Morgan Stanley

Morgan Stanley Europe SE

Annual Report 2021

Register number: HRB 109880

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(1) Please note that the English version of the Annual Financial Statements and Management Report as at 31December 2021 is a convenience translation. Deloitte GmbH Wirtschaftprüfungsgesellschaft, Frankfurt am Main, issued the Independent Auditors’ Report only for the German version of the Financial Statements and the Management Report as at 31 December 2021. Therefore, the German version prevails.

I.

MANAGEMENT REPORT

Overview of 2021

In 2021, Morgan Stanley Europe SE, Frankfurt am Main (the "Company", the "Bank" or "MSESE") as part of the Morgan Stanley Europe Holding SE Group (the "Group" or the "MSEHSE Group") continued to expand its business activities with clients in the European Economic Area ("EEA").

- The Company's net income increased from €2 million in 2020 to €22 million in 2021. This increase was predominantly driven by higher capital markets activity. Overall, total assets increased by only 5% from €38,409 million as of 31 December 2020 to €40,460 million as of 31 December 2021 due to the expanded use of existing netting options on OTC traded derivatives.. Refer to section "Net Assets, Financial Position and Results of Operation" and note 3 for further information.
- In connection with the expansion of the business activities, a capital contribution of €850 million from Morgan Stanley Europe Holding SE ("MSEHSE") to MSESE was made on 15 October 2021.
- With the entry into force of the Regulation (EU) 2019/2033 on the prudential requirements of investment firms and with the implementation of the Directive (EU) 2019/2034 on the prudential supervision of investment firms with the Securities Institutions Act on 26 June 2021, MSESE is considered a CRR credit institution. MSESE expects to be granted a formal authorisation as a CRR credit institution in the course of 2022..
- Although the continuation of the coronavirus ("COVID-19") pandemic led to further health and safety measures and continued use of remote working, the Group has not experienced a decline in efficiency nor a negative impact on business activities.
- In line with increased complexity of the business, the Group further developed the Risk Management framework in 2021. MSESE and Morgan Stanley Bank AG, Frankfurt am Main ("MSBAG") have been granted waivers pursuant to CRR Article 7 and Article 8 in 2019, which permit the Group to manage its own fund requirements at the Group level and liquidity requirements at the MSESE Group level. Capital and liquidity are deemed sufficient to exceed regulatory minimums under both normal and in stressed market environments. Adequate capital and liquidity were maintained as of 31 December 2021. For further information see the chapter "Risk Report".
- The Group initiated the incorporation of climate-related risk in its core business, operations and into the Risk Management framework. For further details refer to the chapter "Climate Report".

Business Model

Corporate Structure

MSEHSE is the parent company of MSESE. On 13 December 2021 the European Central Bank ("ECB") authorised MSEHSE as a financial holding company in accordance with Section 2f (1) and (3) of the German Banking Act (Kreditwesengesetz or "KWG"). MSEHSE is a superordinated undertaking in accordance with Section 10a (2) KWG. The Company coordinates the strategy and financial resources for its subsidiaries and ensures their effective steering.

MSESE is the parent company of MSBAG.

There are control agreements in place between MSEHSE and MSESE and between MSESE and MSBAG which include loss compensations in accordance with Section 302 of the German Stock Corporation Act (Aktiengesetz, or "AktG"). Additionally, Letters of Comfort are set up by MSEHSE to benefit MSESE and MSBAG as well as by MSESE to benefit MSBAG.

On 1 November 2021 Morgan Stanley France Holdings I S.A.S., Paris, France ("MSFH I"), was transferred with its subsidiaries Morgan Stanley France Holdings II S.A.S., Paris, France ("MSFH II") and Morgan Stanley France S.A., Paris, France ("MSF") from its immediate parent undertaking Morgan Stanley International Limited, London, United Kingdom ("UK") ("MSI") into the Group. MSEHSE as the sole shareholder of MSFH I issued additional share capital of €200 million as consideration.

As of 31 March 2021, Morgan Stanley S.V., S.A.U., Madrid, Spain, ("MSSV"), which was a wholly owned subsidiary of MSESE, merged with and into MSESE as acquiring entity. Prior to the merger, certain activities of MSSV transferred to MSIM Fund Management (Ireland) Limited, Dublin, Republic of Ireland, a subsidiary of MSI. The Group received €13 million cash consideration.

The MSEHSE Group's ultimate parent undertaking and controlling entity is Morgan Stanley, New York, United States of America ("U.S."). Morgan Stanley is a global financial services firm authorised as a Financial Holding Company and regulated by the Board of Governors of the Federal Reserve System in the U.S. MSEHSE is a wholly owned subsidiary of MSI. All companies of the MSEHSE Group are fully integrated into the global Morgan Stanley Group ("Morgan Stanley Group").

MSESE, MSEHSE and MSBAG are subject to joint supervision by the ECB, German Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht or "BaFin") and the Deutsche Bundesbank.

MSESE established its business operations as a securities trading bank pursuant to Section 1 (3d) Sentence 5 KWG on 1 March 2019. With the entry into force of the Regulation (EU) 2019/2033 on the prudential requirements of investment firms and with the implementation of the Directive (EU) 2019/2034 on the prudential supervision of investment firms with the Securities Institutions Act on 26 June 2021, MSESE is considered a CRR credit institution. MSESE expects to be granted a formal authorisation as a CRR credit institution in the course of 2022.

The principal activity of MSESE is the provision of financial services to a client base mainly in the EEA consisting of corporations, governments, and financial institutions. MSESE operates branch offices in France, Italy, the Netherlands, Sweden, Spain, and Poland. All of the branches contribute to the overall success of the Group.

Throughout the year 2021, the Management Board consisted of five members and was overseen by the Supervisory Board consisting of eight members. The meetings of the Management Board are generally held bi-weekly, but at least once a month. The Supervisory Board meets at least twice per calendar half-year.

Business Strategy

MSESE's business strategy is closely integrated into the strategy of the Morgan Stanley Group. The Company's principal business units are Institutional Equities Division ("IED"), Fixed Income Division ("FID"), Investment Banking Division ("IBD"), Global Capital Markets ("GCM") and Real Assets.

In implementing Morgan Stanley Group's strategies, MSESE is a significant contributor in the following areas:

- sales, trading, financing and market-making activities in equity and fixed income products, including foreign exchange and commodities;
- financial advisory services, including advice on mergers and acquisitions;
- investment activities;
- advice on restructurings;
- real estate and project finance;
- corporate lending; and
- capital raising.

The Company is Morgan Stanley's primary investment service hub for the aforementioned business operations between institutional clients in the EEA and other Morgan Stanley Group companies. Market making activities such as Euro interest rate swaps, Euro inflation swaps, government bonds linked to inflation as well as automated market-making of European bonds and stocks are risk managed within the Group.

Capital Actions

In connection with the expansion of the business activities, a capital contribution of €850 million from MSEHSE to MSESE has been made on 15 October 2021.

The disclosure report (Pillar 3) is published and available at:
https://www.morganstanley.com/about-us-ir/pillar-uk.html

Economic Report

Business Environment

During the course of 2021, the Group significantly expanded its client and business activities. Despite a series of factors and challenges in the global environment, including but not limited to the continuation of the COVID-19 pandemic, the Group achieved strong results.

Global markets and economic conditions

In the second year of the COVID-19 pandemic, global Gross Domestic Product ("GDP") has generally continued recovering from 2020's record contraction. There were significant regional differences however: large parts of Europe experienced another contraction at the beginning of 2021, as restrictions were re-introduced. U.S. growth was meanwhile less impacted, and emerging market growth weakened around mid-year. Overall, GDP has surpassed pre-crisis levels again in the late summer 2021. More recently, the focus has turned to surging inflation, driven by higher energy prices and disrupted supply chains, as well as the threat of another COVID-19 wave and associated restrictions, and the current conflict in the Ukraine.

Policy has remained very supportive in 2021 to help the global recovery, both on the monetary and fiscal front. Following the inflation surge in the second half of 2021, central banks have turned more hawkish towards year end however, with accelerated tapering in some jurisdictions and first rate increases in others.

In the Euro area, the ECB continued providing accommodation via its Pandemic Emergency Purchase Programme, with its monetary policy portfolio expected to stand at approximately €4.7 trillion as of the end of December 2021, or 39.1% of the region's 2021 annual GDP. Fiscal deficits are expected to remain on levels comparable to 2020, reaching (an estimated) 7.2% of the Euro area's GDP. The European Recovery Fund has been ratified by member states, recovery plans have been submitted by most countries and the first disbursements already took place. The European Recovery and Resilience Facility is worth €724 billion (in current prices) with funds raised from the capital markets. Of the funds raised, €338 billion is to be provided in grants and up to €386 billion in loans. Euro area inflation reached 2.6% in 2021, as the economy rebounded from the record pandemic contraction, with the German measure at 3.1%.

The Bank of England raised its Bank Rate in December 2021 by 10 basis points to 0.25%, with a further 25 basis points hike in March 2022 and is expected to further raise it in the course of 2022. A gradual withdrawal of fiscal stimulus occurred in the UK in 2021, along with the exit from the most acute emergency phase of the pandemic, as fiscal deficit stood at 6.3% of GDP in 2021 .

In the U.S., inflation surged from around mid-year, reaching 7.9% in February 2022, the highest rate since the early 1980s, with the expectation for further increases. The Federal Reserve consequently decided to accelerate tightening of asset purchases by $30 billion per month starting in January 2022, twice the previous pace, with a first 25 basis points hike in the U.S. federal funds rate in March and expectations for several additional hikes in 2022. In terms of fiscal policy, the U.S. government agreed another $1.9 trillion stimulus package, the "American Rescue Plan".

COVID-19

Although the global economy has begun to recover from the COVID-19 pandemic, certain adverse consequences of the pandemic continue to impact the global economy and may persist for some time, including labour shortages and disruptions of global supply chains. Despite those challenges the Group's efficiency and business activities have not been impacted and its profit of the year has significantly increased.

Morgan Stanley and the MSEHSE Group continue to be fully operational. Uncertainty remains regarding a resurgence of the COVID-19 pandemic, including additional variants. Accordingly, the number of employees working in offices and remotely may vary based on health and safety measures. The adjustment and expansion of certain controls in both the First and

Second Lines of Defence has successfully been established to adapt to the extraordinary situation and to assure the appropriate level of supervision for activities conducted from home. These controls include but are not limited to Trader Supervision, Payment processing, and Third Party monitoring. To date, no incidents or operational risk losses have been reported which can be directly related to the COVID-19 pandemic.

In response to the significant economic impact and the continuation of the COVID-19 pandemic, global regulators have released a suite of regulatory measures and programs to stabilise the market and to provide incentives for banks to continue to support households and businesses through the recovery from the pandemic. The impact of the termination of these measures is included within regular forward-looking capital planning.

Whilst periods of heightened market volatility due to the COVID-19 pandemic were observed primarily in 2020 but also in 2021, the Group remained within the set risk appetite. In addition, the Group has developed and maintained pandemic-related scenarios to evaluate possible impact of “downside” scenarios on the Group’s risk and resource profile. The impact of COVID-19 on different risk types is presented in the chapter “Risk Report”.

Net Assets, Financial Position and Results of Operations

MSEHSE Group`s internal control and regulatory reporting is based on IFRS (“International Financial Reporting Standards`). Thus, MSESE is also managed on this basis.

Reconciliation from IFRS to HGB

Set out below is an overview of Profit before tax and balance sheet size according to IFRS from MSEHSE Group to MSESE.

€ in millions		Profit before Tax	Balance Sheet
MSEHSE Group	2021	195	69,411
	2020	34	49,290
Thereof:			
MSESE	2021	102	68,124
	2020	22	44,947

The following table provides a reconciliation of the net income of the years 2021 and 2020 of MSESE from IFRS to the requirements of the German Commercial Code (Handelsgesetzbuch or “HGB”):

€ in millions	2021	2020
PROFIT BEFORE TAX (IFRS)	**102**	**22**
NET INCOME (IFRS)	**82**	**15**
Risk valuation adjustment according to section 340e (3) and (4) HGB	0	(10)
Adjustments for AT1 capital instruments within equity capital	(28)	(6)
Recognition of deferred tax assets	(19)	(2)
Valuation adjustments for pensions and similar obligations	(6)	(3)
Goodwill amortisation under German GAAP	(8)	1
Others	1	7
NET INCOME (HGB)	**22**	**2**

Additional details on the reconciliation effects are presented in note 2 of the financial statements. Details on the risk valuation adjustment according to section 340e (3) and (4) HGB can be found in note 3 of the financial statements.

Income statement

Set out below is an overview of the development of financial results according to HGB for the years 2021 and 2020:

€ in millions	2021	2020	Increase (+) decrease (-)	Variance in %
Net interest result	(62)	12	(74)	(>100%)
Net commission income	493	147	346	>100%
Net income of the trading portfolio	11	(20)	31	>100%
Other operating result	(41)	25	(66)	(>100%)
General administrative expenses	(327)	(151)	176	>100%
Depreciation, amortisation and write-downs	(13)	(7)	6	86%
INCOME FROM ORDINARY ACTIVITIES	**61**	**6**	**55**	**>100%**
Income taxes	39	4	35	>100%
NET INCOME	**22**	**2**	**20**	**>100%**
RETAINED EARNINGS	**22**	**2**	**20**	**>100%**

In 2021, net income of MSESE increased mainly due to significant outperformance in global IBD.

Net interest result

The decrease in net interest income is primarily driven by higher need for liquidity and the associated higher interest expenses.

Net commission income

Net commission income increased mainly due to higher Investment Banking services. These have also been incurred in the branches of MSESE. In addition, fees from investment banking services of €36 million, which were reported in the previous year in net expense of the trading portfolio, are presented in commission expenses in 2021. For further details please refer to note 18 of the financial statements.

Net income of the trading portfolio

The net result of the trading portfolio increased and is in line with the business strategy of hedging the majority of market risk arising from client transactions by means of offsetting hedging transactions with affiliated companies.

Other operating expenses

Other operating income decreased mainly due to the presentation of transfer pricing agreements with other Morgan Stanley Group companies within commission income. Additional details are presented in note 20 of the financial statements.

Other operating expenses increased primarily due to higher financial transaction taxes paid in France and Spain, for which MSESE is tax debtor.

General administrative expenses

The average number of employees during the year increased from 293 in 2020 to 526 in 2021 which primarily drove the increase of general administrative expenses, due to higher personnel expenses including wages and salaries, pension and social security expenses as well as other administrative expenses.

Income taxes

Income taxes increased due to the increase of the profit.

Balance sheet

Set out below is an overview of the development of Financial Position according to HGB for the years 2021 and 2020

€ in millions	31 December 2021	31 December 2020	Increase (+) decrease (-)	Variance in %
ASSETS				
Amounts due from credit institutions and customers	21,636	13,478	8,158	61%
Trading portfolio	17,521	23,932	(6,411)	(27%)
Investments in affiliated companies	603	695	(92)	(13%)
Other assets	700	304	396	>100%
TOTAL ASSETS	**40,460**	**38,409**	**2,051**	**5%**
LIABLITIES				
Amounts due to credit institutions and customers	18,239	13,140	5,099	39%
Trading portfolio	16,926	21,056	(4,130)	(20%)
Subordinated liabilities	1,002	1,002	0	0%
Instruments for Additional Tier 1 Regulatory Capital	600	600	0	0%
Provisions	135	71	64	90%
Other liabilities	296	151	146	97%
Fund for general banking risks	1	0	1	N/A.
TOTAL LIABILITIES	**37,199**	**36,020**	**1,179**	**3%**
EQUITY				
TOTAL EQUITY	**3,261**	**2,389**	**872**	**37%**
TOTAL LIABILITIES AND EQUITY	**40,460**	**38,409**	**2,051**	**5%**

The increase in total assets is primarily due to client novations, increase of trading positions of large clients as well as increased fair values of foreign exchange derivatives due to market movements.

Amounts due from credit institutions and customers

Amounts due from credit institutions and customers consist of receivables on demand due from MSBAG of €7,269 million in 2021 compared to €4,405 million in 2020.

The increase is mainly due to cash collateral provided for derivatives and repurchase agreements.

Trading portfolio

The decline in trading assets and trading liabilities is mainly due to the expanded use of existing netting options on OTC-traded derivatives.

Investments in affiliated companies

Investments in affiliated companies exclusively comprise of shares in MSBAG. The decrease of €92 million is due to the shares of MSSV which merged with and into MSESE as acquiring legal entity effective 31 March 2021.

Other assets

Other assets increased and mainly consists of variation margins received for derivative transactions. These variation margins were reported under other assets in 2021, whereas in 2020 they were reported under 'Amounts due from credit institutions and customers'.

Amounts due to credit institutions and customers

The increase in amounts due to credit institutions and customers is mainly due to cash collateral received from derivatives and securities lending transactions.

Provisions

Provisions increased mainly as a result of personnel and pension-related provisions and tax provisions.

Other liabilities

Other liabilities increased from €151 million to €297 million and mainly consists of variation margins paid for derivatives. These variation margins were reported under other liabilities in 2021, whereas in 2002 they were reported under 'Amounts due to customers'.

Fund for general banking risks according to section 340e (4) HGB

In accordance with section 340e (4) HGB, MSESE contributed €1 million to the fund for general banking risks in the financial year.

Capital Structure

The equity presented in the balance sheet consists of share capital, capital reserves and retained earnings. The increase of equity by 36% from €2,389 million to €3,260 million is mainly due to the capital contribution in cash of €850 million from MSEHSE to MSESE.

The return on investment pursuant to Section 26a (1) Sentence 4 KWG as of 31 December 2021 is positive 0.05% (2020: positive 0.01%).

Liquidity and Funding Management

MSESE and MSBAG have been granted waivers pursuant to CRR Article 7 and Article 8, which permit the Group to manage its own funds requirements at the Group level and liquidity requirements at the MSESE Group level.

The Group views management of capital and liquidity as the basis of its financial strength. It manages resources mainly based on business opportunities, risks, availability, and rates of return, which are driven by internal policies, regulatory requirements, and rating agency guidelines.

Liquidity resources

The Group maintains sufficient liquidity resources ("Liquidity Resources") to cover daily funding needs and to meet strategic liquidity targets sized by the Required Liquidity framework and Liquidity Stress Tests. The total amount of Liquidity Resources is actively managed by the Group considering the following components:

- Balance sheet size and composition, funding needs in a stressed environment inclusive of contingent cash outflows,
- collateral requirements, and
- regulatory requirements.

The amount of Liquidity Resources held is based on the Group's risk tolerance and is subject to change dependent on market and firm-specific events.

The Liquidity Resources consist of cash at central banks and high-quality unencumbered assets. Eligible unencumbered highly liquid securities include primarily Level 1 government bonds and German sub-sovereign obligations.

Additional information on the Liquidity Risk framework, Liquidity framework, and Liquidity Stress Tests are presented in the chapter "Risk Report".

Funding and Balance sheet management

The Group manages its funding in a manner that reduces the risk of disruption to its operations. The Group has a stable funding profile, achieved through its strong capital base, secured and unsecured funding. The main source of unsecured funding for the Group as of 31 December 2021 was an internal source within the Morgan Stanley Group, while debt has also been issued externally in the past and may be issued in 2022.

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

Credit ratings

The Group relies mainly on Morgan Stanley Group internal sources to finance a significant portion of its daily operations. The cost and availability of financing and cash collaterals are impacted by the credit ratings of MSESE, among other variables. In addition, the credit ratings can have an impact on certain trading revenues, particularly in those businesses where longer-term counterparty performance is a key consideration, such as certain over the counter ("OTC") derivative transactions. When determining credit ratings, rating agencies consider both company-specific factors and industry-wide factors. These include regulatory or legislative changes, the macro environment and perceived levels of support or credit enhancement measures, among other things.

At 31 December 2021, MSESE's issuer ratings were as follows:

	Short-Term Debt	Long-Term Debt	Rating Outlook
Moody's Investor Service, Inc ("Moody's")	P-1	Aa3	Stable
Standard & Poor's Rating Service ("S&P")	A-1	A+	Stable

Collateral impact of a downgrade

The Group is a participant in global derivatives markets. A downgrade in credit ratings could require the Group to post collateral to derivative counterparties. To measure collateral call risks, the Group considers all amounts of collateral that could be required to post based on the terms and conditions of the downgrade trigger clauses of the legal agreements.

The impact of potential collateral calls related to the derivative exposures is inherently uncertain and would depend on a number of interrelated factors, including but not limited to, the magnitude of the downgrade, the rating relative to peers, the rating assigned by the relevant agency pre-downgrade, individual client behaviour and potential mitigating actions. The Group manages the risk of potential collateral calls on the derivative positions by employing a variety of risk mitigation strategies. This includes modelling the impact of credit rating agency downgrades in the liquidity stress test program, monitoring historical changes in variation margin, diversifying risk exposures, hedging, managing counterparty and product risk limits as well as maintaining Liquidity Resources to enable the Group to meet unexpected collateral calls or other potentially adverse developments.

Recovery and Resolution Planning ("RRP")

Both the Morgan Stanley Group and the MSEHSE Group prepare on an annual basis a recovery plan which identifies mitigation tools available to both Groups in times of severe stress.

In terms of RRP, the Group is supervised by the Single Resolution Board ("SRB") as well as the BaFin as the national resolution authority. The Group produces information for the aforementioned authorities in the form of resolution reporting templates and ad-hoc regulatory submissions, as necessary under the EU statutory and regulatory requirements.

The Morgan Stanley Group has developed a resolution plan in accordance with the requirements of Section 165(d) of Title I of the Dodd-Frank Wall Street Reform and Consumer Protection Act and its implementing regulations adopted by the Federal Reserve Board and the Federal Deposit Insurance Corporation. The resolution plan presents the Morgan Stanley Group's strategy for resolution of the Morgan Stanley Group upon material financial distress or failure. Both MSESE and MSBAG are considered Material Operating Entities of the Morgan Stanley Group and are within the scope of the resolution strategy adopted by the Morgan Stanley Group.

Minimum Requirement for own funds and Eligible Liabilities ("MREL") and Total Loss Absorbing Capacity ("TLAC")

The Minimum Requirement for own funds and Eligible Liabilities ("MREL") serves to ensure that the Group has sufficient eligible liabilities in a bail-in scenario to absorb losses and safeguard existing capital requirements. The BaFin, as the Group's national supervisor, shares the responsibility to determine MREL requirements with the SRB. Both MSESE and MSBAG had been granted a waiver as per Article 12h (2) of the Single Resolution Mechanism Regulation ("SRM-R"). MREL is applied to the Group on a consolidated basis.

Financial and Non-financial Key Performance Indicators

The financial and non-financial key performance indicators ("KPIs") are managed on the MSEHSE Group level. Thus, the KPI`s are also applicable for MSESE.

The KPI's of the Group are aligned to its objective to further expand its business activities and strengthen performance, soundness and sustainability considering regulatory requirements. In order to effectively implement the Group's strategy, the following major KPIs were implemented by the Management Board and are assessed on a quarterly basis.

Financial Key Performance Indicators

Major financial KPIs to assess the performance of the Group include Profit before tax, Return on Equity, Efficiency Ratio and Credit Rating. Movements in KPIs are primarily explained by the increase in the Group's business activities and are summarised in the section "Net Assets, Financial Position and Results of Operations".

Profit before tax
€ in millions

€ in millions	2021	2020	Increase	Variance in %
Profit before Tax	195	34	161	>100%

Profit before tax (IFRS) increased by 474% from €34 million to €195 million.

Return on Equity ("ROE")
in %

in %	2021	2020
Return on Equity	3.6%	0.7%

Return on Equity ("ROE") represents profit for the year in relation to year-to-date average IFRS equity. The Group's ROE increased from 0.7% to 3.6% compared to the previous year.

Efficiency Ratio
in %

	2021	2020
Net revenues (€ in millions)	686	299
Operating expense (€ in millions)	490	264
Efficiency Ratio (in %)	71%	88%

Efficiency Ratio measures the Group's period-to-period operating performance and improved from 88% to 71% during the financial year.

Credit Rating

The Group's Credit Rating was stable and has not changed throughout the financial year.

Other performance indicators

Client Revenues represent the Group's internal view on productivity of clients in the EEA, sales teams and banking teams.

Market shares and League table Rankings of the Group's business units are monitored and assessed, specifically for the IED, FID and IBD/ GCM. The Group maintained top 3 market positions by volume for cash equity products in the Institutional Equity business in its key markets in Germany, France, Spain, Italy, and Nordics. Additionally, the Group achieved its target share in core products in the Fixed Income business and maintained top 5 position in Mergers and Acquisitions in relevant countries.

Non-financial Key Performance Indicators

In addition to the financial KPIs, the MSEHSE Group takes into account non-financial performance indicators based on Morgan Stanley's values: "Do the Right Thing", "Put Clients First", "Lead with Exceptional Ideas", "Commit to Diversity and Inclusion" and "Give Back". These values form the foundation for the Group's entire business activities.

To promote the corporate culture, numerous connectivity initiatives and various network events were held throughout the financial year. By increasing hiring as part of campus recruitment and by strengthening the female representation at non-executive and executive levels, the Group presents itself as an attractive and diverse employer. The Group values individual and cultural differences as a defining strength and attracts, develops and retains talents reflecting the full diversity of society. The Management Board would like to extend gratitude to all employees for their commitment and their contributions in 2021.

With regards to control and risks, a major non-financial KPI is an effective risk control which is focused on operating below the risk limits set by the Management Board. Limit breaches are assessed and reported on a regular basis to ensure sound processes and setup. Furthermore, minimizing disruptions and incidents that could negatively impact the Group and its Operational setup as well as keeping self-identified risks as part of the Risk and Control Self Assessment within the Group to a minimum are high priorities and are monitored as non-financial KPIs.

Risk Report

During 2021, the Group's Risk Division continued to focus on enhancing the Group's Risk Management Framework and on regulatory engagements. Key areas of focus included:

- Evolution of the Risk Management Framework in line with increased size and complexity of the Group;
- Management of risks resulting from COVID-19 related impacts within the Group's Risk Appetite;
- Initiation of incorporation of climate risk in the Risk Management Framework;
- Continued focus on regulatory approvals for the use of advanced capital models.

Risk Management Framework

Risk taking is an inherent part of the Group's business activities and effective risk management is vital to the success of the Group.

MSESE and MSBAG have been granted waivers pursuant to CRR Article 7 and Article 8, which permit the Group to manage its own funds requirements at the Group level and liquidity requirements at the MSESE Group level. Consistent with this and in alignment with the waiver pursuant to Section 2a KWG, the Group's Risk Management Framework was established at the level of the consolidated MSEHSE Group, encompassing the risk management culture, approach and practices that support risk identification, measurement, monitoring, escalation and decision-making processes.

The Group's Risk Management Culture is rooted in five key principles: integrity, comprehensiveness, independence, accountability, and transparency. The Group's Management Board is responsible for overseeing the adoption of the Morgan Stanley Group's risk culture for the Group.

The Group's Management Board has established a Risk Management Framework, including a Committee Structure and a "Three Lines of Defence" model. The model separately identifies risk owners from independent risk control functions and creates a clear delineation of responsibilities with a view to address potential conflicts of interest. The structure applies to all legal entities and branches within the Group. The functions responsible for carrying out the activities across the Three Lines of Defence are summarised below:

- First Line of Defence: Business units as well as support and control functions have primary responsibility for managing all business unit risks as well as ensuring compliance with applicable laws, rules and regulations and the Group policies.
- Second Line of Defence: Responsible for independent identification, analysis, reporting, management, and escalation of risks arising from the Group's activities. It further sets policies and monitors adherence with these policies. This includes (but is not limited to) the below:
    - The Risk Division is responsible for the independent identification, measurement, monitoring and reporting of credit, market, liquidity, operational and model risk arising from the Group's business activities. It reports to the Chief Risk Officer ("CRO") who is also a member of the Group's Management Board.
    - The Compliance Division maintains an enterprise-wide, independent Compliance Risk Management Program and is responsible for the design and development of an overall Conduct Risk Framework of the Group.
    - The Global Financial Crimes division acts independently from the business units, reporting locally and directly to the Group's Management Board. The team is responsible for the Financial Crimes Risk Management Framework covering money laundering as well as fraud and other relevant criminal offences.
    - The Group's Central Outsourcing Control Office ("COCO") is independent of individual business divisions and is responsible for ensuring the proper

execution of outsourcing frameworks and guidelines, working closely with divisional management accountable for supervising any outsourcings by their division to ensure outsourcing regulatory requirements are maintained on a continuous basis.

- Third Line of Defence: The Internal Audit Division ("IAD") is independent of the First and Second Lines of Defence. The IAD provides an independent assessment of the Group's control environment and risk management processes and further reviews and tests the Group's compliance with internal guidelines set for risk management and risk monitoring, as well as external rules and regulations governing the industry.

The Group has established a number of policies and procedures which set out the standards that govern the identification, assessment, monitoring, management, and mitigation of the various types of risk involved in its business activities.

Risk Division Organisation

The Risk Division reports to the CRO and assists the MSEHSE Group Executive Risk Committee ("ERC") and Management Board in monitoring, managing and mitigating risk through a number of control processes. The CRO is a member of the MSEHSE, MSESE and MSBAG Management Boards and leads the Risk Division, covering Market Risk, Credit Risk, Liquidity Risk, Operational Risk and Model Risk.

The Risk Division is organised by the following departments, each with a Department Head, reporting into the CRO:

- Credit & Liquidity Risk;
- Market Risk;
- Operational Risk;
- Risk Analytics;
- Model Risk Management;
- Risk Control, Stress Testing & Capital and
- Risk Governance & Risk COO (Chief Operating Office).

The Risk Division assists the Group's Management Board in its oversight through a series of control processes as described in the sections for the respective risk types in this Risk Report.

Committee Governance

The Group's Management Board is responsible for the establishment, implementation, and oversight of an effective Risk Management Framework. Therefore, the Management Board has established a committee structure for the governance of material risks. This includes the cross divisional MSEHSE Group ERC, which is chaired by the CRO and assists the Management Board in the oversight of the Group's management of risk. The Committee is responsible for:

(i) the development and implemen-tation of a risk strategy, including the risk appetite statement;

(ii) risk identification and measurement;

(iii) risk framework and policies;

(iv) risk culture;

(v) financial resource management and capital; and

(vi) assessment of recovery and/or resolution limits.

The MSEHSE Group ERC has established a series of sub-committees with dedicated responsibilities for particular risk matters directly reporting to the MSEHSE Group ERC. The following provides an overview about the purpose of each of these sub-committees:

- MSEHSE Group Credit Risk Committee: Reviews, approves, and recommends action on matters related to the Credit Risk Management ("CRM") department within the Group.
- MSEHSE Group Market Risk Committee: Provides oversight of the market risk profile, control and governance framework on matters related to the Market Risk Department ("MRD") within the Group.
- MSEHSE Group Operational Risk Oversight Committee: Assists the MSEHSE Group ERC to discharge its responsibilities in relation to operational risk.
- MSEHSE Group Asset & Liability Committee: Assists the MSEHSE Group ERC in the

oversight of the capital adequacy, funding, and liquidity risk management of the Group.

- MSEHSE Group Stress Testing Committee: Forum to review all aspects of stress testing within the Group.
- MSEHSE Group Model Oversight Committee: Provides the Group with oversight of the development, validation, performance and management of the market, credit, operational, liquidity risk and stress testing models.

In addition to the Committees directly reporting to the MSEHSE Group ERC outlined above, the MSEHSE Group Risk Governance Committee (“RGC”) provides the CRO with oversight of the control framework within the Risk Division.

Risk Appetite, Risk Limits and Tolerances

The Group’s Management Board determines the Risk Strategy of the Group which is consistent with the business strategy and the risks stemming from it. The Risk Strategy sets how risks will be identified, measured, monitored and reported.

The centrepiece of the Risk Strategy is the Risk Appetite Statement (“RAS”), which articulates the aggregate level and type of risk that the Group is willing to accept in order to execute the business strategy while protecting its capital and liquidity resources. The RAS consists of both qualitative and quantitative statements. The Risk Appetite of the Group is translated into a comprehensive set of risk limits and tolerances across market risk, credit risk, operational risk and liquidity risk.

The Group’s aggregate Risk Appetite for market and credit risk is expressed as a percentage of Total Capital Resources. It is operationalised through the Macroeconomic Stress Loss Limit (“MSLL”) and monitored through a suite of severe, but plausible Macroeconomic Scenarios, designed to capture key portfolio vulnerabilities of the Group. Underlying Credit and Market risk limits are calibrated to reflect the MSEHSE Group’s Risk appetite as expressed by the MSLL.

To remain adequate in a changing environment, the Group’s RAS and the underlying limits and tolerance frameworks are reviewed by the Group’s Management Board when required (e.g., when the business strategy is amended by the Management Board), but at least annually. This review takes into account changes in the Group’s business strategy, financial resources and plans as well as any anticipated changes in risk appetite.

The Group has established a framework to identify and assess material risks and risk factors stemming from the Group’s business activities on a quarterly basis (in accordance with Section 25c (4b) No. 2 KWG). The materiality of risks is assessed on a quantitative and qualitative basis to determine the Group’s material risks, using risk specific stress tests where possible. In addition, other risk management processes such as regular risk reviews or horizon scanning are conducted to assess impacts of potential market events and regulations and thereby to support the continuous process of risk identification.

The following risk types involved in the Group’s business activities are currently considered material as determined through the Group’s Risk Identification Framework:

- Credit risk;
- Market risk;
- Liquidity risk;
- Operational risk;
- Model risk;
- Conduct risk;
- Compliance risk;
- Leverage risk;
- Valuation risk;
- Earnings at risk and Strategic risk and
- Reputational risk.

Climate change is a driver of existing risks, including credit risk, operational risk, market risk and liquidity risk, and is managed within the Group’s existing risk appetite. Carbon repricing transition risk is identified as material for Credit Risk. The physical risk from a London Tidal flood is identified as a material business disruption and continuity risk for operational risk given the outsourcing profile of the Group. Further information is included in the “Financial Risk Management” section within the chapter “Climate Report”.

The Group's Management Board has established frameworks to identify, analyse, monitor, mitigate and report these risks. Information on how these risks are managed is summarized in the respective sections in this Risk Report.

Stress Testing

Stress testing provides a flexible approach to understanding the aggregate risk for the Group and assessing the Group's resilience to different scenarios over a range of severities. At a more granular level, stress tests provide detailed insights of potential areas of weakness in portfolios at the business area and counterparty level, respectively. Stress testing is a key risk management tool for the Group, informing a number of processes and associated decisions and is performed in line with internal and external regulatory requirements. Results are communicated to interested parties and committees, such as the MSEHSE Group ERC and the Group's Management Board on a regular basis. The Group conducts regular and ad-hoc stress tests with the following objectives:

- Identification of material risk concentrations and vulnerabilities in adverse scenarios
- Estimation of aggregate size of exposure and losses in adverse shocks
- Management of tail risks or vulnerabilities against risk appetite
- Informing the capital and liquidity risk assessment and plan (Internal Capital Adequacy Assessment Process ("ICAAP"); Internal Liquidity Adequacy Assessment Process ("ILAAP")) and the recovery plan
- Meeting relevant regulatory requirements

The Group employs both cross-risk stress tests and risk specific stress tests.

Cross-risk stress tests ensure that concentration risks are captured and measured across the material risks. These include a suite of severe but plausible macroeconomic scenarios which are designed to comprehensively capture material portfolio vulnerabilities of the Group across market and credit risk. Cross-risk stress tests also include a transition risk scenario to assess the impact of a carbon repricing event. The Group's aggregated risk appetite for market and credit risk, expressed through the Macro Stress Loss Limit ("MSLL"), is monitored against the suite of macroeconomic scenarios. The risk appetite for climate risk as a driver for market and credit risk, as assessed through the carbon repricing scenario, is set within the MSLL via a specific stress loss limit. A subset of macroeconomic scenarios is used for capital planning. Existential threats to the Group's business model are captured through the Group's Reverse Stress Tests ("RST"). The scenarios used in RST are extreme and borderline plausible and are designed for the Group to become unviable and considered as failing or likely to fail. RST is used to inform the ICAAP, the ILAAP and is a key input for recovery planning.

Risk specific stress tests identify and measure vulnerabilities and concentrations that may arise in a particular risk area, country, or industry. The Group conducts risk- specific stress tests for operational risk, market risk, credit risk and liquidity risk.

The combination of a granular Risk Identification Framework together with a Stress Testing Framework ensures that the Group's risks are appropriately identified, limited, and measured and incorporated into the capital and liquidity planning processes.

Impact of COVID-19: Since the start of the pandemic, the Group has developed and maintained pandemic-related scenarios to evaluate possible impact of "downside" scenarios on the Group's risk and resource profile.

Risk Reporting

The Group has put in place a Reporting Framework as a basis to monitor and report the Group's risk profile against set risk limits and tolerances and to provide timely escalation to responsible limit owners, the Group's Risk Committees and the Management Board, as appropriate. Furthermore, the Group's Risk Reporting Framework covers all material risks, it identifies matters for escalation and decisions and highlights emerging risks, mitigating actions and other risk matters that are deemed significant to the Group's Risk Committees and/or Management Board.

The key purpose of risk reporting is to provide decision makers and risk managers with an accurate and timely representation of risk exposures. To provide this information, the Group generates various risk reports across individual risk functions including, e.g., market, credit, operational, liquidity and model risk at different frequencies (daily, weekly, etc.).

In addition, the Group has established a set of overarching principles for risk reports which are applied to risk reporting, such as the appropriate level of aggregation, balance between qualitative and quantitative information or implementation of controls to ensure reported information is complete and accurate. The Group's Data Quality ("DQ") monitoring and reporting processes are integrated into the firm's global DQ management processes. The data quality for risk-related data is reviewed through defined Key Performance Indicators ("KPIs") which are summarized in respective DQ Dashboards for certain risk areas such as credit risk, market risk and liquidity risk. On the Group level, any material data limitations/issues on risk data goes through governance and is escalated to the Group's Management Board if necessary.

Detailed information about the reporting for each risk type is included in the respective risk sections on the following pages.

Internal Capital Adequacy Assessment Process ("ICAAP")

The Group manages its 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. The appropriate level of capital is determined to safeguard the Group's ability to continue with a going concern approach and ensure that it meets all regulatory capital requirements, even under a range of severe but plausible stress scenarios. The key components of the Capital Management Framework used by the Group are set out in the Group's Capital Planning and Management Policy. The ICAAP is the Group's capital adequacy assessment and planning process. It is designed to ensure that all risks to which the Group is exposed to are appropriately capitalised. The ICAAP is updated at the beginning of each year in line with the annual strategic planning process as well as quarterly for material changes.

The ICAAP comprises of two perspectives, the "Normative Perspective" and the "Economic Perspective" which complement each other.

Normative Perspective

The assessment under the Normative Perspective is conducted over a three-year period, assessing the Group's ability to fulfil all its capital-related supervisory requirements. It assesses the Group's capital adequacy under expected and stressed operating environments over the three-year capital planning horizon. It uses stress testing to size a capital buffer aimed at ensuring the Group will continue to operate above regulatory requirements under a range of severe but plausible stress scenarios.

Capital requirements are calculated in accordance with regulatory rules, taking into account the Group's permissions to use internal models.

In addition to capital-related supervisory requirements, internal capital ratio minima are set to ensure the Group has sufficient capital to meet its regulatory requirements at all times.

The Group's capital ratios are summarised in the table below.

€ in millions	31 Dec 2021	31 Dec 2020
Normative Perspective		
Common Equity Tier 1 ("CET1") Capital	3,412	2,846
Additional Tier 1 Capital	600	600
Tier 1 Capital	4,012	3,446
Tier 2 Capital	1,000	1,000
Total Own Funds	**5,012**	**4,446**
Risk Weighted Assets ("RWAs")	21,221	11,880
CET1 Capital Ratio	16.08%	23.95%
Tier 1 Capital Ratio	18.90%	29.00%
Total Capital Ratio	**23.62%**	**37.42%**

Economic Perspective

In the Economic Perspective, the Group assesses its capital adequacy by identifying and quantifying all its risks that could cause losses or have other material impacts on its capital position. Capital requirements are assessed using internal methodologies. In line with the ECB ICAAP guidelines, applied methodologies generally target a 99.9% loss severity over a time horizon of one year.

Credit risk: For the calculation of credit risk capital requirements, the Group employs a multifactor credit concentration model. The model uses internal credit risk parameters for Exposure at Default ("EAD"), Probability of Default ("PD") and Loss Given Default ("LGD") and is applied to all relevant credit risk exposures. Default events are simulated using a Monte-Carlo model, and the tail loss at a 99.9% confidence level is calculated.

Operational risk: To calculate the capital requirements related to operational risk, the Group utilises an internal loss model.

To derive an aggregate loss distribution for the Group, the Operational Risk Capital Model combines marginal loss distributions of all Top Operational Risks. The 99.9th percentile of the final distribution is chosen as the loss estimate.

Market risk: Market risk capital is primarily calculated using the Group's internal Management Value-at-Risk ("VaR") and Incremental Risk Charge. The Management VaR is calculated using historical simulation and includes Derivative Valuation Adjustments ("xVA"). The VaR is derived as the 99.9th percentile of a loss distribution calculated from one day returns of the last 15 years. The VaR is scaled up to a 10-day holding period. For risks for which the 10-day holding period is not deemed appropriate (e.g., for xVA risks) the loss distribution is estimated over a 60-day period.

Other risks under the Economic Perspective include: Interest Rate Risk in the Banking Book ("IRRBB"), pension risk and valuation risk.

Capital requirements are conservatively aggregated without taking into account diversification benefits. Total internal capital requirements are then compared with available internal capital resources, i.e., the Risk Bearing Capacity ("RBC"). To calculate the RBC regulatory Own Funds are used as the starting point and AT1 and Tier 2 capital is deducted; additionally, minor adjustments (e.g., deferred tax assets) are made to reflect other risks.

The Group aims to maintain an Economic Capital Adequacy Ratio (RBC divided by internal capital requirements) of at least 100%. Economic Capital Adequacy is assessed on a quarterly basis. The table below presents a comparison of internal capital (RBC) and economic capital requirements.

€ in millions	31 Dec 2021	31 Dec 2020
Economic Perspective		
Risk Bearing Capacity	**3,365**	**2,807**
Capital Requirements	2,237	1,342
Credit risk	1,514	816
Market risk	221	151
Operational risk	411	316
Other	91	59

As of 31 December 2021, the Group was adequately capitalised and reported an economic capital adequacy ratio of 150% (2020: 209%).

Stress testing has been performed to understand sensitivities of the capital assessment to severe, but plausible macroeconomic stress scenarios.

At the time of measurement, the Group remains well capitalised under these stress scenarios.

Credit Risk

Credit risk is an inherent part of the Group's business activities. Credit risk refers to the risk of loss arising when a borrower, counterparty or issuer does not meet its financial obligations. Credit risk includes country risk – i.e., the risk that economic, social and political conditions and events in a country will adversely affect an obligor's ability and/or willingness to fulfil its obligations. As part of credit risk, credit concentration risk refers to the risk of loss due to an outsized exposure to a counterparty or a group of connected counterparties in the same industry or geographic region. This assessment also considers climate risk, in particular the credit exposure to obligors and counterparties highly vulnerable to transition and/or physical climate risks. Respective definitions and further information are disclosed in the chapter "Climate Report".

The CRM Department is independent from the business units and reports to the CRO. It is responsible for managing and overseeing the credit risk profile of the Group. CRM has put in place a Risk Management Framework to identify, measure, control and report credit risks arising from the business activities. Key components of the Credit Risk Framework include:

(1) Risk Identification: The identification and assessment of credit risks forms an integral part of CRM and is performed on an ongoing, continuous basis. To identify and assess credit risks, CRM uses ongoing monitoring of obligors' credit quality, the utilisation of credit limits, credit risk concentrations and single factor as well as multi-factor stress results. Additionally, the New Product Approval ("NPA") process is leveraged to identify and assess credit risks arising from new activities.

(2) Risk Measurement: The measurement of credit risks primarily comprises of the analysis of obligors' credit quality and credit risk exposures generated from transactions.

    The analysis of obligors' credit quality results in the assignment of internal credit ratings which reflect the obligor's likelihood of default and are subject to credit officer review and approval. As part of this internal rating process, each rating is linked to a single name credit limit and mapped to a specific PD. To estimate the PD, the Group maps internal ratings to S&P ratings and then applies S&P's extensive default history to determine the PD. The Group takes different approaches to estimate PDs for its low default portfolio ("LDP") and its non-LDP.

    To measure credit risk exposures, the Group uses a list of metrics such as current and simulated exposures, as well as single and multi-factor stress metrics and portfolio risk sensitivities, all of which are calculated using internal models.

(3) Risk Appetite and Limits: In order to ensure that credit losses remain within the defined risk appetite, CRM has implemented a Credit Limits Framework to manage credit risk on a single name, portfolio (including country and industry concentrations but also sub-industries such as shadow banks and climate segments) and product level. The Credit Limit Framework includes limit categories to capture single name, industry, country, and product limit concentrations as well as different limit types to monitor lending, counterparty, treasury placement and other exposures to ensure appropriate governance with the different levels comprising the Group's Management Board, the MSEHSE Group ERC, the MSEHSE Group Credit Risk Committee and CRM.

(4) Risk Reporting: All significant credit risk exposures, concentrations and limit utilisations are reported on a regular and ad-hoc basis to the MSEHSE Group ERC, the Group's Management Board and other interested parties.

Credit risks primarily arise from Treasury activities, counterparty risk from trading activities as well as lending.

Credit risks arising from Treasury activities primarily relate to deposit placements at the ECB via the Deutsche Bundesbank.

Counterparty risk arises primarily from traded products, OTC derivatives, foreign exchange, secured financing transactions and listed derivatives. Transactions are executed using industry standard documentation that is commensurate to the type of transaction conducted.

Lending risk arises primarily from the extension of relationship and event loans to corporate clients.

To reduce credit risks arising from Treasury activities and counterparty risk from trading activities and lending, CRM relies on standard risk mitigants including netting provisions and the provision of collateral, including with other Morgan Stanley Group undertakings. Collaterals for derivatives are mostly cash and liquid securities. In alignment with industry standards, the Group does not use a valuation model for collaterals.

Consistent with its business and risk strategy, the Group's credit risk portfolio is dominated by investment grade quality obligors in the EEA.

The Group has established processes to calculate expected credit losses ("ECL") under IFRS 9 provisions. ECLs remain low reflecting the credit quality of the portfolio with a focus on investment grade loans. The Group's provision-ing levels are not material which is a reflection of the high credit quality of the Group's loan book and the use of risk transfers within the wider Morgan Stanley Group.

Further information and figures are presented in note 23 of the MSEHSE Group's consolidated financial statements.

The below table shows Risk Weighted Assets ("RWAs") and EADs for credit and counterparty risk as of 31 December 2021 and 31 December 2020, including Credit Valuation Adjustment risk ("CVA"). The RWAs calculated via the advanced capital models (Internal Model Method, or "IMM" and Foundation Internal Ratings Based, or "F-IRB") and under the standardised approach are shown separately. Consistent with its regulatory approvals, the Group uses the IMM approach for the calculation of own funds requirements for counterparty credit risk and the F-IRB approach for the calculation of own funds requirements for credit risk.

	31 December 2021		31 December 2020	
€ in millions	**RWAs**	**EADs**	**RWAs**	**EADs**
Credit risk	3,262	13,449	1,588	10,731
Of which, internal models (F-IRB)	2,674	13,123	1,341	10,552
Counterparty credit risk (excluding CVA)[1]	7,148	20,056	4,390	11,172
Of which, internal models (IMM)	4,651	9,808	2,898	5,474
Total (excluding CVA and Settlement risk)	**10,410**	**33,505**	**5,978**	**21,903**
Credit Valuation Adjustment (CVA)	3,561	7,469	846	2,599
Settlement risk	336	55	58	53
Total	**14,307**	**41,029**	**6,882**	**24,555**

[1] Exposures subject to Equity IRB approach are reported under Credit Risk. Exposures to central counterparties are reported under Counterparty credit risk.

To monitor credit concentration risk, the Group utilises, for example, the Credit Limit Framework. Credit Risks are primarily concentrated in treasury and counterparty exposures with regional focus on EU 27-countries and the U.S. From a counterparty perspective, the credit portfolio is primarily concentrated in Financials and Governments and from a country perspective in the UK, the U.S. and Germany whereas the latter is mostly driven by central bank cash balances. Overall, the country risk evaluation includes a determination of *Country of Risk* and *Country of Jurisdiction*. The *Country of Risk* is the country whose political, economic, and commercial environment most affects an entity's ability to meet its obligations. The *Country of Jurisdiction* is defined as the country of registered incorporation or formation of the obligor. For capital calculation purpose, the breakdown in the following table is based on the *Country of Jurisdiction* whilst the Industry classifications are based on the Global Industry Classification Standards (“GICS”).

The below tables provide an overview about the Group’s industry and country concentration.

Breakdown per industry EAD € in millions	31 December 2021	31 December 2020
Financials	19,667	10,278
Governments	8,935	9,598
All others	4,958	2,080
Total	**33,560**	**21,956**

Breakdown per country EAD € in millions	31 December 2021	31 December 2020
Germany	10,780	10,291
UK	6,654	2,897
U.S.	4,552	2,367
All others	11,574	6,401
Total	**33,560**	**21,956**

Impact of COVID-19: While periods of heightened market volatility were mostly observed during 2020, the Group’s credit risk remained within risk appetite for 2021 and 2020. The impact of the pandemic on both credit risk exposures as well as obligors’ credit quality will remain a key focus throughout 2022.

Market Risk

Market risk is an inherent part of the Group’s business activities. Market risk is the risk that a change in the level of one or more market prices, rates, indices, volatilities, correlations, or other market factors, such as market liquidity, will result in losses for a position or portfolio owned by the Group. This includes risks from Derivative Valuation Adjustments (“xVA”), which refers to the risk of changes in derivative valuation adjustments due to changes in credit spreads and other market factors. Market risk includes the consideration of financial risk arising from climate change. Further, market risk includes non-traded market risk such as Interest Rate Risk in the Banking Book (“IRRBB”).

Price risk arises for example, in trading portfolios, lending portfolios measured at fair value and associated mark-to-market hedges.

MRD, which is independent from the business units, is responsible for the assessment and monitoring of market risks. MRD has put in place a Risk Management Framework to identify, measure, control and report market risks arising from business activities. Key components of the Market Risk Framework include:

(1) Risk Identification: To identify and assess market risks, MRD monitors significant changes in the market risk profile, limit utilisation, risk concentrations as well as stress tests results.

(2) Risk Measurement: Market risks are measured by applying shocks for a selection of input market parameters from securities and derivatives valuation models, the results of which are used as standard risk sensitivities and stress testing measures. A proprietary VaR Model is maintained to be measured against limits and used for capital requirement purposes. For the VaR Model, a potential loss over a given time horizon (1 day usually) and a confidence interval (95% or 99%) are used.

(3) Risk Appetite and Limits: To ensure that market risk losses remain within risk appetite, MRD has established overarching VaR limits as well as sensitivity limits for individual market risk factors.

(4) Risk Reporting: All significant changes in market risk exposures, market risk concentrations and market risk limit utilisations are reported on a regular and ad-hoc basis to the MSEHSE Group ERC, the Group’s Management Board and other interested parties.

Interest rate risk is inherent in the business of financial institutions. Interest rate risk is the exposure of the Group’s financial condition arising from adverse movements in interest rates both in absolute and relative terms. IRRBB is defined as the risk of losses arising from adverse changes in the interest rate curves within the defined banking book population either from a present value (Delta Economic Value of Equity or “Delta EVE”) or Net Interest Income (Delta Net Interest Income, or “Delta NII”) perspective. IRRBB arises from interest rate exposures derived from traditional treasury and banking activities such as customer lending as well as inter-affiliates borrowing and lending. The MRD and the Group’s Treasury Department are responsible for the monitoring and control of these exposures through the calculation of the measures Delta EVE and Delta NII. As of 31 December 2021, IRRBB exposure is a small component of the Group’s market risk profile. It is monitored daily and reported regularly to senior management. Both, Delta EVE and NII are subject to risk limits to ensure the IRRBB remains within the Group’s Risk Appetite.

The following table presents the results for the regulatory prescribed scenarios as of 31 December 2021:

31 December 2021

€ in millions	Delta EVE
Parallel shock down	(7.3)
Parallel shock up	10.3
Flattener shock	7.8
Steepener shock	(3.0)
Short rates shock down	(5.2)
Short rates shock up	10.7

As of 31 December 2021, IRRBB was approximately 0.6% of CET1 capital under the Delta EVE perspective with “Parallel shock down” as the relevant scenario as it creates the highest loss.

The Group’s business strategy is the execution of the Morgan Stanley Group’s Institutional Securities business with clients in the EEA. Market making activities in Euro interest rate swaps, European government bonds, Euro inflation swaps as well as automated market making of European bonds and stocks are risk managed within the Group. Risk from xVA is also hedged locally by a dedicated trading desk which manages exposures coming from counterparties such as credit and funding risk. The main risk factors resulting from these exposures are credit, interest rates, funding basis, equity, and foreign exchange related exposures. The organic growth of the client activity in the EEA led to an increase in xVA risk being managed on the Group.

The Group uses two separate VaR definitions to assess portfolio market risk. The ‘Regulatory VaR’ is calibrated and scoped using regulatory requirements to capitalise for market risk and is subject to a daily backtesting regime validating the accuracy of the model. In addition, the Management VaR is used for internal risk management purposes to ensure the Group’s risk appetite stays within approved limits. The average total Management VaR of the Group for the year 2021 was €2.1 million (2020: €0.9 million), equally driven by credit sensitivity from xVA as well as interest rate and basis risk from Fixed Income trading activities.

Overall, a large portion of the market risks arising from client transactions are hedged with other Morgan Stanley Group undertakings which reduces the overall risk being managed on the entity.

Additional information on the Management VaR for the Group’s trading portfolio on an annual high and low basis, including comments on movements, is presented in note 23 of the MSEHSE Group consolidated financial statements.

The following shows the market risk RWAs of 31 December 2021 and 31 December 2020, as calculated using advanced capital model (Internal Model Approach, “IMA”) and under the standardised approach, where applicable. Consistent with its regulatory approvals, the Group currently uses the IMA for the calculation of own funds requirements for market risk.

RWAs € in millions	31 December 2021	31 December 2020
Standardised approach	42	16
Internal model approach(1)	6,239	4,393
Total	**6,281**	**4,409**

(1)Including RWAs for Risk not in VaR (“RNIV”)

The increase in RWA is attributable to the increase in interest rate and inflation exposures related to the so-called market making activities, impacting stressed VaR as well as an increase in discounting valuation adjustments on higher collateralised exposures.

Impact of COVID-19: The pandemic has not affected 2021 market volatility as much as it did in the previous year. Volatility levels have generally been more muted in 2021, except for rates volatility that increased towards the end of the fourth quarter of 2021 following central banks change of tone and market interventions.

Liquidity Risk

Liquidity risk, inherent to the Group's business activities, is the risk that the Group's financial condition or overall soundness is adversely affected by an inability or perceived inability to meet its financial obligations in a timely manner. Liquidity risk encompasses the associated funding risk triggered by stress events which may cause unexpected changes in funding needs or an inability to raise new funding.

The responsibility for the daily liquidity management sits within Treasury, while the Liquidity Risk Department ("LRD") is responsible for the oversight of liquidity risk arising from the Group's business activities. LRD has put in place a Risk Management Framework to identify, measure, control and report liquidity risks arising from business activities. Key components of the Liquidity Risk Framework include:

(1) Risk Identification: The identification and assessment of liquidity risks forms an integral part of the Group's liquidity risk management and is performed on an ongoing basis, considering risks to the financial condition or overall soundness in a business-as-usual environment and in stress conditions. To identify and assess liquidity risks, LRD uses ongoing monitoring of limit utilisations, regulatory as well as internal liquidity risk metrics, including the Internal Liquidity Stress Test ("ILST") results. Additionally, the NPA process is leveraged to identify and assess liquidity risks arising from new activities.

(2) Risk Measurement: Liquidity risks are measured using established methods and processes for the assessment of current and projection of future cash and securities flows over various time horizons (including intraday) in business-as-usual and stress scenarios. Key metrics include the Liquidity Coverage Ratio ("LCR"), the Net Stable Funding Ratio ("NSFR") and the coverage of assumed cash outflows under internally developed liquidity stress scenarios which consider market wide as well as idiosyncratic stress scenarios.

(3) Risk Appetite and Limits: In order to ensure that liquidity outflows under stress remain within the defined Board-level risk appetite, LRD has implemented a Liquidity Risk Limit Framework comprising of excess liquidity requirements over regulatory and internal stress requirements as well as minimum cash and business unit level limits and Key Risk Indicators ("KRI").

(4) Risk Reporting: The monitoring of adherence to relevant regulatory requirements, internal limits and KRIs, including ensuring sufficient levels of highly liquid assets is reported on a regular and ad-hoc basis to the MSEHSE Group ERC, the Group's Management Board and other stakeholders.

Liquidity risks from the Group's business activities primarily arise from OTC and listed derivatives as well as lending. These liquidity risks are covered by the Group's liquidity resources. As intraday risk is one of the key liquidity risk drivers, the Group enhanced the intraday stress model in 2021 to better capture product related intraday risk. As of 31 December 2021, the Group held sufficient liquidity to cover its liquidity risk both relative to regulatory requirements as well as internal liquidity stress requirements.

The LCR, per the Delegated Act (EU) 2015/61 as a supplement to the CRR, is a regulatory stress test with the objective of promoting short-term resilience of the Group's liquidity risk profile by ensuring that it has sufficient high-quality liquid assets ("HQLA") to withstand a significant stress scenario lasting 30 days. The Group's LCR exceeded the regulatory minimum requirement as of 31 December 2021 and 31 December 2020. The details of the Group's LCR are presented in the table below:

€ in millions	31 December 2021	31 December 2020
High Quality Liquid Assets	9,349	9,005
Cash Outflows	9,380	7,116
Cash Inflows	5,861	1,457
Net Outflow	3,519	5,659
LCR Ratio	266%	159%

The newly established NSFR is another regulatory metric which measures the stability of the Group's funding profile over a one-year time horizon, as determined by the prescribed factors assigned to on-balance sheet and certain off-balance sheet assets (Required Stable Funding, or "RSF") and liabilities (Available Stable Funding or "ASF"). It complements the LCR by requiring the Group to maintain minimum amounts of stable funding to support the Group's assets, commitments, and derivatives exposures over the one-year horizon. Since introducing NSFR on 28 June 2021, the Group's NSFR ratio exceeded the regulatory minimum requirement.

The Group further uses Liquidity Stress Tests to model external and intercompany liquidity flows across multiple scenarios over a range of time horizons. As of 31 December 2021, the Group maintained sufficient liquidity to meet current and contingent funding obligations as modelled in its Liquidity Stress Tests.

Additional information on financial liabilities is presented in note 23 of the MSEHSE Group consolidated financial statements. Additional information on Capital Structure and Liquidity is presented in the Economic Report as part of the Management Report.

Impact of COVID-19: Adequate excess liquidity was maintained during the pandemic both in 2020 and 2021, including during volatile markets.

Operational Risk

Operational risk is defined as the risk of loss, or damage to the Group's reputation, resulting from inadequate or failed processes or systems, human factors or from external events (e.g., fraud, theft, legal and compliance risks, cyber-attacks or damage to physical assets, the ongoing COVID-19 pandemic or damage caused by climate change). Climate change is a driver of existing risks. The physical risk from a London Tidal flood is identified as a material business disruption and continuity risk for operational risk given the outsourcing profile of the Group.

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. In the event of a new product or a business activity, operational risks are considered and any necessary changes in processes or controls are implemented.

The Operational Risk Department ("ORD"), which is independent from the business units, is responsible for the assessment and monitoring of operational risks. ORD has put in place a comprehensive Risk Management Framework to identify, measure, control and report operational risks arising from business activities. Effective operational risk management is essential to reducing the negative impact of operational risk incidents and mitigating legal and regulatory risks. The Framework is continually evolving to account for changes in the Group and to respond to the changing regulatory and business environment. Key components of the Operational Risk Framework include:

(1) Risk Identification: Operational risk data and assessment systems are employed to monitor and analyse internal and external operational risk events, which are captured in dedicated databases to assess business environment as well as internal control factors and to perform scenario analysis. Operational Risk and Control Self-Assessments ("RCSA") are a key instrument for operational risk identification. RCSAs are executed by the BUs while the ORD

oversees the process and challenges the results.

(2) Risk Measurement: Operational risks are measured using an operational risk capital model which encompasses both quantitative and qualitative assessments. The quantitative results are based on scenario analysis results, which are direct inputs into the model, while internal and external operational incidents, business environment and internal control factors are evaluated as part of the scenario analysis process.

(3) Risk Appetite and Tolerances: To ensure that potential losses remain within the defined Board-level risk appetite the Group's Management Board has set risk tolerance levels for the entity in aggregate and for all Top Operational Risks. ORD monitors that business and control functions remain within the tolerance levels.

(4) Risk Reporting: All significant Operational Risk Incidents and the operational risk profile relative to the tolerance level are reported on a regular and ad-hoc basis to the MSEHSE Group ERC, the Group's Management Board and other stakeholders.

Capital requirements for operational risk are currently calculated under the Basic Indicator Approach ("BIA"). As of 31 December 2021, the Group's operational RWAs were €632 million (2020: €589 million). The Group recognises that the BIA is not a risk-based measure and therefore uses an operational risk modelling approach to calculate internal operational risk capital requirements (refer to the operational risk figure disclosed in the table in the section "Internal Capital Adequacy Assessment Process ("ICAAP")", sub-section "Economic perspective").

The Group holds sufficient capital to cover the incremental capital requirement over and above the Pillar 1 requirement.

Impact of COVID-19: Operational risk impact of the pandemic has been contained. No material incidents or operational risk losses have been reported to date. Sustainability of the current working environment has been an area of continued focus.

The ORD scope also includes oversight of technology risk, cybersecurity risk and information security risk. ORD partners with the MSEHSE Group Anti Money Laundering and Fraud Prevention Officer to oversee fraud risk. ORD, in conjunction with the COCO, oversees third party risk (supplier and affiliate risk).

Cybersecurity

The Group's Cybersecurity and Information Security Framework, which includes policies, procedures and technologies is designed to protect our own, our client and our employee data against unauthorized disclosure, modification or misuse and are also designed to address regulatory requirements. This Framework covers a broad range of areas including the following: identification of internal and external threats, access control, data security, protective controls, detection of malicious or unauthorized activity, incident response and recovery planning.

Business Continuity Management and Disaster Recovery

Morgan Stanley has a Firm Fusion Resilience Center with a purpose to understand, prepare for, respond to, recover, and learn from operational threats and incidents that impact the Group, from cyber and fraud to technology incidents, weather events, terror attacks, geopolitical unrest and pandemics. The Business Continuity Planning & Exercises program provides the framework and supports the development of Business Continuity Plans ("BC Plans"), performs exercises, and leads lessons learned and process improvement activities to build operational resilience for the Group. BC Plans identify business unit processes, their criticality as part of the BIA and appropriate strategies for business units to continue critical business processes during a business continuity incident. Business continuity planning consists of the documented preparation, and testing of that preparation, to provide a reasonable expectation that, during a business continuity incident, the business unit will be able to recover and perform its critical business processes and limit the impact of the business continuity incident to the Group and its clients. The Technology Planning, Testing & Readiness program oversees the documentation of Technical Recovery Plans and disaster recovery testing of critical systems and third parties to validate recovery capability. Technical recovery plans are in place for critical technology assets and document how systems would be recovered following a disruption.

Third Party Risk Management

In connection with its ongoing operations, the Group utilises the services of third party suppliers which includes other Morgan Stanley Group undertakings as well as external third party vendors. The Group mostly utilises services of other Morgan Stanley Group undertakings as they are subject to the same global standards and frameworks. These services include, for example, outsourced processing and support functions and other professional services. The Group's risk-based approach to managing exposure to these services includes the execution of due diligence, risk assessments, implementation of service level and other contractual agreements as well as consideration of operational risks and performance of ongoing monitoring and supervision of the third party suppliers' performance. In addition, a dedicated Second Line of Defence control function (COCO) reviews adherence to applicable regulatory requirements. The Group maintains an Outsourcing and Sourcing Framework which includes governance through policies, procedures, templates, and technology and is designed to meet applicable regulatory requirements and be in line with the firmwide third party risk management program.

Model Risk

Model risk is the potential for adverse consequences from decisions based on incorrect or misused model outputs. Model risk can lead to financial loss, poor business and strategic decision-making or damage to the Group's reputation.

The independent Model Risk Management ("MRM") department performs the Second Line of Defence function with the objective that all models in use are fit for purpose and establishes the standards, principles and practices, governance processes, definitions, roles and responsibilities for sound model risk management. Key components of the Model Risk Framework include:

(1) Risk Identification: MRM employs model identification and tiering frameworks, aligning model risk management activities with the level of models' inherent risk.

(2) Risk Management and Monitoring: MRM conducts independent review and validation of models to verify that the models are performing as expected and in line with their designed objectives and intended use. Ongoing monitoring ensures that models continue to perform consistently with their intended purpose and that the outputs of models remain reliable.

(3) Risk Appetite and Tolerances: To ensure that model risk does not pose a material risk to capital adequacy, reputation and regulatory standing, model governance and control processes have been established.

(4) Risk Reporting: MRM reports on model risk to the MSEHSE Group Model Oversight Committee and provides a quarterly report on model risk to the MSEHSE Group ERC and the Group's Management Board.

The Group uses internal models for valuation, risk management and capital calculations. Valuation models include models that are used to produce valuation and/or risk measures for end of day books and records related to a position and models that are used to adjust a portfolio's value. Risk models are used for the measurement and management of credit risk, market risk, counterparty risk, operational risk, and liquidity risk, for stress testing, and for the calculation, planning, and management of regulatory and internal capital requirements.

Conduct Risk

Conduct risk is defined as the risk arising from misconduct by individual employees or contingent workers (collectively, "Covered Persons") or groups of Covered Persons or the risk arising from conduct by the Group where the outcome has an adverse impact on clients or, markets.

The Group's independent Compliance Division is responsible for the design and development of a

Conduct Risk Framework and for the execution of compliance-related responsibilities. A consistent global framework is in place for managing conduct risk and Conduct Risk Incidents ("CRI") including the management of conduct risk and CRIs within the Group.

Key components of the Conduct Risk Framework include:

(1) Risk Identification: Business units as well as support and control functions are responsible for identifying, assessing, managing, and recording the conduct risks, which arise from their current or planned strategies and activities.

(2) Risk Management and Monitoring: Internal controls and processes have been established to manage conduct risks identified. CRIs are identified and escalated through a range of processes within the First, Second and Third Lines of Defence. A review will be performed by the appropriate division and recommendations made to relevant decision-makers on next steps.

(3) Risk Appetite and Tolerances: The Group does not have an appetite for conduct risk. However, the Group acknowledges that it remains inherent in the Group's products, activities, processes and systems and, therefore, cannot be eliminated entirely.

(4) Risk Reporting: Established processes ensure to report risks and incidents as well as a prompt escalation and appropriate notification. The Group's Head of Compliance attends the Europe, Middle East, and Africa ("EMEA") Conduct Risk Committee and reports to the Group's Management Board periodically on the Group relevant conduct matters and on developments to the Conduct Risk Framework as well as on developments to the applicable regulatory environment.

The Group's Management Board holds executive management accountable for compliance with business conduct risk standards through a variety of measures and controls.

Compliance Risk

Compliance Risk is defined as the risk of legal or regulatory sanctions, material financial loss or damage to reputation resulting from the failure to comply with laws, rules, regulations, related self-regulatory organization standards and codes of conduct applicable to the Group's activities.

The Group's independent Compliance Division is responsible for identifying applicable Compliance risks and obligations as well as for establishing and maintaining a Compliance Risk management program for the Group. All of the Group's businesses and operations are subject to the Compliance Risk management program. Key components of the Compliance Risk programme include:

(1) Risk Identification: Business units as well as support and control functions are responsible for identifying, assessing, managing, and reporting compliance risk. The Group's Compliance Division completes an annual Compliance Risk Assessment for the Group to identify material Compliance Risk.

(2) Risk Management and Monitoring: The annual Compliance Risk Assessment for the Group evaluates Compliance risks and is reported to the Management Board. In addition, the Compliance Division subsequently develops an Annual Compliance Plan for the Group that prioritizes Compliance Division activities (including Compliance monitoring) based on the Compliance Risk Assessment and other inputs, as appropriate.

(3) Risk Appetite and Tolerances: The Group seeks to comply with applicable laws, rules, and regulations, including those related to financial crime. The Group has no appetite for transactions, business activities, or conduct by employees, contingents, customers, or counterparties that give rise to a significant breach of the Group's compliance obligations.

(4) Risk Reporting: The Group's Compliance Division reports to the Group Management Board on a quarterly basis, on compliance risk, significant regulatory compliance related developments and the progress of

the Annual Compliance Plan. The Group's Compliance Division also produces an annual Compliance report which is reviewed by the Management Board.

Other material risks

In addition to the above risks, the Group has put in place a framework to identify, measure, control, and report on the following other material risks:

- Leverage risk: Leverage risk is defined as the risk resulting from an institution's vulnerability due to leverage or contingent leverage that may require unintended corrective measures to its business plan, including distressed selling of assets that might result in losses or in valuation adjustments to its remaining assets.
- Valuation risk: Valuation risk represents the possibility that a valuation estimate of a position measured at fair value would differ from the price in an actual transaction on the same terms at the reporting date.
- Earnings at risk and Strategic risk: Earnings at risk and Strategic risk are defined as the risk to earnings posed by falling or volatile income ("Earnings at risk"), and the broader risk of a legal entities' business model or strategy proving inappropriate due to macroeconomic, geopolitical, industry, regulatory, climate change or other factors ("Strategic risk").
- Reputational risk: Reputational risk (also referred to as "Franchise risk"), describes potential risks associated with the way in which the Group conducts its business and the perception of the Group by external parties including its shareholders, clients, regulators and the public.

Risk summary

The Group's risk strategy and risk appetite are aligned with the Group's business strategy as well as capital and liquidity resources and targets and are embedded into risk management processes. The Group's risk bearing capacity was sufficient at each quarter-end during 2021. In addition, the Group's capital and liquidity are deemed sufficient to exceed regulatory minimums under both normal and in stressed market environments. Adequate capital and liquidity were maintained as of 31 December 2021. Whilst periods of heightened market volatility due to the COVID-19 pandemic were observed primarily in 2020 but also in 2021, the Group remained within the set risk appetite. The Group's Risk Management Framework and the Group's Risk Governance structures are effective and commensurate with the size and complexity of the Group's risk profile and the Group's Risk Division is appropriately staffed with experienced risk managers.

Further information is disclosed in the chapter "Opportunities and Outlook".

Climate Report

The Morgan Stanley Group and the MSEHSE Group recognise the significant potential for climate change to impact clients, investments, operations, employees and local communities, and take an integrated approach to climate change mitigation and adaptation encompassing policies, activities, products and solutions. The Morgan Stanley Group and the MSEHSE Group's efforts aim to mitigate climate-related risk, pursue opportunities at scale for clients and reduce the climate impact of its own footprint.

Central to Morgan Stanley Group's climate strategy is the commitment, announced in September 2020, to reach net-zero financed emissions by 2050. To demonstrate progress toward this commitment, the Morgan Stanley Group set interim 2030 financed emissions lending intensity ("FELI") targets in November 2021 for three carbon-intensive sectors: Auto Manufacturing, Energy and Power. These interim targets will help Morgan Stanley Group align the FELI of its corporate loan portfolios with science-aligned sector pathways on its journey to reach net-zero financed emissions by 2050. The MSEHSE Group will set a KPI that monitors its contribution to the Morgan Stanley Group's targets in these three sectors. This will be owned by the Group's Management Board with a sub-threshold serving as an escalation point for approval based on additional analysis of a client's climate targets and associated transition plans. For details on the Morgan Stanley Group's targets and methodology, including its Measure-Manage-Report framework launched in 2021, refer to: https://www.morganstanley.com/about-us/sustainability-at-morgan-stanley/net-zero-financed-emissions

The Morgan Stanley Group continues to partner with clients and stakeholders to mobilise capital at scale for the low-carbon transition and in 2021, increased its commitment to mobilise capital toward low-carbon solutions to $750 billion by 2030. This goal is part of a larger commitment to mobilise $1 trillion in capital toward broader sustainability solutions in support of the United Nations Sustainable Development Goals. Together, these goals drive the Morgan Stanley Group's efforts to craft innovative, market-leading climate finance and investment solutions that meet growing client demand. By incorporating climate considerations into business activities, the Morgan Stanley Group aims to manage business for the long term while providing value for clients and shareholders. For details, refer to: https://www.morganstanley.com/ideas/low-carbon-finance-1-trillion-dollar-pledge

To coordinate and support the EMEA region's efforts around sustainability, an EMEA Sustainability Steering Committee was established in 2021. This Committee also oversees the implementation of sustainability-related regulatory measures applicable in the EU to Morgan Stanley legal entities.

Climate Risk Strategy

Climate change and environmental degradation pose a significant risk to the global financial system and its ability to sustain a productive, growing economy. Climate change has the potential to impact many facets of the economy, including property, agriculture, infrastructure as well as local communities and individual health. These impacts pose a risk to the financial system, including disorderly price adjustments, disruption to market liquidity, as well as to financial institutions navigating rapidly changing consumer and business preferences, policies and technologies. Additionally, how these risks compound with one another is still uncertain, and market prices may not currently reflect the reality of climate risk.

Climate change drives a number of existing risks for the Morgan Stanley Group and the MSEHSE Group, including credit, operational (including reputational and liability/litigation risk), market and liquidity risk, and is managed within the MSEHSE Group's existing risk appetite. The MSEHSE Group continues to develop its climate risk strategy in alignment with the development of Morgan Stanley Group's strategy, as articulated above and in Morgan Stanley's Taskforce on Climate-related Financial Disclosures ("TCFD") report published in October 2020, which is due to be updated later in 2022: www.morganstanley.com/assets/pdfs/Morgan_Stanley_TCFD_Report_2020.pdf

The management of climate risk leverages existing governance and risk management processes of the Group as described in more detail in the following sections. For detail of Morgan Stanley's approach to managing environmental and social reputational risk, refer to "Environmental and social risk management" section of this Climate Report.

Governance

Morgan Stanley Group takes an integrated approach to climate change management, with oversight from leadership and input from across the business. The CRO, who is a member of the MSEHSE Group Management Board, is also a member of the MSI Group Climate Risk Steering Committee. The Steering Committee oversees Morgan Stanley's development of EMEA's climate risk management framework and responses to EMEA climate-related regulatory guidance and requirements.

As of early 2022, the MSI Group Climate Risk Steering Committee has been merged with the wider EMEA Sustainability Steering Committee and formalised as a management-level Committee that reports into the executive-level EMEA Operating and Risk Committees, and MSEHSE Group Executive Risk Committee.

Financial Risk Management

In line with TCFD recommendations and the ECB guide on climate-related and environmental risks, the Group divides climate-related and environmental risks into three main categories: transition risks, physical risks and other environmental risks.

- Transition risks: Transitioning to a low-carbon economy will entail extensive regulatory, policy, legal, technology and market initiatives as society adapts to climate change and mitigates its causes. Depending on the nature, speed and focus of these changes, transition risks may pose varying types and levels of financial and reputational risk to businesses and other organisations.
- Physical risks: These risks include both acute physical events such as flooding, and chronic physical risks related to longer-term shifts in climate patterns such as more frequent and prolonged drought. Financial implications for organisations can range from direct damage to assets to indirect impacts from supply chain disruption, driven by factors such as changes in water availability, food security and agricultural productivity. Extreme temperature changes may affect an organisation's physical locations, operations, supply chain, transport needs and employee safety.
- Other environmental risks: These refer to financial risks posed by the exposure of financial institutions to activities that may potentially cause or be affected by environmental degradation (such as pollution, scarcity of fresh water, land contamination and desertification, biodiversity loss, and deforestation) and the loss of ecosystem services. Like climate risks, financial risks associated with the environment may be categorised as either physical or transition risks.

Managing climate-related and environmental risks

Climate-related and environmental risks are managed in the MSEHSE Group Risk Framework with requirements incorporated in policies and procedures across credit, market, operational and liquidity risk. The Climate-related and Environmental Risk Framework that brings together how climate-related and environmental risks have been incorporated into existing risk frameworks includes Risk Identification and Materiality Assessment; Risk Appetite and Limit Framework; Scenario Analysis and Stress Testing; and Risk Reporting. The Climate Risk Framework continues to be developed to meet the requirements set out in new and evolving regulations.

Risk identification and materiality assessment

As part of its established Risk Identification and Materiality Assessment process, the Group introduced a granular risk identification and materiality assessment of short-term climate-related and environmental risks in 2021. This includes:

- Risk inventory: The Group's risk inventory captures climate-related and environmental risks. As climate-related and environmental risks manifest themselves in credit, market, operational and liquidity risks, these are incorporated into the relevant risk taxonomies.

Climate-related and environmental risk events considered include those related to transition risk such as environmental policy (e.g., carbon repricing and other environmental regulation to manage water stress, protect biodiversity and curb pollution) as well as a variety of physical risk events, such as a river flood event in Northern Europe.

- Materiality assessment: A quantitative assessment is performed across credit, market, operational and liquidity risk to determine the materiality of the impact of climate-related risk on these risk categories, and additionally of environmental risk for credit risk. This assessment is based on an estimate of the stress loss against existing Risk Identification materiality thresholds.
- Outcome: Carbon repricing transition risk is identified as material for credit risk in the short term. Physical risk from a London tidal flood is identified as a material business disruption and continuity risk for operational risk given the outsourcing profile of the Group. For market risk and liquidity risk, no new material risks are identified. As the assessment is performed quarterly, the materiality assessment may change in the future.

The Group also performed an exploratory long-term assessment of climate-related risks. This materiality assessment concluded that the carbon repricing transition risk is material for credit risk in the long term. Refer to section ”Scenario analysis and stress testing”.

The assessment of the impact of climate-related and environmental risks on reputational risk is in progress and due to complete in 2022, and the impact on liability/litigation risk will be assessed in 2022.

The other environmental risks (outside climate risks) assessed in the Risk Identification and Materiality Assessment are identified as non-material.

Risk appetite and limit framework

Climate risk is incorporated in the MSEHSE Group’s Risk Appetite and Limit Frameworks. Climate risk is incorporated in the MSEHSE Group’s Risk Appetite as a driver of existing risks.

Climate risk is incorporated into the Credit and Market Risk Management Framework through portfolio limits, industry sector limits and country and borrower ratings. Limits and ratings are monitored as per standards set out in Risk Management policies and procedures.

- Portfolio Limit: The MSEHSE Group Management Board approved a portfolio risk appetite via a Climate Stress Loss Limit (“CSLL”). To monitor potential credit and market risk losses against this limit, the Group has approved a short-term transition risk carbon repricing scenario assuming a sudden and sustained carbon repricing in line with global efforts to meet the Paris Agreement. The results of this scenario are reported to the MSEHSE Group Executive Risk Committee and the Group’s Management Board on a monthly basis.
- Industry Sector Limits: Credit risk limits were established for industries highly exposed to climate risk. The recently established industry sector limits enable the Group to monitor and manage credit risks from climate risk in the Group’s portfolios.
- Country Ratings: Development of respective model methodology has been completed. Climate risk, as part of Environmental, Social and Governance (“ESG”) considerations, is currently being incorporated into the internal sovereign credit rating assessment. The sovereign rating is an important input in determining country limits, therefore climate risk and ESG considerations will influence risk appetite at the country level.
- Borrower Ratings: Development of respective model methodology has been completed. Climate risk is currently being incorporated into the rating assessment for corporates.

In addition to the credit limits for lending in industries highly exposed to climate risk, the Group includes an assessment of ESG risks in the transaction approval documentation in line with the European Banking Authority’s guidelines on loan origination and monitoring.

Scenario analysis and stress testing

Scenario Analysis is central to the Group’s Climate Risk Management Framework.

- Short-term credit and market risk scenario analysis: Informed by carbon emissions data from external providers, the Group assesses the financial impact of environmental policy (carbon repricing), the key transition risk, in a scenario that captures both counterparty defaults and market price movements. Physical risk vulnerabilities have also been assessed with loss estimated for the highest impact scenario (flood in Northern Europe). As transition risk poses a greater risk of losses to the Group than physical risk, a CSLL was established. For further detail, refer to the 'Risk appetite and limit framework' section of this Climate Report.
- Operational risk scenario analysis: Workshops are held to assess the impact of a number of physical risk scenarios on the Group, across a varying degree of severities. Scenarios focus on business disruption due to climate change events (including extreme weather) and are selected based on a combination of probability and impact severity. Operational Risk Transition Risk scenarios related to litigation risk are planned for assessment in 2022.
- Long-term strategy scenarios: In addition to the short-term scenarios described above, the Group has conducted an exploratory long term scenario analysis, running two 30-year quantitative scenarios modelling late action (transition risk) and no additional action (physical risk) to inform the Group's materiality assessment and business strategy.

Metrics and targets

Climate Stress Loss Limit ("CSLL")

As of 31 December 2021, the Group remained within its portfolio CSLL.

Credit Exposures

The Group's exposure to industries identified as having high climate transition or physical risk is a small percentage of overall credit exposures.

Exposures to these industries with high climate transition or physical risk comprise 10% and 2% of the Group's aggregate credit and counterparty risk net current exposure, respectively. The calculation includes all Pillar 3 exposure classes or types of exposures.

Financed emissions metrics

The development and embedding of appropriate methodologies to measure financed emissions is critical to achieving the Morgan Stanley Group's commitment to reach net-zero financed emissions by 2050 and the 2030 interim targets. Morgan Stanley has played an active role in key industry-led initiatives that inform how financial institutions set net-zero targets and measure and disclose financed emissions, including the Net-Zero Banking Alliance ("NZBA") and the Partnership for Carbon Accounting Financials ("PCAF").

In the Morgan Stanley Group's TCFD report due to be published later in 2022, financed emissions will be disclosed for lending activities in the sectors for which Morgan Stanley Group has established interim targets. These will be reported in accordance with PCAF's Global Greenhouse Gas Accounting and Reporting Standard and the Morgan Stanley Group's Financed Emissions Lending Intensity metric. For more details on the methodology, refer to: https://www.morganstanley.com/about-us/sustainability-at-morgan-stanley/net-zero-financed-emissions

As an interim step to disclosing global financed emissions, Scope 1, 2 and 3 emissions and the Greenhouse Gas ("GHG") Lending Intensity for the Group's lending portfolio is shown in the following table. This is based on the ECB methodology and includes lending exposure in emissions-intensive sectors for which Morgan Stanley has set interim targets (Auto Manufacturing, Energy and Power) as well as lending exposure in other emissions-intensive sectors as specified by the ECB 2022 Climate Risk Stress Test. For further information on ECB methodology, refer to https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.climateriskstresstest2021~a4de107198.en.pdf

As presented in the following table, the Group's credit exposure to emissions-intensive sectors as specified by the ECB 2022 Climate Risk Stress Test is relatively contained at €2.1 billion. The weighted average GHG Lending Intensity of the portfolio is 2,088 tonnes of 3 years average revenue.

Data of the MSEHSE Group GHG Lending Intensity Figures as per ECB Stress Test Methodology
31 December 2021

Sector	Number of Counter-parties	Exposure (%)	Scope 1 + Scope 2 emissions (tCO2e millions)	Scope 3 emissions (tCO2e millions)	GHG Lending Intensity as per ECB Stress Test methodology (tCO2e/€ in millions of 3 years average revenue)
Energy	4	21%	24	381	4,703
Utilities	8	18%	22	28	1,258
Transportation	4	16%	14	11	680
Automobiles and Components	2	15%	1	180	3,873
Pharma, Biotech & Life Sciences	1	10%	1	4	135
Other as per ECB Climate Stress Test	10	20%	0	10	796
Weighted average			**12**	**117**	**2,088**
Total (%)		**100%**			
Total	**29**	€2,089 million			

Note:

Exposure considers corporate exposures to non-SME ("non-small and medium enterprises"), non-financial obligors, treated under both the internal ratings-based ("IRB") approach and the standardised approach ("STA").Exposures reported by NACE (abbreviation for Statistical Classification of Economic Activities in the European Community) - Codes ("NACE-Codes") in the ECB 2022 climate risk stress test have been mapped to GICs codes in the table. Within each sector, a materiality threshold of 1% of total non-SME corporate credit exposures by sector (i.e., by group of NACE codes) applies, the exposure below that threshold is not reported.

GHG lending intensity metric for counterparties is the counterparties' Scope 1, 2 & 3 GHG emissions (tCO2e) / counterparties' average revenues for the last 3 years. The sector intensity metric is the weighted average (based on exposure) of the GHG intensity of the counterparties in the sector.

GHG data is drawn from two sources – publicly reported company data and third-party data vendor estimations. GHG data is often estimated. Specifically, Scope 3 GHG emissions estimates can vary widely across data sources, introducing accuracy uncertainty. The lagged reporting timeframe of GHG data also presents challenges for disclosure. Typically, emissions data is not available until approximately 12-15 months after the fiscal-year end. Morgan Stanley performs a data quality review of GHG vendor data, ensuring sufficient coverage and a best effort toward accuracy. For further detail on how the Morgan Stanley Group sources GHG data, refer to https://www.morganstanley.com/content/dam/_msdotcom/about-us/netzero/Morgan-Stanley-Net-Zero-Target-Methodology.pdf.

Environmental and social risk management ("ESRM")

Morgan Stanley also takes a Morgan Stanley-wide approach to the management of environmental and social risks that could impact its reputation. Morgan Stanley's ESRM Group provides internal subject matter expertise on environmental and social risk, conducts diligence on relevant transactions, and monitors emerging environmental and social issues. Morgan Stanley Group's due diligence and risk management processes are designed to identify, assess and address potentially significant environmental and social issues that may impact the Morgan Stanley Group, its clients and other stakeholders. As outlined in Morgan Stanley's Environmental and Social Policy Statement, Morgan Stanley has tailored approaches to certain sectors and activities, including carbon-intensive sectors. Transactions that meet designated environmental and social risk criteria may require approval by the Global Franchise Committee, or Regional Franchise Committees such as the EMEA Franchise Committee, as well as senior management. This Policy Statement is reviewed annually and updated to reflect the Morgan Stanley Group's strategy and key developments. For further detail, refer to Morgan Stanley's Environmental and Social Policy Statement which can be found at http://www.morganstanley.com/about-us-governance

Opportunities and Outlook

The Management Report contains certain forward-looking statements. These statements are made by the Management Board in good faith, based on the information available at the time of the approval of this report and such statements should be treated with caution due to the inherent uncertainties, including both economic and business risk factors, underlying any such forward-looking information. In particular, the effects on the Company of the ongoing COVID-19 pandemic, the related global economic crisis and recent geopolitical tensions and armed conflicts continue to represent significant factors of uncertainty.

Global growth is expected to slow from 6.1% in 2021 to 4.3% in 2022. Demand is expected to remain robust and fiscal policy expansionary, even as the degree of monetary policy accommodation will likely be reduced in many places around the globe due to increasing concerns about inflationary pressure. But the recent escalation of the conflict between Russia and Ukraine has furthermore added significant uncertainty, around the previously expected spring pick up by exerting additional upwards pressure on already surging inflation and downward pressure on economic activity.

Europe has generally lagged other key regions in the recovery, but caught up around the middle of 2021, growing stronger than the U.S. and China. The expansion slowed considerably at the end of the year however, driven by supply chain issues, sharply higher inflation, and renewed COVID-19 restrictions on the back of the Omicron wave. Activity is expected to remain weak at the beginning of the year and the Group now also sees downside risks to the previously anticipated spring pick up due to the conflict between Russia and the Ukraine. Germany is particularly exposed to this conflict due to its high energy dependency on Russia as well as its trade links into the region and could consequently see lower growth than many of its European peers. From a medium-term perspective, the EU recovery fund should nonetheless increasingly drive growth in the periphery via higher investments.

Despite the COVID-19 pandemic, the Group achieved strong results of operations in 2021. Both the Morgan Stanley Group and the MSEHSE Group have benefitted from significantly increased capital market activity and strong lending activity, which had a very positive impact on the fee and commission income.

As the Company has not experienced a decline in employee productivity as a result of remote working during the pandemic, the Group is confident that this is unlikely to have a negative impact in the future.

The capital actions during 2021 have strengthened the financial position of the Company which will enable the Company to continue benefitting from new opportunities in a rapidly changing market and business environment. With its business model, the Company considers itself well positioned to serve Morgan Stanley Group clients particularly in the EEA in a targeted manner, as well as to continue to expand the business onwards and thus to improve the profit before tax.

The Company also highlights the opportunities to maintain existing and increase potential client activities and demand for products and services. Specifically, the Company sees business opportunities in its stable and sustainable client relationships, its strategic advisory approach, its extensive product range, and its ability to leverage the Morgan Stanley Group's global footprint with entities in many locations around the world to provide innovative and tailored solutions to its clients. The Company will focus on maintaining its strong positioning in Investment Banking across advisory as well as capital markets activities, both on the debt and equity side. The Company has seen significant interest in clients wanting to strengthen their balance sheet positions and lock-in low rates as well as reposition their activities for the significant changes brought in by the pandemic. In this context, we will continue to monitor the impact on the Group's risk profile and risk appetite closely to ensure the Group's risk management framework remains aligned to its business strategy. Technology, pandemic recovery and sustainable finance would remain key themes for both the clients as well as the Group going forward.

The Company expects to continue developing its sales & trading footprint by investing in technology and talent. The Company will work closely with clients on key topics of importance to them, restructuring portfolios to protect from the changes in inflation expectations and risk in light of heightened geopolitical uncertainties. Significant volatility in energy markets and the transition to green portfolios are additional client concerns. The Group expects to continue to expand its capabilities to support its clients successfully in navigating these challenges over the cyclical and secular horizon.

The Group will also expand its activities in France, including the establishment of a Research & Development ("R&D") Centre in Paris. From the second quarter of 2022, the R&D Centre will provide a platform to foster innovation for the Group's market business through analytical and technological performance.

BaFin set the ratio of the domestic countercyclical capital buffer (“CCyB”) at 0.75% for domestic exposures in its general ruling dated 31 January 2022, which will become effective in February 2023. MSEHSE Group CCyB is set to increase driven by announced increases in domestic and other European country CCyB rates. These changes are incorporated as part of the MSEHSE Group capital planning and target setting processes. Forecast capital resources are sufficient to meet these increased requirements.

The Company leverages Morgan Stanley’s global connectivity and brand, its competitive advantage, economies of scale in technology and infrastructure, and Morgan Stanley Group’s intellectual capital. The Group’s financial KPIs are subject to heightened uncertainty in light of geopolitical developments and their potential impact on market development and conditions in 2022. Absent impact of uncertainties including those noted earlier we expect the MSEHSE Group to show continued progress on the financial KPIs. In 2022, the Company will continue to evolve the Group’s Risk Management Framework consistent with size and complexity of the Group. The Group further acknowledges that climate-related and environmental risk will be a key focus in 2022. Furthermore, the impact of COVID-19 on the risk profile will continue to be a focus for 2022, especially on credit risk exposures and obligors’ credit quality. In addition, the Risk Division will continue to focus on regulatory engagements, such as the ECB Stress Test or the ECB Asset Quality Review.

The Company expects to remain in compliance with all capital requirements as its business continues to grow. Furthermore, the Group expects that the good credit ratings will remain unchanged.

The Group will continue to closely monitor the potential impact of the conflict in Ukraine on business performance, counterparties, and risk profile including its liquidity and capital base.

To ensure talent and operational resilience, the Company will continue to focus on attraction, retention, development and well-being of talent. The Morgan Stanley Group furthermore keeps on strengthening its Conduct and Culture agenda and increase focus on Diversity and Inclusion with enhanced touch points between senior management and employees across locations to emphasise the Morgan Stanley Group’s values.

ANNUAL FINANCIAL STATEMENTS

Balance Sheet as at 31 December 2021

€ in millions	Notes	2021	2020
Amounts due from credit institutions	4, 5		
a) Due on demand		**7,580**	**6,184**
Amounts due from customers	4, 5	**14,055**	**7,294**
thereof: loans granted to local authorities €114 million (2020: €236 million)			
Trading portfolio	7	**17,521**	**23,932**
Investments in affiliated companies	8	**603**	**695**
thereof: credit institutions €603 million (2020: €603 million)			
Intangible assets	8		
a) Goodwill		**70**	**47**
Property, plant and equipment	8	**27**	**26**
Other assets	9	**603**	**230**
Prepaid expenses and deferred charges		**1**	**1**
Total assets		**40,460**	**38,409**

€ in millions	**Notes**		**2021**	**2020**
Amounts due to credit institutions	4, 5			
a) Due on demand			**3,411**	**1,798**
Amounts due to customers	4, 5			
a) Other liabilities				
aa) Due on demand		14,843		3,880
ab) With an agreed maturity/term		8		7,462
			14,851	**11,342**
Trading portfolio	7		**16,926**	**21,056**
Other liabilities	9		**266**	**143**
Deferred income			**7**	**8**
Provisions	11			
a) Provisions for pensions and similar obligations		15		8
b) Provisions for taxation		16		0
c) Other provisions		104		63
			135	**71**
Fund for general banking risks thereof: special items according to Section 340e (4) HGB €1 million (2020: €0 million)	7		**1**	**0**
Subordinated liabilities	12		**1,002**	**1,002**
Instruments of additional regulatory core capital	13		**600**	**600**
Equity capital (shareholder's fund)	14			
a) Subscribed capital		451		451
b) Capital reserve		2,786		1,936
c) Revenue reserves		2		0
d) Retained earnings		22		2
			3,261	**2,389**
Total liabilities and equity			**40,460**	**38,409**

Income Statement for the period from 1 January to 31 December 2021

€ in millions	**Notes**			**2021**	**2020**
Interest income from credit and money market transactions	15		(29)		(14)
thereof: negative interest income €63 million (2020: €47 million)					
Interest expenses	15		33		(26)
thereof: negative interest expenses €64 million (2020: €54 million)					
				(62)	**12**
Commission income	16		567		162
Commission expenses	16		74		15
				493	**147**
Net income of the trading portfolio	17			**11**	**(20)**
thereof: special items according to Section 340e (4) HGB €1 million (2020: €0 million)					
Other operating income	18			**13**	**69**
General administrative expenses					
a) Personnel expenses					
aa) Wages and salaries		185			87
ab) Social security and other pension costs and benefits thereof: Pension scheme €14 million (2020: €9 million)		32			17
			217		104
b) Other administrative expenses			110		47
				327	**151**
Depreciation, amortisation and write-downs of intangible assets, and property, plant and equipment	8			**13**	**5**
Other operating expenses	18			**54**	**44**
Write-downs and valuation allowances on receivables and certain securities, as well as additions to provisions in the lending business				**0**	**2**
Income from ordinary activities				**61**	**6**
Income taxes	19			**39**	**4**
Net profit for the year				**22**	**2**
Net profit				**22**	**2**

€ in millions	Notes	2021	2020
Net income		**22**	**2**
Non-cash items included in net income and reconciliation to cash flow from operating activities			
+/– Depreciation on intangible assets and property, plant and equipment	8	13	5
+/– Increase in/reversal of provisions	11	77	55
+/– Interest expense / income	15	62	(12)
+/– Income tax expense / income	19	39	4
+/– Other adjustments		1	1
= Subtotal		**214**	**55**
Changes in assets and liabilities from operating activities			
+/– Amounts due from credit institutions		(1,804)	(2,904)
+/– Amounts due from customers		(12,588)	(2,100)
+/– Trading portfolio assets		(10,875)	(19,369)
+/– Other assets from operating activities		(410)	378
+/– Amounts due to credit institutions		4,050	1,343
+/– Amounts due to customers		10,114	4,221
+/– Trading portfolio liabilities		10,341	16,972
+/– Other liabilities from operating activities		114	(183)
+ Interest received		81	87
– Interest paid		(101)	(64)
– Income taxes paid		(16)	(10)
Cash flow from operating activities		**(880)**	**(1,574)**
– Payments for the acquisition of intangible assets and property, plant and equipment		(4)	(2)
– Payments for the merger of companies		63	(24)
– Payments for the sale of business units	1	13	0
Cash flow from investing activities		**72**	**(26)**
+ Payments from the issuance of instruments for Additional Tier 1 Regulatory Capital (AT1)	13	0	600
+ Proceeds from contributions to equity	14	850	0
+ Payments from subordinated liabilities	12	0	1,000
– Interest paid for instruments for Additional Tier 1 Regulatory Capital (AT1)		(31)	0
– Interest paid for subordinated liabilities		(11)	0
Cash flow from financing activities		**808**	**1,600**
= Change in cash and cash equivalents		0	0
+ Cash and cash equivalents at the beginning of the period		0	0
Cash and cash equivalents at the end of the period		0	0

General Information

1. Corporate information

Morgan Stanley Europe SE (the “Company”, “Bank” or “MSESE”) is a stock corporation under European Law (European Company (Societas Europaea)) based in Frankfurt am Main. The Company is registered in the Commercial Register B of the Local Court in Frankfurt am Main under number HRB 109880.

Morgan Stanley Europe Holding SE, Frankfurt am Main, (“MSEHSE”) is the sole shareholder of MSESE. MSESE is the sole shareholder of Morgan Stanley Bank AG, Frankfurt am Main ("MSBAG").

MSESE established its business operations as a securities trading bank pursuant to Section 1 (3d) Sentence 5 KWG on 1 March 2019. With entry into force of the Investment Firm Regulation and the implementation of the Investment Firm Directives of 26 June 2021, MSESE has been reclassified as CRR credit institution. MSESE is expecting to receive formally the CRR Credit Institution licence in the course of 2022.

The principal activity of MSESE is the operation of banking activities and the provision of financial services through the business units Institutional Equities Division, Fixed Income Division, Investment Banking Division and Real Assets to a client base mainly in the EEA.

For the further expansion of business activities, the capital reserve of €850 million was increased effective 15 October 2021.

On 31 March 2021, Morgan Stanley S.V., S.A.U., Madrid, Spain, (“MSSV”) merged with and into MSESE as acquiring legal entity. Prior to the merger, certain business activities together with 5 employees were transferred from MSSV to MSIM Fund Management (Ireland) Limited, Dublin, Ireland ("MSIM FMIL"), a subsidiary of Morgan Stanley International Limited, London, United Kingdom (“MSI”). In consideration of the business transfer, MSESE received a compensation payment of €13 million. This business transfer is based on an opinion according to IDW S1 “Principles for the Performance of Business Valuations”.

2. Basis of accounting

The financial statements as at 31 December 2021 have been prepared in accordance with the regulations of the German Commercial Code (Handelsgesetzbuch or “HGB”), the German Ordinance on Accounting Policies for Banks and Financial Service Providers (Verordnung über die Rechnungslegung der Kreditinstitute und Finanzdienstleistungsinstitute or “RechKredV”) as well as the German Stock Corporation Act (Aktiengesetz or “AktG”). If not stated otherwise, amounts are stated as € in millions.

The company, which prepares the consolidated financial statements for the smallest consolidation scope, is MSEHSE and the company which prepares the consolidated financial statements for the largest consolidation scope, is Morgan Stanley, New York, USA. The consolidated financial statements of Morgan Stanley are published at SEC (Securities and Exchange Commission) in New York, USA, under Central Index Key Number 0000895421. Both consolidated financial statements are available at the entity.

According to Section 291 (1) and (2) HGB, MSESE is exempt from preparing consolidated financial statements and a management report for the subgroup. The exempting consolidated financial statements and the Group management report of the Morgan Stanley Europe Holding SE Group, Frankfurt am Main, (the “MSEHSE Group”) according to Section 291 (1) HGB in conjunction with Section 315e (3) HGB are prepared in accordance with the International Financial Reporting Standards (“IFRS”). They are published in the German language in the electronic Federal Gazette.

In contrast to the principles of German accounting, the following significant differences existed in the IFRS consolidated financial statements of the MSEHSE Group for the financial year 2021:

- The valuation of financial instruments as well as net income of the trading portfolio is carried out according to IFRS without a risk discount.
- According to HGB, OTC traded derivatives in the trading portfolio may be netted if the variation margin is calculated and paid daily on the basis of their fair value. Furthermore, there are possibilities for netting receivables and liabilities according to Section 10 RechKredV. In the IFRS consolidated financial statements, however, financial assets and financial liabilities are offset against each other and only the net amount is reported if there is a legal right to offset the recognised amounts in the normal course of business and in the event of a counterparty default. In addition, there must be an intention either to settle on a net basis or to realise the asset and settle the liability simultaneously.
- Commodity futures that are only physically settled are not treated as financial instruments under HGB. Under IFRS, however, these transactions fulfil the criteria of a derivative.
- The valuation of provisions for pensions and similar obligations in actuarial opinions is based on different valuation assumptions. The result is reported in IFRS consolidated financial statements under other comprehensive income.
- Deferred tax assets are recognized in the consolidated financial statements in accordance with IFRS.
- Issued AT1 instruments are reported in equity in the consolidated financial statements in accordance with IFRS.

3. Accounting policies

Receivables

Amounts due to credit institutions and customers are accounted at acquisition costs, including pro rata interests, and are reduced by necessary valuation allowances.

Loan loss provision

The Bank recognises loan loss provisions for inherent credit risks for amounts due from credit institutions and customers in the form of general value adjustments in accordance with commercial law principles.

A parameter-based Expected Credit Loss (ECL) calculation based on IDW RS BFA 7, which is consistent with IFRS 9, is used for this purpose. Thus, the loss is determined on the basis of the parameters probability of default (PD), loss given default (LGD) and the exposure at default (EAD). In calculating loan loss provisions, macroeconomic influences are taken into account in addition to borrower-related risk factors. Loan loss provisions for irrevocable loan commitments are reported in other provisions. The amount of loan loss provisions for individually considered counterparty risks is determined by the difference between the carrying amount of the receivable and the present value calculated using the discounted cash flow method. This is determined from the expected future cash inflows taking into account valuable collaterals on these receivables.

Trading portfolio

The financial instruments of the trading portfolio are measured at fair value less a risk discount in accordance with Section 340e (3) HGB. In accordance with Section 255(4) HGB, the fair value corresponds to the market price. Financial assets and liabilities are measured at the bid and ask price.

Fair value is defined as the amount at which a financial instrument could be exchanged in a current transaction between knowledgeable, willing and unrelated counterparties at the measurement date.

The fair value is determined on the basis of the observability of the input factors within a three-tier hierarchy. Observable input factors include those that would be used by market participants in the valuation of the financial instrument on the basis of market data. These are obtained from sources that are independent of MSESE. Unobservable input factors reflect the assumption of MSESE that market participants would use in the valuation of the financial instrument on the basis of the best information available in the circumstances.

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

- Level 1: Quoted prices (unadjusted) in an active market for identical assets or liabilities
- Level 2: Valuation techniques using observable inputs
- Level 3: Valuation techniques with significant unobservable inputs

Where necessary, valuation adjustments will be made. Factors taken into account include liquidity risk (price range between bid and ask price), address default risks, model collateral and concentration risks.

The availability of observable data may vary by product and is influenced by a variety of factors, such as the type of product, whether the product is new and not yet established in the market, market liquidity and other product-specific characteristics. To the extent that valuation is based on models or input factors that are less observable or unobservable, the measurement of fair value is accompanied by additional discretionary decisions.

In order to take into account any remaining realisation risks, the result of the valuation at fair value is reduced by a risk discount, which is taken into account as a deduction of trading portfolio assets. The risk discount is calculated on the basis of the regulatory value-at-risk, in which the anticipated maximum loss from the trading book will not be exceeded with a 99% confidence level over a holding period of 10 days.

In addition to the risk discount, 10% of the net income from the trading portfolio (after risk discount) is allocated to the fund for general banking risks in accordance with Section 340e (4) HGB each year at the expense of the net income from the trading portfolio. The allocation is made until this special item has reached an amount of 50% of the five-year average of the net income of the trading portfolio after risk discount. The special item may only be reversed to offset a net expense of the trading portfolio or if it exceeds the 50% limit.

The Bank deposits cash collateral and securities collateral in respect of the OTC derivatives in the form of initial margin and variation margin. Variation margins paid or received are recognised as other assets or other liabilities as is customary in the industry.

Derivatives in the trading portfolio are offset against the associated variation margin payments with counterparties if, on the basis of a legally enforceable framework agreement containing a credit support annex (CSA), the exchange of the cash collateral takes place on a daily basis, taking into account the fair value of the derivative financial instruments. For each counterparty, the amount offset includes the positive and negative market values of derivatives as well as the collateral paid or received.

The conversion to new reference rates for derivatives in connection with the IBOR reform resulted in compensation payments which are accounted through profit or loss.

Valuation units

Physically settling commodity futures (underlying transaction) are combined with offsetting hedging transactions to form micro-valuation units in accordance with Section 254 HGB. There is a match in amount and maturity between the underlying and collateral transactions. The Company applies the freezing method, in which the changes in value resulting from the hedged risk are not shown on the balance sheet. In order to assess the effectiveness of a valuation unit, the method of matching of critical terms is used. Any unrealised losses from negative changes in fair value relating to the same type of risk are not recognised during the period of the hedge, unless a net loss arises (negative ineffectiveness), in which these are recognised as a provision for imminent losses. Any unrealised gains are not recognized.

Securities lending and repurchase agreements

Securities repurchase agreements are reported in accordance with the applicable principles of Section 340b HGB. Securities lent and securities sold under repurchase agreements continue to be recognised by the Bank in accordance with their economic ownership, while securities borrowed and securities bought under repurchase agreements are not recognised in the balance sheet. Receivables and liabilities from repurchase agreements and securities lending transactions that meet the requirements for offsetting under Section 10 RechKredV are shown net.

Investments in affiliated companies

Investments in affiliated companies are carried at amortised cost. If an impairment of an investment is expected to be permanent, the carrying amount is written down to the lower fair value.

Intangible assets and property, plant and equipment

Intangible assets and property, plant and equipment are reported at acquisition cost and, if subject to amortisation, reduced by scheduled depreciation. The underlying useful lives are based on the economic useful life. Write-downs are made for any impairment that is likely to be permanent. Goodwill reported under intangible assets is amortised over its estimated useful life of 10 years in accordance with Section 253 (3) sentence 4 HGB. Low-value assets are fully depreciated in the year of acquisition.

Other assets

Other assets are measured at acquisition costs (nominal value) considering the strict lower-of-cost-or-market principle.

Liabilities

Liabilities are recognised at their settlement amount, including accrued interest according to Section 253 (1) sentence 2 HGB.

Accruals and deferrals

Accruals and deferrals are released to income on a straight-line basis over their term.

Provisions

Provisions for contingent liabilities are recognised at the settlement amount required according to reasonable business judgement. If the remaining term of the provision for contingent liabilities is longer than one year, the provision is discounted. The applicable discount rate is determined and announced by the Deutsche Bundesbank in accordance with the Regulation on the Discounting of Provisions.

Provisions for pensions and similar obligations are calculated using the projected-unit-credit method. This is based on the “Richttafeln Heubeck 2018G” tables, using an average market interest rate of the last 10 years with an assumed remaining term of 15 years (amounting to 1.9%) as published by Deutsche Bundesbank according to Section 253 (2) HGB. The valuation includes actuarial assumptions on demographic developments, increases in salaries and pensions as well as inflation rates.

According to Section 246 (2) HGB, with respect to the various plans of the reinsurance, the pension obligations are offset against the fair value plan assets, and the respective expenses and income are also netted. The Company has outsourced the reinsurance policies covering the general pension plan to a contractual trust arrangement (“CTA”).

A potential provisioning requirement for interest rate risks is examined within the loss-free valuation of interest related financial instruments in the banking book. Therefore, the Bank uses the present/book value method. The valuation resulted unchanged in no need for the formation of provisions for onerous contracts.

Instruments for Additional Tier 1 Regulatory Capital

The issued instruments for the additional regulatory capital are qualified as liabilities and are stated at their settlement or nominal amount. Interest expense is accrued on the basis of expected payments.

Deferred tax assets and liabilities

Deferred tax assets and liabilities are recognised for temporary differences between the accounting and tax values for goodwill, provisions for pensions and similar obligations and interest carry forwards. Deferred tax liabilities are netted against deferred tax assets and the remaining deferred tax assets were not recognised in the balance sheet in accordance with the accounting option set out in Section 274 (1) sentence 2 HGB.

Currency conversion

Currency conversion is carried out in accordance with the regulations of Section 256a in conjunction with Section 340h HGB. Assets and liabilities denominated in a foreign currency are translated using uniform group exchange rates as of the reporting date. Resulting gains and losses are recognised in the income statement. Foreign exchange rate fluctuations from trading portfolios are reported in the net expense of the trading portfolio. Due to the special coverage in the same currency, resulting gains and losses from currency translation are recognised netted in the income statement.

Notes to the Balance Sheet

4. Maturity structure

The maturity structure of amounts due from credit institutions and customers break down as follows:

€ in millions	2021	2020
Amounts due from credit institutions		
due on demand	7,580	6,184
Total	**7,580**	**6,184**

€ in millions	2021	2020
Amounts due from customers		
due on demand	13,044	2,157
with a remaining maturity of:		
up to three months	261	4,846
three months to one year	750	291
Total	**14,055**	**7,294**

The maturity structure of amounts due to credit institutions and customers break down as follows:

€ in millions	2021	2020
Amounts due to credit institutions		
due on demand	3,411	1,798
Total	**3,411**	**1,798**

€ in millions	2021	2020
Amounts due to customers		
due on demand	14,843	3,880
with a remaining maturity of		
up to three months	8	7,436
three months to one year	0	22
from one year to five years	0	1
more than five years	0	3
Total	**14,851**	**11,342**

5. Relationship with affiliated companies

The following table breaks down the amounts due to and from affiliated companies.

€ in millions	2021	2020
Amounts due from credit institutions	7,269	4,345
Amounts due from customers	9,946	2,651
Amounts due to credit institutions	111	39
Amounts due to customers	9,381	4,205
Subordinated liabilities	1,002	1,002
Instruments for Additional Tier 1 Regulatory Capital	600	600

6. Repurchase agreements

The carrying amount of the assets recognised in the balance sheet and sold under repurchase agreements is €4,609 million (2020: €315 million).

7. Trading portfolio

The institutional specific criteria for the inclusion of financial instruments in the trading portfolio remained unchanged in the financial year.

MSESE has a allocated an amount of €1 million (2020: €0 million) from the net income of the trading portfolio to the fund for general banking risks in the financial year 2021.

The following tables further break down the trading portfolio:

	2021	
€ in millions	**Trading assets**	**Trading liabilities**
Derivative financial instruments	13,458	14,639
Receivables	1,755	2,287
Bonds and other fixed-income securities	2,188	0
Shares and other non-fixed-income securities	129	0
Risk discount Value-at-Risk	(9)	0
Total	**17,521**	**16,926**

Derivatives within trading assets and liabilities include offsetting of positive fair values of €56,702 million with negative fair values of €52,205 million which have been offset against cash collateral paid (variation margin) of €8,365 million and cash collateral received (variation margin) of €12,862 million. The increase results, among other things, from the fact that bilaterally traded OTC derivatives are included in the netting for the first time.

The nominal amount of derivative financial instruments is broken down by type and scope as at 31 December 2021 as follows:

	2021
€ in millions	**Nominal amount**
OTC traded products	
Interest-related transactions	2,360,416
Exchange-rate-related transactions	671,725
Equity-related transactions	119,653
Credit derivatives	38,706
Other transactions	16,862
Total	**3,207,362**

The basic assumptions used to determine the fair value using recognised valuation techniques are described in note 2 "Accounting policies".

The following table breaks down the fair value as follows :

	2021	
	Fair Value	
€ in millions	**Asset**	**Liability**
OTC traded products		
Interest-related transactions	4,289	4,676
Exchange-rate-related transactions	4,757	5,861
Equity-related transactions	1,492	1,276
Credit derivatives	460	421
Other transactions	2,460	2,405
Total	**13,458**	**14,639**

8. Changes in fixed assets

The following table shows changes in fixed assets:

€ in millions	Intangible assets	Property, plant and equipment	Investments in affiliated companies
Acquisition / production cost 01 Jan 2021	**48**	**35**	**695**
Merger MSSV	44	0	(92)
Additions	0	12	0
Disposals	13	5	0
Acquisition / production cost 31 Dec 2021	**79**	**42**	**603**
Accumulated depreciation 01 Jan 2021	**1**	**9**	**0**
Depreciation	8	5	0
Additions	0	1	0
Accumulated depreciation 31 Dec 2021	**9**	**15**	**0**
Carrying amount as at 31 Dec 2020	**47**	**26**	**695**
Carrying amount as at 31 Dec 2021	**70**	**27**	**603**

Intangible assets mainly consist of goodwill, which increased by €31 million in the financial year due to the merger of MSSV into MSESE.

Operating and office equipment included in property, plant and equipment amounts to €4 million (2020: €3 million).

The investments in affiliated companies at the end of the financial year relate exclusively to shares in MSBAG. The net profit of MSBAG as at 31 December 2021 amounts to €46 million with equity of €614 million. The decrease in investments in affiliated companies of €92 million is due to the merger of MSSV with MSESE.

9. Other assets

Other assets of €603 million (2020: €230 million) and other liabilities of €266 million (2020: €143 million) mainly consist of collateral received or paid for derivatives of €598 million (2020: €219 million) and €230 million (2020: €118 million) respectively. In contrast to the previous year, variation margins are not reported under amounts due from credit institutions and amounts due from customers and amounts due to customers in order to ensure a presentation that is customary in the industry.

10. Foreign currency volumes

The following table breaks down the total amounts in foreign currency as at the balance sheet date:

€ in millions	2021	2020
Assets	13,771	3,631
Liabilities	12,992	5,044

11. Provisions

Provisions of €15 million (2020: €9 million) were made for pensions and similar obligations. The significant increase is mainly due to the actuarial assumption on pension dynamics which increased form 1.5% to 2.3% in the financial year, driven by the significant increase in inflation in Germany in the second half of 2021.

The main actuarial assumptions used as at 31 December 2021 are shown in the following table:

Actuarial assumptions	2021	2020
Discount rate	1.9%	2.3%
Income dynamics	2.5%	2.5%
Pension dynamics	2.3%	1.5%

The valuation difference between the 10-year average interest rate of 1.9% and the 7-year average interest rate of 1.4% is subject to a distribution ban in accordance with Section 253 (6) HGB and amounts to €5 million as at 31 December 2021 (2020: €5 million).

Other provisions of €105 million (2020: €63 million) mainly include provisions for personnel which are an additional component of employee compensation. These consist of variable, deferred and share-based compensations measured at fair value of Morgan Stanley shares at the balance sheet date.

12. Subordinated liabilities

As at the balance sheet date, there is subordinated debt of €1,002 million (2020. €1,002 million) with a variable interest rate at EURIBOR plus 1.6% and maturity date of 27 October 2031. The subordinated loan was issued by the Company to its immediate parent MSEHSE on 27 October 2020 to strengthen the prudential supplementary capital (Tier 2).

Subordinated liabilities do not contain any conditions for converting into equity or any other form of debt. They are not obliged to repay them early.

In the event of a liquidation or insolvency of the company, the claims and interest claims of the subordinated creditors will only be repaid after the claims of all non-subordinated creditors have been satisfied. The interest expense on subordinated liabilities at the end of 2021 includes interests not yet due of €2 million (2020: €2 million).

13. Instruments for Additional Tier 1 Regulatory Capital

To strengthen the regulatory core capital, MSESE has issued regulatory core capital (“AT1-bonds”) in accordance with CRR. The AT1-bonds with a total nominal amount of €600 million and a denomination of €5 million each were issued on 29 October 2020.

The AT1 bonds represent the Company's perpetual, unsecured and subordinated liabilities. The bonds are interest bearing at a fixed annual interest rate of 4.7% from the issue date until the first termination date effective 30 November 2025. They do not have a maturity date. Interest expense on the bonds includes accrued interest not yet due of €2 million (2020: €5 million) at year-end 2021 which is included in other liabilities.

14. Equity

Equity as at the balance sheet date is composed as follows:

€ in millions	2021	2020
Subscribed capital	451	451
Capital reserves	2,786	1,936
Revenue reserves	2	0
Retained earnings	22	2
Total	**3,261**	**2,389**

Subscribed capital

MSEHSE is the sole shareholder of the Company. The subscribed capital amounts to €451 million and is entirely comprised of 451 million no-par-value registered shares of €1 each.

Capital reserves

The increase in the capital reserve by €850 million to €2,786 million results exclusively from contributions by MSEHSE on 15 October 2021.

In the previous year, the capital reserve increased by a total of €143 million due to the transferred company values of the companies MSSV in the amount of €92 million and Morgan Stanley AB, Stockholm, Sweden ("MSAB") in the amount of €51 million. The values obtained are based on an IDW S1 opinion "Principles for the Execution of Company Valuations".

Revenue reserves

The net income for the financial year ending 31 December 2020 in the amount of €2 million were transferred to revenue reserves by resolution of the Supervisory Board on 27 May 2021.

Retained earnings

It is proposed to include the net profits for the financial year ending 31 December 2021 in the amount of €22 million to retained earnings.

Notes to the Income Statement

15. Interest income / expenses

Interest income from the Company's credit and money market transactions mainly result from negative interest rates on deposits with group companies and repurchase agreements.

Interest expenses mainly consists of negative interest on collateral received from clients and companies of the Morgan Stanley Group as well as on securities lending transactions.

16. Commission income and commission expenses

Commission income in the total amount of €567 million (2020: €162 million) results from advisory services in investment banking in the amount of €326 million (2020: €65 million). These were also incurred in the branches. In addition, the item includes income from the brokerage of financial products in the amount of €241 million (2020: €97 million).

Commission expenses of €74 million (2020: €15 million) mainly result from services received from intra-group companies and fees for securities services to companies outside the Morgan Stanley Group. In the financial year, fees for investment services amounting to €36 million (2020: €20 million), which were reported in the previous year under net expenses of the trading portfolio, were recognised under commission expenses for the first time in order to improve the economic presentation.

17. Net income of the trading portfolio

The net income of the trading portfolio of €11 million (2020: net expenses of the trading portfolio of €20 million) is in line with the business strategy that the majority of market price risks arising from client transactions are hedged by offsetting hedges with affiliated companies.

18. Other operating income and expenses

Other operating income of €13 million (2020: €69 million) comprises primarily intra-group service charges of €10 million (2020: €45 million) from ongoing operations with affiliated companies in Germany, the UK and the U.S. The decrease in other operating income is mainly due to the income from transfer pricing agreements with other Morgan Stanley entities of €81 million (2020: €37 million) reported under fee and commission income in the financial year for better economic presentation.

Other operating expenses of €54 million (2020: €44 million) consist mainly of French financial transaction taxes of €37 million (2020: €39 million) or Spain financial transaction taxes in the amount of €9 million (2020: €0), for which MSESE is liable for.

19. Income taxes

Income taxes are composed of the following:

€ in millions	2021	2020
Corporation tax	31	2
Trade tax	8	1
Prior Year taxes	0	1
Total	**39**	**4**

Additional Comments

20. Valuation unit

In the financial year, the company traded derivatives on CO_2 certificates with non-group companies for the first time. These were hedged by counter-derivatives with companies of the Morgan Stanley Group. These valuation units have an average residual maturity of one year. The pending transactions not reported on the balance sheet at year-end are as follows:

€ in millions	Nominal amount	Fair value positive	Fair value negative
Underlying transaction	624	2	466
Hedging Instrument	624	466	2

21. Contingencies

MSESE has issued a hard letter of comfort in favour of MSBAG.

22. Auditor's fee

We refer to the consolidated financial statements of MSEHSE Group.

23. Employees

The average number of employees by groups were as follows:

Business Units	2021	2020
Institutional Securities Group	239	111
Real Assets	18	4
Infrastructure and Control	270	178
Total	**526**	**293**

Infrastructure and Control consists primarily of Operations, Finance, Risk Management and Legal and Compliance.

24. Management Board and Supervisory Board

During the financial year and at the time of the preparation of the annual financial statements, the Management Board is comprised as follows:

- Oliver Behrens,
  Chairman of the Management Board
- Martin Borghetto,
  Member of the Management Board
- Philipp Lingnau,
  Member of the Management Board
- André Munkelt,
  Member of the Management Board
- Dr. Hanns Christoph Siebold,
  resigned with effect from 28 February 2022
  Member of the Management Board
- Dr. Jana Währisch,
  Member of the Management Board

Dr Hanns Christoph Siebold resigned as a member of the Supervisory Board of Morgan Stanley (France) S.A., Paris, France, with effect from 28 February 2022.

The total remuneration of the Management Board for the financial year amounted to €9 million (2020: €9 million). Pension provisions for members of the Management Board amounted to €6 million (2020: €5 million). Compensation was paid to members of the Supervisory Board of €1 million (2020: €1 million).

The Company has not granted any loans to the members of the Board of Management and the Supervisory Board or has entered liability relationships with them.

During the financial year and at the time of the preparation of the annual financial statements, the Supervisory Board is comprised as follows:

- Clare Woodman,
  Chairman of the Supervisory Board,
  Managing Director
- Frank Mattern,
  Deputy Chairman of the Supervisory Board, independent advisor
- Raja Akram,
  Managing Director, appointed effective as of 12 January 2021
- David Cannon,
  Independent advisor
- Lee Guy,
  Managing Director
- Dr. Lutz R. Raettig,
  Independent advisor
- Lucrezia Reichlin,
  Professor, appointed effective as of 1 January 2021
- David A. Russell,
  Managing Director
- Paul Wirth,
  Managing Director, resigned with effect from 12 January 2021

25. Events after the reporting period

David Best is appointed to the MSESE Management Board effective 1 April 2022.

In April 2022, the share capital shall be increased by €600 million through the issuance of no-par value registered shares of €1 each and Additional Tier 1 capital instruments of €400 million shall be issued.

Russia's invasion of Ukraine on 24 February 2022 has had and is expected to continue to have a significant impact on the German, European and global financial markets in 2022. As a result, the achievement of the Group’s goals for the financial year 2022 could be negatively affected. These effects do not represent significant events after the balance sheet date and therefore have no influence on the recognition and measurement of assets and liabilities as at balance sheet date.

MSESE has only limited direct exposures to companies in Russia and no exposures to companies in Ukraine.

Due to the current impairment of finical markets, global payment systems and capital streams as well as the impact of sanctions, there may be a negative impact on the global economy. The extent of this impact on the Group’s business, financial condition, results of operations and regulatory capital and liquidity ratios depends on future developments, including further escalation or de-escalations and is highly uncertain and unpredictable. The Group will continue to closely monitor the potential impact of the conflict in Ukraine on its busines development, counterparties, and risk profile, including its liquidity and capitalisation.

Frankfurt am Main, 31 March 2022

Morgan Stanley Europe SE
The Management Board

Oliver Behrens (Chairman)

Martin Borghetto

Philipp Lingnau

André Munkelt

Dr. Jana Währisch

Independent Auditor's Report

To Morgan Stanley Europe SE, Frankfurt am Main

REPORT ON THE AUDIT OF THE ANNUAL FINANCIAL STATEMENTS AND OF THE MANAGEMENT REPORT

Audit Opinions

We have audited the annual financial statements of Morgan Stanley Europe SE, Frankfurt am Main, which comprise the balance sheet as at 31 December 2021, the income statement for the financial year from 01 January 2021 to 31 December 2021, and the notes to the financial statements, including the accounting policies. In addition, we have audited the management report of Morgan Stanley Europe SE, Frankfurt am Main, for the financial year from 01 January 2021 to 31 December 2021. In accordance with German legal requirements, we have not audited the references to the website of the Morgan Stanley Group included in Climate report section of the management report.

In our opinion, on the basis of the knowledge obtained in the audit,

- the accompanying annual financial statements comply, in all material respects, with the requirements of German commercial law applicable to business corporations and give a true and fair view of the assets, liabilities and financial position of the Company as at 31 December 2021 and of its financial performance for the financial year 01 January 2021 to 31 December 2021 in compliance with German Legally Required Accounting Principles, and

- the accompanying management report as a whole provides an appropriate view of the Company's position. In all material respects, this management report is consistent with the annual financial statements, complies with German legal requirements and appropriately presents the opportunities and risks of future development. Our audit opinion on the management report does not cover the references to the website of the Morgan Stanley Group included in section Climate report of the management report.

Pursuant to Section 322 (3) sentence 1 German Commercial Code ("HGB"), we declare that our audit has not led to any reservations relating to the legal compliance of the annual financial statements and the management report.

Basis for the Audit Opinions

We conducted our audit of the annual financial statements and the management report in accordance with Section 317 HGB and the EU Audit Regulation (No. 537/2014; hereinafter referred to as EU Audit Regulation") and in compliance with German Generally Accepted Standards for Financial Statement Audits promulgated by the Institut der Wirtschaftsprüfer (IDW). Our responsibilities under those requirements and principles are further described in the "Auditor's Responsibilities for the Audit of the Annual Financial Statements and of the Management Report" section of our auditor's report. We are independent of the Company in accordance with the requirements of European law as well as German commercial and professional law, and we have fulfilled our other German professional responsibilities in accordance with these requirements. In addition, in accordance with Article 10 (2) point (f) of the EU Audit Regulation, we declare that we have not provided non-audit services prohibited under Article 5 (1) of the EU Audit Regulation. We believe that the audit evidence we have obtained is sufficient and appropriate to serve as a basis for our audit opinions on the annual financial statements and the management report.

Key Audit Matters in the Audit of the Annual Financial Statements

Key audit matters are those matters that, in our professional judgment, were most significant in our audit of the annual financial statements for the financial year from 01 January to 31 December 2021. These matters were taken into account in the context of our audit of the annual financial statements as a whole and in forming our audit opinion thereon; we do not provide a separate audit opinion on these matters.

In the following, we present the key audit matter of determining the fair value of assets and liabilities of the trading portfolio within category Level 3.

We have structured our presentation of these key audit matters as follows:

a) Description (including reference to corresponding information in the annual financial statements)

b) Audit procedures

Determination of the fair value of assets and liabilities of the trading portfolio within category Level 3

a) Morgan Stanley Europe SE’s core business activity is, among other financial services, proprietary trading in financial instruments. The assets (EUR 17,521 million) and liabilities (EUR 16,926 million) derived from this business activity amount to EUR 34,447 million after netting as of 31 December 2021. An amount that is not considered to be immaterial relates to assets and liabilities in the trading portfolio for which significant valuation input parameters were not observable in the reporting period (Level 3 category). These are reported by the Company in the trading portfolio within assets or liabilities on the balance sheet and measured at fair value. Due to the provisions of section 340c HGB and the associated recognition of unrealized gains and losses, the measurement at fair value less a risk discount has not only a direct impact on the Company's net assets, but also on its results of operations.

   For financial instruments for which there is no active market and therefore no observable price-determining parameters, the fair value must be determined on the basis of model prices using unobservable parameters (“Level 3"). The characteristics of unobservable inputs used represent assumptions or estimates made by management with regard to the valuation assumptions used by market participants to determine the pricing of these assets and liabilities.

   In our view, the determination of the fair values for financial instruments classified as Level 3 is of particular importance because the assumptions or estimates are based on the judgment of the Company's management and involve inherent and significant estimation uncertainty for financial reporting purposes.

   The disclosures by the Company's legal representatives on the accounting policies for the trading portfolio are included in Note 3.

b) As part of our audit of the financial statements, we obtained an understanding of the valuation models used by the Company to determine the fair value of Level 3 financial instruments. Furthermore, we assessed the extent to which the approach was influenced by subjectivity, complexity or other inherent risk factors.

   We have identified the controls implemented by the Company for the fair value measurement and assessed their adequacy and effectiveness. For this purpose, we have assessed, among other things, the appropriateness of the models and input factors used and their stringent and proper processing. We have also considered the relevant business organization and IT systems. Processes and controls that uniformly affect the entire Morgan Stanley Group are performed by a shared service center and audited by the auditors of the Morgan Stanley Group. We have used the results of their work as part of the audit of the annual financial statements.

   We also evaluated the work of the Group's auditors with respect to the case-by-case fair value measurements for individual Level 3 financial instruments.

Other Information

The Management Board is responsible for the other information. The other information includes:

- the references to the website of the Morgan Stanley Group included in Climate report section of the management report,
- all other parts of the published annual report,
- but not the annual financial statements, not the audited content of the management report and not our auditor's report thereon.

Our audit opinions on the annual financial statements and the management report do not cover the other information and consequently we do not express an audit opinion or any other form of assurance conclusion on them.

In connection with our audit, we have a responsibility to read the other information identified above and to consider whether the other information:

- has material discrepancies with the annual financial statements, with the management report or with the knowledge we have obtained during the audit, or
- otherwise appears to be materially misstated.

Responsibilities of the Management Board and the Supervisory Board for the Annual Financial Statements and the Management Report

The Management Board is responsible for the preparation of the annual financial statements that comply, in all material respects, with the requirements of German commercial law applicable to business corporations, and that the annual financial statements give a true and fair view of the assets, liabilities, financial position and financial performance of the Company in compliance with German Legally Required Accounting Principles. Furthermore, the Management Board is responsible for the internal controls which they, in accordance with German Legally Required Accounting Principles, have determined necessary to enable the preparation of annual financial statements that are free of material misstatements, whether due to fraud or error.

In preparing the annual financial statements, the Management Board is responsible for assessing the Company's ability to continue as a going concern. Furthermore, they have the responsibility for disclosing, as applicable, matters related to going concern. In addition, they are responsible for financial reporting on the basis of the going concern accounting principle, provided no actual or legal circumstances conflict therewith.

Furthermore, the Management Board is responsible for the preparation of the management report, which as a whole provides an appropriate view of the Company's position and is, in all material respects, consistent with the annual financial statements, complies with German legal requirements and appropriately presents the opportunities and risks of future development. In addition, the Management Board is responsible for such arrangements and measures (systems) that they have deemed necessary to enable the preparation of a management report in accordance with the applicable German legal requirements, and to be able to provide sufficient appropriate evidence for the assertions in the management report.

The Supervisory Board is responsible for overseeing the Company's financial reporting process for the preparation of the annual financial statements and of the management report.

Auditor's Responsibilities for the Audit of the Annual Financial Statements and of the Management Report

Our objectives are to obtain reasonable assurance as to whether the annual financial statements as a whole are free of material misstatement, whether due to fraud or error, and whether the management report as a whole gives an appropriate view of the Company's position and, in all material respects, is consistent with the annual financial statements and with the knowledge obtained during the audit, complies with the German legal requirements and appropriately presents the opportunities and risks of future development, as well as to issue an auditor's report containing our audit opinions on the annual financial statements and the management report.

Reasonable assurance is a high level of assurance but is not a guarantee that an audit conducted in accordance with Section 317 HGB and the EU Audit Regulation and in compliance with German Generally Accepted Standards for Financial Statement Audits promulgated by the Institut der Wirtschaftsprüfer (IDW) will always detect a material misstatement. Misstatements may result from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users made on the basis of these annual financial statements and the management report.

Throughout the audit, we exercise professional judgment and maintain professional scepticism. In addition, we:

- identify and assess the risks of material misstatement of the annual financial statements and the management report, whether due to fraud or error, design and perform audit procedures in response to these risks, and obtain audit evidence that is sufficient and appropriate to serve as a basis for our audit opinions. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal controls.
- obtain an understanding of the internal controls relevant to the audit of the annual financial statements and the arrangements and measures relevant to the audit of the management report in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an audit opinion on the effectiveness of these systems of the Company.
- evaluate the appropriateness of the accounting policies used by the Management Board as well as the reasonableness of estimates made by the Management Board and related disclosures.
- conclude on the appropriateness of the Management Board's use of the going concern accounting principle and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that there is a material uncertainty, we are required to draw attention in the auditor's report to the related disclosures in the annual financial statements and in the management report or, if such disclosures are inadequate, to modify our respective audit opinions. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or circumstances may cause the Company to cease to be able to continue as a going concern.
- evaluate the overall presentation, structure and content of the annual financial statements, including the disclosures, and whether the annual financial statements present the underlying transactions and events in a manner that the annual financial statements give a true and fair view of the Company's assets, liabilities, financial position and financial performance in compliance with German Legally Required Accounting Principles.
- evaluate the consistency of the management report with the annual financial statements, its conformity with German law and the view it conveys of the Company's position.
- perform audit procedures on the prospective disclosures presented by the Management Board in the management report. On the basis of sufficient appropriate audit evidence, we evaluate, in particular, the significant assumptions on which the Management Board bases the prospective disclosures , and assess the proper derivation of the prospective disclosures from these assumptions. We do not express an additional audit opinion on the prospective disclosures or on the underlying assumptions. There is a substantial unavoidable risk that future events will differ materially from the prospective disclosures.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, as well as significant audit findings, including any significant deficiencies in internal controls that we identify during our audit.

We provide a statement to those charged with governance that we have complied with the relevant independence requirements and communicate with them all relationships and other matters that may reasonably be considered to bear on our independence, and where applicable, the related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were most significant in the audit of the annual financial statements for the current period and are therefore the key audit matters. We describe these matters in the auditor's report unless law or regulation preclude the public disclosure of the matter.

OTHER LEGAL AND REGULATORY REQUIREMENTS

Further information pursuant to Article 10 of the EU Audit Regulation

We were elected as auditor by the annual general meeting on 27 May 2021. We were engaged by the Supervisory Board on 15 December 2021. We have been the auditor of Morgan Stanley Europe SE, Frankfurt am Main, without interruption since the financial year 2018 and as statutory auditors since the financial year 2019.

We declare that the audit opinions expressed in this auditor's report are consistent with the additional report to the Audit Committee pursuant to Article 11 of the EU Audit Regulation (long-form audit report).

In addition to the financial statement audit, we have provided to the audited Company or its controlled entities the following services which were not disclosed in the annual financial statements or management report:

- Audit pursuant to section 89 (1) WpHG (Securities Trading Act), and
- Agreed upon procedures to fulfill the reporting obligations to the National Resolution Authority for the calculation of the 2022 annual contribution to the Single Resolution Fund.

GERMAN PUBLIC AUDITOR RESPONSIBLE FOR THE ENGAGEMENT

The German Public Auditor responsible for the engagement is Martin Kopatschek.

Frankfurt am Main, 26 April 2022

Deloitte GmbH
Wirtschaftsprüfungsgesellschaft

Martin Kopatschek Wirtschaftsprüfer (German Public Auditor)	Kevin Vogt Wirtschaftsprüfer (German Public Auditor)

Report of the Supervisory Board in Accordance with Sec. 171 (2) of the German Stock Corporation Act (AktG)

In 2021 the Supervisory Board of Morgan Stanley Europe SE (the "Company") had a strong focus on the development and business activites of the Company as well as its strategic direction in the European Economic Area through the provision of financial services. There were seven Supervisory Board meetings that took place during 2021. The Supervisory Board discussed fundamental aspects of the corporate planning, business policy, business development, risk situation and risk management with the Management Board. At the Supervisory Board meetings and whenever required, the Management Board regularly reported comprehensively and promptly on all incidents of significant importance and on the development of the financial figures.

The Management Board of Morgan Stanley Europe SE provided the Supervisory Board with the annual financial statements and management report for the financial year 2021 without delay after their preparation. The financial statements consist of:

- Balance sheet,
- Income statement and
- Notes.

The Management Board therefore carried out its obligations in accordance with section 170 (1) AktG. At the same time, the Supervisory Board was presented with the Proposal for the Profit Allocation in accordance with section 170 (2) AktG at the Annual General Meeting. This proposal provides for the net profit of € 21,580,157.79 to be allocated to other revenue reserves.

The Supervisory Board examined the documentation submitted in accordance with section 171 (1) AktG. The Auditor's information was included into the examination. The examination has not led to any reservations.

The Supervisory Board subsequently approved the annual financial statements for the financial year 2021. As a result, the annual financial statements of Morgan Stanley Europe SE were determined in accordance with section 172 AktG.

The statutory auditors, Deloitte GmbH Wirtschaftsprüfungsgesellschaft, Frankfurt am Main, have issued an unqualified audit opinion for the annual financial statement and the Management Report.

The Supervisory Board would like to extend its gratitude to the Management Board and to all employees for their exceptional commitment and successful contributions in 2021.

27 April 2022

Clare Woodman (Chairman)