**Registered number: 05758075**

Registered office:
20 Bank Street
Canary Wharf
London
E14 4AD
United Kingdom

# EUROPEAN PRINCIPAL ASSETS LIMITED

**Report and financial statements**

**31 December 2018**

## EUROPEAN PRINCIPAL ASSETS LIMITED

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## EUROPEAN PRINCIPAL ASSETS LIMITED

## STRATEGIC REPORT

The Directors present their Strategic report for European Principal Assets Limited (the "Company") for the year ended 31 December 2018.

### PRINCIPAL ACTIVITY

The principal activity of the Company is to engage in financing transactions with other Morgan Stanley Group undertakings. 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.

The principal activity of the Company was previously the management of residential mortgage-backed debt, however, in December 2016, the Company disposed of its loan notes to a third party and in January 2017 it disposed of its remaining held for trading assets.

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".

### BUSINESS REVIEW

#### Overview of 2018

The Company's statement of comprehensive income for the year ended 31 December 2018 is set out on page 8. The Company made a loss after tax for the financial year of €528,000 compared with €883,000 in the prior year. Results in the prior year are impacted by the Company's former trading activities, which recognised a trading income of €173,000 and other expenses of €703,000 during 2017. Excluding the impact of its former trading activities, the Company generated post-tax losses of €528,000 in the current year compared with €353,000 in the prior year. Losses are primarily due to interest expense on a loan borrowing from another Morgan Stanley Group undertaking, which increased in the current year due to higher average proxy rates in 2018.

The statement of financial position as at 31 December 2018 is set out on page 10. The Company is reporting net assets of €2,097,000 compared with net liabilities of €30,375,000 as at 31 December 2017. The Company received a capital contribution of €33,000,000 from its immediate parent undertaking and repaid its entire loan borrowings in December 2018. Total liabilities have decreased by €31,604,000 to €1,000 comprised of other payables whereas total assets have increased by €868,000 to €2,098,000 following the capital contribution and recognition of 2018 losses.

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

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.

#### Risk management

The Company leverages the risk management policies and procedures of the Morgan Stanley Group. The Company also manages the risk of potential impact on its business (including but not limited to the impact of the United Kingdom's ("UK") decision to leave the European Union (the "EU")) by maintaining a constant planning dialogue with the wider Morgan Stanley Group.

The Directors consider that the Company's key financial risks are credit risk, primarily its concentration of exposure to other Morgan Stanley Group undertakings and liquidity risk arising primarily through its exposure to other Morgan Stanley Group undertakings presented within other receivables and payables, loans and advances and debt and other borrowings. The Company leverages the Morgan Stanley Group's credit and liquidity risk frameworks to identify measure, monitor and control credit risk and to ensure that the Company has access to adequate funding.

## STRATEGIC REPORT

### BUSINESS REVIEW (CONTINUED)

**Risk management (continued)**

The Company also has some limited exposure to market, operational and legal, regulatory and compliance risks.

*Market risk*
Market risk refers to the risk that a change in interest rates or other market factors, such as exchange rate movements, will result in losses.

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.

*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".

*Legal, regulatory and compliance risk*
Legal, regulatory and compliance risk includes the risk of 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.

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.

More detailed qualitative and quantitative disclosures about the Company's management of and exposure to financial risks are included in note 16 to the financial statements.

**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 RUSSELL DAY

27 SEPTEMBER 2019

Director

## 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 18) for the Company for the year ended 31 December 2018.

### RESULTS AND DIVIDENDS

The loss for the year, after tax, was €528,000 (2017: €883,000).

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 (except where otherwise shown):

R Day
M J DeFilippo
N.P Whyte

### 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 and 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.

## EUROPEAN PRINCIPAL ASSETS LIMITED

## DIRECTORS' REPORT

### *DIRECTORS' RESPONSIBILITIES STATEMENT*

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

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

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

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

Approved by the Board and signed on its behalf by RUSSELL DAY

27 SEPTEMBER 2019

Director

## INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF EUROPEAN PRINCIPAL ASSETS LIMITED

**Report on the audit of the financial statements**

**Opinion**

In our opinion the financial statements of European Principal Assets 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 18.

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 (the "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.

## INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF EUROPEAN PRINCIPAL ASSETS LIMITED (CONTINUED)

**Other information**

The Directors are responsible for the other information. The other information comprises the information included in the annual report, other than the financial statements and our auditor's report thereon. Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

We have nothing to report in respect of these matters.

**Responsibilities of Directors**

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

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

**Auditor's responsibilities for the audit of the financial statements**

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

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

**Report on other legal and regulatory requirements**

**Opinions on other matters prescribed by the Companies Act 2006**

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

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

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

## INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF EUROPEAN PRINCIPAL ASSETS LIMITED (CONTINUED)

**Matters on which we are required to report by exception**

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

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

We have nothing to report in respect of these matters.

**Use of our report**

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

P Cowley

Paul Cowley, C.A. (Senior Statutory Auditor)
for and on behalf of Deloitte LLP
Statutory Auditor
Glasgow, United Kingdom
Date 27 September 2019

## EUROPEAN PRINCIPAL ASSETS LIMITED

## STATEMENT OF COMPREHENSIVE INCOME
**Year ended 31 December 2018**

| | Note | 2018 €'000 | 2017 €'000 |
|---|---|---|---|
| Trading income | | - | 173 |
| Interest income | 4 | 9 | 81 |
| Interest expense | 4 | (479) | (425) |
| Other income | 5 | - | 20 |
| Other expense | 6 | (58) | (732) |
| **LOSS BEFORE TAXATION** | | (528) | (883) |
| Income tax expense | 7 | - | - |
| **LOSS AND TOTAL COMPREHENSIVE INCOME FOR THE YEAR** | | (528) | (883) |

All operations were continuing in the current and prior year.

The notes on pages 11 to 25 form an integral part of the financial statements.

EUROPEAN PRINCIPAL ASSETS LIMITED

## STATEMENT OF CHANGES IN EQUITY
**Year ended 31 December 2018**

| | Share capital €'000 | Capital contribution reserve €'000 | Retained losses €'000 | Total equity €'000 |
|---|---|---|---|---|
| **Balance at 1 January 2017** | 182,484 | 359,000 | (570,976) | (29,492) |
| Loss and total comprehensive income for the year | - | - | (883) | (883) |
| **Balance at 31 December 2017** | 182,484 | 359,000 | (571,859) | (30,375) |
| Capital contribution | - | 33,000 | - | 33,000 |
| Loss and total comprehensive income for the year | - | - | (528) | (528) |
| **Balance at 31 December 2018** | 182,484 | 392,000 | (572,387) | 2,097 |

The notes on pages 11 to 25 form an integral part of the financial statements.

**EUROPEAN PRINCIPAL ASSETS LIMITED**
*Registered number: 05758075*

## STATEMENT OF FINANCIAL POSITION
## As at 31 December 2018

| | Note | 2018 €'000 | 2017 €000 |
|---|---|---|---|
| **ASSETS** | | | |
| Cash and short-term deposits | | 465 | 148 |
| Loans and advances | 8 | 543 | - |
| Other receivables | 9 | 1,090 | 1,082 |
| **TOTAL ASSETS** | | 2,098 | 1,230 |
| | | | |
| **LIABILITIES AND EQUITY** | | | |
| Other payables | 10 | 1 | 18 |
| Debt and other borrowings | 11 | - | 31,587 |
| **TOTAL LIABILITIES** | | 1 | 31,605 |
| | | | |
| **EQUITY** | | | |
| Share capital | 13 | 182,484 | 182,484 |
| Capital contribution reserve | 13 | 392,000 | 359,000 |
| Retained losses | | (572,387) | (571,859) |
| **Equity attributable to owners of the Company** | | 2,097 | (30,375) |
| | | | |
| **TOTAL EQUITY** | | 2,097 | (30,375) |
| | | | |
| **TOTAL LIABILITIES AND EQUITY** | | 2,098 | 1,230 |

These financial statements were approved by the Board and authorised for issue on 27 SEPTEMBER 2019

Signed on behalf of the Board

RUSSELL DAY

Director

The notes on pages 11 to 25 form an integral part of the financial statements.

## EUROPEAN PRINCIPAL ASSETS LIMITED

## NOTES TO THE FINANCIAL STATEMENTS
**Year ended 31 December 2018**

### 1. CORPORATE INFORMATION

The Company is incorporated and domiciled in England and Wales, United Kingdom, at the following registered address: 20 Bank Street, Canary Wharf, London, E14 4AD United Kingdom. The Company is a private company and is limited by shares. The registered number of the Company is 05758075.

The Company's immediate parent undertaking is Morgan Stanley International Holdings Inc., which has its registered office c/o The Corporation Trust Company, 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.

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

### 2. BASIS OF PREPARATION

**Statement of compliance**

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

The Company meets the definition of a qualifying entity and is a Financial Institution as defined in FRS 100 *Application of Financial Reporting Requirements*. The Company has taken advantage of the disclosure exemptions available under FRS 101 in relation to fair value measurement (as applicable to assets and liabilities other than financial instruments), presentation of comparative information in respect of shares outstanding, presentation of a cash-flow statement, accounting standards not yet effective and related party transactions.

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

**New standards and interpretations adopted during the year**

The following standards and amendments to standards relevant to the Company's operations were adopted during the year. Except where otherwise stated, these standards and amendments to standards 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. However, the Company has updated the presentation of its primary statements on transition to IFRS 9 to provide more relevant information to users of the financial statements. Impairment of financial assets is based on expected credit losses ("ECL") and the effect on opening reserves was €nil.

## 2. BASIS OF PREPARATION (CONTINUED)

**New standards and interpretations adopted during the year (continued)**

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

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

**Basis of measurement**

The financial statements of the Company are prepared under the historical cost basis; except for certain financial instruments that have been measured at fair value as explained in the accounting policies below, and in accordance with applicable UK Accounting Standards, including FRS 101, and UK company law.

**Critical judgements in applying the Company's accounting policies**

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

**The going concern assumption**

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

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 Euro, 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 Euro.

### b. Foreign currencies

All monetary assets and liabilities denominated in currencies other than Euro are translated into Euro at the rates ruling at the reporting date. Transactions denominated in currencies other than Euro 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 income' or 'Other expense', except where noted in 3(c) below.

## 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

### c. Financial instruments

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

**Trading financial instruments (applicable prior to 1 January 2018)**

Trading financial instruments include government debt securities and loan notes, where the Company acquires the financial asset for the purpose of selling in the near term or is part of a portfolio for which there is evidence of short term profit taking.

With the exception of loans, trading financial instruments, 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'.

For loans classified as trading, from the date a loan's terms are agreed (trade date), until the loan is funded (settlement date), the Company recognises any unrealised fair value changes in the loan as trading financial instruments. On settlement date, the fair value of consideration given is recognised as a trading financial asset.

**ii) Financial assets and financial liabilities at amortised cost**

Financial assets and liabilities at amortised cost primarily comprise of loans and advances/ debt and other borrowings and other receivables/ payables.

Loans and advances/ debt and other borrowings and other receivables/ payables are recognised when the Company becomes a party to the contractual provisions of the instrument and are initially measured at fair value and subsequently measured at amortised cost (less allowance for impairment on financial assets). Interest is recognised in the statement of comprehensive income using the effective interest rate ("EIR") method.

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

### 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.

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.

## 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

### d. Fair value (continued)

*Fair value measurement (continued)*

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

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

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

- Level 2 – Valuation techniques using observable inputs

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

- Level 3 – Valuation techniques with significant unobservable inputs

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

*Valuation techniques*

Many cash instruments 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.

Fair value for many financial instruments 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.

*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.

## 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

### e. Modification and derecognition of financial assets and liabilities

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

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

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

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

### f. Impairment of financial instruments

From 1 January 2018, the Company recognises loss allowances for expected credit losses ("ECL") for its financial assets classified at amortised cost. ECLs are the present value of cash shortfalls over the expected life of the financial instrument, discounted at the asset's EIR. ECL is recognised in the statement of comprehensive income within 'Net impairment loss on financial instruments' and is reflected against the carrying amount of the impaired asset on the statement of financial position as an ECL allowance. Until 31 December 2017, impairment losses on financial assets were measured as the difference between the carrying amount and the present value of estimated cash flows discounted at the asset's original EIR.

### g. Cash and cash equivalents

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

### 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 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 income statement, except when it relates to items charged or credited directly to other comprehensive income or equity, in which case the current tax is also recorded within other comprehensive income or equity respectively.

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.

### i. Offsetting of financial assets and financial liabilities

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

## 4. INTEREST INCOME AND INTEREST EXPENSE

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

## 5. OTHER INCOME

| | 2018 €'000 | 2017 €'000 |
|---|---|---|
| Net foreign exchange gains | - | 15 |
| Other | - | 5 |
| | - | 20 |

## 6. OTHER EXPENSE

| | 2018 €'000 | 2017 €'000 |
|---|---|---|
| Auditor's remuneration: | | |
| Fees payable to the Company's auditor for the audit of the Company's annual financial statements | - | 16 |
| Net foreign exchange losses | 58 | - |
| Other | - | 716 |
| | 58 | 732 |

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

Audit fees of €15,000 have been borne by another Morgan Stanley Group undertaking in current year.

The Company's three Directors in the year are employed by other Morgan Stanley Group entities. 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).

In the prior year, other expenses included a write-off of €703,000 in respect of amounts receivable deemed unrecoverable.

## 7. INCOME TAX EXPENSE

**Analysis of expense in the year**

| | 2018 €'000 | 2017 €'000 |
|---|---|---|
| **Current tax expense** | | |
| UK corporation tax at 19.00% (2017: 19.25%) | | |
| - Current year | - | - |
| **Income tax expense** | - | - |

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

**Reconciliation of effective tax rate**

The current year income tax expense is higher (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 before taxation | (528) | (883) |
| Income tax using the average standard rate of corporation tax in the UK of 19.00% (2017: 19.25%) | (100) | (170) |
| Impact on tax of: | | |
| Expenses not deductible for tax purposes | - | 144 |
| Group relief surrendered for no cash consideration | 100 | 26 |
| **Total income tax expense in the statement of comprehensive income** | - | - |

## 8. LOANS AND ADVANCES

| | 2018 €'000 | 2017 €'000 |
|---|---|---|
| Amounts due from another Morgan Stanley Group undertaking | 543 | - |

## 9. OTHER RECEIVABLES

| | 2018 €'000 | 2017 €'000 |
|---|---|---|
| Amounts due from other Morgan Stanley Group undertakings | 1,006 | 998 |
| Other amounts receivable | 84 | 84 |
| | 1,090 | 1,082 |

## 10. OTHER PAYABLES

| | 2018 €'000 | 2017 €'000 |
|---|---|---|
| Amounts due to other Morgan Stanley Group undertakings | 1 | 18 |

## 11. DEBT AND OTHER BORROWINGS

| | 2018 €'000 | 2017 €'000 |
|---|---|---|
| Amounts due to another Morgan Stanley Group undertaking | - | 31,587 |

## 12. PROVISIONS

| | Litigation €'000 |
|---|---|
| At 1 January 2017 | 1,487 |
| Provisions utilised | (1,487) |
| **At 31 December 2017** | - |

Provisions balance as at 31 December 2018 is € nil.

**Litigation matters**

On 31 December 2013, the Company disposed of its investment in Fonspa. The Company has received from the purchasers of Fonspa notice of a number of potential claims for breaches of warranty under the relevant share purchase agreement in relation to customer claims arising from Fonspa's lending activities. The final date for receipt of warranty claims in relation to the sale of Fonspa was 31 October 2015. In November 2017 the Company settled this dispute in line with the amount provided at 31 December 2016.

## 13. EQUITY

| | Ordinary shares of €1 each Number | Ordinary shares of €1 each €'000 | Ordinary shares of $1 each Number | Ordinary shares of $1 each €'000 | Total ordinary shares €'000 |
|---|---|---|---|---|---|
| **Allotted and fully paid** | | | | | |
| At 1 January 2018 and 31 December 2018 | 36,958,577 | 36,959 | 193,000,000 | 145,525 | 182,484 |

All ordinary shares are recorded at the rates of exchange ruling at the date the shares were paid up.

**Reserves**

*Capital contribution reserve*

On 12 December 2018, the Company received a further capital contribution of €33,000,000 from its immediate parent, Morgan Stanley International Holdings Inc. taking the total of the 'Capital contribution reserve' to €392,000,000 (2017: €359,000,000).

## 14. EXPECTED MATURITY OF ASSETS AND LIABILITIES

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

| At 31 December 2018 | Less than or equal to twelve months €'000 | More than twelve months €'000 | Total €'000 |
|---|---|---|---|
| **ASSETS** | | | |
| Cash and short-term deposits | 465 | - | 465 |
| Loans and receivables | - | 543 | 543 |
| Other receivables | 1,090 | - | 1,090 |
| | 1,555 | 543 | 2,098 |
| **LIABILITIES** | | | |
| Other payables | 1 | - | 1 |
| | 1 | - | 1 |

## 14. EXPECTED MATURITY OF ASSETS AND LIABILITIES (CONTINUED)

**At 31 December 2017**

| | Less than or equal to twelve months €'000 | More than twelve months €'000 | Total €'000 |
|---|---|---|---|
| **ASSETS** | | | |
| Cash and short-term deposits | 148 | - | 148 |
| Other receivables | 1,082 | - | 1,082 |
| | 1,230 | - | 1,230 |
| **LIABILITIES** | | | |
| Other payables | 18 | - | 18 |
| Debt and other borrowings | - | 31,587 | 31,587 |
| | 18 | 31,587 | 31,605 |

## 15. SEGMENT REPORTING

The Company has only one class of business as described in the Strategic Report and operates in one geographic market, Europe, Middle East and Africa ("EMEA").

## 16. FINANCIAL RISK MANAGEMENT

**Risk management procedures**

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 is consistent with and leverages the risk management policies and procedures of the Morgan Stanley Group and which include escalation to appropriate senior management personnel of the Company.

Risks faced by the Company resulting from its financing activities are set out below.

**Credit risk**

Credit risk refers to the risk of loss arising when a borrower, counterparty or issuer does not meet its financial obligations to the Company. The Company primarily incurs credit risk exposure to institutions through its Institutional Securities business segment.

**Credit risk management**

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.

## 16. FINANCIAL RISK MANAGEMENT (CONTINUED)

**Credit risk management (continued)**

The Company enters into the majority of its financial asset transactions with other Morgan Stanley Group undertakings, and both the Company and the other Morgan Stanley Group undertakings are wholly-owned subsidiaries of the same ultimate parent entity, Morgan Stanley. As a result of the implicit support that would be provided by Morgan Stanley, the Company is considered exposed to the credit risk of Morgan Stanley, except where the Company transacts with other Morgan Stanley Group undertakings that have a higher credit rating to that of Morgan Stanley.

**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 the Company believes are subject to credit risk. Within the table financial instruments subject to accounting ECL are distinguished from those that are not.

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

The Company does not hold financial assets considered to be credit-impaired.

**Exposure to credit risk by class**

| | Gross credit exposure [1] | |
|---|---|---|
| | **2018** | **2017** |
| | **€'000** | **€'000** |
| **Subject to ECL:** | | |
| Cash and short-term deposits | 465 | 148 |
| Loans and advances | 543 | - |
| Other receivables | 1,090 | 1,082 |
| | 2,098 | 1,230 |

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

The Company has not entered into any credit enhancements therefore gross credit exposure reflected in the above table is also the net credit exposure.

**Expected credit loss measurement**

At 31 December 2018, the Company has determined that the ECL for its financial instruments is not material, reflecting their short term nature and/ or the benefit of other credit mitigants.

**Exposure to credit risk by internal rating grades**

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

The following table provides an analysis of the credit risk exposure of 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

## 16. FINANCIAL RISK MANAGEMENT (CONTINUED)

**Exposure to credit risk by internal rating grades (continued)**

**31 December 2018**

| | €'000 |
|---|---|
| **Cash and short-term deposits:** | |
| **Credit grade** | |
| Investment grade | 352 |
| Non-investment grade | 113 |
| | 465 |
| **Loans and advances:** | |
| **Credit grade** | |
| Investment grade | 543 |
| | 543 |
| **Other receivables:** | |
| **Credit grade** | |
| Investment grade | 1,006 |
| Unrated | 84 |
| | 1,090 |
| **Gross carrying amount** | 2,098 |

**Liquidity risk**

Liquidity risk refers to the risk that the Company will be unable to finance its operations in a timely manner due to 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 negatively affect the Company's liquidity.

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 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.

The Required Liquidity Framework establishes the amount of liquidity the Morgan Stanley Group 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.

## 16. FINANCIAL RISK MANAGEMENT (CONTINUED)

**Liquidity risk (continued)**

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

The Company is not considered a major operating subsidiary for the purposes of liquidity risk. However, the Company would have access to cash or liquidity reserves held by Morgan Stanley in the unlikely event they were unable to access adequate financing to service their financial liabilities when they become payable.

*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 Institutional Securities business provides the Morgan Stanley Group and the Company with flexibility in managing the size of its balance sheet.

*Maturity analysis*

In the following maturity analysis of financial assets and financial liabilities, all amounts represent undiscounted cash flows receivable and payable by the Company arising from its financial assets and financial liabilities to earliest contractual maturities as at 31 December 2018 and 31 December 2017. Receipts of financial assets and repayments of financial liabilities that are subject to immediate notice are treated as if notice were given immediately and are classified as on demand. This presentation is considered by the Company to appropriately reflect the liquidity risk arising from these financial assets and financial liabilities, presented in a way that is consistent with how the liquidity risk on these financial assets and financial liabilities is managed by the Company.

| 31 December 2018 | On demand €'000 | Equal to or more than 1 year but less than 5 years €'000 | Total €'000 |
|---|---|---|---|
| **Financial assets** | | | |
| Cash and short-term deposits | 465 | - | 465 |
| Loans and receivables | - | 543 | 543 |
| Other receivables | 1,090 | - | 1,090 |
| **Total financial assets** | 1,555 | 543 | 2,098 |
| **Financial liabilities** | | | |
| Other payables | 1 | - | 1 |
| **Total financial liabilities** | 1 | - | 1 |

## 16. FINANCIAL RISK MANAGEMENT (CONTINUED)

**Liquidity risk (continued)**

| 31 December 2017 | On demand €'000 | Equal to or more than 1 year but less than 5 years €'000 | Total €'000 |
|---|---|---|---|
| **Financial assets** | | | |
| Cash and short-term deposits | 148 | - | 148 |
| Other receivables | 1,082 | - | 1,082 |
| **Total financial assets** | 1,230 | - | 1,230 |
| **Financial liabilities** | | | |
| Other payables | 18 | 31,587 | 31,605 |
| **Total financial liabilities** | 18 | 31,587 | 31,605 |

### 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 is primarily exposed to interest rate risk and currency risk under this definition.

*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 changes in the future cash flows of floating rate intercompany borrowing. As at 31 December 2018 and 31 December 2017, the interest rate risk arising from changes in rates is not considered material.

*Currency risk*

The Company has foreign currency exposure on its assets and liabilities in currencies other than the Euro, which it actively manages by hedging with other Morgan Stanley Group undertakings. As at 31 December 2018 and 31 December 2017, the residual currency risk is not considered material.

## 17. ASSETS AND LIABILITIES NOT MEASURED AT FAIR VALUE

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

## 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 common 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 and, therefore, in the future may expand or contract its capital base to address the changing needs of its businesses.

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

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

The Company manages the following items as capital:-

| | 2018<br>€'000 | 2017<br>€'000 |
|---|---|---|
| Ordinary share capital | 182,484 | 182,484 |
| Reserves | (180,387) | (212,859) |
| | 2,097 | (30,375) |