

Registered number: 05702837

Registered office:
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Canary Wharf
London
E14 4AD
United Kingdom

MORGAN STANLEY PACIFIC SERVICES LIMITED

Report and financial statements

31 December 2018



MORGAN STANLEY PACIFIC SERVICES LIMITED

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MORGAN STANLEY PACIFIC SERVICES LIMITED

STRATEGIC REPORT

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

PRINCIPAL ACTIVITY

The principal activity of the Company is the provision of financial services to financial institutions.

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".

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

United Kingdom withdrawal from the European Union

On 23 June 2016, the United Kingdom (the "UK") electorate voted to leave the European Union (the "EU"). On 29 March 2017, the UK invoked Article 50 of the Lisbon Treaty which triggered a two-year period, subject to extension (which would need the unanimous approval of the EU Member States), during which the UK government negotiated a form of withdrawal agreement with the EU.

On 22 March 2019, the UK and the other EU Member States agreed to an extension of the two-year period to 22 May 2019, (if the UK Parliament approved the withdrawal agreement by 29 March 2019) or 12 April 2019 (if it did not). On 11 April 2019, the UK and the other EU Member States agreed to a further extension to 31 October 2019. Absent any further changes to this time schedule, the UK will leave the EU on 31 October 2019.

The Morgan Stanley Group is continuing to prepare its European operations regardless of whether or not a withdrawal or transition agreement is reached. However, the Company's principal activity and risks are expected to remain unchanged.

Overview of 2018

The statement of comprehensive income for the year is set out on page 13. The Company's loss after tax for the year is \$289,000 (2017: profit of \$105,000), primarily driven by a net financing expense on the collateral held by the entity. Net trading income which represents fair value movements on foreign exchange options and equity swaps has decreased by \$54,000 to \$803,000 (2017: \$857,000). The Company has net interest income of \$1,359,000 (2017: \$431,000). This movement is primarily due to an increase in secured borrowing activity.

The statement of financial position for the year is set out on page 15. The total assets of the Company are \$121,975,000 (2017: \$56,366,000) in the current year. This increase is primarily due to an increase in trade and other receivables. The total liabilities for the year are \$101,646,000 (2017: \$35,748,000). This increase is primarily due to an increase in trade and other payables.

The performance of the Company is included in the results of the Morgan Stanley Group which are disclosed in the Morgan Stanley Group's Annual Report on Form 10-K to the United States of America ("US") Securities and Exchange Commission. The Morgan Stanley Group manages its key performance indicators on a global basis but in consideration of individual legal entities. For this reason, 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.

The risk management section below sets out the Company's and the Morgan Stanley Group's policies for the management of liquidity and cash flow risk and other significant business risks.

MORGAN STANLEY PACIFIC SERVICES LIMITED

STRATEGIC REPORT

BUSINESS REVIEW (CONTINUED)

Risk management

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

Set out below is an overview of the Company's policies for the management of financial risk and other significant business risks. More detailed qualitative and quantitative disclosures about the Company's management of and exposure to financial risks are included in note 15 to the financial statements.

Market risk

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

The Company manages the market risk associated with its trading activities at both a trading division and an individual product level.

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.

Market risk management policies and procedures for the Company are consistent with those of the Morgan Stanley Group and include escalation to appropriate senior management personnel.

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. Further detail on the Morgan Stanley Group's management of country risk is set out below.

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

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

Country risk exposure

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

MORGAN STANLEY PACIFIC SERVICES LIMITED

STRATEGIC REPORT

BUSINESS REVIEW (CONTINUED)

Risk management (continued)

Country risk exposure (continued)

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

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

The Morgan Stanley Group conducts periodic stress testing that seeks to measure the impact on the Company's credit and market risk stemming from negative economic or political scenarios. When deemed appropriate by the Morgan Stanley Group's risk managers, the stress test scenarios include possible contagion effects. The analysis, and the results of the stress tests, may result in the amendment of limits or exposure mitigation.

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 also encompasses the Company's ability (or perceived ability) to meet its financial obligations without experiencing significant business disruption or reputational damage that may threaten its viability as a going concern. Liquidity risk also encompasses the associated funding risks triggered by the market or idiosyncratic stress events that may cause unexpected changes in funding needs or an inability to raise new funding. Generally, the Company incurs liquidity and funding risk as a result of its trading activities.

The primary goal of the Morgan Stanley Group's liquidity risk management framework is to ensure that the Morgan Stanley Group, including the Company, has access to adequate funding across a wide range of market conditions and time horizons. The framework is designed to enable the Morgan Stanley Group to fulfil its financial obligations and support the execution of the Company's business strategies. The framework is further described in note 15.

The Company continues to actively manage its capital and liquidity position to ensure adequate resources are available to support its activities, to enable it to withstand market stresses.

Operational risk

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

MORGAN STANLEY PACIFIC SERVICES LIMITED

STRATEGIC REPORT

BUSINESS REVIEW (CONTINUED)

Risk management (continued)

Operational risk (continued)

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

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 governance framework, a comprehensive risk management program and insurance. Operational risks and associated risk exposures are assessed relative to the risk tolerance reviewed and confirmed by the Board and are prioritised accordingly.

The breadth and variety of operational risk are such that the types of mitigating activities are wide-ranging. Examples of activities include continuous enhancement of defences against cyber attacks; use of legal agreements and contracts to transfer and/or limit operational risk exposures; due diligence; implementation of enhanced policies and procedures; exception management processing controls; and segregation of duties.

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

The Operational Risk Department provides independent oversight of operational risk management and assesses measures and monitors operational risk against tolerance. The Operational Risk Department works with the business divisions and control groups to help ensure a transparent, consistent and comprehensive framework for managing operational risk within each area and across the Company.

MORGAN STANLEY PACIFIC SERVICES LIMITED

STRATEGIC REPORT

BUSINESS REVIEW (CONTINUED)

Risk management (continued)

Operational risk (continued)

The Operational Risk Department scope includes oversight of technology risk, cybersecurity risk, information security risk and data risk management programmes (e.g., cybersecurity), and fraud risk management and prevention programme and a third party risk management (supplier and 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 maintains programmes for business continuity management and technology disaster recovery that facilitate activities designed to mitigate risk to the Morgan Stanley Group during a business continuity event. A business continuity event is an interruption with potential impact to normal business activity of the Company's people, operations, technology, suppliers and/or facilities. The business continuity management programme's core functions are business continuity planning and crisis management. As part of business continuity planning, business divisions and control groups maintain business continuity plans identifying processes and strategies to continue business critical processes during a business continuity event. Crisis management is the process of identifying and managing the Company's operations during business continuity events. Disaster recovery plans supporting business continuity are in place for critical facilities and resources across the Company.

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

In connection with its ongoing operations, the Company utilises the services of third party suppliers, 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's risk-based approach to managing exposure to these services includes the performance of due diligence, implementation of service level and other contractual agreements, consideration of operational risk and ongoing monitoring of the third party suppliers' performance. The Company maintains a third party risk programme with appropriate governance, policies, procedures, and technology that supports alignment with our risk tolerance and is designed to meet regulatory requirements. The third party risk programme includes the adoption of appropriate risk management controls and practices through the supplier management lifecycle including, but not limited to assessment of information security, service failure, financial stability, disaster recoverability, reputational risk, contractual risk and safeguards against corruption.

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 which 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, anti-corruption and terrorist financing rules and regulations. The Company is generally subject to extensive regulation in the different jurisdictions in which it conducts its business.

MORGAN STANLEY PACIFIC SERVICES LIMITED

STRATEGIC REPORT

BUSINESS REVIEW (CONTINUED)

Risk management (continued)

Legal, regulatory and compliance risk (continued)

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.

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 and banking industries globally 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 reinforcing and confirming adherence to the core values through our governance framework, tone from the top, management oversight, risk management and controls, and a three lines of defence structure (business, control functions such as Risk Management and Compliance, and Internal Audit). The Morgan Stanley Group's Board is responsible for overseeing the Morgan Stanley Group's practices and procedures relating to culture, values and conduct, as set forth in the Morgan Stanley Group's Corporate Governance Policies. The Morgan Stanley Group's Culture, Values and Conduct Committee is the senior management committee that oversees the Firm-wide culture, values and conduct program. A fundamental building block of this program is the Morgan Stanley Group's Code of Conduct, which establishes standards for employee conduct that further reinforce the Morgan Stanley Group's commitment to integrity and ethical conduct. Every new hire and every employee annually must attest to their understanding of and adherence to the Code of Conduct. The Morgan Stanley UK Group's Conduct Risk Management Policy also sets out a consistent framework for managing Conduct Risk (i.e. the risk arising from misconduct by employees of contingent workers) and Conduct Risk incidents. The annual employee performance evaluation process includes an evaluation of employee conduct related to risk management practices and the Morgan Stanley Group's expectations. The Morgan Stanley Group also has several mutually reinforcing processes to identify employee conduct that may have an impact on employment status, current year compensation and/or prior year compensation. For example, the Global Incentive Compensation Discretion Policy sets forth standards for managers when making annual compensation decisions and specifically requires managers to consider whether their employees effectively managed and/or supervised risk control practices during the performance year. Management committees from control functions periodically meet to discuss employees whose conduct does not meet the Firm's standards. These results are incorporated in the employees' performance evaluation, which links to compensation and promotion decisions. The Morgan Stanley Group's clawback and cancellation provisions, which permit recovery of deferred incentive compensation and cover a broad scope of employee conduct, including any act or omission (including with respect to direct supervisory responsibilities) that constitutes a breach of obligation to the Morgan Stanley Group or causes a restatement of the Morgan Stanley Group's financial results, constitutes a violation of the Morgan Stanley Group's global risk management principles, policies and standards, or causes a loss of revenue associated with a position on which the employee was paid and the employee operated outside of internal control policies.

MORGAN STANLEY PACIFIC SERVICES LIMITED

STRATEGIC REPORT

BUSINESS REVIEW (CONTINUED)

Going concern

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

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 **STEWART BATHFELD**



26 SEPTEMBER 2019

Director

MORGAN STANLEY PACIFIC SERVICES LIMITED

DIRECTORS' REPORT

The Directors present their report and financial statements (which comprise the statement of comprehensive income, the statement of changes in equity, the statement of financial position and the related notes, 1 to 19) for the Company for the year ended 31 December 2018.

RESULTS AND DIVIDENDS

The loss for the year, after tax, was \$289,000 (2017: profit of \$105,000).

During the year, no dividends were paid or proposed (2017: \$nil).

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:

S Bayfield (Appointed 23 September 2019)
T MacLeod
B.M.L Young

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.

DIRECTORS' INDEMNITY

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

EVENTS AFTER THE REPORTING DATE

There have been no significant events since the reporting date.

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.

MORGAN STANLEY PACIFIC SERVICES LIMITED

DIRECTORS' RESPONSIBILITIES STATEMENT

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

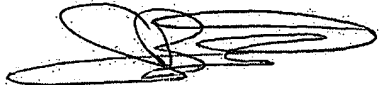
Company law requires the Directors to prepare financial statements for each financial year. Under that law the Directors have elected to prepare the financial statements in accordance with UK Generally Accepted Accounting Practice (UK Accounting Standards and applicable law), including Financial Reporting Standard 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 United Kingdom 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

STEWART DAYFIELD



26 SEPTEMBER 2019

Director

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF MORGAN STANLEY PACIFIC SERVICES LIMITED

Report on the audit of the financial statements

Opinion

In our opinion the financial statements of Morgan Stanley Pacific Services Limited ("the Company"):

- give a true and fair view of the state of the company's affairs as at 31 December 2018 and of its loss 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 which comprise:

- the statement of comprehensive income;
- the statement of changes in equity;
- the statement of financial position; and
- the related notes 1 to 19.

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 ("FRC'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.

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.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF MORGAN STANLEY PACIFIC SERVICES LIMITED (CONTINUED)

Other information (continued)

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.

**INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF MORGAN
STANLEY PACIFIC SERVICES LIMITED (CONTINUED)**

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.

Matters on which we are required to report by exception

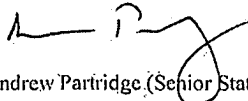
Under the Companies Act 2006, we are required to report in respect of the following matters if, in our opinion:

- 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 (Senior Statutory Auditor)

for and on behalf of Deloitte LLP

Statutory Auditor

Glasgow, United Kingdom

26/9/19.

MORGAN STANLEY PACIFIC SERVICES LIMITED

STATEMENT OF COMPREHENSIVE INCOME

Year ended 31 December 2018

	Note	2018 \$'000	2017 \$'000
Net trading income:		803	857
Other revenue	5	95	253
Total non-interest revenues		<u>898</u>	<u>1,110</u>
Interest income	6	3,100	973
Interest expense	6	(1,741)	(542)
Net interest income:		<u>1,359</u>	<u>431</u>
Non-interest expense:			
Other expense	7	(2,571)	(1,410)
(LOSS)/PROFIT BEFORE TAXATION		<u>(314)</u>	<u>131</u>
Income tax benefit/(expense)	8	25	(26)
(LOSS)/PROFIT AND TOTAL COMPREHENSIVE INCOME FOR THE YEAR		<u>(289)</u>	<u>105</u>

All operations were continuing in the current and prior year.

The notes on pages 16 to 47 form an integral part of the financial statements.

MORGAN STANLEY PACIFIC SERVICES LIMITED

STATEMENT OF CHANGES IN EQUITY

Year ended 31 December 2018

	Share capital \$'000	Share premium \$'000	Retained earnings \$'000	Total equity \$'000
Balance at 1 January 2017	-	15,000	5,513	20,513
Profit and total comprehensive income for the year	-	-	105	105
Balance at 31 December 2017	-	15,000	5,618	20,618
Loss and total comprehensive expense for the year	-	-	(289)	(289)
Balance at 31 December 2018	-	15,000	5,329	20,329

The notes on pages 16 to 47 form an integral part of the financial statements.

MORGAN STANLEY PACIFIC SERVICES LIMITED

Registered number: 05702837

STATEMENT OF FINANCIAL POSITION

As at 31 December 2018

	Note.	2018 \$'000	2017 \$'000
ASSETS			
Cash and short-term deposits	9	5,201	5,000
Trading financial assets	9	138	3,827
Trade and other receivables	10	116,636	47,539
TOTAL ASSETS		<u>121,975</u>	<u>56,366</u>
LIABILITIES AND EQUITY			
Trading financial liabilities	9	33,747	144
Trade and other payables	11	67,882	35,578
Current tax liabilities		-	26
Accruals and deferred income		17	-
TOTAL LIABILITIES		<u>101,646</u>	<u>35,748</u>
EQUITY			
Share capital	12	-	-
Share premium account	12	15,000	15,000
Retained earnings		5,329	5,618
TOTAL EQUITY		<u>20,329</u>	<u>20,618</u>
TOTAL LIABILITIES AND EQUITY		<u>121,975</u>	<u>56,366</u>

These financial statements were approved by the Board and authorised for issue on 26 September 2019

Signed on behalf of the Board



STEWART BAYFIELD

Director

The notes on pages 16 to 47 form an integral part of the financial statements.

MORGAN STANLEY PACIFIC SERVICES LIMITED

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: 20 Bank Street, Canary Wharf, London E14 4AD, UK. The Company is a private company and is limited by shares. The registered number of the Company is 05702837.

2. BASIS OF PREPARATION

Statement of compliance

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

The Company meets the definition of a qualifying entity and is a Financial institution as defined in Financial Reporting Standard 100 *Application of Financial Reporting Requirements*. The Company has taken advantage of the disclosure exemptions available under FRS 101 in relation to fair value measurement, 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 19.

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.

IFRS 9 'Financial Instruments' ("IFRS 9") was issued by the IASB in November 2009, reissued in October 2010, amended in November 2013, and revised and reissued by the IASB in July 2014. It is effective for annual periods beginning on or after 1 January 2018 and was endorsed by the EU in November 2016. The Company has adopted IFRS 9 from 1 January 2018 with no restatement of comparative periods under the transitional provisions of the Standard. There is no impact on the classification and measurement of the Company's financial assets and liabilities.

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

The main aspects of IFRS 9 which impact 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.

MORGAN STANLEY PACIFIC SERVICES LIMITED

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

As a result of this evaluation, no financial assets or financial liabilities have changed classification.

There was no impact on the Company's retained earnings at 1 January 2018 as a result of changes to classification or adoption of ECL model. However, 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 'Summary of significant accounting policies' 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 '*Financial Instruments: Recognition and Measurement*' ("IAS 39").

To reflect the differences between IFRS 9 and IAS 39, IFRS 7 '*Financial Instruments: Disclosures*' was updated by the IASB and the Company adopted the updated IFRS 7 for the year beginning 1 January 2018. The updated requirements include transition disclosures shown in note 4, in addition to qualitative and quantitative information about the ECL as set out in note 15.

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 or interpretations relevant to the Company's operations which were adopted during the year.

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 United Kingdom Accounting Standards, including FRS 101, and UK company law.

Critical judgements in applying the Company's accounting policies

No judgements other than those involving estimations noted below 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.

Key sources of estimation uncertainty

The preparation of the Company's financial statements requires management to make judgements involving estimations and other assumptions regarding the valuation of certain financial instruments, impairment of assets and other matters that affect the financial statements and related disclosures.

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

The going concern assumption

The Company's business activities, together with the factors likely to affect its future development, performance and position, are reflected in the Business review section of the Strategic report on pages 1 to 7. In addition, the notes to the financial statements include the Company's objectives, policies and processes for managing its capital; its financial risk management objectives; details of its financial instruments; and its exposures to credit risk and liquidity risk.

MORGAN STANLEY PACIFIC SERVICES LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2018.

2. BASIS OF PREPARATION (CONTINUED)

The going concern assumption (continued)

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. All translation differences are taken through the statement of comprehensive income. Exchange differences recognised in the statement of comprehensive income 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

Trading financial instruments (applicable both prior to and from 1 January 2018)

Trading financial instruments, 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, unrealised interest and dividends are reflected in the statement of comprehensive income in 'Net trading income'.

Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial instrument. For all trading financial instruments, transaction costs are excluded from the initial fair value measurement of the financial instrument. These costs are recognised in the statement of comprehensive income in 'Other expense'.

ii) Financial assets and financial liabilities at amortised cost

Applicable from 1 January 2018

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

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 statement of comprehensive income in 'Interest income', using the effective interest rate ("EIR") method as described below. 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 statement of comprehensive income in 'Net impairment loss on financial instruments'.

MORGAN STANLEY PACIFIC SERVICES LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2018

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

c. Financial instruments (continued)

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

Applicable until 31 December 2017

Financial assets classified as loans and receivables were recognised when the Company became a party to the 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 statement of comprehensive income in 'Interest income', using the effective interest rate 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 statement of comprehensive income in 'Other expense'.

Financial assets classified as loans and receivables included cash and short-term deposits, cash collateral on securities borrowed, trade receivables, loans and advances and other receivables.

Applicable until 31 December 2017 and from 1 January 2018

Financial liabilities classified at amortised cost include certain secured borrowings, trade and other payables and accruals and deferred income.

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 statement of comprehensive income 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.

MORGAN STANLEY PACIFIC SERVICES LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2018

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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.

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.

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 fair value 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.

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.

MORGAN STANLEY PACIFIC SERVICES LIMITED

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)

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 from Level 2 to Level 3 of the fair value hierarchy.

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, the total fair amount is disclosed in the level appropriate for the lowest level input that is significant to the total fair value of the asset or liability.

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

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

Valuation techniques

Many cash instruments and OTC derivative contracts have bid and ask prices that can be observed in the marketplace. Bid prices reflect the highest price that a party is willing to pay for an asset. Ask prices represent the lowest price that a party is willing to accept for an asset. The 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.

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.

MORGAN STANLEY PACIFIC SERVICES LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2018

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

d. Fair value (continued)

Valuation techniques (continued)

The Company applies credit-related valuation adjustments to its OTC derivatives. The Company considers the impact of changes in both the Company's and the counterparty's credit rating is considered when measuring fair value. In determining the expected exposure the Company simulates the distribution of the future exposure to a counterparty, then applies market-based default probabilities to the future exposure, leveraging external third-party credit default swap ("CDS") spread data. Where CDS spread data are unavailable for a specific counterparty, bond market spreads, CDS spread data based on the counterparty's credit rating or CDS spread data that reference a comparable counterparty may be utilised. The Company also considers collateral held and legally enforceable master netting agreements that mitigate its exposure to each counterparty.

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

The Company may apply a concentration adjustment to certain of its OTC derivatives portfolios to reflect the additional cost of closing out a particularly large risk exposure. Where possible, these adjustments are based on observable market information but in many instances significant judgement is required to estimate the costs of closing out concentrated risk exposures due to the lack of liquidity in the marketplace.

Valuation process

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.

Model Review. VC, in conjunction with the Model Risk Management Department ("MRM"), which reports to the Chief Risk Officer of the Morgan Stanley Group ("CRO"), independently reviews valuation models' theoretical soundness, the appropriateness of the valuation methodology and calibration techniques developed by the business units using observable inputs. Where inputs are not observable, VC reviews the appropriateness of the proposed valuation methodology to determine that it is consistent with how a market participant would arrive at the unobservable input. The valuation methodologies utilised in the absence of observable inputs may include extrapolation techniques and the use of comparable observable inputs. As part of the review, VC develops a methodology to independently verify the fair value generated by the business unit's valuation models. The Company generally subjects valuations and models to a review process initially and on a periodic basis thereafter.

MORGAN STANLEY PACIFIC SERVICES LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2018

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

d. Fair value (continued)

Valuation process (continued)

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, VC independently validates the fair values of financial instruments determined using valuation models by determining the appropriateness of the inputs used by the business units and by testing compliance with the documented valuation methodologies approved in the model review process described above.

The results of this independent price verification and any adjustments made by VC 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.

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

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

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

Gains and losses on inception

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

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

MORGAN STANLEY PACIFIC SERVICES LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2018

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

e. Modification and derecognition of financial assets and liabilities

Applicable until 31 December 2017 and from 1 January 2018

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 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 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 renegotiation or modification of the contractual cash flows of a financial asset can lead to derecognition where the modification is "substantial", determined by qualitative assessment of whether the revised contractual terms of a financial asset, such as a loan, are significantly different from those of the original financial asset. In the event that the qualitative assessment is unclear, a quantitative 10% cash flow test is performed.

Where modifications do not result in derecognition of the asset, the gross carrying amount of the financial asset is recalculated and a modification gain/ (loss) is recognised in the statement of comprehensive income.

Upon derecognition of a financial asset, the difference between the previous carrying amount and the sum of any consideration received, together with the transfer of any cumulative gain/ loss previously recognised in equity, are recognised in the statement of comprehensive income within 'Net gains/ (losses) on derecognition of financial assets measured at amortised cost'.

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

f. Impairment of financial assets

Applicable from 1 January 2018

The Company recognises loss allowances for ECL for financial assets measured at amortised cost.

Measurement of ECL

For financial assets, ECL 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.

Where a financial asset is credit-impaired at the reporting date, the ECL is measured as the difference between the asset's gross carrying amount and the present value of future cash flows, discounted at the original EIR.

MORGAN STANLEY PACIFIC SERVICES LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2018

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

f. Impairment of financial assets (continued)

Measurement of ECL (continued)

The Company applies a three stage approach to measuring ECL based on the change in credit risk since initial recognition:

- Stage 1: if the credit risk of the financial instrument at the reporting date has not increased significantly since initial recognition then the loss allowance is calculated as the lifetime cash shortfalls that will result if a default occurs in the next 12 months, weighted by the probability of that default occurring.
- Stage 2: if there has been a significant increase in credit risk ("SICR") since initial recognition, the loss allowance is calculated as the ECL over the remaining life of the financial instrument. If it is subsequently determined that there has no longer been a SICR since initial recognition, then the loss allowance reverts to reflecting 12 month expected losses.
- Stage 3: if there has been a SICR since initial recognition and the financial instrument is deemed credit-impaired (see below for definition of credit-impaired), the loss allowance is calculated as the ECL over the remaining life of the financial instrument. If it is subsequently determined that there has no longer been a SICR since initial recognition, then the loss allowance reverts to reflecting 12 month expected losses.

The Company's accounting policy is to not use the 'low' credit risk practical expedient. As a result, the Company monitors all financial instruments which do not have a significant financing component that are subject to impairment for SICR, with the exception of trade receivables for which a lifetime ECL is always calculated.

In general, ECL are measured so that they reflect:

- a) A probability-weighted range of possible outcomes
- b) The time value of money; and
- c) Relevant information relating to past, current and future economic conditions.

When measuring ECL, the Company considers multiple scenarios, except where practical expedients are used to determine ECL. Practical expedients are used where they are consistent with the principles described above. ECL on certain trade receivables are calculated using a 'matrix' approach which reflects the previous history of credit losses on these financial assets, applying different provision levels based on the age of the receivable. Alternatively where there is a history of no credit losses, and where this is expected to persist into the future for structural or other reasons, such as collateral or other credit enhancement, in which case it is determined that the ECL for a financial instrument is *de minimis* (highly immaterial) and it may not be necessary to recognise the ECL.

The Company measures ECL on an individual asset basis and has no purchased or originated credit-impaired financial assets.

If a financial asset has been the subject of modification which does not lead to its derecognition (refer accounting policy 3(c) SICR is assessed by comparing the risk of default of the financial instrument, based on the modified terms at the reporting date, with the risk of default of the financial instrument at inception, based on the financial instrument's original, unmodified, terms.

MORGAN STANLEY PACIFIC SERVICES LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2018

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

f. Impairment of financial assets (continued)

Measurement of ECL (continued)

Where the modification of contractual cash flows of a financial asset leads to its derecognition and the recognition of a new asset (refer accounting policy 3(e)), the date of modification is treated as the date of initial recognition for the new financial asset when determining whether a SICR has occurred for that modified financial asset. In rare circumstances, after modification, the new asset is considered to be credit-impaired, in which case it is treated as an asset which was credit-impaired at origination.

More information on measurement of ECL is provided in note 15 Financial risk management.

Presentation of ECL

ECL is recognised in the statement of comprehensive income within 'Net impairment loss on financial instruments'. ECL on financial assets measured at amortised cost are presented as an ECL allowance. The allowance reduces the net carrying amount on the face of the statement of financial position.

Credit-impaired financial instruments

In assessing the impairment of financial instruments under the ECL model, the Company defines credit-impaired financial instruments in accordance with Credit Risk Management Department's policies and procedures. A financial instrument is credit-impaired when, based on current information and events, it is probable that the Company will be unable to collect all scheduled payments of principal or interest when due according to the contractual terms of the agreement.

Definition of Default

In assessing the impairment of financial instruments under the ECL model, the Company defines default in accordance with Credit Risk Management Department's policies and procedures. This considers whether the borrower is unlikely to pay its credit obligations to the Company in full and takes into account qualitative indicators, such as breaches of covenants. The definition of default also includes a presumption that a financial asset which is more than 90 days past due ("DPD") has defaulted.

Write-offs

Loans and debt securities are written off (either partially or in full) when they are deemed uncollectible which generally occurs when all commercially reasonable means of recovering the loan balance have been exhausted. Such determination is based on an indication that the borrower can no longer pay the obligation, or that the proceeds from collateral will not be sufficient to pay the loan. Partial write-offs are made when a portion of the loan is uncollectable. However, financial assets that are written off could still be subject to enforcement activities for recoveries of amounts due. If the amount to be written off is greater than the accumulated loss allowance, the difference is reflected directly in the statement of comprehensive income within 'Net impairment loss on financial instruments' and is not recognised in the loss allowance account. Any subsequent recoveries are credited to 'Net impairment loss on financial instruments' within the statement of comprehensive income.

Applicable until 31 December 2017

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 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.

MORGAN STANLEY PACIFIC SERVICES LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2018

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

f. Impairment of financial assets (continued)

Applicable until 31 December 2017 (continued)

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 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 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 statement of comprehensive income 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.

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 by financial asset in note 3(c)(ii). 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. Cash and cash equivalents

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

h. Income tax

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

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 statement of comprehensive income 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 statement of comprehensive income, 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.

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.

MORGAN STANLEY PACIFIC SERVICES LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2018

4. TRANSITION TO IFRS 9

As discussed at note 2, the Company adopted a new standard from 1 January 2018, IFRS 9, however there has been no impact to retained earnings.

The disclosures below set out the impact of adopting IFRS 9 on the statement of financial position and retained earnings, including the effect of replacing IAS 39's incurred credit loss models with the ECL framework under IFRS 9.

a. IFRS 9: Classification of financial instruments on the date of initial application

The following table shows the original measurement categories in accordance with IAS 39 and the new measurement categories under IFRS 9 for the Company's financial assets and financial liabilities as at 1 January 2018 in accordance with the Company's updated accounting policies on the classification and impairment of financial instruments under IFRS 9 as set out in note 3(f).

	Original classification under IAS 39	New classification under IFRS 9	Original carrying amount under IAS 39 \$'000	New carrying amount under IFRS 9 \$'000
Financial assets				
Cash and short-term deposits	Loans and receivables	Financial assets at amortised cost	5,000	5,000
Trading financial assets	FVPL	FVPL (trading)	3,827	3,827
Trade and other receivables	Loans and receivables	Financial assets at amortised cost	47,539	47,539
Total financial assets			56,366	56,366
Financial liabilities				
Trading financial liabilities	FVPL	FVPL (trading)	144	144
Trade and other liabilities	Financial liabilities at amortised cost	Financial liabilities at amortised cost	35,578	35,578
Total financial liabilities			35,722	35,722

The application of these policies resulted in the reclassifications set out in the table above. There has been no re-measurement of financial assets and liabilities upon transition to IFRS 9.

There was no effect on retained earnings at 1 January 2018 as a result of the adoption of IFRS 9.

b. IFRS 9: Expected credit losses

The Company had no impairment provisions under IAS 39 at 31 December 2017 and has no ECL impairment allowance as at 1 January 2018.

MORGAN STANLEY PACIFIC SERVICES LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2018

5. OTHER REVENUE

	2018 \$'000	2017 \$'000
Net foreign exchange gains	95	253

6. 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 financial assets at amortised cost other than as disclosed as 'Interest income', and foreign exchange differences disclosed in 'Other revenue' (note 5).

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 revenue' (note 5).

7. OTHER EXPENSE

	2018 \$'000	2017 \$'000
Auditor's remuneration:		
Fees payable to the Company's auditor and its associates for the audit of the Company's annual financial statements	71	20
Other::		
Commission expenses	2,413	986
Management charges from other Morgan Stanley Group undertakings	16	340
Other expenses	71	64
	<u>2,571</u>	<u>1,410</u>

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 19).

MORGAN STANLEY PACIFIC SERVICES LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2018

8. INCOME TAX (BENEFIT)/ EXPENSE

Analysis of expense in the year:

	2018 \$'000	2017 \$'000
Current tax expense		
UK corporation tax at 19% (2017: 19.25%)		
- Current year	1	26
- Adjustment in respect of prior years	(26)	-
Total current tax	<u>(25)</u>	<u>26</u>

Reconciliation of effective tax rate

The current year income tax benefit is lower (2017: higher) than that resulting from applying the average standard rate of corporation tax in the UK for the year of 19.00% (2017: 19.25%). The main differences are explained below:

	2018 \$'000	2017 \$'000
(Loss)/ profit before taxation	<u>(314)</u>	<u>131</u>
Income tax using the average standard rate of corporation tax in the UK of 19.00% (2017: 19.25%)	(60)	25
(Over)/ under provided in prior years	(26)	-
Currency translation on tax	1	1
Group relief surrendered for no cash consideration	60	-
Total income tax (benefit)/ expense in the statement of comprehensive income	<u>(25)</u>	<u>26</u>

MORGAN STANLEY PACIFIC SERVICES LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2018

9. FINANCIAL ASSETS AND FINANCIAL LIABILITIES BY MEASUREMENT CATEGORY

The following table analyses financial assets and financial liabilities as at 31 December 2018 presented in the statement of financial position by IFRS 9 classifications.

2018	FVPL (mandatorily) \$'000	Amortised cost \$'000	Total \$'000
Cash and short-term deposits	-	5,201	5,201
Trading financial assets	138	-	138
Trade and other receivables	-	116,636	116,636
Total financial assets	138	121,837	121,975
Trading financial liabilities	33,747	-	33,747
Trade and other payables	-	67,882	67,882
Accruals and deferred income	-	17	17
Total financial liabilities	33,747	67,899	101,646

All trading financial instruments are Derivatives which represent foreign exchange options and equity contracts.

There are no terms and conditions of any trading asset or trading liability may individually significantly affect the amount, timing and certainty of future cash flows for the Company.

The following table analyses financial assets and financial liabilities as at 31 December 2017 presented in the statement of financial position by IAS 39 classifications.

2017	FVPL (held for trading) \$'000	Loans and receivables \$'000	Financial liabilities at amortised cost \$'000	Total \$'000
Cash and short-term deposits	-	5,000	-	5,000
Trading financial assets	3,827	-	-	3,827
Trade and other receivables	-	47,539	-	47,539
Total financial assets	3,827	52,539	-	56,366
Trading financial liabilities	144	-	-	144
Trade and other payables	-	-	35,578	35,578
Total financial liabilities	144	-	35,578	35,722

10. TRADE AND OTHER RECEIVABLES

	2018 \$'000	2017 \$'000
Trade and other receivables (amortised cost):		
Trade receivable:		
Amounts due from other Morgan Stanley Group undertakings	115,694	25,875
Other receivables:		
Amounts due from other Morgan Stanley Group undertakings	937	21,641
Other amounts receivable	5	23
	116,636	47,539

MORGAN STANLEY PACIFIC SERVICES LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2018

15. FINANCIAL RISK MANAGEMENT (CONTINUED)

Credit risk management (continued)

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 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 helps ensure that credit exposure is actively monitored and managed. The evaluation of counterparties and borrowers includes an assessment of the probability that an obligor will default on its financial obligations and any subsequent losses that may occur when an obligor defaults. In addition, credit risk exposure is actively managed by credit professionals and committees within the Credit Risk Management Department and through various risk committees, whose membership includes individuals from the Credit Risk Management Department.

A Credit Limits Framework is utilised to manage credit risk levels across the 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 and industry. The Credit Risk Management Department helps ensure timely and transparent communication of material credit risks, compliance with established limits and escalation of risk concentrations to appropriate senior management. The Credit Risk Management Department also works closely with the Market Risk Department ("MRD") and applicable business units to monitor risk exposures and to perform stress tests to identify, analyse and control credit risk concentrations arising from the Company's lending and trading activities. The stress tests shock market factors (e.g. interest rates, commodity prices, credit spreads), risk parameters (e.g. default probabilities and loss given default), in order to assess the impact of stresses on exposures, profit and loss, and the Company's capital position. Stress tests are conducted in accordance with established Company policies and procedures.

Credit Evaluation

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

In addition to assessing and monitoring its credit exposure and risk at the individual obligor level, the Company also reviews its credit exposure and risk to geographic regions. As at 31 December 2018, credit exposure was concentrated in Asian and Western European countries. In addition, the Company pays particular attention to smaller exposures in emerging markets given their unique risk profile. Sovereign ceiling ratings i.e. the maximum credit rating that can be assigned to a counterparty with a designated country of risk, are derived using methodologies generally consistent with those employed by external rating agencies.

The Company also reviews its credit exposure and risk to certain types of customers. At 31 December 2018, the Company's material credit exposure was to financial institutions.

MORGAN STANLEY PACIFIC SERVICES LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2018

15. FINANCIAL RISK MANAGEMENT (CONTINUED)

Credit risk (continued)

Risk Mitigation

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

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

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

- *Derivatives*

The Company may seek to mitigate credit risk from its derivatives transactions in multiple ways, including documentation, collateral provisions, guarantees and hedges. At the transaction level, the Company seeks to mitigate risk through management of key risk elements such as size, tenor, financial covenants, seniority and collateral. The Company actively hedges its derivatives exposure through various financial instruments that may include single-name, portfolio and structured credit derivatives. The Company may enter into master netting agreements and collateral arrangements with counterparties. These master netting agreements and collateral arrangements may 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 netting agreement in the event of counterparty default. 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.

MORGAN STANLEY PACIFIC SERVICES LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2018

15. FINANCIAL RISK MANAGEMENT (CONTINUED)

Credit risk (continued)

Risk Mitigation (continued)

Exposure to credit risk

The maximum exposure to credit risk ("gross credit exposure") of the Company as at 31 December 2018 is disclosed below, based on the carrying amounts of the financial assets and the maximum amount that the Company could have to pay in relation to unrecognised financial instruments, which the Company believes are subject to credit risk. Within the table financial instruments subject to accounting ECL are distinguished from those that are not. Those financial instruments that bear credit risk but are not subject to ECL are subsequently measured at fair value. Exposure arising from financial instruments not recognised on the statement of financial position is measured as the maximum amount that the Company could have to pay, which may be significantly greater than the amount that would be recognised as a liability. This table does not include receivables arising from pending securities transactions with market counterparties as credit risk is considered to be insignificant. 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 Company does not have any significant exposure arising from items not recognised on the balance sheet.

Trading financial assets are subject to traded credit risk through exposure to the issuer of the financial asset; the Company manages this issuer credit risk through its market risk management infrastructure.

MORGAN STANLEY PACIFIC SERVICES LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2018

15. FINANCIAL RISK MANAGEMENT (CONTINUED)

Credit risk (continued)

Exposure to credit risk by product

31 December 2018.

	Gross credit exposure (1)	Credit enhancements	Net credit exposure
	\$'000	\$'000	\$'000
Subject to ECL:			
Cash and short-term deposits	5,201	-	5,201
Trade and other receivables	116,636	-	116,636
Not subject to ECL⁽²⁾:			
Trading financial assets:			
Derivatives	138	(88)	50
	<u>121,975</u>	<u>(88)</u>	<u>121,887</u>

(1) The carrying amount recognised in the statement of financial position best represents the Company's maximum exposure to credit risk.

(2) Financial assets measured at FVPL are not subject to ECL.

Maximum exposure to credit risk for 2017 is presented below:

31 December 2017

	Gross credit exposure (1)	Credit enhancements	Net Credit exposure
	\$'000	\$'000	\$'000
Loans and receivables:			
Cash and short-term deposits	5,000	-	5,000
Trade receivables	25,875	-	25,875
Other receivables	21,664	-	21,664
Financial assets classified as held for trading:			
Derivatives	3,827	(3,803)	24
	<u>56,366</u>	<u>(3,803)</u>	<u>52,563</u>

(1) The carrying amount recognised in the statement of financial position best represents the Company's maximum exposure to credit risk.

MORGAN STANLEY PACIFIC SERVICES LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2018

15. FINANCIAL RISK MANAGEMENT (CONTINUED)

Credit risk (continued)

ECL Measurement

a Assessment of SICR

As explained in note 3(f), in order to assess whether an instrument is subject to a 12 month ECL or to a lifetime ECL, and therefore its appropriate staging, the Company determines whether there has been a SICR for the instrument since initial recognition.

When making this assessment, the Company considers both quantitative and qualitative information and analysis based on the Company's historical experience and expert credit risk assessment, including forward-looking information.

The PD is derived from internal credit rating grades (based on available information about the borrower) and multiple forward-looking macroeconomic scenarios which are probability weighted. Credit risk is considered to have increased significantly if the PD has significantly increased at the reporting date relative to the PD of the facility, at the date of initial recognition. The assessment of whether a change in PD is "significant" is based both on a consideration of the relative change in PD and on qualitative indicators of the credit risk of the facility, which indicate whether a loan is performing or in difficulty. In addition, as a backstop, the Company considers that SICR has occurred in all cases when an asset is more than 30 DPD.

b Calculation of ECL

ECL are calculated using three main components:

- PD: for accounting purposes, the 12 month and lifetime PD represent the expected point-in-time probability of a default over the next 12 months and over the remaining lifetime of the financial instrument respectively, based on conditions existing at the balance sheet date and future economic conditions.
- LGD: the LGD represents expected loss conditional on default, taking into account the mitigating effect of collateral, including the expected value of the collateral when realised and the time value of money.
- Estimated exposure at default ("EAD"): this represents the expected EAD, taking into account the expected repayment of principal and interest from the balance sheet date to the default event together with any expected drawdowns of the facility over that period.

These parameters are generally derived from internally developed statistical models, incorporating historical, current and forward-looking macro-economic data.

The 12-month ECL is equal to the sum over the next 12 months of quarterly PD multiplied by LGD and EAD, with such expected losses being discounted at the EIR. Lifetime ECL is calculated using the discounted present value of total quarterly PDs multiplied by LGD and EAD, over the full remaining life of the facility.

Incorporation of forward looking information

The Company uses internal macro-economic research and country risk expert judgement to support the calculation of ECL. The macro-economic scenarios are reviewed quarterly.

There have been no changes made to estimation techniques or significant assumptions for estimating impairment, during the year.

MORGAN STANLEY PACIFIC SERVICES LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2018

15. FINANCIAL RISK MANAGEMENT (CONTINUED)

Credit risk (continued)

Exposure to credit risk by internal rating grades

Internal credit ratings are derived using methodologies generally consistent with those used by external agencies.

a. Recognised and unrecognised financial instruments subject to ECL

The following table provides an analysis of the credit risk exposure by ECL stage per class of recognised and unrecognised financial instrument subject to ECL, based on the following internal credit rating grades:

Investment grade: internal grades AAA - BBB
 Non-investment grade: internal grades BB - CCC
 Default: internal grades D.

31 December 2018

	ECL staging		Total \$'000
	Stage 1 12-month ECL \$'000	Stage 2 Lifetime ECL \$'000	
	Cash and short-term deposits:		
Credit grade:			
Investment grade	5,201	-	5,201
Carrying amount	5,201	-	5,201
Trade and other receivables:			
Credit grade:			
Investment grade	116,636	-	116,636
Carrying amount	116,636	-	116,636

b. Recognised financial instruments not subject to ECL

At 31 December 2018 there were no financial assets past due but not impaired or individually impaired (2017: none).

MORGAN STANLEY PACIFIC SERVICES LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2018

15. FINANCIAL RISK MANAGEMENT (CONTINUED)

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 the market or idiosyncratic stress events that may cause unexpected changes in funding needs or an inability to raise new funding. Generally, the Company incurs liquidity risk as a result of its trading, lending, investing and client facilitation activities.

The Morgan Stanley Group's Liquidity Risk Management Framework is critical to helping ensure that the Company maintains sufficient liquidity reserves and durable funding sources to meet its daily obligations and to withstand unanticipated stress events. The Liquidity Risk Department is a distinct area in Risk Management, which oversees and monitors liquidity risk. The Liquidity Risk Department 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 the EMEA Assets/ Liability Management Committee ("ALCO") and EMEA Risk Committee as appropriate.

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

The Company's liquidity risk management policies and procedures are consistent with those of the Morgan Stanley Group.

The 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.

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

MORGAN STANLEY PACIFIC SERVICES LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2018

15. FINANCIAL RISK MANAGEMENT (CONTINUED)

Liquidity risk (continued)

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 Tests should anticipate, and account for, periods of limited access to funding.

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

Required Liquidity Framework

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

Liquidity Stress Tests

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

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 reserves that are subject to any regulatory, legal or tax constraints.

Liquidity Reserve

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

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, investor and region) and attempts to ensure that the tenor of its liabilities equals or exceeds the expected holding period of the assets being financed.

MORGAN STANLEY PACIFIC SERVICES LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2018

15. FINANCIAL RISK MANAGEMENT (CONTINUED)

Liquidity risk (continued)

Funding management (continued)

The Company funds itself through diverse sources. These sources may include the Company's equity capital, borrowings, securities lending and deposits. The Company has active financing programmes for both standard and structured products, targeting global investors and currencies.

Balance sheet management

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

Maturity analysis

In the following maturity analysis of financial liabilities, derivative contracts and other trading financial liabilities measured at fair value are presented at fair value, consistent with how these financial liabilities are managed, and disclosed as on demand. Derivatives not held as part of the Company's trading activities and financial liabilities designated at fair value through profit or loss which contain an embedded derivative are disclosed according to their earliest contractual maturity; all such amounts are presented at their fair value, consistent with how these financial liabilities are managed. All other amounts represent undiscounted cash flows payable by the Company arising from its financial liabilities to earliest contractual maturities as at 31 December 2018 and 31 December 2017. Repayments of financial liabilities that are subject to immediate notice are treated as if notice were given immediately and are classified as on demand. This presentation is considered by the Company to appropriately reflect the liquidity risk arising from those financial liabilities, presented in a way that is consistent with how the liquidity risk on these financial liabilities is managed by the Company.

	On demand	Equal to or more than 1 year but less than 5 years	Total
31 December 2018	\$'000	\$'000	\$'000
Financial liabilities			
Trading financial liabilities	33,747	-	33,747
Trade and other payables	2,340	65,542	67,882
Accruals and deferred income	17	-	17
Total financial liabilities	<u>36,104</u>	<u>65,542</u>	<u>101,646</u>

As at 31 December 2017, all of the Company's financial liabilities are considered as on demand.

Market risk

Market risk is defined by IFRS-7 'Financial instruments – Disclosures' ("IFRS 7") as the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices.

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

MORGAN STANLEY PACIFIC SERVICES LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2018

15. FINANCIAL RISK MANAGEMENT (CONTINUED)

Market risk (continued)

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 including monitoring Management Value-at-Risk ("VaR") and stress testing analyses, routinely reports risk summaries and maintains the VaR and scenario analysis methodologies. 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 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, currency risk and equity investments price risk.

Interest rate risk

Interest rate risk is defined by IFRS 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 derivatives classified as trading financial instruments partially offset by its loans at amortised cost. As at 31 December 2018 and 31 December 2017, the residual interest rate risk arising from these transactions is not material.

Equity investments price risk

The Company is exposed to equity price risk arising from its trading activities, which it actively manages by hedging with other Morgan Stanley Group undertakings. The residual risk for the Company from this activity is not material.

Currency risk

The Company has foreign currency exposure arising from its trading activities. It actively manages by hedging with other Morgan Stanley undertakings. The residual risk for the Company from its activity is not material.

MORGAN STANLEY PACIFIC SERVICES LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2018

16. ASSETS AND LIABILITIES MEASURED AT FAIR VALUE

As disclosed in note 2 Statement of Compliance, the Company is exempt from certain disclosure requirements of IFRS 13 'Fair value measurement' to the extent that they apply to assets and liabilities other than financial instruments. As such the disclosure included in this note relates only to financial instruments.

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.

2018

	Quoted prices in active market (Level 1) \$'000	Valuation techniques using observable inputs (Level 2) \$'000	Valuation techniques with significant unobservable inputs (Level 3) \$'000	Total \$'000
Trading financial assets:				
Derivatives	-	138	-	138
Total financial assets measured at fair value	-	138	-	138
Trading financial liabilities:				
Derivatives	-	33,747	-	33,747
Total financial liabilities measured at fair value	-	33,747	-	33,747

2017

	Quoted prices in active market (Level 1) \$'000	Valuation techniques using observable inputs (Level 2) \$'000	Valuation techniques with significant unobservable inputs (Level 3) \$'000	Total \$'000
Trading financial assets:				
Derivatives	-	3,827	-	3,827
Total financial assets measured at fair value	-	3,827	-	3,827
Trading financial liabilities:				
Derivatives	-	144	-	144
Total financial liabilities measured at fair value	-	144	-	144

MORGAN STANLEY PACIFIC SERVICES LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2018

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

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

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

Corporate Equities

Exchange-Traded Equity Securities

Fair value is generally determined based on quoted prices for the exchange. To the extent these securities are actively traded, valuation adjustments are not applied.

Derivative and Other Contracts

OTC Derivative Contracts

OTC derivative contracts include swap and option contracts related to equity prices and foreign currencies respectively.

Depending on the product and the terms of the transaction, the fair value of OTC derivative products can be either observed or modelled 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, certain option contracts and certain credit default swaps. In the case of more established derivative products, the pricing models used by the Company are widely accepted by the financial services industry.

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 material transfers between Level 1 and Level 2 of the fair value hierarchy during the current and prior year.

17. ASSETS AND LIABILITIES NOT MEASURED AT FAIR VALUE

As disclosed in note 2 Statement of Compliance, the Company is exempt from certain disclosure requirements of IFRS 13 'Fair value measurement' to the extent that they apply to assets and liabilities other than financial instruments. As such the disclosure included in this note relates only to financial instruments.

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.

MORGAN STANLEY PACIFIC SERVICES LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2018

18. 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's required capital ("Required Capital") estimation is based on the Required Capital Framework, an internal capital adequacy measure. This framework is a risk-based and leverage use-of-capital measure, which is compared with the Morgan Stanley Group's regulatory capital to ensure that the Morgan Stanley Group maintains an amount of going concern capital after absorbing potential losses from stress events where applicable, at a point in time. The Morgan Stanley Group defines the difference between its total average common equity and the sum of the average common equity amounts allocated to our business segments as Parent Company equity. The Morgan Stanley Group generally holds Parent Company equity for prospective regulatory requirements, organic growth, acquisitions and other capital needs.

The Required Capital Framework is expected to evolve over time in response to changes in the business and regulatory environment, for example, to incorporate changes in stress testing or enhancements in modelling techniques. The Morgan Stanley Group will continue to evaluate the framework with respect to the impact of future regulatory requirements, as appropriate.

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. In the future, the Morgan Stanley Group 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, sell assets to reduce debt.

The Company manages the following items as capital:

	2018	2017
	\$'000	\$'000
Ordinary share capital	-	-
Share premium	15,000	15,000
Reserves	5,329	5,618
	<u>20,329</u>	<u>20,618</u>

MORGAN STANLEY PACIFIC SERVICES LIMITED

NOTES TO THE FINANCIAL STATEMENTS

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19. RELATED PARTY DISCLOSURES

Parent and subsidiary relationships

Parent and ultimate controlling entity

The Company's immediate parent undertaking is Morgan Stanley International Holdings Inc., which 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.

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 has its registered office c/o The Corporation Trust Company, The Corporation Trust Center, 1209 Orange Street, Wilmington, DE 19801, United States of America and is incorporated in the state of Delaware in the United States of America. Copies of its financial statements can be obtained from www.morganstanley.com/investorrelations.

Key management compensation

Directors' remuneration

The Company has three directors in the period who are employed by another group company. The directors' services to the Company are considered to be incidental to their other responsibilities within the Morgan Stanley Group and as such, directors' remuneration is \$nil for the current year (2017: \$nil).