Registered number: 43542

Registered office:
c/o Maples Corporate Services Limited
PO Box 309
Ugland House
Grand Cayman
KY1 - 1104
Cayman Islands

MORGAN STANLEY CAPITAL (CAYMAN ISLANDS) LIMITED

Report and financial statements

31 December 2015

MORGAN STANLEY CAPITAL (CAYMAN ISLANDS) LIMITED

CONTENTS **PAGE**

Strategic report	1
Directors' report	6
Directors' responsibilities statement	7
Report of the réviseur d’entreprises agréé	8
Statement of comprehensive income	10
Statement of changes in equity	11
Statement of financial position	12
Statement of cash flows	13
Notes to the financial statements	14

STRATEGIC REPORT

The Directors present their Strategic report for Morgan Stanley Capital (Cayman Islands) Limited (the "Company") for the year ended 31 December 2015.

PRINCIPAL ACTIVITY

The Company is an exempt company incorporated under the laws of the Cayman Islands.

The principal activity of the Company is the issuance of Optimised Portfolios as Listed Securities ("OPALS") and the hedging of the obligations arising pursuant to such issuances with Equity Linked Obligations ("ELOs").

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

During the first half of 2015, global growth was supported by a rebound in the U.S. and firmer growth in the euro zone and the United Kingdom economies, partially offset by sluggishness in major emerging market economies. During the second half of 2015, global growth slowed as a result of the continued sluggishness of emerging market economies, declines in energy prices, and the slowdown of China's economic growth. Global real gross domestic product growth decelerated in 2015 from 2014. Growth in emerging market economies slowed for a fourth straight year, while growth in developed market economies was steady but sluggish. Notable trends during the year included falling oil and other commodity prices, an appreciating U.S. dollar weighing on global trade flows and increasing policy challenges in a number of major emerging market economies, most notably China. The U.S. Federal Reserve announced a rate increase in December 2015 based on cumulative labour market progress and rising confidence in achieving its inflation target. However, with Europe and Japan still struggling and China decelerating, the European Central Bank, the Bank of Japan and the People's Bank of China acted to continue their targeted monetary policy easing measures. Subsequent to 31 December 2015, the Bank of Japan announced a programme of Quantitative and Qualitative Monetary Easing ('QE') with a Negative Interest Rate that introduced a three tier policy rate system for bank reserves with a low rate of negative 0.1%. Additionally, in March 2016 the European Central Bank ("ECB") announced a further QE programme and reduced interest rates with the deposit facility rate falling from negative 0.3% to negative 0.4% and the benchmark interest rate falling from 0.05% to zero%.

The statement of comprehensive income is set out on page 10. The Company's result for the year is $nil which is consistent with the Company's function and the prior year. Interest income and interest expense decreased by $4,182,000 compared to 31 December 2014. This is due to a reduction in the average outstanding loan receivable and payable balances with other Morgan Stanley Group undertakings during the year when compared to the prior year.

The statement of financial position is set out on page 12. The Company has seen a decrease in the level of OPALS in issuance compared with 2014. As a result, the value of financial assets and financial liabilities designated at fair value through profit or loss, which are represented by ELOs and OPALS respectively, have decreased by $1,085,653,000 to $1,131,995,000 at 31 December 2015. The decrease in OPALS is due to fair value movements, issuances and redemptions during the year, which has resulted in a corresponding decrease in ELOs. Other receivables and other payables have increased by $125,000 and $127,000 respectively, which is primarily due to interest income earned and interest expense charged on intercompany balances during the year.

The performance of the Company is included in the results of the Morgan Stanley Group which are disclosed in the Morgan Stanley Group's Annual Report on Form 10-K to the US Securities and Exchange Commission. The Morgan Stanley Group manages its key performance indicators on a global basis but in consideration of individual legal entities. For this reason, the Company's Directors believe that providing further performance indicators for the Company itself would not enhance an understanding of the development, performance or position of the business of the Company.

STRATEGIC REPORT

BUSINESS REVIEW (CONTINUED)

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

Risk management

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

Set out below is an overview of the Company’s policies for the management of financial risk and other significant business risks. More detailed qualitative and quantitative disclosures about the Company’s management of and exposure to financial risks are included in note 11 to the financial statements.

Market risk
Market risk refers to the risk of losses for a position or portfolio due to changes in rates, foreign exchange, equities, implied volatilities, correlations or other market factors.

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

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

It is the policy and objective of the Company not to be exposed to market risk.

Credit risk
Credit risk refers to the risk of loss arising when a borrower, counterparty or issuer does not meet its financial obligations to the Company. Credit risk includes the risk that economic, social and political conditions and events in a foreign country will adversely affect an obligor’s ability and willingness to fulfil their obligations.

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

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

Liquidity and funding risk
Liquidity and funding 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 and funding risk also encompasses the Company’s ability to meet its financial obligations without experiencing significant business disruption or reputational damage that may threaten its viability as a going concern.

The primary goal of the Morgan Stanley Group’s liquidity and funding 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. 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 14.

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

STRATEGIC REPORT

BUSINESS REVIEW (CONTINUED)

Risk management (continued)

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

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

The Company has established an operational risk framework to identify measure, monitor and control risk across the Company. This framework is consistent with the framework established by the Morgan Stanley Group and includes escalation to the Company's Board of directors and appropriate senior management personnel. Effective operational risk management is essential to reducing the impact of operational risk incidents and mitigating legal and reputational risks. The framework is continually evolving to account for changes in the Company and to respond to the changing regulatory and business environment. The Company has implemented operational risk data and assessment systems to monitor and analyse internal and external operational risk events, to assess business environment and internal control factors and to perform scenario analysis. The collected data elements are incorporated in the operational risk capital model. The model encompasses both quantitative and qualitative elements. Internal loss data and scenario analysis results are direct inputs to the capital model, while external operational incidents, business environment and internal control factors are evaluated as part of the scenario analysis process.

In addition, the Company employs a variety of risk processes and mitigants to manage its operational risk exposures. These include a strong governance framework, a comprehensive risk management programme and insurance. Operational risks and associated risk exposures are assessed relative to the risk tolerance established by the Board and are prioritised accordingly. The breadth and range of operational risk are such that the types of mitigating activities are wide-ranging. Examples of activities include enhancing defences against cyberattacks; use of legal agreements and contracts to transfer and/or limit operational risk exposures; due diligence; implementation of enhanced policies and procedures; exception management processing controls; and segregation of duties.

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

STRATEGIC REPORT

BUSINESS REVIEW (CONTINUED)

Risk management (continued)

Operational risk (continued)

The Operational Risk Department is independent of the divisions and reports to the Chief Risk Officer. The Operational Risk Department provides oversight of operational risk management and independently assesses measures and monitors operational risk. The Operational Risk Department works with the divisions and control groups to help ensure a transparent, consistent and comprehensive framework for managing operational risk within each area and across the Company. The Operational Risk Department scope includes oversight of technology and data risks (e.g., cybersecurity) and a supplier management (vendor risk oversight and assessment) programme. Furthermore, the Operational Risk Department supports the collection and reporting of operational risk incidents and the execution of operational risk assessments; provides the infrastructure needed for risk measurement and risk management; and ensures ongoing validation and verification of the Company’s advanced measurement approach for operational risk capital.

Business Continuity Management is responsible for identifying key risks and threats to the Company’s resiliency and planning to ensure that a recovery strategy and required resources are in place for the resumption of critical business functions following a disaster or other business interruption. Disaster recovery plans are in place for critical facilities and resources, and redundancies are built into the systems as deemed appropriate. The key components of the Company’s Business Continuity Management Programme include: crisis management; business recovery plans; applications/data recovery; work area recovery; and other elements addressing management, analysis, training and testing.

The Company maintains an information security programme that coordinates the management of information security risks and is designed to address regulatory requirements. Information security policies are designed to protect the Company’s information assets against unauthorised disclosure, modification or misuse. These policies cover a broad range of areas, including: application entitlements, data protection, incident response, Internet and electronic communications, remote access and portable devices. The Company has also established policies, procedures and technologies to protect its computers and other assets from unauthorised access.

In connection with its ongoing operations, the Company utilises the services of external vendors, which it anticipates will continue and may increase in the future. These services include, for example, outsourced processing and support functions and consulting and other professional services. The Company manages its exposures to these services through a variety of means such as the performance of due diligence, consideration of operational risk, implementation of service level and other contractual agreements, and ongoing monitoring of the vendors’ performance. The Company maintains a supplier risk management programme with policies, procedures, organisation, governance and supporting technology that satisfies regulatory requirements. The programme is designed to ensure that adequate risk management controls over the services exist, including, but not limited to information security, operational failure, financial stability, disaster recoverability, reputational risk, safeguards against corruption and termination.

STRATEGIC REPORT

BUSINESS REVIEW (CONTINUED)

Risk management (continued)

Legal, regulatory and compliance risk

Legal, regulatory and compliance risk includes the risk of legal or regulatory sanctions, material financial loss; including fines, penalties, judgements, damages and/ or settlements or loss to reputation the Company may suffer as a result of a failure to comply with laws, regulations, rules, related self-regulatory organisation standards and codes of conduct applicable to our business activities. This risk also includes contractual and commercial risk, such as the risk that a counterparty's performance obligations will be unenforceable. It also includes compliance with Anti-Money Laundering and terrorist financing rules and regulations. The Company is generally subject to extensive regulation in the different jurisdictions in which it conducts its business. In the current environment of rapid and possibly transformational regulatory changes, the Company also views regulatory changes as a component of legal risk.

The Company has established procedures designed to foster compliance with applicable statutory and regulatory requirements. The Company, principally through the Morgan Stanley Group's Legal and Compliance Division, also has established procedures that are designed to require that the Morgan Stanley Group's policies relating to business conduct, ethics and practices are followed globally. In connection with its businesses, the Company continuously develops various procedures addressing issues such as regulatory capital requirements, sales and trading practices, new products, information barriers, potential conflicts of interest, structured transactions, use and safekeeping of customer funds and securities, lending and credit granting, anti-money laundering, privacy and recordkeeping. In addition, the Company has established procedures to mitigate the risk that a counterparty's performance obligations will be unenforceable, including consideration of counterparty legal authority and capacity, adequacy of legal documentation, the permissibility of a transaction under applicable law and whether applicable bankruptcy or insolvency laws limit or alter contractual remedies. The legal and regulatory focus on the financial services industry presents a continuing business challenge for the Company.

Culture, values and conduct of employees

All of the Morgan Stanley Group's employees have accountability for risk management. The Morgan Stanley Group strives to establish a culture of effective risk management through its defined core values, governance framework, management oversight, training and development programs, policies, procedures, and defined roles and responsibilities within the Morgan Stanley Group. The actions and conduct of each employee are essential to risk management. The Morgan Stanley Group's Code of Conduct (the "Code") has been established to provide a framework and standards for employee conduct that further reinforces the Morgan Stanley Group's commitment to integrity and high ethical standards. Every new hire and every employee annually must certify to their understanding of and adherence to the Code. The employee annual review process includes evaluation of adherence to the Code. The Global Incentive Compensation Discretion Policy sets forth standards that specifically provide that managers must consider whether the employee effectively managed and supervised the risk control practices of his/her employee reports during the performance year. The Morgan Stanley Group has several mutually reinforcing processes to identify incidents of employee conduct that may have an impact on the employment status, current year compensation or prior year compensation. The Morgan Stanley Group's clawback and cancellation provisions permit recovery of deferred incentive compensation where, for example, an employee's act or omission (included with respect to direct supervisory responsibilities) causes a restatement of the Morgan Stanley Group's consolidated financial results, constitutes a violation of the Morgan Stanley Group's global risk management principles, policies and standards, or causes a loss of revenue associated with a position on which the employee was paid and the employee operated outside of internal control policies.

Approved by the Board and signed on its behalf by

Director – 25 April 2016

DIRECTORS' REPORT

The Directors present their report and financial statements (which comprise the statement of comprehensive income, the statement of changes in equity, the statement of financial position, the statement of cash flows, and the related notes, 1 to 15) for the Company for the year ended 31 December 2015.

RESULTS AND DIVIDENDS

The result for the year, after tax, was $nil (2014: $nil).

During the year, no dividends were paid or proposed (2014: $nil).

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".

RISK MANAGEMENT AND FUTURE DEVELOPMENTS

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

DIRECTORS

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

H. Nakajima
M. Stern

DIRECTORS' LIABILITY INSURANCE

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

DIRECTORS' INDEMNITY

Qualifying third party indemnity provisions were in force during the year and up to and including the date of the Directors' report for the benefit of the Directors of the Company.

EVENTS AFTER THE REPORTING DATE

There have been no significant events since the reporting date.

AUDITOR

Deloitte Audit has expressed their willingness to continue in office as auditor of the Company and will be deemed to be re-appointed.

Statement as to disclosure of information to the auditor

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

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

This confirmation is given and should be interpreted in accordance with the provisions of section 418 of the Companies Act 2006 of the UK (the "Companies Act 2006").

Approved by the Board and signed on its behalf by

Director – 25 April 2016

DIRECTORS' RESPONSIBILITIES STATEMENT

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

The Company was incorporated as an exempted company in the Cayman Islands under the laws of the Cayman Islands. The Directors and the shareholders of the Company require the financial statements of the Company to be prepared in accordance with Part 15 of the Companies Act 2006 of the United Kingdom (that would have applied had these been statutory accounts under the Companies Act 2006) and drawn up in US dollars.

UK Company law requires the Directors to prepare financial statements for each financial year. Under that law the Directors have elected to prepare the financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union ("EU"). Under UK company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period.

In preparing these financial statements, the Directors are required by International Accounting Standard ("IAS") '*Presentation of financial statements' ("IAS 1")* to:

- properly select and apply accounting policies;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- provide additional disclosures when compliance with the specific requirements in IFRSs is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance; and
- make an assessment of the Company's ability to continue as a going concern.

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

Furthermore, as the Company is an issuer whose securities are admitted to trading on the Luxembourg stock exchange, which is a regulated market, the Company must comply, amongst others, with Article 3(2) (c) of the Luxembourg law of 11 January 2008, as amended, in relation to certain transparency requirements (the "Transparency Law").

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

- the financial statements have been prepared in accordance with IFRSs as issued by the International Accounting Standards Board ("IASB") and as endorsed by the EU, and give a true and fair view of the assets, liabilities, financial position and result of the Company; and

- the management report represented by the Directors' report includes a fair review of the development and performance of the business and the 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 by

Director – 25 April 2016

Deloitte.

Deloitte Audit
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To the Board of Directors of
Morgan Stanley Capital (Cayman Islands) Limited
Cayman Islands

REPORT OF THE RÉVISEUR D'ENTREPRISES AGRÉÉ

Report of the financial statements

We have audited the accompanying financial statements of Morgan Stanley Capital (Cayman Islands) Limited for the year ended 31 December 2015 which comprise the statement of comprehensive income, the statement of changes in equity, the statement of financial position as at 31 December 2015 and the statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Board of Directors' responsibility for the financial statements

The Board of Directors is responsible for the preparation and fair presentation of these financial statements in accordance with International Standards as adopted by the European Union, and for such internal control as the Board of Directors determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Responsibility of the réviseur d'entreprises agréé

Our responsibility to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Finance Reporting Standards on Auditing as adopted for Luxembourg by the *Commission de Surveillance du Secteur Financier*. Those standards require us to comply with the ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the réviseur d'entreprises agréé judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud of error. In making those risk assessments, the réviseur d'entreprises agréé considers internal control relevant to the Company's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.

An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the Board of Directors, as well as evaluating the overall presentation of the financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Société à responsabilité limitée au capital de 35,000 €
RCS Luxembourg B 67.895
Autorisation d'établissement : 10022179

Deloitte.

Opinion

In our opinion the financial statements give a true and fair view of the financial position of Morgan Stanley Capital (Cayman Islands) Limited as of 31 December 2015 and of its financial performance and its cash flows for the year ended in accordance with International Financial Reporting Standards as adopted by the European Union.

Report on other legal and regulatory requirements

The Strategic report and the Directors' report, which are the responsibility of the Board of Directors, are consistent with the financial statements.

For Deloitte Audit, *Cabinet de révision agréé*

Martin Flaunet, *Réviseur d'entreprises agréé*

Partner

Luxembourg, April 25, 2016

STATEMENT OF COMPREHENSIVE INCOME
Year ended 31 December 2015

	Note	2015 $'000	2014 $'000
Net gains on financial instruments designated at fair value through profit or loss		-	-
Interest income	4, 15	65	4,247
Interest expense	4, 15	(65)	(4,247)
RESULT BEFORE INCOME TAX		-	-
Income tax	6	-	-
RESULT AND TOTAL COMPREHENSIVE INCOME FOR THE YEAR		-	-

All operations were continuing in the current and prior year.

The notes on pages 14 to 36 form an integral part of the financial statements.

STATEMENT OF CHANGES IN EQUITY
Year ended 31 December 2015

	Share capital $'000	Retained earnings $'000	Total equity $'000
Balance at 1 January 2014	1	-	1
Result and total comprehensive income for the year	-	-	-
Balance at 31 December 2014	1	-	1
Result and total comprehensive income for the year	-	-	-
Balance at 31 December 2015	1	-	1

The notes on pages 14 to 36 form an integral part of the financial statements.

MORGAN STANLEY CAPITAL (CAYMAN ISLANDS) LIMITED
Registered number: 43542

STATEMENT OF FINANCIAL POSITION
As at 31 December 2015

	Note	2015 $'000	2014 $'000
ASSETS			
Loans and receivables:			
Other receivables	15	3,147	3,022
Financial assets designated at fair value through profit or loss	7,11,12,15	1,131,995	2,217,648
TOTAL ASSETS		1,135,142	2,220,670
LIABILITIES AND EQUITY			
Financial liabilities at amortised cost:			
Bank loans and overdrafts		-	2
Other payables	15	3,146	3,019
Financial liabilities designated at fair value through profit or loss	7,11,12	1,131,995	2,217,648
TOTAL LIABILITIES		1,135,141	2,220,669
EQUITY			
Share capital	8,14	1	1
Retained earnings		-	-
Equity attributable to owners of the Company		1	1
TOTAL EQUITY		1	1
TOTAL LIABILITIES AND EQUITY		1,135,142	2,220,670

These financial statements were approved by the Board and authorised for issue on 25 April 2016

Signed on behalf of the Board

Director

The notes on pages 14 to 36 form an integral part of the financial statements.

STATEMENT OF CASH FLOWS
Year ended 31 December 2015

	2015	2014
	$'000	$'000
OPERATING ACTIVITIES		
Result for the year	-	-
Adjustments for:		
Interest income	(65)	(4,247)
Interest expense	65	4,247
Operating cash flows before changes in operating assets and liabilities	-	-
Changes in operating assets		
(Increase)/decrease in loans and receivables	(60)	189,286
Decrease/ (increase) in financial assets designated at fair value through profit or loss	1,085,653	(298,177)
	1,085,593	(108,891)
Changes in operating liabilities		
Increase/(decrease) in financial liabilities at amortised cost	62	(189,288)
(Decrease)/ increase in financial assets designated at fair value through profit or loss	(1,085,653)	298,177
	(1,085,591)	108,889
NET CASH FLOWS FROM/(USED) IN OPERATING ACTIVITIES	2	(2)
NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS	2	(2)
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE YEAR	(2)	-
CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR	-	(2)

The notes on pages 14 to 36 form an integral part of the financial statements.

NOTES TO THE FINANCIAL STATEMENTS
Year ended 31 December 2015

1. CORPORATE INFORMATION

The Company is incorporated and domiciled in the Cayman Islands, at the following address:

Maples Corporate Services Limited, PO Box 309, Ugland House, Grand Cayman, KY1-1104, Cayman Islands.

The Company is engaged in the issuance of OPALS 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 IFRSs issued by the International Accounting Standards Board ("IASB") as adopted by the European Union ("EU"), Interpretations issued by the IFRS Interpretations Committee ("IFRIC") and Part 15 of the Companies Act 2006.

New standards and interpretations adopted during the year

The following amendments to standards and interpretations relevant to the Company's operations were adopted during the year. These amendments to standards and interpretations did not have a material impact on the Company's financial statements.

As part of the 2010 – 2012 Annual Improvements Cycle published in December 2013, the IASB made amendments to the following standards that are relevant to the Company's operations: IFRS 2 '*Share-based payment'* , IFRS 3 '*Business combinations'*, , IFRS 13 '*Fair value measurement*', IAS 16 '*Property, plant and equipment*', IAS 24 '*Related party disclosures*' and IAS 38 '*Intangible assets*' (for application in accounting periods beginning on or after 1 July 2014). The improvements were endorsed by the EU in December 2014 requiring application on or after 1 February 2015, with earlier application permitted. The Company adopted the 2010 – 2012 Annual Improvements with effect from 1 January 2015.

As part of the 2011 – 2013 Annual Improvements Cycle published in December 2013, the IASB made amendments to the following standards that are relevant to the Company's operations: IFRS 13 '*Fair value measurement*' (for application in accounting periods beginning on or after 1 July 2014). The improvements were endorsed by the EU in December 2014 requiring application on or after 1 January 2015, with earlier application permitted. The Company adopted the 2011 – 2013 Annual Improvements with effect from 1 January 2015.

There were no other 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 standards, amendments to standards and interpretations relevant to the Company's operations were issued by the IASB but not yet mandatory. Except where otherwise stated, the Company does not expect that the adoption of the following standards, amendments to standards and interpretations will have a material impact on the Company's financial statements.

An amendment to IAS 1 '*Presentation of financial statements'* in relation to the 'Disclosure initiative' was issued by the IASB in December 2014, for application in annual periods beginning on or after 1 January 2016.

IFRS 9 *'Financial instruments'* ("IFRS 9") was issued by the IASB in November 2009, amended in November 2013, and revised and reissued by the IASB in July 2014. IFRS 9 is applicable retrospectively, except where otherwise prescribed by transitional provisions of the standard, and is effective for annual periods beginning on or after 1 January 2018. Early adoption, either in full or relating to own credit in isolation, is permitted. The Company is currently assessing the impact of IFRS 9 on its financial statements.

2. BASIS OF PREPARATION (CONTINUED)

New standards and interpretations not yet adopted (continued)

As part of the September 2014 Improvements to IFRSs, the IASB made amendments to the following standards that are relevant to the Company's operations: IFRS 7 '*Financial instruments: Disclosures*', IAS 19 *'Employee benefits'* and IAS 34 '*Interim financial reporting*' (for application in accounting periods beginning on or after 1 January 2016).

Basis of measurement

The financial statements of the Company are prepared under the historical cost basis except for certain financial instruments that have been measured at fair value as explained in the accounting policies below.

Use of estimates and sources of uncertainty

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

For further details on the judgements used in determining fair value of certain assets and liabilities, see note 12.

The going concern assumption

The Company's business activities, together with the factors likely to affect its future development, performance and position, are reflected in the Business Review section of the Strategic report on pages 1 to 4. In addition, the notes to the financial statements include the Company's objectives, policies and processes for managing its capital; its financial risk management objectives; details of its financial instruments; and its exposures to credit risk and liquidity risk.

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

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

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

a. Functional currency

Items included in the financial statements are measured and presented in US dollars, the currency of the primary economic environment in which the Company operates.

All currency amounts in the financial statements and Strategic report 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 denominated in currencies other than US dollars are recorded at the rates prevailing at the dates of the transactions. All other 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

The Company classifies its financial assets into the following categories on initial recognition: financial assets designated at fair value through profit or loss and loans and receivables.

The Company classifies its financial liabilities into the following categories on initial recognition: financial liabilities designated at fair value through profit or loss and financial liabilities at amortised cost.

More information regarding these classifications is included below:

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

The Company has designated certain financial instruments at fair value through profit or loss when the financial instrumentt contains an embedded derivative that significantly modifies the cash flows that would otherwise be required under the contract.

From the date the transaction in a financial instrument designated at fair value through profit or loss is entered into (trade date) until settlement date, the Company recognises any unrealised fair value changes in the contract as financial instruments designated at fair value through profit or loss. On settlement date, the fair value of consideration given or received is recognised as a financial instrument designated at fair value through profit or loss (see note 3(d) below). All subsequent changes in fair value, foreign exchange differences, interest and dividends are reflected in the statement of comprehensive income in 'Net gains/on financial instruments 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'.

ii) Loans and receivables and financial liabilities at amortised cost

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

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

c. Financial instruments (continued)

ii) Loans and receivables and financial liabilities at amortised cost (continued)

Financial liabilities at amortised cost are recognised when the Company becomes a party to the contractual provisions of the instrument. They are initially measured at fair value (see note 3(d) below) and subsequently measured at amortised cost. Interest is recognised in the statement of comprehensive income in 'Interest expense' using the effective interest rate method as described below. Transaction costs that are directly attributable to the issue of the financial liability are added to or deducted from the fair value on initial recognition.

The effective interest rate method is a method of calculating the amortised cost of a financial instrument (or a group of financial instruments) and of allocating the interest income or interest expense over the expected life of the financial instrument. The effective interest rate is the rate that exactly discounts the estimated future cash payments and receipts through the expected life of the financial instrument (or, where appropriate a shorter period) to the carrying amount of the financial instrument. The effective interest rate is established on initial recognition of the financial instrument. The calculation of the effective interest rate includes all fees and commissions paid or received, transaction costs, and discounts or premiums that are an integral part of the effective interest rate. Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial instrument.

d. Fair value

Fair value measurement

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

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 determining fair value, the Company uses various valuation approaches and establishes a hierarchy for inputs used in measuring fair value that maximises the use of relevant observable inputs and minimises the use of unobservable inputs by requiring that the most observable inputs be used when available. Observable inputs are inputs that market participants would use in pricing the asset or liability that were developed based on market data obtained from sources independent of the Company. Unobservable inputs are inputs that reflect assumptions the Company believes other market participants would use in pricing the asset or liability, that are developed based on the best information available in the circumstances.

The hierarchy is broken down into three levels based on the observability of inputs as follows:

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

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

- Level 2 – Valuation techniques using observable inputs

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

- Level 3 – Valuation techniques with significant unobservable inputs

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

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

d. Fair value (continued)

The availability of observable inputs can vary from product to product and is affected by a wide variety of factors, including, for example, the type of product, whether the product is new and not yet established in the marketplace, the liquidity of markets and other characteristics particular to the product. To the extent that valuation is based on models or inputs that are less observable or unobservable in the market, the determination of fair value requires more judgement. Accordingly, the degree of judgement exercised by the Company in determining fair value is greatest for instruments categorised in Level 3 of the fair value hierarchy.

The Company considers prices and inputs that are current as of the measurement date, including during periods of market dislocation. In periods of market dislocation, the observability of prices and inputs may be reduced for many instruments. This condition could cause an instrument to be reclassified from Level 1 to Level 2 or Level 2 to Level 3 of the fair value hierarchy.

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, for disclosure purposes, the level in the fair value hierarchy within which the fair value measurement falls in its entirety is determined based on the lowest level input that is significant to the fair value measurement in its entirety.

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 short-term and long-term borrowings (primarily structured notes) for which the fair value option was elected and to OTC derivatives. The Company considers the impact of changes in its own credit spreads based upon observations of the secondary bond market spreads when measuring the fair value for short-term and long-term 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. The Company also considers collateral held and legally enforceable master netting agreements that mitigate its exposure to each counterparty.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

d. Fair value (continued)

Valuation techniques (continued)

Adjustments for model uncertainty are taken for positions whose underlying models are reliant on significant inputs that are neither directly nor indirectly observable, hence requiring reliance on established theoretical concepts in their derivation. These adjustments are derived by making assessments of the possible degree of variability using statistical approaches and market-based information where possible. The Company generally subjects all valuations and models to a review process initially and on a periodic basis thereafter.

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

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

Where the Company manages a group of financial assets and financial liabilities on the basis of its net exposure to either market risks or credit risk, the Company measures the fair value of that group of financial instruments consistently with how market participants would price the net risk exposure at the measurement date.

Valuation process

The Valuation Review Group (“VRG”) within the Financial Control Group (“FCG”) is responsible for the Company’s fair value valuation policies, processes and procedures. VRG is independent of the business units and reports to the Chief Financial Officer of the Morgan Stanley Group (“CFO”), who has final authority over the valuation of the Company’s financial instruments. VRG implements valuation control processes to validate the fair value of the Company’s financial instruments measured at fair value including those derived from pricing models. These control processes are designed to assure that the values used for financial reporting are based on observable inputs wherever possible. In the event that observable inputs are not available, the control processes are designed to ensure that the valuation approach utilised is appropriate and consistently applied and that the assumptions are reasonable.

The Company’s control processes apply to financial instruments categorised in Level 1, Level 2 or Level 3 of the valuation hierarchy, unless otherwise noted. These control processes include:

> *Model Review*. VRG, in conjunction with the Market Risk Department (“MRD”) and, where appropriate, the Credit Risk Management Department, both of which report to the Chief Risk Officer of the Morgan Stanley Group (“CRO”), independently review valuation models’ theoretical soundness, the appropriateness of the valuation methodology and calibration techniques developed by the business units using observable inputs. Where inputs are not observable, VRG reviews the appropriateness of the proposed valuation methodology to ensure it is consistent with how a market participant would arrive at the unobservable input. The valuation methodologies utilised in the absence of observable inputs may include extrapolation techniques and the use of comparable observable inputs. As part of the review, VRG develops a methodology to independently verify the fair value generated by the business unit’s valuation models. All of the Company’s valuation models are subject to an independent annual review.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

d. Fair value (continued)

Valuation process (continued)

Independent Price Verification. The business units are responsible for determining the fair value of financial instruments using approved valuation models and valuation methodologies. Generally on a monthly basis, VRG independently validates the fair values of financial instruments determined using valuation models by determining the appropriateness of the inputs used by the business units and by testing compliance with the documented valuation methodologies approved in the model review process described above.

VRG uses recently executed transactions, other observable market data such as exchange data, broker/ dealer quotes, third-party pricing vendors and aggregation services for validating the fair values of financial instruments generated using valuation models. VRG assesses the external sources and their valuation methodologies to determine if the external providers meet the minimum standards expected of a third-party pricing source. Pricing data provided by approved external sources are evaluated using a number of approaches; for example, by corroborating the external sources' prices to executed trades, by analysing the methodology and assumptions used by the external source to generate a price and/ or by evaluating how active the third-party pricing source (or originating sources used by the third-party pricing source) is in the market. Based on this analysis, VRG generates a ranking of the observable market data to ensure that the highest-ranked market data source is used to validate the business unit's fair value of financial instruments.

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

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

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

e. Derecognition of financial assets and liabilities

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

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

f. Impairment of financial assets

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

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

f. Impairment of financial assets (continued)

Impairment losses on loans and receivables are measured as the difference between the carrying amount of the loans and receivables and the present value of estimated cash flows discounted at the asset's original effective interest rate. Such impairment losses are recognised in the statement of comprehensive income within 'Other expense' and are recognised against the carrying amount of the impaired asset on the statement of financial position. Interest on the impaired asset continues to be accrued on the reduced carrying amount based on the original effective interest rate of the asset.

If in a subsequent year, the amount of the estimated impairment loss decreases because of an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed as detailed by financial asset in note 3(c)(ii). Any reversal is limited to the extent that the value of the asset may not exceed the original amortised cost of the asset had no impairment occurred.

g. Cash and cash equivalents

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

h. Offsetting of financial assets and financial liabilities

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

4. INTEREST INCOME AND INTEREST EXPENSE

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

No other gains or losses have been recognised in respect of loans and receivables other than as disclosed as 'Interest income'.

No other gains or losses have been recognised in respect of financial liabilities at amortised cost other than as disclosed as 'Interest expense' within the statement of comprehensive income.

5. AUDIT FEES

Audit fees of $56,000 (2014: $61,000) have been borne by another Morgan Stanley Group undertaking in both the current and prior year.

6. INCOME TAX EXPENSE

The Company has been granted exempt status in the Cayman Islands. A 20 year tax exemption certificate was issued in 2012.

7. FINANCIAL ASSETS AND FINANCIAL LIABILITIES DESIGNATED AT FAIR VALUE THROUGH PROFIT OR LOSS

Financial instruments designated at fair value through profit or loss consist primarily of the following financial liabilities and financial assets:

OPALS – These instruments are securities whose investment performance corresponds generally to that of a benchmark index by an indirect investment in a basket of shares. All dividends and certain other amounts associated with these baskets, net of certain expenses, are received by the Company to enable it to fulfil its obligations to holders of OPALS. These instruments contain an embedded derivative which significantly modifies the cash flows of the issuance. The return on the instrument is linked to an underlying that is not clearly and closely related to the debt host including, but not limited to, equity, credit or commodity- linked notes. Using the fair value option, the entire instrument is measured at fair value through profit or loss.

ELOs – The Company is a party to a Master Equity Linked Obligation Agreement and to a Master Equity Linked Counterparty Agreement with other Morgan Stanley Group undertakings. ELOs are purchased to hedge the issuance of OPALS and track the value of a basket of equities. These instruments contain an embedded derivative that significantly modifies the cash flows that would otherwise be required under the contract. Using the fair value option, the entire instrument is measured at fair value through profit or loss.

	2015		2014	
	Assets $'000	**Liabilities $'000**	**Assets $'000**	**Liabilities $'000**
OPALS	-	1,131,995	-	2,217,648
ELOs	1,131,995	-	2,217,648	-
	1,131,995	1,131,995	2,217,648	2,217,648

There were no significant gains or losses attributable to changes in own credit risk for financial liabilities designated at fair value for year ended 31 December 2015 (2014: $nil).

The carrying amount of financial liabilities designated at fair value at 31 December 2015 and 31 December 2014 is considered to be a reasonable approximation of the contractual value at maturity.

8. EQUITY

	Ordinary shares of $1 each
	Number
Authorised	
At 1 January 2014, 31 December 2014 and 31 December 2015	500,000

	Ordinary shares of $1 each	Ordinary shares of $1 each
	Number	**$'000**
Issued and fully paid		
At 1 January 2014, 31 December 2014 and 31 December 2015	1,000	1

The holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled, on a show of hands, to one vote and, on a poll, one vote per share at meetings of the shareholders of the Company.

9. 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 2015	Less than or equal to twelve months $'000	More than twelve months $'000	Total $'000
ASSETS			
Loans and receivables:			
Other receivables	3,147	-	3,147
Financial assets designated at fair value through profit or loss	-	1,131,995	1,131,995
	3,147	1,131,995	1,135,142
LIABILITIES			
Financial liabilities at amortised cost:			
Other payables	3,146	-	3,146
Financial liabilities designated at fair value through profit or loss	-	1,131,995	1,131,995
	3,146	1,131,995	1,135,141

At 31 December 2014	Less than or equal to twelve months $'000	More than twelve months $'000	Total $'000
ASSETS			
Loans and receivables:			
Other receivables	3,022	-	3,022
Financial assets designated at fair value through profit or loss	-	2,217,648	2,217,648
	3,022	2,217,648	2,220,670
LIABILITIES			
Financial liabilities at amortised cost:			
Bank loans and overdrafts	2	-	2
Other payables	3,019	-	3,019
Financial liabilities designated at fair value through profit or loss	-	2,217,648	2,217,648
	3,021	2,217,648	2,220,669

10. SEGMENT REPORTING

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

Business segments

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 segments are consistent with those of Morgan Stanley.

10. SEGMENT REPORTING (CONTINUED)

The Company has one reportable business segment, Institutional Securities, which provides financial services to financial institutions. The Company's business includes the issuance of financial instruments and the hedging of the obligations arising pursuant to such issuances.

11. FINANCIAL RISK MANAGEMENT

Risk management procedures

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

The principal activity of the Company is the issuance of OPALS and the 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. On issuance of each financial instrument, the Company enters into economics hedges of its obligations by purchasing financial instruments from another Morgan Stanley Group undertaking.

Significant risks faced by the Company resulting from its trading activities are set out below.

Credit risk

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

The Company's credit risk management policies and procedures establish the framework for ensuring transparency of material credit risks, ensuring compliance with established limits and escalation of risk concentrations to appropriate senior management.

The Company 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.

The maximum exposure to credit risk of the Company at the reporting date is the carrying amount of the financial assets held in the statement of financial position. The Company has not entered into any credit enhancements to manage its exposure to credit risk.

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

Maximum exposure to credit risk by credit rating[(1)]

Credit rating	Gross credit exposure 2015 $'000	Gross credit exposure 2014 $'000
A	1,135,142	2,220,670

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

11. FINANCIAL RISK MANAGEMENT (CONTINUED)

Credit risk (continued)

At 31 December 2015 there were no financial assets past due but not impaired or individually impaired (2014: $nil).

Liquidity and funding risk

Liquidity and funding 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 and funding risk also encompasses the Company's 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. Market or idiosyncratic stress events may negatively affect the Company's liquidity and may impact its ability to raise new funding. Generally, the Company incurs liquidity and funding risk as a result of its trading, lending, investing and client facilitation activities.

The Morgan Stanley Group's Liquidity Risk Management Framework is critical to helping ensure that the Company maintains sufficient liquidity reserves and durable funding sources to meet its daily obligations and to withstand unanticipated stress events. In 2015, the Morgan Stanley Group established the Liquidity Risk Department as a distinct area in Risk Management to oversee and monitor liquidity and funding risk. The Liquidity Risk Department is independent of the business units and reports to the Chief Risk Officer. The Liquidity Risk Department ensures transparency of material liquidity and funding risks, compliance with established risk limits and escalation of risk concentrations to appropriate senior management. To execute these responsibilities, the Liquidity Risk Department establishes limits in line with the Morgan Stanley Group's risk appetite, identifies and analyzes emerging liquidity and funding risks to ensure such risks are appropriately mitigated, monitors and reports risk exposures against metrics and limits, and reviews the methodologies and assumptions underpinning the Morgan Stanley Group's Liquidity Stress Tests to ensure sufficient liquidity and funding under a range of adverse scenarios. The liquidity and funding risks identified by these processes are summarized in reports produced by the Liquidity Risk Department that are circulated to and discussed with senior management, as appropriate.

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

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

The primary goal of the Company's liquidity risk and funding management framework is to ensure that the Company has access to adequate funding across a wide range of market conditions. 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 Company's liquidity and funding 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.

11. FINANCIAL RISK MANAGEMENT (CONTINUED)

Liquidity and funding risk (continued)

The Company hedges all of its financial liabilities with financial assets entered into with other Morgan Stanley Group undertakings, where both the Company and other Morgan Stanley Group undertakings are wholly-owned subsidiaries of the same parent, Morgan Stanley. Further, the maturity profile of the financial assets matches the maturity profile of the financial liabilities.

Liquidity management policies

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 reflects 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 at a consolidated and legal entity level.

Liquidity Stress Tests

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

The assumptions underpinning the Liquidity Stress Tests include, but are not limited to, the following:

- no government support;
- no access to equity and unsecured debt markets;
- repayment of all unsecured debt maturing within the stress horizon;
- higher haircuts and significantly lower availability of secured funding;
- additional collateral that would be required by trading counterparties, certain exchanges and clearing organisations related to credit rating downgrades;
- additional collateral that would be required due to collateral substitutions, collateral disputes and uncalled collateral;
- discretionary unsecured debt buybacks;
- drawdowns on lending commitments provided to third parties;
- client cash withdrawals and reduction in customer short positions that fund long positions;
- limited access to the foreign exchange swap markets; and
- maturity roll-off of outstanding letters of credit with no further issuance.

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 settlement risk related to intra-day settlement and clearing of securities and financial activities is taken into consideration.

11. FINANCIAL RISK MANAGEMENT (CONTINUED)

Liquidity and funding risk (continued)

Liquidity Stress Tests (continued)

Since the Company hedges the liquidity 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.

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. The following components are considered in sizing the Global Liquidity Reserve: 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 dependent 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 include 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 policies

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, by investor and by 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 may include the Morgan Stanley Group's equity capital, long-term debt, securities sold under agreements to repurchase ("repurchase agreements"), securities lending, deposits, commercial paper, 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.

11. FINANCIAL RISK MANAGEMENT (CONTINUED)

Liquidity and funding risk (continued)

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. A substantial portion of the Morgan Stanley Group's total assets consists of liquid marketable securities arising principally from its Institutional Securities business segment's sales and trading activities. The liquid nature of these assets provides the Morgan Stanley Group and the Company with flexibility in managing the size of its balance sheet.

Maturity analysis

In the following maturity analysis of financial assets and financial liabilities, derivative contracts, financial assets designated at fair value through profit or loss and financial liabilities designated at fair value through profit or loss 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 2015 and 31 December 2014. 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.

11. FINANCIAL RISK MANAGEMENT (CONTINUED)

Liquidity and funding risk (continued)

Maturity analysis (continued)

31 December 2015	On demand $'000
Financial assets	
Loans and receivables:	
Other receivables	3,147
Financial assets designated at fair value through profit or loss: ELOs	1,131,995
Total financial assets	1,135,142
Financial liabilities	
Financial liabilities at amortised cost:	
Other payables	3,146
Financial liabilities designated at fair value through profit or loss: OPALS	1,131,995
Total financial liabilities	1,135,141

31 December 2014	On demand $'000
Financial assets	
Loans and receivables:	
Other receivables	3,022
Financial assets designated at fair value through profit or loss: ELOs	2,217,648
Total financial assets	2,220,670
Financial liabilities	
Financial liabilities at amortised cost:	
Bank loans and overdrafts	2
Other payables	3,019
Financial liabilities designated at fair value through profit or loss: OPALS	2,217,648
Total financial liabilities	2,220,669

11. FINANCIAL RISK MANAGEMENT (CONTINUED)

Market risk

Market 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 prices.

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

To execute these responsibilities, the Morgan Stanley Group monitors the market risk of the firm against limits on aggregate risk exposures, performs a variety of risk analyses, routinely reports risk summaries and maintains the VaR and scenario analysis methodologies. These limits are designed to control market risk. The Company is managed within the Morgan Stanley Group's global framework. The market risk management policies and procedures of the Company include performing risk analyses and reporting any material risks identified to appropriate senior management of the Company.

The Company enters into all of its financial asset transactions with other Morgan Stanley Group undertakings, where both the Company and the other Morgan Stanley Group undertakings are wholly-owned subsidiaries of the same group parent entity, Morgan Stanley.

The issued OPALS 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 dollar, the risk of changes in rates of exchange between the US dollar and the other relevant currencies. The Company uses the risk mirroring contracts, in the form of ELOs, which it purchases from another Morgan Stanley Group undertaking, to match the price, interest rate and foreign currency risks associated with the issuance of the OPALS, consistent with the Company's risk management strategy. As such, the Company is not exposed to any market risk on these financial instruments.

12. 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.

2015

	Quoted prices in active market (Level 1) $'000	Valuation techniques using observable inputs (Level 2) $'000	Valuation techniques with significant unobservable inputs (Level 3) $'000	Total $'000
Financial assets designated at fair value through profit or loss:				
ELOs	-	1,131,995	-	1,131,995
Total financial assets measured at fair value	-	1,131,995	-	1,131,995
Financial liabilities designated at fair value through profit or loss:				
OPALS	-	1,131,995	-	1,131,995
Total financial liabilities measured at fair value	-	1,131,995	-	1,131,995

2014

	Quoted prices in active market (Level 1) $'000	Valuation techniques using observable inputs (Level 2) $'000	Valuation techniques with significant unobservable inputs (Level 3) $'000	Total $'000
Financial assets designated at fair value through profit or loss:				
ELOs	-	2,217,648	-	2,217,648
Total financial assets measured at fair value	-	2,217,648	-	2,217,648
Financial liabilities designated at fair value through profit or loss:				
OPALS	-	2,217,648	-	2,217,648
Total financial liabilities measured at fair value	-	2,217,648	-	2,217,648

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

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

OPALS

The Company issues OPALS, which are securities whose investment performance corresponds generally to that of a benchmark index by an indirect investment in a basket of shares. The fair value of OPALS is determined using valuation models, incorporating observable inputs referencing identical or comparable securities to the underlying shares. The impact of own credit spreads is also considered and included as appropriate. OPALS are categorised in Level 2 of the fair value hierarchy.

ELOs

ELOs are purchased to hedge the issuance of OPALS as the investment performance of the ELOs corresponds generally to that of the same benchmark index by an indirect investment in a basket of shares, as that of the OPALS they were purchased to hedge. The fair value of the ELOs is determined using valuation models, incorporating observable inputs referencing identical or comparable securities to the underlying shares. The impact of own credit spreads is also considered and included as appropriate. ELOs are categorised in Level 2 of the fair value hierarchy.

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 into or out of Level 2 of the fair value hierarchy during the current year and prior year.

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

Non-recurring fair value measurements of assets and 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 year or prior year.

13. ASSETS AND LIABILITIES NOT MEASURED AT FAIR VALUE

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

14. CAPITAL MANAGEMENT

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

The Morgan Stanley Group's required capital ("Required Capital") estimation is based on the Required Capital Framework, an internal capital adequacy measure. This framework is a risk-based and leverage use of capital measure, which is compared with the Morgan Stanley Group's regulatory capital to ensure that the Morgan Stanley Group maintains an amount of going concern capital after absorbing potential losses from extreme stress events where applicable, at a point in time. The Morgan Stanley Group defines the difference between its regulatory capital and aggregate Required Capital as Parent capital.

14. CAPITAL MANAGEMENT (CONTINUED)

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

The Morgan Stanley Group actively manages its consolidated capital position based upon, among other things, business opportunities, risks, capital availability and rates of return together with internal capital policies, regulatory requirements and rating agency guidelines and, therefore, in the future may expand or contract its capital base to address the changing needs of its businesses.

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

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

The Company manages the following items as capital:

	2015 $'000	2014 $'000
Ordinary share capital	1	1

15. RELATED PARTY DISCLOSURES

Parent and ultimate controlling entity

The entire issued share capital of the Company is held under the terms of a trust established under Cayman Islands law with Deutsche Bank (Cayman) Limited.

In the Directors opinion, for accounting purposes, 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 and 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 Morgan Stanley Capital (Cayman Islands) Limited.

Compensation paid to key management personnel in respect of their services rendered to the Company is:

15. RELATED PARTY DISCLOSURES (CONTINUED)

Key management compensation (continued)

	2015 $'000	2014 $'000
Short-term employee benefits	5	5
Other long-term employee benefits	-	1
	5	6

Key management personnel compensation is borne by other Morgan Stanley Group undertakings in both the current and prior years.

Transactions with related parties

The Morgan Stanley Group conducts business for clients globally through a combination of both functional and legal entity organisational structures. Accordingly, the Company is closely integrated with the operations of the Morgan Stanley Group and enters into transactions with other Morgan Stanley Group undertakings on an arm's length basis for the purposes of utilising financing, trading and risk management, and infrastructure services. The nature of these relationships along with information about the transactions and outstanding balances is given below. Settlement of the outstanding balances will be made in cash/ via inter-company mechanisms. The Company has not recognised any expense and has made no provision for impairment relating to the amount of outstanding balances from related parties (2014: $nil).

Funding

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

General funding is undated, unsecured, floating rate lending. 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 or expense recognised in the statement of comprehensive income during the year are shown in the table below:

	2015		2014	
	Interest $'000	Balance $'000	Interest $'000	Balance $'000
Amounts due from other Morgan Stanley Group undertakings	65	3,147	4,247	3,022
Amounts due to the Company's direct and indirect parent undertakings	1	45	1	44
Amounts due to other Morgan Stanley Group undertakings	64	3,101	4,246	2,975
	65	3,146	4,247	3,019

15. RELATED PARTY DISCLOSURES (CONTINUED)

Transactions with related parties (continued)

Trading and risk management

The Company issues OPALS and hedges the obligations arising from the issuance by entering into ELOs with another Morgan Stanley Group undertaking. 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 OPALS and ELOs were as follows:

	2015 $'000	2014 $'000
Amounts due from other Morgan Stanley Group undertakings	1,131,995	2,217,648

Infrastructure services

In the current and prior year, the Company uses infrastructure services, including the provision of office facilities, operated by other Morgan Stanley Group undertakings at no charge. In addition, as disclosed in note 5, the audit fees have been borne by another Morgan Stanley Group undertaking.