

MORGAN STANLEY ASIA PRODUCTS LIMITED

Report and financial statements

31 December 2019

MORGAN STANLEY ASIA PRODUCTS LIMITED

REPORT AND FINANCIAL STATEMENTS

Year ended 31 December 2019

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MORGAN STANLEY ASIA PRODUCTS LIMITED

DIRECTORS' REPORT

The Directors present their report, responsibility statement and financial statements (which comprise the statement of comprehensive income, statement of changes in equity, statement of financial position, statement of cash flows and the related notes, 1 to 17) of Morgan Stanley Asia Products Limited (the "Company") for the year ended 31 December 2019.

RESULTS AND DIVIDENDS

The result for the year, after tax, was US\$Nil (2018: US\$Nil).

During the year, no dividends were paid or proposed (2018: US\$Nil).

PRINCIPAL ACTIVITY

The principal activity of the Company is the issuance of financial instruments, with a primary focus on the Asia markets, and the hedging of the obligations arising pursuant to such issuances.

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

Global market and economic conditions

Global economic growth slowed to 3.0%Y in 2019 from 3.7%Y in 2018. The slowdown was broad-based across both developed and emerging markets, with growth in developed markets slowing to 1.7%Y in 2019 from 2.1%Y in 2018, while in emerging markets, growth softened to 3.9%Y in 2019 from 4.8%Y in 2018. Trade tensions weighed heavily on global growth through the year via its impact on corporate sentiment and capital spending, as well as on the manufacturing and trade sectors, although there were some signs that trade and manufacturing were beginning to recover in 4Q19, helped by an easing in both trade tensions and policy. Over the course of the year, both monetary and fiscal policies were eased. In particular, the Federal Reserve cut interest rates by 75bps in the second half of the year and resumed an expansion of its balance sheet in response to tightening liquidity conditions. The ECB announced a series of easing measures in the second half of the year, cutting rates by 10bps, introducing a two-tier system for excess reserve holdings, and restarting QE. The BOE held rates unchanged against a backdrop of weak global growth and Brexit uncertainties. China's policymakers implemented both fiscal and monetary easing measures throughout the year, including government bond issuance and interest rate reform. In India, growth continued to slow in a fairly broad-based manner, and policy makers responded by cutting corporate taxes and reducing interest rates by 135bps. In Hong Kong, GDP contracted for the full year, as growth in 2H19 was weighed down by the impact of the protests. Other major central banks, including CBR, BCB and BoK, also cut interest rates to multi-year lows.

Subsequent to the year end, the emergence of COVID 19 (coronavirus) has created economic and financial disruptions in the global economy which has led to operational challenges that could impair many industries' ability to manage or conduct some of its businesses around the world. Additionally, the financial effects of the outbreak have a high degree of uncertainty, given that they are dependent on external factors such as the spread of the virus and the measures taken by the various governments and central banks, and have resulted in significant volatility observed in the global marketplace.

UK Referendum

It is difficult to predict the future of the United Kingdom's (the "U.K.") relationship with the European Union (the "E.U."), the uncertainty of which may increase the volatility in the global financial markets in the short- and medium-term and may negatively disrupt regional and global financial markets. Additionally, depending on the outcome, such uncertainty may adversely affect the manner in which we operate certain of our businesses in Europe.

MORGAN STANLEY ASIA PRODUCTS LIMITED

DIRECTORS' REPORT (CONTINUED)

On January 31, 2020, the U.K. withdrew from the E.U. under the terms of a withdrawal agreement between the U.K. and the E.U. The withdrawal agreement provides for a transition period to the end of December 2020, during which time the U.K. will continue to apply E.U. law as if it were a member state, and U.K. firms' passporting rights to provide financial services in E.U. jurisdictions will continue. Under the terms of the withdrawal agreement the U.K. and the E.U. may agree to an extension of the transition period for up to two years, although the U.K. Government has signaled that it will not seek any extension.

With respect to financial services, the withdrawal agreement provides that the U.K. and the E.U. will endeavor to conclude by June 2020 whether they will grant each other equivalence under European financial regulations. Equivalence would provide a degree of access to E.U. markets for U.K. financial firms, although the extent and duration of such access remains subject to negotiation.

If equivalence (or any alternative arrangement) is not agreed, our U.K. licensed entities may be unable to provide regulated services in a number of E.U. jurisdictions from the end of December 2020, absent further regulatory relief.

Potential effects of the U.K. exit from the E.U. and potential mitigation actions may vary considerably depending on the nature of the future trading arrangements between the U.K. and the E.U.

While the Morgan Stanley Group has taken steps to make changes to its European operations in an effort to ensure that it can continue to provide cross-border banking and investment and other services in E.U. member states without the need for separate regulatory authorizations in each member state, as a result of the political uncertainty described above, it is currently unclear what the final post-Brexit structure of its European operations will be. Given the potential negative disruption to regional and global financial markets, and depending on the extent to which it may be required to make material changes to its European operations beyond those implemented or planned, its results of operations and business prospects could be negatively affected.

Overview of 2019

The statement of comprehensive income for the year is set out on page 16. The result for the year was US\$Nil which is consistent with the Company's function and the prior year. The Company hedges its issuances with derivatives classified as trading financial instruments, loans designated at fair value through profit or loss and prepaid equity securities contracts. Net gains/ (losses) on trading financial liabilities and other financial liabilities held at fair value represent fair value movements on the issued warrants and structured notes. Issued warrants, which contribute to a major population of the Company's issuance, have underlying securities predominantly in the Hong Kong, China and India markets. During the year ended 31 December 2019, the change in the value of underlying securities due to the market movements primarily in these regions, resulted in a loss of US\$47,061,000 on trading financial liabilities and other financial liabilities held at fair value (2018: gain of US\$969,705,000). As a result of the Company's hedging strategy, a corresponding gain (2018: loss) was recognised on trading and other financial assets held at fair value, which mainly represents the fair value movement on derivative contracts and prepaid equity securities contracts.

The statement of financial position for the Company is set out on page 18. The Company's financial position at the end of the year shows that the total assets and total liabilities were US\$297,971,000 and US\$297,921,000 respectively, an increase of 3% each from the prior year. The increase during the year is primarily due to Company's portfolio expansion into the Hong Kong market.

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DIRECTORS' REPORT (CONTINUED)

Risk management

Risk is an inherent part of both Morgan Stanley and the Company's business activity and is managed by the Company within the context of the broader Morgan Stanley Group. The Morgan Stanley Group 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's own risk management policies and procedures are consistent with those of the Morgan Stanley Group. The risk management policy framework includes escalation to appropriate senior management of the Company.

Set out below is an overview of the Company's policies for the management of financial risk and other significant business risks. Note 12 to the financial statements provides more detailed quantitative disclosures as well as qualitative information on the Company's financial risk management.

During 2019, the Company redeemed warrants valuing US\$433,462,000 (2018: US\$2,450,570,000) and also issued new warrants of US\$391,639,000 (2018: US\$264,168,000). The redemptions were mainly driven by retirement and maturity of the warrants. However, the Company had sufficient financial assets in the form of prepaid equity securities contracts, redeeming at the same time to meet the redemption obligations of the issued warrants. Further, all issuances of financial liabilities are guaranteed by Morgan Stanley.

The Company has also entered into a financial support agreement with its immediate parent, Morgan Stanley Asia Securities Products LLC ("MSASP") and with Morgan Stanley Hong Kong 1238 Limited ("MSHK 1238"), whereby MSASP and MSHK 1238 agree to provide financial support by way of funds injection in the form of equity capital or shareholders loan in the event the Company needs funds to fulfil its obligations and liabilities under its issuance program.

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 is subject to market price risk exposure for its issuances, however, for each issuance, the Company enters into risk-mirroring contracts to fully hedge each type of market risk arising from its issuances. Accordingly, the Company has no net exposure to market risk.

The Morgan Stanley Group manages the market risk associated with its trading activities on a global basis, at both a trading division and an individual product level, which includes consideration of market risk for each individual legal entity.

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

It is the policy and objective of the Company not to be exposed to market risk on a net basis as a result of its issuance activities.

Credit risk

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

Credit risk exposure is managed on a global basis. 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.

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.

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DIRECTORS' REPORT (CONTINUED)

The primary goal of the Morgan Stanley Group's liquidity risk management framework is to ensure that the Morgan Stanley Group, including the Company, have 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 12.

The Company hedges all of its financial liabilities with financial assets entered into, with its immediate parent, other Morgan Stanley Group undertakings and other financial assets.

The maturity analysis provided in note 10 reflects the liquidity risk arising from the financial assets and the 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. As at 2019, the Company had a payable of US\$283,603,000 (2018: US\$231,389,000) within less than one year from the date of the financial statements. As a result of the Company's hedging strategy, the Company has adequate financial assets to meet the settlement of this obligation. As at 2019, the Company had financial assets of US\$289,168,000 (2018: US\$231,439,000) expected to be maturing within a year from the date of the financial statements.

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".

The Company, through the Morgan Stanley Group, has established an operational risk framework to identify, measure, monitor and control risk. It includes escalation to the Company's Board of Directors and appropriate senior management personnel. The Morgan Stanley Group employs a variety of risk processes and mitigates to manage its operational risk exposures. These include a governance framework, a comprehensive risk management programme 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 defenses against cyberattacks; use of legal agreements and contracts to transfer and/or limit operational risk exposures; due diligence; implementation of enhanced policies and procedures; exception management processing controls; and segregation of duties.

The Operational Risk Department provides independent oversight of operational risk 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 Morgan Stanley Group. The Operational Risk Department scope includes oversight of the technology risk, cybersecurity risk, information security risk and data risk management programme (e.g. cybersecurity), fraud risk management and prevention programme and third party risk management (supplier and affiliate 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 Morgan Stanley Group'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

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DIRECTORS' REPORT (CONTINUED)

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 Morgan Stanley Group 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 Morgan Stanley Group's information asset 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.

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 the Company's 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, 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 Morgan Stanley Group's policies relating to business conduct, ethics and practices are followed globally.

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 (the "Code") 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 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 require 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.

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DIRECTORS' REPORT (CONTINUED)

DIRECTORS

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

Adrian Priddis

Christopher Blackman (Resigned 3 March 2020)

Jason Yates

Young Lee

Richard Smerin (Appointed 3 April 2019)

Scott Honey (Appointed 3 April 2019)

EVENTS AFTER THE REPORTING DATE

The emergence of COVID 19 (coronavirus) has created economic and financial disruptions in the global economy which has led to operational challenges that could impair Morgan Stanley's ability to manage or conduct some of its businesses around the world. In line with many national and local guidelines, Morgan Stanley has required nearly all staff to work from home and business travel is severely restricted, however Morgan Stanley remains open for business.

Given the disruptions in the financial markets, Morgan Stanley and the Company are closely tracking their operational capacity. Additionally, the financial effects of the outbreak have a high degree of uncertainty, given that they are dependent on external factors such as the spread of the virus and the measures taken by the various governments and central banks. Morgan Stanley and the Company have already observed significant volatility in the global marketplace which could have an impact on their financial results and financial position in the future. Morgan Stanley and the Company continue to use their Risk Management framework including stress testing to understand the attendant uncertainties and their potential impact on our operations, liquidity and capital. Morgan Stanley is maintaining an active dialogue with all its relevant global regulators during this period.

This is a non-adjusting event as the significant changes in the business activities and economic conditions occurred as a result of events occurring after the reporting date.

The Company's capital and liquidity is deemed sufficient to deal with both a normal and in a stressed market environment, including the current and potential stresses of COVID 19 (coronavirus) for the foreseeable future. The impact of the economic and financial disruption due to the emergence of COVID 19 has been considered as part of the going concern analysis, including impact on the operational capacity of the business, access to liquidity and capital, contractual obligations, asset valuations and other critical accounting judgements and key sources of estimation uncertainty. The Company has access to further Morgan Stanley Group capital and liquidity as required. Morgan Stanley continues to have significant liquidity and is in a position to support the Company.

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 and over a period of at least 12 months from the date of the approval of the financial statements. Accordingly, they continue to adopt the going concern basis in preparing the annual report and financial statements.

MORGAN STANLEY ASIA PRODUCTS LIMITED

DIRECTORS' REPORT (CONTINUED)

AUDITOR

Deloitte LLP, London, have expressed their willingness to continue in office as auditor of the Company and a resolution to re-appoint them will be proposed at the forthcoming annual general meeting.

Approved by the Board and signed on its behalf

A handwritten signature in black ink, consisting of several fluid, overlapping strokes, positioned above a horizontal line.

Director

Date 22 APR 2020

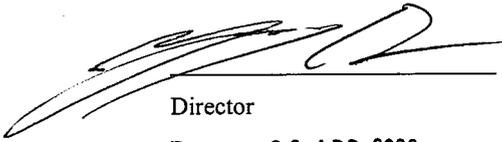
MORGAN STANLEY ASIA PRODUCTS LIMITED

DIRECTORS' RESPONSIBILITY STATEMENT

The Directors, the names of whom are set out above, confirm that to the best of their knowledge:

- (a) the financial statements, which have been prepared in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board, have been prepared in accordance with the applicable set of accounting standards and give a true and fair view of the assets, liabilities, financial position and result of the Company; and
- (b) the Directors' report includes a fair review of the development and performance of the business and position of the Company, together with a description of the principal risks and uncertainties that the Company faces.

Approved by the Board and signed on its behalf on



Director

Date: 22 APR 2020

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF MORGAN STANLEY ASIA PRODUCTS LIMITED

REPORT ON THE AUDIT OF THE FINANCIAL STATEMENTS

Opinion

In our opinion the financial statements of Morgan Stanley Asia Products Limited (the "Company"):

- give a true and fair view of the state of the Company's affairs as at 31 December 2019 and of the Company's profit for the year then ended; and
- have been properly prepared in accordance with International Financial Reporting Standards ("IFRSs") as issued by the International Accounting Standards Board ("IASB").

We have audited the financial statements which comprise:

- Statement of financial position;
- Statement of comprehensive income;
- Statement of changes in equity;
- Statement of cash flows; and
- Notes 1 to 17 to the financial statements.

The financial reporting framework that has been applied in their preparation is applicable law and IFRSs as issued by the IASB.

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") Ethical Standard as applied to listed entities, 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.

Summary of our audit approach

Key audit matters	The key audit matters that we identified in the current year were: <ul style="list-style-type: none">• Valuation of Level 2 financial instruments; and• Impact of COVID-19 on the financial statements.
Materiality	The materiality that we used in the current year was \$2.98 million, which was determined on the basis of 1% of Total Assets.
Scoping	<p>The planning and scoping of our audit considers the Company's business, organisational structure and global operating model. This model comprises a common control structure for key business processes and internal controls over financial reporting.</p> <p>Based on this global operating model, our audit scope is globally integrated with the audit testing procedures performed by Deloitte & Touche LLP, US, the lead auditor of the ultimate parent company, Morgan Stanley.</p> <p>The scope of our audit identifies those components that are financially significant to the Company and the locations where account balances included in the Company's financial statements are managed and controlled.</p>

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF MORGAN STANLEY ASIA PRODUCTS LIMITED

	As a result, we involved component auditors based in North America for the purposes of our audit of the financial statements.
Significant changes in our approach	<p>In the prior period we identified our key audit matter as the valuation of Level 3 financial instruments. This was a key audit matter due to the subjectivity of the inputs and the significance of the judgements used by the Company in determining the methodologies underlying the valuation of these instruments, in particular the fact that a significant portion of the inputs used in the calculation of the valuation of these instruments being unobservable. As the Company does not hold any Level 3 financial instruments as at 31 December 2019, the key audit matter in the current period relates to valuation of Level 2 financial instruments which have a degree of subjectivity and management judgement in determining the appropriate valuation.</p> <p>We have also identified an additional key audit matter relating to the going concern assessment and post balance sheet events disclosure due to the rapid spread of COVID-19 and the ongoing uncertainty surrounding its impact which has resulted in us focusing a greater degree of effort on the Directors' judgements. There are no other significant changes in our approach apart from the changes in key audit matters.</p>

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 the 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.

Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) that we identified. These matters included those which had the greatest effect on: the overall audit strategy, the allocation of resources in the audit; and directing the efforts of the engagement team.

These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Valuation of Level 2 financial instruments	
Relevant references in the financial statements	<p>Note 2 – Basis of Preparation – Critical judgments in applying the Company's accounting policies</p> <p>Note 3 – Summary of significant accounting policies – (d) Fair value</p> <p>Note 14 – Assets and liabilities measured at fair value (a) (b) (c) (d)</p>
Key audit matter description	The Company's trading and financing activities will at times result in the Company carrying material financial asset and liability positions having limited price transparency. These financial instruments generally include derivative, security or lending positions spanning a broad array of product types.

INDEPENDENT AUDITOR’S REPORT TO THE MEMBERS OF MORGAN STANLEY ASIA PRODUCTS LIMITED

	<p>Under IFRS 13 <i>Fair Value Measurement</i>, these financial instruments are generally classified as Level 2 or Level 3 assets or liabilities.</p> <p>Unlike other financial instruments whose values are quoted in an active market and therefore more easily independently corroborated, the valuation of financial instruments classified as Level 2 or Level 3 are inherently subjective, and often involve valuation methodologies that are complex. This degree of subjectivity may also give rise to potential fraud through management intentionally inflating fair values or incorporating management bias in determining fair values. Auditing the Company’s valuation of these instruments is therefore subjective and presents certain challenges in evaluating the appropriateness of the Company’s valuation judgments and estimates.</p> <p>As at 31 December 2019, the Company’s total financial assets and liabilities measured at fair value were \$285.8 million and \$297.9 million, respectively, of which Level 2 financial assets and liabilities were \$282.2 million and \$283.6 million, respectively. As noted, the Company did not hold any Level 3 financial instruments at the period end.</p>
<p>How the scope of our audit responded to the key audit matter</p>	<p>To address the complexities associated with auditing the value of Level 2 financial instruments, we involved our valuation specialists who have significant quantitative and modelling expertise.</p> <p>We obtained an understanding and tested relevant valuation controls including the:</p> <ul style="list-style-type: none"> • Model Risk Management control, which is designed to review a model’s theoretical soundness and the appropriateness of its valuation methodology and calibration techniques developed by the business units; and • Price Verification control, which is designed to review the appropriateness of valuation methodologies to derive model inputs. <p>We also performed the following:</p> <ul style="list-style-type: none"> • Evaluated management’s valuation methodologies, including the input assumptions against the expected assumptions of other market participants leveraging relevant external data; • Developed independent valuation estimates, using externally sourced inputs and challenger models, and used such estimates to further evaluate management’s fair value measurement by investigating the differences between our estimate and that of the Firm, including comparing the fair value estimate with similar transactions.
<p>Key observations</p>	<p>Based on our audit procedures performed, we concluded that the valuation of Level 2 financial instruments was appropriate.</p>

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF MORGAN STANLEY ASIA PRODUCTS LIMITED

Impact of COVID-19 on the financial statements	
Relevant references in the financial statements	Directors' Report – 'Events After the Reporting Date' page 6 Note 2 – The going concern assumption, page 21
Key audit matter description	<p>The ongoing uncertainty relating to the impact of the COVID-19 pandemic has increased the judgement involved in the Director's assessment of the Company's ability to continue as a going concern over a period of at least 12 months from the date of approval of the financial statements.</p> <p>There is also an increased risk and a greater level of audit work associated with the adequacy of disclosures over the going concern assessment and events after the reporting date.</p> <p>In making their assessment, the Directors consider that the going concern basis of accounting is appropriate and that there is no material uncertainty related to going concern.</p>
How the scope of our audit responded to the key audit matter	<p>In response to the impact of the COVID-19 pandemic, we focused our audit effort to understand whether there was a material uncertainty over the Company's ability to continue as a going concern over a period of at least twelve months from the date of approval of the financial statements.</p> <p>In particular we considered management's assessment of the Company's operational resilience, the Morgan Stanley ("MS") Group's implementation of its business continuity plan, and the fact that the Company's business model is designed to be market risk flat.</p> <p>As the Company relies on the MS Group to hedge its market facing positions, we also considered the ability of the MS Group to continue as a going concern over the same period.</p> <p>We challenged and assessed management's consideration of the MS Group's evaluation of its profitability, solvency, liquidity and funding forecast position.</p> <p>We held meetings with Senior Management to discuss the Director's assessment of going concern and to challenge matters arising from our review of Management's going concern papers. As part of this assessment, we reviewed the minutes of, and attended relevant executive forums, governance committees, and other meetings to corroborate Management's responses and the information provided.</p> <p>We have reviewed the disclosures made by Management in relation to events after the reporting date and going concern, to assess whether they adequately reflect the deterioration in economic outlook arising from the COVID-19 pandemic, including the impact on the Company and the MS Group, and checked the consistency of the disclosures with our knowledge of the Company and MS Group based on our audit.</p>
Key observations	<p>Based on our audit procedures performed, we concluded that the adoption of the going concern basis of accounting was appropriate.</p> <p>We also concluded that the disclosures in relation to going concern and events after the reporting date are appropriate.</p>

Our application of materiality

We define materiality as the magnitude of misstatement in the financial statements that makes it probable that the economic decisions of a reasonably knowledgeable person would be changed or influenced. We use materiality both in planning the scope of our audit work and in evaluating the results of our work.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF MORGAN STANLEY ASIA PRODUCTS LIMITED

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

Materiality	\$2.98 million (2018: \$2.88 million)
Basis for determining materiality	1% (2018: 1%) of Total Assets
Rationale for the benchmark applied	We have considered Total Assets to be the most appropriate benchmark, consistent with prior year, as the Company is engaged in the issuance of financial instruments and the hedging of obligations pursuant to such issuances. As such, Total Assets is of importance to the key users of the financial statements. These key users include Regulators, external rating agencies and the ultimate parent entity.

We set performance materiality at a level lower than materiality to reduce the probability that, in aggregate, uncorrected and undetected misstatements exceed the materiality for the financial statements as a whole.

Performance materiality was set at 70% of materiality for the 2019 audit (2018: 70%). In determining performance materiality, we considered the following factors:

- our risk assessment, including our assessment of the Company's overall control environment and that we consider it appropriate to rely on controls over a number of business processes; and
- our past experience of the audit, which has indicated a low number of corrected and uncorrected misstatements identified in prior periods.

We agreed with the directors of the Company that we would report to the directors all audit differences in excess of \$0.15 million (2018: \$0.14 million), as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds. We also report to the directors on disclosure matters that we identified when assessing the overall presentation of the financial statements.

An overview of the scope of our audit

Identification and scoping of components

Morgan Stanley is a globally managed business with a global operating model in which major classes of transactions are subject to a common control processing environment irrespective of product, region or legal entity. Given this global operating model for the Company, we audit certain controls, financial reporting processes and balances centrally. The scope of our audit identifies the component that is financially significant to the Company and the locations where account balances included in the Company's financial statements are managed and controlled. Based on the above, we involved auditors based in North America for the purposes of our audit of the Company's financial statements, consistent with the prior year. We instructed our component auditor, Deloitte & Touche LLP, US to perform their audit procedures at a materiality level of \$1.77 million (2018: \$2.45 million).

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF MORGAN STANLEY ASIA PRODUCTS LIMITED

Involvement with component auditors

We exercised oversight over the work of our component auditors by remaining in active dialogue at regular intervals throughout the duration of the audit. We attended the audit planning meetings in New York involved the component auditors in our team briefing and issued a set of instructions to the component auditor setting out the audit work and the specified audit procedures we requested them to undertake. We undertook a visit to our North America (New York) component auditor during the final stage of our audit to discuss key findings arising from their work and to review their audit work papers. We also formally received audit clearance documentation from both component auditors confirming that they had performed the audit and the specified audit procedures in accordance with our instructions.

Audit procedures undertaken at the Company level

We designed our audit approach for the Company based on our understanding of the business undertaken by the Company and our independent assessment of the risks of material misstatement arising in the financial statements. These procedures included, amongst others, the preparation of the financial statements as well as obtaining an understanding and testing of relevant controls over the financial reporting process.

Other information

The directors are responsible for the other information. The other information comprises the information included in the annual report, including the Directors' 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 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.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF MORGAN STANLEY ASIA PRODUCTS LIMITED

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.

Use of our report

This report is made solely to the company's directors in accordance with the company's reporting obligations of the Irish and Hong Kong stock exchanges. 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's members as a body, for our audit work, for this report, or for the opinions we have formed.



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

22 April 2020

MORGAN STANLEY ASIA PRODUCTS LIMITED

STATEMENT OF COMPREHENSIVE INCOME
Year ended 31 December 2019

	Note	2019 US\$'000	2018 US\$'000
Net trading income on financial assets		3,908	13
Net trading expense on financial liabilities		(4,041)	(88)
Net trading expense on financial instruments		(133)	(75)
<i>Net gains/ (losses) on other financial assets held at fair value</i>			
Net losses on financial assets designated at fair value through profit or loss (before interest)		(22)	(4,361)
Interest income		19	1,809
Net losses on financial assets designated at fair value through profit or loss		(3)	(2,552)
Net gains/ (losses) on non-trading financial assets at fair value through profit or loss		43,034	(967,166)
		43,031	(969,718)
<i>Net (losses)/ gains on other financial liabilities held at fair value</i>			
Net (losses)/ gains on financial liabilities designated at fair value through profit or loss		(43,020)	969,793
Net income from other financial instruments held at fair value		11	75
Total non-interest expense		(122)	-
Interest income	4	122	-
Net revenues		-	-
RESULT BEFORE INCOME TAX		-	-
Income tax	5	-	-
RESULT AND TOTAL COMPREHENSIVE INCOME FOR THE YEAR		-	-

All operations were continuing in the current and prior year.

The notes on pages 20 to 59 form an integral part of the financial statements.

MORGAN STANLEY ASIA PRODUCTS LIMITED

STATEMENT OF CHANGES IN EQUITY Year ended 31 December 2019

	Share capital US\$'000	Retained earnings US\$'000	Total equity US\$'000
Balance at 1 January 2018	50	-	50
Result and total comprehensive income for the year	-	-	-
Balance at 31 December 2018	50	-	50
Result and total comprehensive income for the year	-	-	-
Balance at 31 December 2019	50	-	50

The notes on pages 20 to 59 form an integral part of the financial statements.

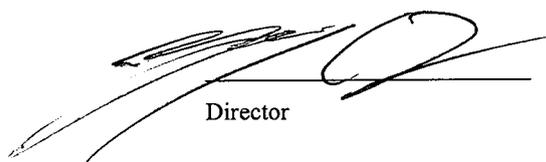
MORGAN STANLEY ASIA PRODUCTS LIMITED

STATEMENT OF FINANCIAL POSITION
As at 31 December 2019

	Note	2019 US\$'000	2018 US\$'000
ASSETS			
Cash		600	521
Trading financial assets	7	3,991	10
Loans	6	468	1,856
Prepaid equity securities contracts	6	281,353	285,269
Trade and other receivables		<u>11,559</u>	<u>459</u>
TOTAL ASSETS		<u><u>297,971</u></u>	<u><u>288,115</u></u>
LIABILITIES AND EQUITY			
Trading financial liabilities	7	16,052	3
Trade and other payables		49	930
Issued warrants	6	281,353	285,269
Issued structured notes	6	<u>467</u>	<u>1,863</u>
TOTAL LIABILITIES		<u>297,921</u>	<u>288,065</u>
EQUITY			
Share capital	8	50	50
Retained earnings		<u>-</u>	<u>-</u>
Equity attributable to owners of the Company		<u>50</u>	<u>50</u>
TOTAL EQUITY		<u>50</u>	<u>50</u>
TOTAL LIABILITIES AND EQUITY		<u><u>297,971</u></u>	<u><u>288,115</u></u>

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

Signed on behalf of the Board



Director

The notes on pages 20 to 59 form an integral part of the financial statements.

MORGAN STANLEY ASIA PRODUCTS LIMITED

STATEMENT OF CASH FLOWS

	Note	2019 US\$'000	2018 US\$'000
NET CASH FLOWS FROM/ (USED IN) OPERATING ACTIVITIES	9b	10,132	(589)
INVESTING ACTIVITIES			
Purchase of prepaid equity securities contracts		(391,639)	(264,168)
Purchase of derivative contracts		(1)	(7,022)
Proceeds from sale and maturity of prepaid equity securities contracts		433,462	2,450,570
Proceeds from loan repayment		1,364	37,589
Issue of loan to another Morgan Stanley Group undertakings		(10,052)	-
Interest received		19	1,809
NET CASH FLOWS FROM INVESTING ACTIVITIES		<u>33,153</u>	<u>2,218,778</u>
FINANCING ACTIVITIES			
Issue of warrants		391,639	264,168
Redemption of issued structured notes		(1,383)	(32,376)
Redemption of issued warrants		(433,462)	(2,450,570)
NET CASH FLOWS USED IN FINANCING ACTIVITIES	9c	<u>(43,206)</u>	<u>(2,218,778)</u>
NET INCREASE/ (DECREASE) IN CASH AND CASH EQUIVALENTS		79	(589)
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE YEAR		<u>521</u>	<u>1,110</u>
CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR	9a	<u><u>600</u></u>	<u><u>521</u></u>

The notes on pages 20 to 59 form an integral part of the financial statements.

MORGAN STANLEY ASIA PRODUCTS LIMITED

NOTES TO THE FINANCIAL STATEMENTS **Year ended 31 December 2019**

1. CORPORATE INFORMATION

Morgan Stanley Asia Products Limited (the “Company”) is an exempt company incorporated and domiciled in the Cayman Islands with limited liability, at the following registered address c/o Maples Corporate Services Limited, P.O. Box 309, Uglund House, South Church Street, George Town, Grand Cayman, KY1-1104, Cayman Islands.

The Company’s immediate parent undertaking is Morgan Stanley Asia Securities Products LLC which is incorporated in the Cayman Islands.

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

The Company is engaged in the issuance of financial instruments and the hedging of obligations pursuant to such issuances.

2. BASIS OF PREPARATION

Statement of compliance

The Company has prepared its annual financial statements in accordance with International Financial Reporting Standards (“IFRSs”) issued by the International Accounting Standards Board (“IASB”) and Interpretations issued by the IFRS Interpretations Committee (“IFRIC”).

New standards and interpretations adopted during the year

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

New standards and interpretations not yet adopted

At the date of authorisation of these financial statements, the following amendment to standards relevant to the Company’s operations were issued by the IASB but not mandatory for accounting periods beginning 1 January 2019. Except where otherwise stated, the Company does not expect that the adoption of the following amendment to standards will have a material impact on the Company’s financial statements.

Amendments to IAS 1 ‘*Presentation of Financial Statements*’ and IAS 8 ‘*Accounting Policies, Changes in Accounting Estimates and Errors*’: Definition of Material were issued by the IASB in October 2018, for application in accounting periods beginning on or after 1 January 2020.

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.

MORGAN STANLEY ASIA PRODUCTS LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2019

2. BASIS OF PREPARATION (CONTINUED)

Critical accounting judgements and key sources of estimation uncertainty

In preparing the financial statements, the Company makes judgements and estimates that affect the application of accounting policies and reported amounts.

Critical accounting judgements are key decisions made by management in the application of the Company's accounting policies, other than those involving estimations, which have the most significant effects on the amounts recognised in the financial statements.

Key sources of estimation uncertainty represent assumptions and estimations made by management that have a significant risk of resulting in a material adjustment to the carrying amount of assets and liabilities within the next financial year.

The critical judgements in applying the Company's accounting policies are for valuation of certain financial instruments. For further details on the judgements used in determining fair value of financial instruments, see note 3(d) and for valuation of Level 3 financial instruments, see note 14.

There are no key sources of estimation uncertainty in the reporting period that may have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities in the next financial year.

The Company evaluates the critical accounting judgements on an ongoing basis and believes that these are reasonable.

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 Directors' 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.

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

The Company's capital and liquidity is deemed sufficient to deal with both a normal and in a stressed market environment, including the current and potential stresses of COVID 19 (coronavirus) for the foreseeable future. The impact of the economic and financial disruption due to the emergence of COVID 19 has been considered as part of the going concern analysis, including impact on the operational capacity of the business, access to liquidity and capital, contractual obligations, asset valuations and other critical accounting judgements and key sources of estimation uncertainty. The Company has access to further Morgan Stanley Group capital and liquidity as required.

Taking the above factors into consideration, the Directors believe it is reasonable to assume that the Company will have access to adequate resources to continue in operational existence for the foreseeable future and over a period of at least 12 months from the date of the approval of the financial statements. 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.

MORGAN STANLEY ASIA PRODUCTS LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2019

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

a. Functional currency (continued)

Unless otherwise stated, all currency amounts in the financial statements and Directors' report 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 income' 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

Trading financial instruments comprising of derivatives, are initially recorded on trade date at fair value (see note 3(d) below). All subsequent changes in fair value and foreign exchange differences are reflected in the statement of comprehensive income in 'Net trading income/ (expense) on financial assets' or 'Net trading income/ (expense) on financial liabilities'.

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'.

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

Non-trading financial assets at FVPL includes prepaid equity securities contracts.

Non-trading financial assets at FVPL are principally financial assets where the Company makes decisions based upon the assets' fair value and are generally recognised on settlement date at fair value (see note 3(d) below), since they are neither regular way nor are they derivatives. From the date the terms are agreed (trade date), until the financial asset is funded (settlement date), the Company recognises any unrealised fair value changes in the financial asset as non-trading financial assets at FVPL. On settlement date, the fair value of consideration given is recognised as a non-trading financial asset at FVPL. All subsequent changes in fair value, foreign exchange differences and interest are reflected in the statement of comprehensive income in 'Net gains/ (losses) on non-trading financial assets at fair value' as part of 'Net gains/ (losses) on other financial assets held at fair value'.

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

ii) Financial instruments designated at fair value through profit or loss

Financial instruments designated at FVPL include loans, issued warrants and issued structured notes.

The Company has designated certain financial instruments at FVPL when the designation at fair value eliminates or significantly reduces an accounting mismatch which would otherwise arise. The Company has also designated certain financial liabilities at FVPL where the financial liability forms part of a group of financial assets or financial liabilities or both which are managed, evaluated and reported internally on a fair value basis.

From the date the transaction in a financial instrument designated at FVPL is entered into (trade date) until settlement date, the Company recognises any unrealised fair value changes in the contract as

MORGAN STANLEY ASIA PRODUCTS LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2019

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

c. Financial instruments (Continued)

ii) Financial instruments designated at fair value through profit or loss (Continued)

financial instruments designated at FVPL in the statement of financial position. On settlement date, the fair value of consideration given or received is recognised as a financial instrument designated at FVPL (see note 3(d) below).

All subsequent changes in fair value, foreign exchange differences, interest are reflected in the statement of comprehensive income in 'Net gains/ (losses) on financial assets designated at fair value through profit or loss' or 'Net gains/ (losses) on financial liabilities designated at fair value through profit or loss'.

The Company has determined that the presentation in other comprehensive income of amounts attributable to changes in the credit risk of financial liabilities designated at fair value through profit or loss ("DVA") would create or enlarge an accounting mismatch in the statement of comprehensive income. Therefore, all gains or losses arising on such financial liabilities designated at fair value through profit or loss, including the DVA, continue to be reflected in the statement of comprehensive income in 'Net gains/ (losses) on financial liabilities designated at fair value through profit or loss'.

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'.

See note 6 for an analysis of financial assets and financial liabilities designated at FVPL.

iii) Financial assets and financial liabilities at amortised cost

Financial assets at amortised cost include cash 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. 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'.

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

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 the financial liability are added to or 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 ASIA PRODUCTS LIMITED

NOTES TO THE FINANCIAL STATEMENTS Year ended 31 December 2019

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.

In determining fair value, the Company uses various valuation approaches and establishes a hierarchy for inputs used in measuring fair value that requires 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 were 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.

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.

MORGAN STANLEY ASIA PRODUCTS LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2019

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

d. Fair value (Continued)

Fair value measurement (Continued)

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

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

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

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.

The Company applies credit-related valuation adjustments to its Borrowings (primarily structured notes) which are designated at fair value through profit or loss and to OTC derivatives. The Company considers the impact of changes in own credit spreads based upon observations of the secondary bond market spreads when measuring the fair value for Borrowings. For OTC derivatives, 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.

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

Valuation process

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

MORGAN STANLEY ASIA PRODUCTS LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2019

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

d. Fair value (Continued)

Valuation process (continued)

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.

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 Finance 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.

MORGAN STANLEY ASIA PRODUCTS LIMITED

NOTES TO THE FINANCIAL STATEMENTS Year ended 31 December 2019

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

d. Fair value (Continued)

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.

e. Derecognition of financial assets and liabilities

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

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 instruments

The Company recognises loss allowances for ECL for the following financial instrument that is not measured at FVPL:

- financial assets measured at amortised cost;

Measurement of ECL

For financial assets, ECLs are the present value of cash shortfalls (i.e. the difference between contractual and expected cash flows) over the expected life of the financial instrument, discounted at the asset's EIR.

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.

The Company applies a three stage approach to measuring ECLs 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.

MORGAN STANLEY ASIA PRODUCTS LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2019

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

f. Impairment of financial instruments (Continued)

Measurement of ECL (Continued)

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.

Assessment of significant increase in credit risk

When assessing SICR, 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 probability of default ("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 days past due.

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 are subject to impairment for SICR.

In general, ECLs 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.

Calculation of ECL

ECL are calculated using three main components:

- Probability of default ("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.
- Expected loss given default ("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 and country risk expert judgement. The macro-economic scenarios are reviewed quarterly.

MORGAN STANLEY ASIA PRODUCTS LIMITED

NOTES TO THE FINANCIAL STATEMENTS Year ended 31 December 2019

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

f. Impairment of financial instruments (Continued)

Calculation of ECL (Continued)

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.

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 ("POCI") financial assets.

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 is 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.

MORGAN STANLEY ASIA PRODUCTS LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2019

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

f. Impairment of financial instruments (Continued)

Write-offs

Loans and receivables 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.

g. Cash and cash equivalents

Cash and cash equivalents comprise cash, net of outstanding bank overdrafts, 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. 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

All interest income relates to financial assets at amortised cost and is calculated using the EIR method (refer to note 3(c)(iii)).

5. INCOME TAX

The Government of the Cayman Islands, has not, under existing legislation, imposed any income, corporate or capital gains tax, estate duty, inheritance tax, gift tax or withholding tax upon the Company.

MORGAN STANLEY ASIA PRODUCTS LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2019

6. FINANCIAL ASSETS AND FINANCIAL LIABILITIES BY MEASUREMENT CATEGORY

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

31 December 2019	FVPL (mandatorily) US\$'000	FVPL (designated) US\$'000	Amortised cost US\$'000	Total US\$'000
Cash	-	-	600	600
Trading financial assets	3,991	-	-	3,991
Loans	-	468	-	468
Prepaid equity securities contracts	281,353	-	-	281,353
Trade and other receivables	-	-	11,559	11,559
Total financial assets	285,344	468	12,159	297,971
Trading financial liabilities	16,052	-	-	16,052
Trade and other payables	-	-	49	49
Issued warrants	-	281,353	-	281,353
Issued structured notes	-	467	-	467
Total financial liabilities	16,052	281,820	49	297,921
31 December 2018	FVPL (mandatorily) US\$'000	FVPL (designated) US\$'000	Amortised cost US\$'000	Total US\$'000
Cash	-	-	521	521
Trading financial assets	10	-	-	10
Loans	-	1,856	-	1,856
Prepaid equity securities contracts	285,269	-	-	285,269
Trade and other receivables	-	-	459	459
Total financial assets	285,279	1,856	980	288,115
Trading financial liabilities	3	-	-	3
Trade and other payables	-	-	930	930
Issued warrants	-	285,269	-	285,269
Issued structured notes	-	1,863	-	1,863
Total financial liabilities	3	287,132	930	288,065

MORGAN STANLEY ASIA PRODUCTS LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2019

6. FINANCIAL ASSETS AND FINANCIAL LIABILITIES BY MEASUREMENT CATEGORY (CONTINUED)

Financial assets and financial liabilities designated at FVPL

Financial assets and liabilities in the table above which are designated at FVPL consist primarily of the following financial assets and financial liabilities:

Loans – These are loans to other Morgan Stanley Group undertakings that, along with derivatives contracts classified as held for trading, are part of the hedging strategy for the obligations arising pursuant to the issuance of the structured notes. Loans are designated at FVPL because the designation at FVPL eliminates or significantly reduces an accounting mismatch which would otherwise arise.

Issued warrants – These are zero strike price in nature involving the payment of an initial amount which approximates the fair values of the underlying equity securities at inception. These warrants are designated at fair value through profit or loss as the risks to which the Company is a contractual party are risk managed on a fair value basis as part of the Company’s trading portfolio and the risk is reported to key management personnel on this basis.

Issued structured notes – These relate to financial liabilities which arise from selling structured products generally in the form of notes or certificates. The structured notes are designated at FVPL as the risks to which the Company is a contractual party are risk managed on a fair value basis as part of the Company’s trading portfolio and the risk is reported to key management personnel on this basis.

	2019		2018	
	Assets US\$'000	Liabilities US\$'000	Assets US\$'000	Liabilities US\$'000
Loans	468	-	1,856	-
Issued warrants	-	281,353	-	285,269
Issued structured notes	-	467	-	1,863
	<u>468</u>	<u>281,820</u>	<u>1,856</u>	<u>287,132</u>

The maximum exposure to credit risk of financial assets which are designated at FVPL as at 31 December 2019 is US\$468,000 (2018: US\$1,856,000).

There were no significant gains or losses attributable to changes in counterparty credit risk for financial assets designated at FVPL or in own credit risk for financial liabilities designated at FVPL for the year ended 31 December 2019 (2018 : US\$nil).

The Company determines the amount of changes in fair value attributable to changes in counterparty credit risk or own credit risk, as relating to financial assets and financial liabilities designated at FVPL, by first determining the fair value including the impact of counterparty credit risk or own credit risk, and then deducting those changes in fair value representing managed market risk. In determining fair value, the Company considers the impact of changes in own credit spreads based upon observations of the secondary bond market spreads when measuring the fair value for issued structured notes. The Company considers that this approach most faithfully represents the amount of change in fair value due to both counterparty credit risk and the Company’s own credit risk.

The carrying amount of financial liabilities designated at FVPL for which all changes in fair value are presented through the statement of comprehensive income was US\$nil lower (2018: US\$1,000 lower than the contractual amount due at maturity).

At initial recognition of a specific structured note issuance program, the Company’s issuance process, and any planned hedging structure relating to the issuance of those structured notes, has been considered, to determine whether the presentation of fair value changes attributable to changes in the credit risk of those structured notes (“DVA”) through other comprehensive income would create or enlarge an accounting

MORGAN STANLEY ASIA PRODUCTS LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2019

6. FINANCIAL ASSETS AND FINANCIAL LIABILITIES BY MEASUREMENT CATEGORY (CONTINUED)

mismatch in the statement of comprehensive income. If financial instruments, such as derivatives/ loans, measured at fair value for which changes in fair value incorporating counterparty credit risk are reflected within the statement of comprehensive income in 'Net gains/ (losses) on financial assets designated at fair value through profit or loss', are traded to economically hedge the structured note issuances in full, the fair value incorporating any counterparty credit risk ("CVA") arising on the hedging instruments may materially offset any DVA applied to structured notes, where the counterparties of the hedging instruments are part of the Morgan Stanley Group. In such cases, DVA of those structured notes is not reflected within other comprehensive income, and instead is presented in the statement of comprehensive income in 'Net gains/ (losses) on financial liabilities designated at fair value through profit or loss'.

The Company's hedging structure is such that the fair value movements on the derivatives and loans, including CVA, are recognised in the statement of comprehensive income and offset the fair value movements including DVA on the issued structured notes. The counterparty credit risk of the hedging instruments is strongly correlated with the own credit risk of the Company, as the counterparties are members of the Morgan Stanley Group.

7. TRADING FINANCIAL ASSETS AND LIABILITIES

Trading assets and trading liabilities are summarised as follows:

	2019		2018	
	Assets US\$'000	Liabilities US\$'000	Assets US\$'000	Liabilities US\$'000
Derivatives- Equity contracts				
Bilateral OTC	344	476	10	3
Issued listed derivative contracts	-	15,576	-	-
Other listed derivative contracts	3,647	-	-	-
	<u>3,991</u>	<u>16,052</u>	<u>10</u>	<u>3</u>

8. EQUITY

	Ordinary shares of US\$1 each Number
Authorised	
At 1 January 2018, 31 December 2018 and 31 December 2019	<u>50,000</u>
	Ordinary shares of US\$1 each
	Number US\$
Issued and fully paid	
At 1 January 2018, 31 December 2018 and 31 December 2019	<u>50,000</u> <u>50,000</u>

MORGAN STANLEY ASIA PRODUCTS LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2019

8. EQUITY (CONTINUED)

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

9. ADDITIONAL CASH FLOW INFORMATION

a. Cash and cash equivalents

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

b. Reconciliation of cash flows from operating activities

	2019 US\$'000	2018 US\$'000
Result for the year	-	-
<i>Adjustments for:</i>		
Net trading income on financial assets	(3,908)	(13)
Net trading expense on financial liabilities	4,041	88
Net (gains)/ losses on other financial assets held at fair value	(43,031)	969,718
Net losses/ (gains) on other financial liabilities held at fair value	43,020	(969,793)
Interest income	(122)	-
Operating cash flows before changes in operating assets and liabilities	<u>-</u>	<u>-</u>
Changes in operating assets		
Increase in trading financial assets	(3,991)	-
(Increase)/ decrease in trade receivables	(1,048)	558
	<u>(5,039)</u>	<u>558</u>
Changes in operating liabilities		
Increase in trading financial liabilities	16,052	-
Decrease in trade and other payables	(881)	(1,147)
	<u>15,171</u>	<u>(1,147)</u>
Net cash flows from/ (used in) operating activities	<u><u>10,132</u></u>	<u><u>(589)</u></u>

MORGAN STANLEY ASIA PRODUCTS LIMITED

NOTES TO THE FINANCIAL STATEMENTS
Year ended 31 December 2019

9. ADDITIONAL CASH FLOW INFORMATION (CONTINUED)

c. Reconciliation of liabilities arising from financing activities

	Balance at 1	Cash flows	Non-cash changes		Balance at
	January				31
	2019				December
	US\$'000	US\$'000	Foreign exchange revaluation US\$'000	Fair value changes US\$'000	US\$'000
Issued warrants	285,269	(41,823)	127	37,780	281,353
Issued structured notes	1,863	(1,383)	-	(13)	467
Total liabilities from financing activities	287,132	(43,206)	127	37,767	281,820
	Balance at 1	Cash flows	Non-cash changes		Balance at
	January				31
	2018				December
	US\$'000	US\$'000	Foreign exchange revaluation US\$'000	Fair value changes US\$'000	US\$'000
Issued warrants	3,477,876	(2,186,402)	2,573	(1,008,778)	285,269
Issued structured notes	36,866	(32,376)	(1,877)	(750)	1,863
Total liabilities from financing activities	3,514,742	(2,218,778)	696	(1,009,528)	287,132

MORGAN STANLEY ASIA PRODUCTS LIMITED

NOTES TO THE FINANCIAL STATEMENTS
Year ended 31 December 2019

10. 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 2019

	Less than or equal to twelve months US\$'000	More than twelve months US\$'000	Total US\$'000
ASSETS			
Cash	600	-	600
Trading financial assets	454	3,537	3,991
Loans	468	-	468
Prepaid equity securities contracts	276,087	5,266	281,353
Trade and other receivables	11,559	-	11,559
	<u>289,168</u>	<u>8,803</u>	<u>297,971</u>

LIABILITIES

Trading financial liabilities	7,000	9,052	16,052
Trade and other payables	49	-	49
Issued warrants	276,087	5,266	281,353
Issued structured notes	467	-	467
	<u>283,603</u>	<u>14,318</u>	<u>297,921</u>

At 31 December 2018

ASSETS

Cash	521	-	521
Trading financial assets	-	10	10
Loans	1,388	468	1,856
Prepaid equity securities contracts	229,071	56,198	285,269
Trade and other receivables	459	-	459
	<u>231,439</u>	<u>56,676</u>	<u>288,115</u>

LIABILITIES

Trading financial liabilities	-	3	3
Trade and other payables	930	-	930
Issued warrants	229,071	56,198	285,269
Issued structured notes	1,388	475	1,863
	<u>231,389</u>	<u>56,676</u>	<u>288,065</u>

MORGAN STANLEY ASIA PRODUCTS LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2019

11. SEGMENT REPORTING

Segment information is presented in respect of the Company's business and geographical segments. The business segment and geographical segment are based on the Company's management and internal reporting structure.

Business segment

Morgan Stanley structures its business segments primarily based upon the nature of the financial products and services provided to customers and Morgan Stanley's internal management structure. The Company's own business segment is consistent with that of Morgan Stanley.

The Company has one reportable business segment, equity. Its business includes the issuance of financial instruments and the hedging of the obligations arising pursuant to such issuance.

Geographical segment

The Company operates in one geographic region, Asia. The basis for attributing external revenue and total assets to one geographic region is determined by trading desk location.

12. FINANCIAL RISK MANAGEMENT

Risk management procedures

Risk is an inherent part of both the Morgan Stanley Group's and the Company's business activity and is managed by the Company within the context of the broader Morgan Stanley Group. The Morgan Stanley Group 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's own risk management policies and procedures are consistent with those of the Morgan Stanley Group.

The principal activity of the Company continues to be the issuance of financial instruments under a Warrant and Note Programme and the economic hedging of the obligations arising pursuant to such issuances. It is the policy and objective of the Company not to be exposed to market risk as a result of its issuance activities. On the issuance of each financial instrument, the Company enters into economic hedges of its obligations by purchasing financial instruments from another Morgan Stanley Group entity and from the market.

Significant risks faced by the Company resulting from its issuance activities and hedging strategies are set out below.

Credit risk

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

Credit risk management

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.

MORGAN STANLEY ASIA PRODUCTS LIMITED

NOTES TO THE FINANCIAL STATEMENTS Year ended 31 December 2019

12. FINANCIAL RISK MANAGEMENT (CONTINUED)

Credit risk management (Continued)

The Company may incur credit risk in its warrant issuance business through a variety of activities, including, but not limited to, the following:

- entering into derivative contracts under which counterparties may have obligations to make payments to the Company;
- providing short or long-term funding to Morgan Stanley Group undertakings;

The Company hedges all of its financial liabilities by entering into prepaid OTC contracts with its immediate parent, derivative contracts with other Morgan Stanley Group undertakings and other derivative contracts. Except for cash and other derivative contracts, the Company enters into all 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 and exposure to credit risk by internal rating grades

The maximum exposure to credit risk (“gross credit exposure”) of the Company as at 31 December 2019 is disclosed below, based on the carrying amounts of the financial assets which the Company believes are subject to credit risk. The table includes financial instruments subject to ECL and not subject to ECL. Those financial instruments that bear credit risk but are not subject to ECLs are subsequently measured at fair value. The table below 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 in note 13 ‘*Financial Assets and Financial Liabilities Subject to Offsetting*’.

The Company does not have any exposure arising from items not recognised on the balance sheet.

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

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

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

MORGAN STANLEY ASIA PRODUCTS LIMITED

NOTES TO THE FINANCIAL STATEMENTS Year ended 31 December 2019

12. FINANCIAL RISK MANAGEMENT (CONTINUED)

Exposure to credit risk and exposure to credit risk by internal rating grades (Continued)

2019	Gross credit exposure ⁽¹⁾⁽²⁾ US\$'000	Counterparty	Rating	Credit grade
Subject to ECL⁽³⁾⁽⁴⁾:				
Cash	85	Standard Chartered Bank	A	Investment Grade
	48	ANZ Bank Limited	A	Investment Grade
	210	The Hong Kong and Shanghai Banking Corporation Limited	A	Investment Grade
	257	Sumitomo Mitsui Banking Corp	A	Investment Grade
Total Cash	600			
Trade and other receivables	10,774	Morgan Stanley Asia Securities Products LLC	BBB	Investment Grade
	118	Morgan Stanley & Co. International plc	A	Investment Grade
Total trade and other receivables	10,892			
Not subject to ECL⁽⁵⁾:				
Trading financial assets	344	Morgan Stanley & Co. International plc	A	Investment Grade
	3,647	Hong Kong Securities Clearing Company Limited ("HKSCC")	A	Investment Grade
Total trading financial assets	3,991			
Loans	468	Morgan Stanley International Finance S.A.	BBB	Investment Grade
Prepaid equity securities contracts	281,353	Morgan Stanley Asia Securities Products LLC	BBB	Investment Grade

- (1) The carrying amount recognised in the statement of financial position best represents the Company's maximum exposure to credit risk.
- (2) Of the gross credit exposure, intercompany cross product netting arrangements are in place which would allow for an additional US\$ 154,328 to be offset in the ordinary course of business and/ or in the event of default.
- (3) Both cash and trade receivables are at stage 1
- (4) There is no ECL and loss allowance on cash and trade receivables.
- (5) Financial assets measured at FVPL are not subject to ECL.

MORGAN STANLEY ASIA PRODUCTS LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2019

12. FINANCIAL RISK MANAGEMENT (CONTINUED)

Exposure to credit risk and exposure to credit risk by internal rating grades (Continued)

Maximum exposure to credit risk for 31 December 2018 is presented as follows, reflecting the balance sheet categories used in 2018:

2018	Gross credit exposure ⁽¹⁾⁽²⁾ US\$'000	Counterparty	Rating	Credit grade
Subject to ECL⁽³⁾⁽⁴⁾:				
Cash	28	Standard Chartered Bank	A	Investment Grade
	46	ANZ Bank Limited	A	Investment Grade
	194	The Hong Kong and Shanghai Banking Corporation Limited	A	Investment Grade
	253	Sumitomo Mitsui Banking Corp	AA	Investment Grade
Total Cash	521			
Trade receivables	459	Morgan Stanley Asia Securities Products LLC	BBB	Investment Grade
Not subject to ECL⁽⁵⁾:				
Trading financial assets	10	Morgan Stanley & Co. International plc	A	Investment Grade
Loans	1,856	Morgan Stanley International Finance S.A.	BBB	Investment Grade
Prepaid equity securities contracts	285,269	Morgan Stanley Asia Securities Products LLC	BBB	Investment Grade

- (1) The carrying amount recognised in the statement of financial position best represents the Company's maximum exposure to credit risk.
- (2) Of the gross credit exposure, intercompany cross product netting arrangements are in place which would allow for an additional US\$69,349,000 to be offset in the ordinary course of business and/ or in the event of default.
- (3) Both cash and trade receivables are at stage 1
- (4) There is no ECL and loss allowance on cash and trade receivables.
- (5) Financial assets measured at FVPL are not subject to ECL.

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 and investing activities.

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

MORGAN STANLEY ASIA PRODUCTS LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2019

12. FINANCIAL RISK MANAGEMENT (CONTINUED)

Liquidity risk (Continued)

The primary goal of Morgan Stanley Group'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 following principles guide the Morgan Stanley Group'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 Company hedges all of its financial liabilities by entering into prepaid OTC contracts with its immediate parent, derivative contracts with other Morgan Stanley Group undertakings and other derivative contracts. In general, the maturity profile of the financial assets matches the maturity profile of the financial liabilities.

The core components of the Morgan Stanley Group's liquidity management framework, which includes consideration of the liquidity risk for each individual legal entity, are the Required Liquidity Framework, Liquidity Stress Tests and the Global Liquidity Reserve, which support the Morgan Stanley Group's target liquidity profile.

Required Liquidity Framework

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. The Required Liquidity Framework considers the most constraining liquidity requirement to satisfy all regulatory and internal limits.

Liquidity Stress Tests

The Morgan Stanley Group 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 Liquidity Stress Tests are important components of the Required Liquidity Framework.

The Liquidity Stress Tests are produced for Morgan Stanley and its major operating subsidiaries, as well as at major currency levels, to capture specific cash requirements and cash availability at various legal entities. The Liquidity Stress Tests assume that subsidiaries will use their own liquidity first to fund their obligations before drawing liquidity from Morgan Stanley. It is also assumed that Morgan Stanley will support its subsidiaries and will not have access to cash that may be held at certain subsidiaries. In addition to the assumptions underpinning the Liquidity Stress Tests, the Morgan Stanley Group takes into consideration the settlement risk related to intra-day settlement and clearing of securities and financial activities.

Since the Company hedges the risk of its financial liabilities with financial assets that match the maturity profile of the financial liabilities, the Company is not considered a major operating subsidiary for the purposes of liquidity risk. However, the Company would have access to the cash or liquidity reserves held by Morgan Stanley in the unlikely event that it was unable to access adequate financing to service its financial liabilities when they become payable.

MORGAN STANLEY ASIA PRODUCTS LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2019

12. FINANCIAL RISK MANAGEMENT (CONTINUED)

Liquidity risk (Continued)

The Required Liquidity Framework and Liquidity Stress Tests are evaluated on an ongoing basis and reported to the Firm Risk Committee, Asset/Liability Management Committee, and other appropriate risk committees.

Global Liquidity Reserve

The Morgan Stanley Group maintains sufficient liquidity reserves (the “Global 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 Global Liquidity Reserve is actively managed by the Morgan Stanley Group 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 Morgan Stanley Group’s Global Liquidity Reserve includes a discretionary surplus based on the Morgan Stanley Group’s risk tolerance and is subject to change depending on market and firm-specific events.

The Morgan Stanley Group’s Global Liquidity Reserve, to which the Company has access, is held within Morgan Stanley and its major operating subsidiaries and is composed of diversified cash and cash equivalents and unencumbered highly liquid securities.

Eligible unencumbered highly liquid securities including US government securities, US agency securities, US agency mortgage-backed securities, non-US government securities and other highly liquid investment grade securities.

The ability to monetise assets during a liquidity crisis is critical. The Morgan Stanley Group believes that the assets held in its Global Liquidity Reserve can be monetised within five business days in a stressed environment given the highly liquid and diversified nature of the reserves.

Funding management

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

The Morgan Stanley Group funds its balance sheet on a global basis through diverse sources, which includes consideration of the funding risk of each legal entity. These sources include the Morgan Stanley Group’s equity capital, long-term borrowing, securities sold under agreements to repurchase (“repurchase agreements”), securities lending, deposits, letters of credit and lines of credit.

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

MORGAN STANLEY ASIA PRODUCTS LIMITED

NOTES TO THE FINANCIAL STATEMENTS Year ended 31 December 2019

12. FINANCIAL RISK MANAGEMENT (CONTINUED)

Liquidity risk (Continued)

Maturity analysis

In the following maturity analysis of financial assets and financial liabilities, derivative contracts, prepaid equity securities contracts, loans, issued warrants and issued structured notes are disclosed according to their earliest contractual maturity; all such amounts are presented at their fair value, consistent with how these financial instruments are managed. All other amounts represent undiscounted cash flows receivable and payable by the Company arising from its financial assets and financial liabilities to earliest contractual maturities as at 31 December 2019 and 31 December 2018. 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.

	On demand US\$'000	Less than 1 month US\$'000	1 month - 3 months US\$'000	3 months - 1 year US\$'000	1 year - 5 years US\$'000	Total US\$'000
31 December 2019						
Financial assets						
Cash	600	-	-	-	-	600
Trading financial assets	-	-	-	454	3,537	3,991
Loans	-	-	-	468	-	468
Prepaid equity securities contracts	-	-	20,247	255,840	5,266	281,353
Trade and other receivables ⁽¹⁾	1,507	-	-	-	10,052	11,559
Total financial assets	2,107	-	20,247	256,762	18,855	297,971
Financial liabilities						
Trading financial liabilities	-	956	463	5,581	9,052	16,052
Trade and other payables	49	-	-	-	-	49
Issued warrants	-	45,405	20,247	210,435	5,266	281,353
Issued structured notes	-	-	-	467	-	467
Total financial liabilities	49	46,361	20,710	216,483	14,318	297,921
31 December 2018						
Financial assets						
Cash	521	-	-	-	-	521
Trading financial assets	-	-	-	-	10	10
Loans	-	926	462	-	468	1,856
Prepaid equity securities contracts	-	29,548	63,585	135,938	56,198	285,269
Trade and other receivables	459	-	-	-	-	459
Total financial assets	980	30,474	64,047	135,938	56,676	288,115
Financial liabilities						
Trading financial liabilities	-	-	-	-	3	3
Trade and other payables	930	-	-	-	-	930
Issued warrants	-	30,099	63,034	135,938	56,198	285,269
Issued structured notes	-	926	462	-	475	1,863
Total financial liabilities	930	31,025	63,496	135,938	56,676	288,065

MORGAN STANLEY ASIA PRODUCTS LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2019

12. FINANCIAL RISK MANAGEMENT (CONTINUED)

Liquidity risk (Continued)

Maturity analysis (Continued)

- (1) Trade and other receivables include certain receivables due from the Company's direct parent undertaking which is dated on a rolling 395 day terms and includes a voluntary bilateral early settlement provision. Although these receivables are disclosed based on the required contractual maturity excluding the effect of voluntary bilateral early settlement provision, it is expected early repayment can be agreed with the Company's direct parent undertaking if required.

Market risk

Market risk is identified by IFRS 7 'Financial instruments: Disclosures' '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 issued warrants and issued structured notes expose the Company to the risk of changes in market prices of the underlying securities, interest rate risk and, where denominated in currencies other than US dollars, the risk of changes in rates of exchange between the US dollar and the other relevant currencies. The Company uses the risk mirroring contracts that it purchases from other Morgan Stanley Group undertakings to match the price risk, foreign currency and other market risks associated with the issuance of the warrants and structured notes, consistent with the Company's risk management strategy. As such, the Company is not exposed to any net market risk on these financial instruments. Different components of market risks from the issued securities resulting from price movements in underlying securities, exchange rates and others will be offset by the same but opposite price movements in the risk-mirroring contracts. Due to Company's hedging strategy, the gain in the equity price sensitivity analysis as shown in table below will be hedged and offset by fair value movements into risk-mirroring contracts.

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

The market price risk exposure from the financial assets is mainly equity price risk, interest rate risk and currency risk, although all such risks are offset by equal and offsetting exposure to risk on the issued securities. Equity price risk refers to the risk of changes in the equity price of the assets underlying these financial assets.

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 loans held at amortised cost and at fair value.

The application of a parallel shift in market interest rates of 50 basis points increase or decrease to these positions, would result in a net gain or loss of approximately US\$160 (2018: US\$nil) in the statement of comprehensive income.

MORGAN STANLEY ASIA PRODUCTS LIMITED

NOTES TO THE FINANCIAL STATEMENTS Year ended 31 December 2019

12. FINANCIAL RISK MANAGEMENT (CONTINUED)

Market risk (Continued)

Equity price sensitivity analysis

The sensitivity analysis below is determined based on the exposure to equity price risk at 31 December 2019 and 31 December 2018 respectively.

The market risk related to such equity price risk is measured by estimating the potential reduction in total comprehensive income associated with a 10% decline in the underlying asset values as shown in the table below.

Equity price sensitivity analysis (Continued)

	<i>Impact on Total Comprehensive Income Gains/(losses)</i>	
	2019	2018
	US\$'000	US\$'000
Trading financial assets	(399)	-
Prepaid equity securities contracts	(28,135)	(28,527)
Trading financial liabilities	1,605	-
Issued warrants	28,135	28,527
	<u>1,206</u>	<u>-</u>

The Company's equity risk price risk is mainly concentrated on equity securities in Asia.

MORGAN STANLEY ASIA PRODUCTS LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2019

13. FINANCIAL ASSETS AND FINANCIAL LIABILITIES SUBJECT TO OFFSETTING

In order to manage credit exposure arising from its business activities, the Company applies various credit risk management policies and procedures, see note 12 for further details. Primarily in connection with the issuance and hedging activities, the Company enters into master netting arrangements with certain counterparties. These agreements provide the Company with the right, in the ordinary course of business and/ or in the event of a counterparty default (such as bankruptcy or a counterparty's failure to pay or perform), to net a counterparty's rights and obligations under such agreement.

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

The following tables present information about offsetting of financial instruments.

	Gross amounts US\$'000	Amounts offset in the statement of financial position US\$'000	Net amounts presented in the statement of financial position US\$'000
31 December 2019			
Assets			
Trading financial assets: derivatives	3,991	-	3,991
Loans	468	-	468
Prepaid equity securities contracts	281,353	-	281,353
Trade and other receivables	11,559	-	11,559
TOTAL	297,371	-	297,371
Liabilities			
Trading financial liabilities: derivatives	16,052	-	16,052
Trade and other payables	49	-	49
Issued warrants	281,353	-	281,353
Issued structured notes	467	-	467
TOTAL	297,921	-	297,921

MORGAN STANLEY ASIA PRODUCTS LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2019

**13. FINANCIAL ASSETS AND FINANCIAL LIABILITIES SUBJECT TO OFFSETTING
(CONTINUED)**

	Net amounts presented in the statement of financial position US\$'000	Amounts not offset in the statement of financial position		Net exposure US\$'000
		Financial instruments ⁽¹⁾ US\$'000	Cash collateral ⁽²⁾ US\$'000	
31 December 2019				
Assets				
Morgan Stanley & Co. International plc	462	(344)	(118)	-
Morgan Stanley Asia Securities Products LLC	292,127	(153,866)	-	138,261
Morgan Stanley International Finance S.A.	468	-	-	468
Others	4,314	-	-	4,314
TOTAL	297,371	(154,210)	(118)	143,043
Liabilities				
Morgan Stanley & Co. International plc	476	(344)	(118)	14
Morgan Stanley Asia Securities Products LLC	153,866	(153,866)	-	-
Morgan Stanley & Co. LLC	47	-	-	47
Others	143,532	-	-	143,532
TOTAL	297,921	(154,210)	(118)	143,593

(1) These are amounts that would be offset in the ordinary course of business and/ or in the event of default according to the intercompany cross-product legally enforceable netting arrangements with the respective Morgan Stanley Group undertakings.

(2) The cash collateral not offset is recognized in the statement of financial position within Trade and other receivables.

MORGAN STANLEY ASIA PRODUCTS LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2019

**13. FINANCIAL ASSETS AND FINANCIAL LIABILITIES SUBJECT TO OFFSETTING
(CONTINUED)**

	Gross amounts US\$'000	Amounts offset in the statement of financial position US\$'000	Net amounts presented in the statement of financial position US\$'000
31 December 2018			
Assets			
Trading financial assets: derivatives	10	-	10
Loans	1,856	-	1,856
Prepaid equity securities contracts	285,269	-	285,269
Trade and other receivables	459	-	459
TOTAL	287,594	-	287,594
Liabilities			
Trading financial liabilities: derivatives	3	-	3
Trade and other payables	930	-	930
Issued warrants	285,269	-	285,269
Issued structured notes	1,863	-	1,863
TOTAL	288,065	-	288,065

MORGAN STANLEY ASIA PRODUCTS LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2019

**13. FINANCIAL ASSETS AND FINANCIAL LIABILITIES SUBJECT TO OFFSETTING
(CONTINUED)**

	Net amounts presented in the statement of financial position US\$'000	Amounts not offset in the statement of financial position		Net exposure US\$'000
		Financial instruments ⁽¹⁾ US\$'000	Cash collateral US\$'000	
31 December 2018				
Assets				
Morgan Stanley & Co. International plc	10	(3)	-	7
Morgan Stanley Asia Securities Products LLC	285,728	(69,346)	-	216,382
Morgan Stanley International Finance S.A.	1,856	-	-	1,856
TOTAL	287,594	(69,349)	-	218,245
Liabilities				
Morgan Stanley & Co. International plc	3	(3)	-	-
Morgan Stanley Asia Securities Products LLC	69,346	(69,346)	-	-
Morgan Stanley & Co. LLC	47	-	-	47
Others	218,669	-	-	218,669
TOTAL	288,065	(69,349)	-	218,716

(1) These are amounts that would be offset in the ordinary course of business and /or in the event of default according to the intercompany cross-product legally enforceable netting arrangements with the respective Morgan Stanley Group undertakings.

MORGAN STANLEY ASIA PRODUCTS LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2019

14. ASSETS AND LIABILITIES MEASURED AT FAIR VALUE

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

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

	Quoted prices in active market (Level 1) US\$'000	Valuation techniques using observable inputs (Level 2) US\$'000	Valuation techniques with significant unobservable inputs (Level 3) US\$'000	Total US\$'000
2019				
Trading financial assets:				
Derivatives	3,647	344	-	3,991
Loans	-	468	-	468
Prepaid equity securities contracts	-	281,353	-	281,353
Total financial assets measured at fair value	<u>3,647</u>	<u>282,165</u>	<u>-</u>	<u>285,812</u>
Trading financial liabilities:				
Derivatives	14,302	1,750	-	16,052
Issued warrants	-	281,353	-	281,353
Issued structured notes	-	467	-	467
Total financial liabilities measured at fair value	<u>14,302</u>	<u>283,570</u>	<u>-</u>	<u>297,872</u>
2018				
Trading financial assets:				
Derivatives	-	10	-	10
Loans	-	1,856	-	1,856
Prepaid equity securities contracts	-	257,335	27,934	285,269
Total financial assets measured at fair value	<u>-</u>	<u>259,201</u>	<u>27,934</u>	<u>287,135</u>
Trading financial liabilities:				
Derivatives	-	3	-	3
Issued warrants	-	257,335	27,934	285,269
Issued structured notes	-	1,863	-	1,863
Total financial liabilities measured at fair value	<u>-</u>	<u>259,201</u>	<u>27,934</u>	<u>287,135</u>

MORGAN STANLEY ASIA PRODUCTS LIMITED

NOTES TO THE FINANCIAL STATEMENTS
Year ended 31 December 2019

14. 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 all classes of financial instruments recognised at fair value on a recurring basis is as follows:

Asset and Liability / Valuation Technique	Valuation Hierarchy Classification
Derivatives	
Listed Derivative Contracts	
<ul style="list-style-type: none"> Listed derivatives that are actively traded are valued based on quoted prices from the exchange. Listed derivatives that are not actively traded are valued using the same techniques as those applied to OTC derivatives. 	<ul style="list-style-type: none"> Level 1 - listed derivatives that are actively traded Level 2 - listed derivatives that are not actively traded
OTC Derivative Contracts	
<ul style="list-style-type: none"> Over-the-counter derivative contracts include option contracts related to equity prices. Depending on the product and the terms of the transaction, the fair value of OTC derivative products can be modeled using a series of techniques, including closed-form analytic formulas, such as the Black-Scholes option-pricing model, simulation models or a combination thereof. Many pricing models do not entail material subjectivity as the methodologies employed do not necessitate significant judgement, since model inputs may be observed from actively quoted markets, as is the case for option contracts. In the case of more established derivative products, the pricing models used by the Company are widely accepted by the financial services industry. 	<ul style="list-style-type: none"> Generally Level 2 - OTC derivative products valued using observable inputs, or where the unobservable input is not deemed significant Level 3 - OTC derivative products for which the unobservable input is deemed significant
Prepaid equity securities contracts, issued warrants and issued structured notes	
<ul style="list-style-type: none"> The Company issues warrants, structured notes and trades prepaid equity securities contracts which are primarily composed of instruments whose payments and redemption values are linked to the performance of equity securities, indices or currencies. Fair value of warrants, structured notes and traded prepaid equity securities contracts is determined using valuation models for the derivative and debt portions of the notes and traded prepaid equity securities contracts. These models incorporate observable inputs referencing identical or comparable securities, including prices to which the notes are linked, interest rate yield curves, option volatility and currency rates, and equity prices. Independent, external and traded prices for the notes are considered as well, the impact of the Company's own credit spreads which are based on observed secondary bond market spreads. 	<ul style="list-style-type: none"> Generally Level 2 Level 3 - in instances where the unobservable inputs are deemed significant

MORGAN STANLEY ASIA PRODUCTS LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2019

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

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

Loans

- The fair value of loans to other Morgan Stanley Group undertakings is estimated based on the present value of expected future cash flows using its best estimate of interest rate yield curves.
 - Generally Level 2
-

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

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

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

The following tables present the changes in the fair value of the Company's Level 3 financial assets and financial liabilities for the years ended 31 December 2019 and 31 December 2018. Level 3 instruments may be hedged with instruments classified in Level 1 and Level 2. The realised and unrealised gains/ (losses) for assets and liabilities within the Level 3 category presented in the following tables do not reflect the related realised and unrealised gains/(losses) on hedging instruments that have been classified by the Company within the Level 1 and/ or Level 2 categories.

Unrealised gains/(losses) during the year for assets and liabilities within the Level 3 category presented in the following tables herein may include changes in fair value during the period that were attributable to both observable and unobservable inputs.

The Morgan Stanley Group operates a number of intra-group policies to ensure that, where possible, revenues and related costs are matched. Where the trading positions included in the below tables are risk managed using financial instruments held by other Morgan Stanley Group undertakings, these policies potentially result in the recognition of offsetting gains or losses in the Company.

MORGAN STANLEY ASIA PRODUCTS LIMITED

NOTES TO THE FINANCIAL STATEMENTS
Year ended 31 December 2019

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

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

2019	Balance at 1 January 2019 US\$'000	Total gains or (losses) recognised in statement of comprehensive income ⁽¹⁾ US\$'000	Purchases US\$'000	Sales US\$'000	Settlements US\$'000	Net transfers in and / or out of Level 3 US\$'000	Balance at 31 December 2019 US\$'000	Unrealised gains or (losses) for Level 3 assets / liabilities outstanding as at 31 December 2019
								US\$'000
Prepaid equity securities contracts	27,934	862	-	(28,796)	-	-	-	-
Total financial assets measured at fair value	27,934	862	-	(28,796)	-	-	-	-
Issued warrants	(27,934)	(862)	-	-	28,796	-	-	-
Total financial liabilities measured at fair value	(27,934)	(862)	-	-	28,796	-	-	-

⁽¹⁾ The total gains or (losses) are recognised in the statement of comprehensive income as detailed in the financial instruments accounting policy (note 3(c)).

MORGAN STANLEY ASIA PRODUCTS LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2019

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

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

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

2018	Balance at 1 January 2018 US\$'000	Total gains or (losses) recognised in statement of comprehensive income ⁽¹⁾ US\$'000	Purchases US\$'000	Sales US\$'000	Settlements US\$'000	Net transfers in and / or out of Level 3 ⁽²⁾ US\$'000	Balance at 31 December 2018 US\$'000	Unrealised gains or (losses) for Level 3 assets / liabilities outstanding as at 31 December 2018 ⁽³⁾ US\$'000
Prepaid equity securities contracts	18,999	(3,744)	-	(14,044)	-	26,723	27,934	(5,386)
Total financial assets measured at fair value	18,999	(3,744)	-	(14,044)	-	26,723	27,934	(5,386)
Issued warrants	(18,999)	3,744	-	-	14,044	(26,723)	(27,934)	5,386
Total financial liabilities measured at fair value	(18,999)	3,744	-	-	14,044	(26,723)	(27,934)	5,386

⁽¹⁾ The total gains or (losses) are recognised in the statement of comprehensive income as detailed in the financial instruments accounting policy (note 3(c)).

⁽²⁾ For financial assets and financial liabilities that were transferred into and out of Level 3 during the year, gains or (losses) are presented as if the assets or liabilities had been transferred into or out of Level 3 as at the beginning of the year.

⁽³⁾ Amounts represent unrealised gains or (losses) for the year ended 31 December 2018 related to assets and liabilities still outstanding at 31 December 2018. The unrealised gains or (losses) are recognised in the statement of comprehensive income as detailed in the financial instruments accounting policy (note 3(c)).

During the year ended 31 December 2018, the Company reclassified approximately US\$33,320,000 of prepaid equity securities contracts and US\$33,320,000 of issued warrants from Level 2 to Level 3. The reclassifications were due to certain significant inputs to the fair value measurement becoming unobservable.

During the year ended 31 December 2018, the Company reclassified approximately US\$6,597,000 of prepaid equity securities contracts and US\$6,597,000 of issued warrants from Level 3 to Level 2. The reclassifications were due to certain significant inputs to the fair value measurement becoming observable.

MORGAN STANLEY ASIA PRODUCTS LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2019

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

d. Valuation of Level 3 financial assets and liabilities recognised at fair value on a recurring basis

The following disclosures provide information on the sensitivity of fair value measurements to key inputs and assumptions.

1. Quantitative information about and qualitative sensitivity of significant unobservable inputs

The following table provides information on the valuation techniques, significant unobservable inputs and their ranges and averages for each material category of assets and liabilities measured at fair value on a recurring basis.

The level of aggregation and breadth of products cause the range of inputs to be wide and not evenly distributed across the inventory. Further, the range of unobservable inputs may differ across groups in the financial services industry because of diversity in the types of products included in each group's inventory. The following disclosures also include qualitative information on the sensitivity of the fair value measurements to changes in the significant unobservable inputs. There are no predictable relationships between multiple significant unobservable inputs attributable to a given valuation technique. A single amount is disclosed when there is no significant difference between the minimum, maximum and average (weighted average or similar average / median).

	Fair value		Predominant valuation technique/ Significant unobservable inputs	Range (Weighted averages or simple averages/median ⁽¹⁾)	
	2019	2018		2019	2018
	US\$'000	US\$'000			
Prepaid equity securities contracts	-	27,934	Comparable Pricing/ Comparable equity price	-	100%
Issued warrants	-	(27,934)	Option Model/ Comparable equity price	-	100%

(1) Amounts represent weighted averages except where simple averages and the median of the inputs are provided when more relevant.

Significant Unobservable Inputs — Description and Sensitivity

An increase (decrease) to the following inputs would generally result in a higher (lower) fair value:

- Comparable equity price: A price derived from equity raises, share buybacks and external bid levels, etc. A discount or premium may be included in the fair value estimate.

MORGAN STANLEY ASIA PRODUCTS LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2019

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

d. Valuation of Level 3 financial assets and liabilities recognised at fair value on a recurring basis (Continued)

2. Sensitivity of fair values to changing significant assumptions to reasonably possible alternatives

As detailed in note 2, the valuation of Level 3 financial instruments requires the application of critical accounting judgement, involving estimations and assumptions and it is recognised that there could be a range of reasonably possible alternative values.

The Morgan Stanley Group has reviewed the unobservable parameters to identify those which would change the fair value measurement significantly if replaced by a reasonably possible alternative assumption.

In estimating the potential variability, the unobservable parameters were varied individually using statistical techniques and historic data. The potential variability estimated is likely to be greater than the actual uncertainty relating to the financial instruments as any diversification effect has been excluded.

Varying the unobservable parameters as at 31 December 2019 would have no material impact to the profit or loss, total assets less total liabilities or equity of the Company (2018:US\$nil).

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

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

15. 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.

16. CAPITAL MANAGEMENT

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

The Morgan Stanley Group actively manages its consolidated capital position based upon, among other things, business opportunities, risks, capital availability and rates of return together with internal capital policies, regulatory requirements and rating agency guidelines. 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 or sell assets to reduce debt. The Company manages its ordinary share capital of US\$50,000 (2018: US\$50,000) as capital.

MORGAN STANLEY ASIA PRODUCTS LIMITED

NOTES TO THE FINANCIAL STATEMENTS

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16. CAPITAL MANAGEMENT (CONTINUED)

The issuance of securities is part of the Company's operating activities. The Company has contractual obligations to deliver cash or underlying financial instruments to holders of the issued securities. Also, these obligations will not be settled in the Company's own equity instruments. These liabilities are not subordinated and the security holders rank equally with other creditors of the Company. The issued securities are also not contracts that evidence any residual interest in the assets of the Company. The Company therefore does not regard the financial liabilities derived from its issuance activity as part of its capital.

The Company has also entered into financial support agreement with its immediate parent, Morgan Stanley Asia Securities Products LLC ("MSASP") and with Morgan Stanley Hong Kong 1238 Limited ("MSHK 1238"), whereby MSASP and MSHK 1238 agree to provide financial support by way of funds injection in the form of equity capital or shareholder's loan in the event the Company needs funding to fulfil its obligations and liabilities under its issuance program.

17. RELATED PARTY DISCLOSURES

Parent and subsidiary relationships

Parent and ultimate controlling entity

The Company's immediate parent undertaking is Morgan Stanley Asia Securities Products LLC, which is registered in the Cayman Islands.

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 is incorporated in the State of Delaware, the United States of America. Copies of its financial statements can be obtained from www.morganstanley.com/investorrelations.

Key management compensation

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

Due to the nature of the Company's activities, key management personnel provide minimal services specific to the Company and as a result, no compensation is paid to key management personnel in respect of their services to the Company.

Transactions with related parties

The Morgan Stanley Group conducts business for clients globally through a combination of both functional and legal entity organisational structures. Accordingly, the Company is closely integrated with the operations of the Morgan Stanley Group and enters into transactions with other Morgan Stanley Group undertakings on an arm's length basis for the purposes of utilising financing, trading and risk management, and infrastructure services. The nature of these relationships along with information about the transactions and outstanding balances is given below. All the amounts outstanding as disclosed below are unsecured and will be settled in cash via intercompany mechanism. The Company has not recognised any expense and has made no provision for impairment relating to the amount of outstanding balances from related parties (2018: US\$nil).

Audit fees have been borne by another Morgan Stanley Group undertaking in both the current and prior year.

All operating expenses are borne by other Morgan Stanley Group undertakings.

All issuances of financial liabilities are guaranteed by Morgan Stanley

MORGAN STANLEY ASIA PRODUCTS LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2019

17. RELATED PARTY DISCLOSURES (CONTINUED)

Funding

The Company receives funding from and provides funding to other Morgan Stanley Group undertakings in the following forms:

General funding

General funding is undated, unsecured, floating rate lending, other than certain funding which is dated on a rolling 395 day term. Funding may be received or provided for specific transaction related funding requirements, or for general operational purposes. The interest rates are established by the Morgan Stanley Group Treasury function for all entities within the Morgan Stanley Group and approximate the market rate of interest that the Morgan Stanley Group incurs in funding its business.

Details of the outstanding balances on these funding arrangements and the related interest income recognised in the statement of comprehensive income during the year are shown in the table below:

				2019		2018	
				Interest	Balance	Interest	Balance
				\$'000	\$'000	\$'000	\$'000
<i>Rolling 395 day term</i>							
Amounts due from:							
The Company's	direct	parent					
undertakings				122	10,052	-	-
				<hr/>	<hr/>	<hr/>	<hr/>
<i>Undated</i>							
Amounts due from:							
The Company's	direct	parent					
undertakings				-	722	-	-
Amounts due to:							
Other Morgan	Stanley	Group					
undertakings				-	47	-	-
				<hr/>	<hr/>	<hr/>	<hr/>

MORGAN STANLEY ASIA PRODUCTS LIMITED

NOTES TO THE FINANCIAL STATEMENTS

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17. RELATED PARTY DISCLOSURES (CONTINUED)

Trading and risk management

The Company issues warrants and structured notes and hedges the obligations arising from the issuance by entering into prepaid equity securities contracts, derivative contracts and loans designated at FVPL with other Morgan Stanley Group undertakings. All such transactions are entered into on an arm's length basis. These transactions may give rise to credit risk either for the Company, or to a related party towards the Company.

The total amounts receivable and payable on issued warrants, issued structured notes, prepaid equity securities contracts, derivative contracts and loans designated at FVPL outstanding at the year-end were as follows:

	2019 US\$'000	2018 US\$'000
Amounts due from:		
The Company's direct parent undertaking	281,353	285,728
Other Morgan Stanley Group undertakings	930	1,866
	<u>282,283</u>	<u>287,594</u>
Amounts due to:		
The Company's direct parent undertaking	153,886	69,346
Other Morgan Stanley Group undertakings	523	50
	<u>154,409</u>	<u>69,396</u>