see note 3(d) below), since they are neither regular way nor are they derivatives. From the date the terms are agreed (trade date), until the financial asset is funded (settlement date), the Company recognises any unrealised fair value changes in the financial asset as non-trading financial assets at FVPL. On settlement date, the fair value of consideration given is recognised as a non-trading financial asset at FVPL. All subsequent changes in fair value and foreign exchange differences are reflected in the income statement in 'Net income from other financial instruments held at fair value'. For these instruments, interest is not included as a component of an instrument's fair value, and is therefore included within 'Interest income' or 'Interest expense'.

For all non-trading financial assets at FVPL, transaction costs are excluded from the initial fair value measurement of the financial assets. These costs are recognised in the income statement in 'Other expense'.

ii) Available-for-sale financial assets

Applicable until 31 December 2017

Financial assets classified as available-for-sale comprised of investment securities (unlisted equities).

Financial assets classified as available-for-sale were non-derivative financial assets that were either designated in this category, or not classified in any of the other categories applicable until 31 December 2017. Financial assets classified as available-for-sale were recorded on trade date and were 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.

iii) Investments in subsidiaries

Subsidiaries are entities over which the Company has control. The Company controls an entity when it is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity.

Investments in subsidiaries are stated at cost, less provision for any impairment (see note 3(f) below). Dividends, impairment losses and reversals of impairment losses are recognised in the income statement in 'Net gains/ (losses) on investments in subsidiaries'.

iv) Financial assets and financial liabilities at amortised cost

Applicable from 1 January 2018

Financial assets are recognised at amortised cost when the Company's business model objective is to collect the contractual cash flows of the assets and where these cash flows are solely payments of principal and interest ("SPPI") on the principal amount outstanding until maturity. Such assets are recognised when the Company becomes a party to the contractual provisions of the instrument. The instruments are initially measured at fair value (see note 3(d) below) and subsequently measured at amortised cost less ECL allowance. Interest is recognised in the income statement in 'Interest income', using the effective interest rate ("EIR") method as described below. Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial instrument. Transaction costs that are directly attributable to the acquisition of the financial asset are added to the fair value on initial recognition. ECL and reversals thereof are recognised in the income statement in 'Net impairment loss on financial instruments'.

MORGAN STANLEY UK GROUP

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2018

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

c. Financial instruments (continued)

iv) Financial assets and financial liabilities at amortised cost (continued)

Financial assets at amortised cost include cash and short-term deposits, loans and advances and trade and other receivables.

Applicable until 31 December 2017

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

Financial assets classified as loans and receivables included cash and short-term deposits and trade and other receivables.

Applicable until 31 December 2017 and from 1 January 2018

Financial liabilities are classified as being subsequently measured at amortised cost, except where they are held for trading or are designated as measured at FVPL. They are recognised when the Company becomes a party to the contractual provisions of the instrument and 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 EIR method as described below. Transaction costs that are directly attributable to the issue of a financial liability are deducted from the fair value on initial recognition.

The EIR 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 EIR 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 EIR is established on initial recognition of the financial instrument. The calculation of the EIR includes all fees and commissions paid or received, transaction costs, and discounts or premiums that are an integral part of the EIR.

Financial liabilities classified at amortised cost include trade and other payables and debt and other borrowings.

v) Secured financing

The Company enters into arrangements which involve the purchase of securities with resale agreements.

From 1 January 2018, securities received by the Company under resale arrangements are generally not recognised on the statement of financial position.

d. Fair value

Fair value measurement

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

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

MORGAN STANLEY UK GROUP

NOTES TO THE FINANCIAL STATEMENTS Year ended 31 December 2018

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

d. Fair value (continued)

Fair value measurement (continued)

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 assumptions 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.

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

- **Level 1 – Quoted prices (unadjusted) in an active market for identical assets or liabilities**
Valuations based on quoted prices in active markets that the Morgan Stanley Group has the ability to access for identical assets or liabilities. Valuation adjustments and block discounts are not applied to Level 1 instruments. Since valuations are based on quoted prices that are readily and regularly available in an active market, valuation of these products does not entail a significant degree of judgement.
- **Level 2 – Valuation techniques using observable inputs**
Valuations based on one or more quoted prices in markets that are not active or for which all significant inputs are observable, either directly or indirectly.
- **Level 3 – Valuation techniques with significant unobservable inputs**
Valuations based on inputs that are unobservable and significant to the overall fair value measurement.

Valuation techniques

Fair value for financial instruments is derived using pricing models. Pricing models take into account the contract terms, as well as multiple inputs including, where applicable, 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.

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.

Adjustments for model uncertainty are taken for positions whose underlying models are reliant on significant inputs that are neither directly nor indirectly observable, hence requiring reliance on established theoretical concepts in their derivation. These adjustments are derived by making assessments of the possible degree of variability using statistical approaches and market-based information where possible.

Valuation process

Valuation Control ("VC") within the Financial Control Group ("FCG") is responsible for the Company's fair value valuation policies, processes and procedures. VC 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. VC implements valuation control processes designed to validate the fair value of the Company's financial instruments measured at fair value including those derived from pricing models.

MORGAN STANLEY UK GROUP

NOTES TO THE FINANCIAL STATEMENTS Year ended 31 December 2018

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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

If the Company 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 Company 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 or cancelled or when they expire.

f. Impairment of financial instruments

Applicable from 1 January 2018

The Company recognises loss allowances for ECL for its financial assets classified at amortised cost. ECLs are the present value of cash shortfalls (i.e. the difference between contractual and expected cash flows) over the expected life of the financial instrument, discounted at the asset's EIR. ECL is recognised in the income statement within 'Net impairment loss on financial instruments' and is presented as an ECL allowance. The allowance reduces the net carrying amount on the face of the statement of financial position.

Applicable until 31 December 2017

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

Impairment losses on available-for-sale financial assets were 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 was evidence that the available-for-sale financial asset was impaired, the cumulative loss that had been previously recognised in other comprehensive income was reclassified from the 'Available-for-sale reserve' and recognised in the income statement.

Impairment losses on loans and receivables were 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 EIR. Such impairment losses were recognised in the income statement within 'Other expense' and were recognised against the carrying amount of the impaired asset on the statement of financial position. Interest on the impaired asset continued to be accrued on the reduced carrying amount based on the original EIR of the asset.

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

Applicable until 31 December 2017 and from 1 January 2018

Impairment losses on investments in subsidiaries are measured as the difference between cost and the current estimated recoverable amount. When the recoverable amount is less than the cost, an impairment is recognised within the income statement in 'Net gains/ (losses) on investments in subsidiaries' and is reflected against the carrying amount of the impaired asset on the statement of financial position.

MORGAN STANLEY UK GROUP

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2018

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

g. Revenue recognition and contract assets and liabilities

Revenues are recognised when property services are provided to other Morgan Stanley Group undertakings, in an amount that is based on the consideration the Company expects to receive in exchange for those services when such amounts are not probable of significant reversal. Fee income in the income statement comprises of management fees charged to Morgan Stanley Group undertakings for the provision of the related services.

Receivables from contracts with other Morgan Stanley Group undertakings are recognised within 'Trade and other receivables' in the statement of financial position when the underlying performance obligations have been satisfied and the Company has the right per the contract to bill the respective group undertaking. Contract assets are recognised when the Company has satisfied its performance obligations, however, payment is conditional, and are presented within 'Prepayments and accrued income'. Contract liabilities are recognised when the Company has collected payment based on the terms of the contract, but the underlying performance obligations are not yet satisfied, and are presented within 'Accruals and deferred income'.

Incremental costs to obtain the contract are expensed as incurred. Revenues are not discounted when payment is expected within one year.

h. Property, plant and equipment

Property, plant and equipment are stated at cost net of depreciation and any provision for impairment in value (see note 3(i) below) which are included within 'Other expense' in the income statement.

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

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

Leasehold improvements, including reinstatement assets	- shorter of remaining lease term and 39 years
Fixtures, fittings and equipment	- 2 to 9 years

The carrying amount of an item of property, plant and equipment shall be derecognised on disposal or when no further economic benefits are expected from its use or disposal.

Gains and losses on disposals are determined by comparing proceeds with carrying amount.

i. Impairment of non-financial assets

Non-financial assets that are subject to depreciation 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.

MORGAN STANLEY UK GROUP

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2018

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

j. 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.

k. Grants

Grants received in respect of capital expenditure are treated as deferred income and released to 'Other income' in the income statement over the expected useful lives of the related asset on a straight line basis.

l. 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 taxation 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.

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.

m. Operating leases

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

n. 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.

MORGAN STANLEY UK GROUP

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2018

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

o. 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. FEE INCOME

	2018 \$'000	2017 \$'000
Revenue from contracts with customers:		
Management charges to other Morgan Stanley Group undertakings for property services provided	<u>201,482</u>	<u>229,087</u>

5. NET GAINS ON DERECOGNITION OF FINANCIAL ASSETS MEASURED AT FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME

	2018		2017	
	Carrying amount of financial assets sold \$'000	Gains arising from derecognition \$'000	Carrying amount of financial assets sold \$'000	Gains arising from derecognition \$'000
Investment securities	<u>-</u>	<u>-</u>	<u>29,022</u>	<u>10,803</u>

On 9 June 2017, the Company disposed of its available-for-sale investment to Morgan Stanley & Co. International plc for consideration of €35,413,000 (\$39,825,000), resulting in the cumulative gain of \$10,803,000 in the available-for-sale reserve being realised and therefore reclassified to the income statement.

6. OTHER REVENUE

	2018 \$'000	2017 \$'000
Government grants	<u>1,070</u>	<u>494</u>

Income from government grants relates to a Regional Selective Assistance grant awarded towards capital expenditure. The related expense is recognised in 'Other expense'.

7. INTEREST INCOME AND INTEREST EXPENSE

No other gains or losses have been recognised in respect of financial assets measured at amortised cost other than as disclosed as 'Interest income', and foreign exchange differences disclosed in 'Other expense' (note 9).

No other gains or losses have been recognised in respect of financial liabilities at amortised cost other than as disclosed as 'Interest expense', and foreign exchange differences disclosed in 'Other expense' (note 9).

MORGAN STANLEY UK GROUP

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2018

7. INTEREST INCOME AND INTEREST EXPENSE (CONTINUED)

The table below presents interest income and expense by accounting classification. Interest income and expense is calculated using the effective interest method for financial assets and financial liabilities measured at amortised cost. Interest income includes realised interest on financial assets measured at FVPL.

	2018 \$'000	2017 \$'000
Financial assets not measured at FVPL		
Financial assets measured at amortised cost	12,985	74,518
Financial assets measured at FVPL		
Non-trading financial assets at FVPL	15	-
Total interest income	<u>13,000</u>	<u>74,518</u>
Financial liabilities measured at amortised cost	23,599	90,294
Total interest expense	<u>23,599</u>	<u>90,294</u>

In the prior year, financial assets measured at amortised cost were classified as loans and receivables.

8. NET GAINS ON INVESTMENTS IN SUBSIDIARIES

	2018 \$'000	2017 \$'000
Income from investments in subsidiaries	<u>609</u>	<u>348,625</u>

9. OTHER EXPENSE

	2018 \$'000	2017 \$'000
Property service costs	89,434	78,992
Operating lease rentals	53,879	74,213
Depreciation on property, plant and equipment (note 15)	46,792	58,251
Loss on disposal of property, plant and equipment	1	108
Net foreign exchange losses	389	1,416
Auditor's remuneration:		
Fees payable to the Company's auditor for the audit of the Company's annual financial statements	<u>67</u>	<u>71</u>
	<u>190,562</u>	<u>213,051</u>

A description of the Company's significant leasing arrangements is presented at note 20 Commitments and contingencies.

The Company employed no staff during the year (2017: nil).

The amount of remuneration received by Directors in respect of their qualifying services to the Company is disclosed in the Related Party Disclosures note (note 25).

MORGAN STANLEY UK GROUP

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2018

10. INCOME TAX

Analysis of (benefit)/ expense in the year

	2018	2017
	\$'000	\$'000
Current tax expense		
UK corporation tax at 19% (2017: 19.25%)		
- Current year	-	30,884
- Prior year	182	550
Foreign tax		
- Current year	-	306
Total current tax	<u>182</u>	<u>31,740</u>
Deferred tax benefit		
Origination and reversal of temporary differences	(1,239)	(2,530)
Adjustment in respect of prior years	351	(47)
Effect of changes in tax rates	(99)	(70)
Total deferred tax	<u>(987)</u>	<u>(2,647)</u>
Income tax (benefit)/ expense	<u>(805)</u>	<u>29,093</u>

Finance (No.2) Act 2015 enacted a reduction in the UK corporation tax rate to 19% with effect from 1 April 2017. Finance Act 2016 enacted a further reduction in the UK corporation tax rate to 17% with effect from 1 April 2020. These reductions in the tax rate may impact the current tax charge in future periods.

Reconciliation of effective tax rate

The current year income tax expense is lower (2017: lower) than that resulting from applying the average standard rate of corporation tax in the UK for the year of 19% (2017: 19.25%). The main differences are explained below:

	2018	2017
	\$'000	\$'000
Profit before taxation	<u>2,000</u>	<u>360,182</u>
Income tax using the average standard rate of corporation tax in the UK of 19% (2017: 19.25%)	380	69,335
Impact on tax of:		
Tax under/(over) provided in prior years	533	503
Expenses not deductible for tax purposes	3,482	4,808
Group relief received for no cash consideration	(4,985)	-
Effect of changes in tax rate	(99)	(70)
Effect of taxes in foreign jurisdictions	-	306
Currency translation on tax	-	565
Tax exempt dividends	(116)	(44,275)
Non-taxable gain on disposal of fixed asset investments	-	(2,079)
Total income tax (benefit)/ expense in the income statement	<u>(805)</u>	<u>29,093</u>

MORGAN STANLEY UK GROUP

NOTES TO THE FINANCIAL STATEMENTS Year ended 31 December 2018

11. SECURED FINANCING

The following table provides an analysis of secured financing by measurement classification:

	2018 \$'000	2017 \$'000
Non-trading FVPL		
Securities purchased under agreements to resell	<u>50,995</u>	<u>-</u>

12. LOANS AND ADVANCES

	2018 \$'000	2017 \$'000
Loans and advances at amortised cost		
Amounts due from other Morgan Stanley Group undertakings	<u>371,750</u>	<u>342,342</u>

13. TRADE AND OTHER RECEIVABLES

	2018 \$'000	2017 \$'000
Trade and other receivables (amortised cost)		
Trade receivables		
Contracts with other Morgan Stanley Group undertakings	12,349	20,566
Other receivables		
Amounts due from other Morgan Stanley Group undertakings	710	738
Total trade and other receivables (amortised cost)	<u>13,059</u>	<u>21,304</u>

In the prior year, trades and other receivables at amortised cost were classified as loans and receivables.

14. INVESTMENTS IN SUBSIDIARIES

	Subsidiary undertakings \$'000
Cost	
At 1 January 2018 and 31 December 2018	<u>78</u>
Carrying amounts	
At 31 December 2017 and 31 December 2018	<u>78</u>

MORGAN STANLEY UK GROUP

NOTES TO THE FINANCIAL STATEMENTS Year ended 31 December 2018

14. INVESTMENTS IN SUBSIDIARIES (CONTINUED)

Details of all subsidiary undertakings of the Company at 31 December 2018 and 31 December 2017 are as follows:

Name of company	Address of undertaking's registered office	Proportion of shares held by the Company ⁽¹⁾⁽²⁾		Nature of business
		2018	2017	
Morgan Stanley Amalthea UK Limited	20 Bank Street, Canary Wharf, London, E14 4AD, UK	100%	100%	Financial services
Morgan Stanley Services (UK) Limited	25 Cabot Square, Canary Wharf, London, E14 4QA, UK	100%	100%	Financial services
Morgan Stanley Wertpapiere GmbH	Junghofstrasse 13-15, 60311, Frankfurt am Main, Germany	100%	100%	Financial services

Notes:

- (1) The proportion of voting rights held by the Company is the same as the proportion of shares held by the Company.
- (2) All shares held in each Company are ordinary shares.

15. PROPERTY, PLANT AND EQUIPMENT

	Leasehold improvement \$'000	Fixtures, fittings and equipment \$'000	Total \$'000
Cost			
At 1 January 2018	817,655	103,951	921,606
Additions	9,026	-	9,026
Disposals	(9,835)	(25,140)	(34,975)
At 31 December 2018	<u>816,846</u>	<u>78,811</u>	<u>895,657</u>
Depreciation			
At 1 January 2018	511,443	103,906	615,349
Charge for the year	46,792	-	46,792
Disposals	(8,794)	(25,095)	(33,889)
At 31 December 2018	<u>549,441</u>	<u>78,811</u>	<u>628,252</u>
Carrying amount			
At 31 December 2018	<u>267,405</u>	<u>-</u>	<u>267,405</u>

16. TRADE AND OTHER PAYABLES

	2018 \$'000	2017 \$'000
Other payables (amortised cost)		
Amounts due to other Morgan Stanley Group undertakings	1,811	760
Other amounts payable	4	4
	<u>1,815</u>	<u>764</u>

MORGAN STANLEY UK GROUP

NOTES TO THE FINANCIAL STATEMENTS Year ended 31 December 2018

17. DEBT AND OTHER BORROWINGS

	2018 \$'000	2017 \$'000
Debt and other borrowings (amortised cost)		
Amounts due to other Morgan Stanley Group undertakings	<u>493,331</u>	<u>481,268</u>

18. PROVISIONS

Provisions recognised under IAS 37

The following table sets out the provisions recognised under IAS 37:

	Onerous lease contracts \$'000	Lease reinstatement provisions \$'000	Total \$'000
At 1 January 2018	61,330	57,531	118,861
Additional provisions	15,805	-	15,805
Provisions utilised	(17,028)	(2,452)	(19,480)
Unused provisions reversed	-	(1,393)	(1,393)
Effect of unwinding discount rate	2,864	2,241	5,105
Foreign exchange revaluation	(3,709)	(3,304)	(7,013)
At 31 December 2018	<u>59,262</u>	<u>52,623</u>	<u>111,885</u>

Onerous lease contracts

The onerous lease contracts represent the net present value of expected future costs of excess office space (net of expected sublease income).

Lease reinstatement provisions

Lease reinstatement provisions represent the net present value of expected future costs of reinstating leasehold improvements at the end of the lease term. Lease reinstatement provisions are released when the reinstatement obligations have been fulfilled. The related asset for lease reinstatement provisions is included in 'Leasehold improvements' within 'Property, plant and equipment' (note 15).

19. DEFERRED TAX LIABILITIES

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

	2018 Deferred tax liability \$'000	2017 Deferred tax liability \$'000
At 1 January	(7,575)	(10,222)
Amount recognised in the income statement		
Current year timing differences	1,239	2,530
Adjustments in respect of prior years	(351)	47
Impact of change in UK corporation tax rate	99	70
At 31 December	<u>(6,588)</u>	<u>(7,575)</u>

MORGAN STANLEY UK GROUP

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2018

19. DEFERRED TAX LIABILITIES (CONTINUED)

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

	Deferred tax liability 2018 \$'000	Income statement 2018 \$'000	Deferred tax liability 2017 \$'000	Income statement 2017 \$'000
Accelerated capital allowances	(6,588)	987	(7,575)	2,647

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

20. COMMITMENTS AND CONTINGENCIES

Leases

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

	2018 \$'000	2017 \$'000
Lease payments under non-cancellable operating leases recognised as an expense in the year:		
- Minimum lease payments	53,879	74,213

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

	2018 \$'000	2017 \$'000
Within one year	61,813	68,044
In the second to fifth years inclusive	245,880	263,778
After five years	627,273	849,447
	<u>934,966</u>	<u>1,181,269</u>

Additionally the Company guaranteed certain obligations of another Morgan Stanley Group undertaking under a lease agreement with an unrelated third party. The Company's ultimate parent undertaking, Morgan Stanley, will provide sufficient financial support to the Company to allow it to pay the relevant guaranteed sums in the event that the Company itself cannot timeously do so from its own resources.

MORGAN STANLEY UK GROUP

NOTES TO THE FINANCIAL STATEMENTS Year ended 31 December 2018

21. EQUITY

	2018		2017	
	Number	\$'000	Number	\$'000
Allotted and fully paid				
Ordinary shares of \$1 each	10,000,000	10,000	10,000,000	10,000

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

2017 transactions with owners

On 26 May 2017 the Company reduced and cancelled its 200,000,000 Class A preference shares of \$1 each, for par consideration.

On 8 June 2017, the Company issued 6,314,671,635 ordinary shares of \$1 each as a bonus issue to Morgan Stanley International Limited, in exchange for the Company's existing 'Capital contribution reserve' of \$6,064,670,000 and 'Capital redemption reserve' of \$250,000,000.

On 8 June 2017 the Company transferred its \$1,300,000,000 holding of Additional Tier 1 capital in Morgan Stanley & Co. International plc to Morgan Stanley International Limited as consideration for the cancellation of the Company's issued Additional Tier 1 capital.

On 9 June 2017, the Company's shareholder reduced the Company's existing share premium account of \$304,218,000 to create distributable reserves.

On 9 June 2017, the Company consolidated 11,953,467,678 ordinary shares of \$1 each into 10,000,000 ordinary shares of \$1,195.346768 each and then performed a capital reduction to reduce the nominal value of each ordinary share to \$1 each. The Company's resultant share capital consists of 10,000,000 ordinary shares of \$1 each.

22. DIVIDENDS

In the current year, no dividends were paid or proposed. The following amounts represent the dividends in the prior year.

	2017	
	Per share	Total
	\$	\$'000
Dividends on Class A preference shares	0.019700	3,940
Dividends on Class B preference shares	0.102292	69,910
Dividends on Class C preference shares	0.085947	74,344
Coupon payment on Additional Tier 1 securities	-	95,228
Dividend in specie	-	14,633,802
		<u>14,877,224</u>

MORGAN STANLEY UK GROUP

NOTES TO THE FINANCIAL STATEMENTS Year ended 31 December 2018

23. 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 2018.

	Less than or equal to twelve months \$'000	More than twelve months \$'000	Total \$'000
ASSETS			
Cash and short-term deposits	18,397	-	18,397
Secured financing	50,995	-	50,995
Loans and advances	371,750	-	371,750
Trade and other receivables	13,059	-	13,059
Current tax assets	-	933	933
Prepayments and accrued income	23,365	-	23,365
Investments in subsidiaries	-	78	78
Property, plant and equipment	-	267,405	267,405
	<u>477,566</u>	<u>268,416</u>	<u>745,982</u>
LIABILITIES			
Trade and other payables	1,815	-	1,815
Debt and other borrowings	-	493,331	493,331
Provisions	14,782	97,103	111,885
Current tax liabilities	7,252	-	7,252
Deferred tax liabilities	-	6,588	6,588
Accruals and deferred income	8,627	65,306	73,933
	<u>32,476</u>	<u>662,328</u>	<u>694,804</u>

Total financial liabilities of \$124,005,000 included in the above and relating to lease obligations, fall due for payment after more than five years from the reporting date.

MORGAN STANLEY UK GROUP

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2018

23. EXPECTED MATURITY OF ASSETS AND LIABILITIES (CONTINUED)

At 31 December 2017	Less than or equal to twelve months \$'000	More than twelve months \$'000	Total \$'000
ASSETS			
Cash and short-term deposits	51,242	-	51,242
Loans and advances	294,481	47,861	342,342
Trade and other receivables	21,304	-	21,304
Current tax assets	980	-	980
Prepayments and accrued income	23,446	-	23,446
Investments in subsidiaries	-	78	78
Property, plant and equipment	-	306,257	306,257
	<u>391,453</u>	<u>354,196</u>	<u>745,649</u>
LIABILITIES			
Trade and other payables	764	-	764
Debt and other borrowings	-	481,268	481,268
Provisions	-	118,861	118,861
Current tax liabilities	8,037	-	8,037
Deferred tax liabilities	-	7,575	7,575
Accruals and deferred income	4,313	76,458	80,771
	<u>13,114</u>	<u>684,162</u>	<u>697,276</u>

24. SEGMENT REPORTING

The principal activity of the Company is to provide property services to other Morgan Stanley Group undertakings in the UK.

25. RELATED PARTY DISCLOSURES

Parent and subsidiary relationships

Parent and ultimate controlling entities

The parent and ultimate controlling entities are disclosed in note 1 to the financial statements.

Subsidiary relationships

The Company's subsidiary undertakings at 31 December 2018 and 31 December 2017 are provided in note 14 to the financial statements.

MORGAN STANLEY UK GROUP

NOTES TO THE FINANCIAL STATEMENTS Year ended 31 December 2018

25. RELATED PARTY DISCLOSURES (CONTINUED)

Directors' remuneration

The Company paid no remuneration to its Directors during the current or prior year. The charges in respect of Directors' qualifying services to the Company have been borne by another Morgan Stanley Group undertaking. The amount of remuneration received by Directors in respect of their qualifying services to the Company is disclosed below:

	2018 \$'000	2017 \$'000
Total remuneration of all Directors:		
Aggregate remuneration	650	727
Long term incentive schemes	27	36
Company contributions to pension schemes	18	20
	<u>695</u>	<u>783</u>
Disclosures in respect of the highest paid Director:		
Aggregate remuneration	636	259
Long term incentive schemes	26	13
Company contributions to pension schemes	18	8
	<u>680</u>	<u>280</u>

Directors' remuneration has been calculated as the sum of cash, bonuses, and benefits in kind.

All Directors who are employees of the Morgan Stanley Group are eligible for shares and share options of the parent company, Morgan Stanley, awarded under the Morgan Stanley Group's equity-based long term incentive schemes. In accordance with Schedule 5 paragraph 1(3)(a) of The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008, the above disclosures include neither the value of shares awarded, nor the gains made on exercise of share options. During the year three Directors received restricted stock unit awards in respect of qualifying services (2017: three).

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

The Morgan Stanley Group operates a defined contribution pension scheme, the Morgan Stanley UK Group Pension Plan. There are three Directors to whom retirement benefits are accruing under this defined contribution scheme (2017: two).

One Director has benefits accruing under the Alternative Retirement Plan, a defined benefit scheme, operated by Morgan Stanley UK Limited (2017: one).

The Company has provided the following advances and credit to its Directors during the year:

	Interest rate	Amount of advance/ credit		Total amount repaid	
		2018 \$'000	2017 \$'000	2018 \$'000	2017 \$'000
Season ticket loan	0%	<u>-</u>	<u>5</u>	<u>-</u>	<u>5</u>

Season ticket loans

Loans provided for the purpose of obtaining a season travel or parking ticket are recoverable over six or ten months, depending on the length of the ticket.