

Morgan Stanley

Morgan Stanley Europe SE
Annual Report 2020

Register number: HRB 109880

Registered office:
Grosse Gallusstrasse 18
60312 Frankfurt am Main

TABLE OF CONTENTS ⁽¹⁾

MANAGEMENT REPORT	3
Business Model.....	4
Restructuring.....	5
Economic Report.....	6
Outlook and Opportunities.....	12
Risk Report	14
Climate Risk.....	27
BALANCE SHEET AS AT 31 DECEMBER 2020.....	30
INCOME STATEMENT FOR THE PERIOD FROM 1 JANUARY TO 31 DECEMBER 2020	32
NOTES.....	33
General Information	33
Notes to the Balance Sheet.....	37
Notes to the Income Statement.....	42
Additional Comments	43
INDEPENDENT AUDITOR'S REPORT	46
REPORT OF THE SUPERVISORY BOARD IN ACCORDANCE WITH SEC. 171 (2) OF THE GERMAN STOCK CORPORATION ACT (AKTG).....	50

(1) Please note that the English version of the Annual Financial Statements and Management Report as at 31 December 2020 is a convenience translation. Deloitte GmbH Wirtschaftsprüfungsgesellschaft, 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 2020. Therefore the German version prevails.

MANAGEMENT REPORT

- I. Business Model
- II. Restructuring
- III. Economic Report
- IV. Outlook and Opportunities
- V. Risk Report
- VI. Climate Risk

Business Model

On 31 January 2020, the United Kingdom (“UK”) withdrew from the European Union (“EU”) under the terms of a withdrawal agreement. The withdrawal agreement provided for a transition period until 31 December 2020 (“transition period”), during which the UK continued to apply EU law and UK firms continued to have access to provide financial services in EU jurisdictions.

On 24 December 2020 the EU and the UK reached an agreement in principle on a new “trade and cooperation agreement” governing their future relations. The agreement is provisionally applicable with effect from 1 January 2021 pending formal ratification by the EU.

The global Morgan Stanley Group (“Morgan Stanley Group”) has restructured its European operations to ensure that it can continue to provide its services in EU member states and in other states of the European Economic Area (“EEA”). As a result, the Morgan Stanley Europe SE Group (the “Company” or “MSESE”) serves Morgan Stanley Group clients primarily from the EEA.

During 2020, MSESE continued to expand its operations in the EEA and increased capital to position itself for future growth. MSESE engaged with existing clients and those clients who had decided to establish business operations with MSESE before the expiry of the transition period. Based on the implemented business model and the existing capital resources, MSESE is well positioned to further expand its business activity from 1 January 2021.

Morgan Stanley Europe Holding SE, Frankfurt am Main (“MSEHSE”) is the parent company of MSESE. MSEHSE is a financial holding company and a superordinated undertaking in accordance with Section 10a (2) of the German Banking Act (Kreditwesengesetz or “KWG”). MSESE is sole shareholder of Morgan Stanley Bank AG, Frankfurt am Main (“MSBAG”) as well as Morgan Stanley S.V., S.A.U., Madrid, Spain (“MSSV”), which was transferred into MSESE on 27 November 2020. MSESE operates branch offices

in France, Italy, the Netherlands, Sweden, Spain and Poland.

MSEHSE, together with MSESE and its subsidiaries, forms the Morgan Stanley Europe Holding SE Group (the “Group” or “MSEHSE Group”).

There are domination 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”).

The Group’s ultimate parent undertaking and controlling entity is Morgan Stanley, New York, United States of America (“USA”). 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 USA. MSEHSE is a wholly owned subsidiary of Morgan Stanley International Limited, London, UK (“MSI”). All companies of the MSEHSE Group are fully integrated into the global Morgan Stanley Group.

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, Fixed Income Division, Investment Banking Division and Real Assets.

In implementing Morgan Stanley Group’s strategies, MSESE is a significant contributor in the following areas: capital raising; financial advisory services, including advice on mergers and acquisitions; restructurings; real estate and project finance; corporate lending; sales, trading, financing and market-making activities in equity and fixed income products, including foreign exchange and commodities; and investment activities.

MSESE is Morgan Stanley’s primary investment service hub for the aforementioned business operations between institutional clients and other Morgan Stanley Group companies. Activities

such as Euro interest rate swaps trading, Euro inflation trading and automated market-making for certain products are risk managed within MSESE. The risk from Derivative Valuation Adjustments (“xVA”) is also managed locally.

Prior to the end of the transition period for the UK leaving the EU on 31 December 2020, clients and parts of the business units Institutional Equities Division, Fixed Income Division, Investment Banking Division, Real Assets as well as Lending and Loan Trading were transferred from other Morgan Stanley Group companies to the Group. These transfers together with increased client activity resulted in a significant increase of total assets of MSESE. Further details are included in the section ‘Restructuring’.

MSESE established its business operations as a securities trading bank pursuant to Section 1 (3d)

Sentence 5 of the KWG on 1 March 2019. According to the EU Capital Requirements Regulation (“CRR”; Article 4 (3)) MSESE is an investment firm.

Both MSESE and MSEHSE Group are subject to the German supervisory authorities. Additionally, the MSESE Group is subject to supervision by the European Central Bank (“ECB”).

Throughout the year 2020, business decisions for the Company were made by a four-person Management Board. The Management Board was overseen by a seven-person Supervisory Board. Meetings of the Management Board are generally held bi-weekly, but at least once a month. The Supervisory Board meets at least four times a year.

Restructuring

During 2020, the following intra-group restructurings were carried out by the Morgan Stanley Group to enhance efficiency, optimise the global and particularly the European business and company structure and to continue to serve clients after the end of the transition period:

Contribution of subsidiaries and mergers

All shares of Morgan Stanley AB, Stockholm, Sweden (“MSAB”) were transferred from MSI to the Company on 5 June 2020. As of 30 October 2020, MSAB, which provides Investment Banking services, was merged with and into MSESE as acquiring entity.

Furthermore, all shares of MSSV were transferred from MSI to the Company on 27 November 2020. The business units of MSSV comprise the Institutional Equities Division, Fixed Income Division, Investment Banking Division and Real Assets. On 31 March 2021 MSSV was merged with and into MSESE as acquiring entity.

Capital actions

In connection with the restructuring and expansion of the Group's business activities, subordinated debt of €1,000,000 thousand and Additional Tier 1 (“AT1”) capital instruments of €600,000 thousand were issued by the Company to MSEHSE on 27 October 2020 and 29 October 2020, respectively.

Transfer of businesses

Certain parts of the business units Institutional Equities Division, Fixed Income Division, Investment Banking Division and Real Assets were transferred from Morgan Stanley & Co. International plc, London, UK (“MSIP”) and Morgan Stanley Bank International Limited, London, UK (“MSBIL”) to MSESE’s branches in Poland, the Netherlands and Italy, as well as MSSV in the second half of 2020. Additionally, the Real Assets business unit of MSBAG was transferred to the Company.

Economic Report

Business Environment

During the course of 2020, the Company has been impacted by a series of factors in the global environment, each of which introduces risks that could have adversely affected the results of operations of the Company. The emergence of the coronavirus disease ("COVID-19") at the beginning of the year created challenges for the economy and contributed to a global economic contraction, while creating significant market volatility.

Despite the challenges posed by the global COVID-19 pandemic, key milestones in the Morgan Stanley Group's intercompany restructurings, including the transfers of clients and client businesses, subsidiaries and employees, were successfully completed.

COVID-19

The COVID-19 pandemic and related voluntary and government-imposed social and business restrictions have adversely impacted global economic conditions. This has led in particular to increased volatility in the global financial markets, increased unemployment, and operational challenges such as the temporary closure of businesses, sheltering-in-place directives and increased remote work protocols.

Governments around the world have supported the development, manufacturing, and distribution of COVID-19 vaccines. Moreover, governments and central banks have reacted to the economic crisis caused by the pandemic by implementing stimulus and liquidity programs and cutting interest rates.

During 2020, the Company saw a significant increase in revenues, driven by high levels of client trading activity related to increased market volatility due to the COVID-19 pandemic.

As of 31 December 2020 approximately 90% of the Morgan Stanley Group employees worked successfully from home. Operationally, the Company initiated a work remotely protocol and restricted business travel of the workforce.

Conducting professional activities from home has resulted in the adjustment or expansion of certain controls in both the First and Second Lines of Defense. These controls include those related to Trader Supervision, Payment processing, and Third-Party monitoring. To date, no material incidents or operational risk losses have been reported related to the COVID-19 pandemic.

In response to the significant economic impact 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 lending to business and consumers. The impact of the termination of these measures is included within the regular forward-looking capital planning.

The Morgan Stanley Group continues to use its Risk Management framework, including stress testing, to manage the significant uncertainty in the present economic and market conditions.

Global markets and economic conditions

The COVID-19 pandemic severely damaged economic activities across both developed and emerging markets. Global Gross Domestic Product ("GDP") fell at an unprecedented rate through the second quarter of 2020, but rebounded strongly in the third quarter 2020, as economies began to reopen. On an annual average basis, the global economy shrank by 3.3% in 2020, with the developed markets' economy contracting by 5.3% and the emerging markets' economy declining by 1.8%.

In response to the sharp deterioration of economic activities in the first half of 2020, global policy makers swiftly implemented massive monetary and fiscal policy easing measures to provide support to households and businesses. In the US, the Federal Reserve cut the federal funds rate to the zero-lower bound in March 2020 and expanded its balance sheet by \$ 3.2 trillion during 2020, equivalent to 15.3% of the annual GDP. The US government also introduced significant spending packages, including the \$2.2

trillion Coronavirus Aid, Relief, and Economic Security (“CARES”) Act passed in March 2020 and another \$ 900 billion relief bill passed in December 2020, bringing its fiscal deficit to 14.9% of annual GDP, the highest since 1946. In the Euro area, the ECB expanded its balance sheet by € 2.3 trillion as of the end of December 2020, or 20.5% of the region’s 2020 annual GDP. It is estimated that its fiscal deficit reaches 9.5% of the Eurozone’s GDP. The ECB has also asked certain banks in the EU not to pay dividends or buy back shares, or to limit such distributions. The latest request in December 2020 extended this suspension until September 2021. In addition, the European Commission in July 2020 agreed to establish the European Recovery Fund worth € 750 billion, with funds raised from the capital markets. Of the funds raised, € 390 billion are to be provided in grants and € 360 billion in loans. The Bank of England lowered its Bank Rate to the lower bound in March 2020. It is estimated that its balance sheet expanded by £ 340 billion, or 16.1% of GDP, in 2020. The various fiscal stimulus packages from the

government also pushed the fiscal deficit to 12.9% of GDP. Likewise, in Germany, the government launched a record fiscal response to the crisis with measures including short-time work schemes and tax relief, increasing its 2020 fiscal deficit to 6.3% of GDP.

Net Assets, Financial Position and Results of Operations

Net assets, financial position and results of operations in 2020 were strongly influenced by the continuation of the Morgan Stanley Group’s restructuring activities in the EEA and the increase of business activities on the European markets. Overall, the Company’s total assets increased by € 24.185.654 thousand to € 38.409.378 thousand. Income from ordinary activity increased by € 23,499 thousand to € 5,943 thousand.

Income statement

Set out below is an overview of the development of financial results for the years 2020 and 2019.

in €'000	2020	2019	Increase (+) decrease (-)	Variance in %
Net interest income	12,135	- 14,800	26,935	> 100%
Net commission income	146,762	82,087	64,675	79%
Net expense of the trading portfolio	- 19,897	- 2,448	- 17,449	> - 100%
Other operating income	25,457	49,571	- 24,114	- 49%
General administrative expenses	151,518	124,461	27,057	22%
Other expenses	6,996	2,434	4,562	> 100%
Expenses from loss compensation	0	5,071	- 5,071	N.A.
INCOME FROM ORDINARY ACTIVITIES	5,943	- 17,556	23,499	> 100%
Income taxes	- 3,739	- 956	- 2,783	> - 100%
Income from loss compensation	0	18,512	- 18,512	N.A.
NET INCOME	2,204	0	2,204	N.A.
RETAINED EARNINGS	2,204	0	2,204	N.A.

In 2020, the Company benefitted from a high level of client activity in its Institutional Securities business driven by exceptional financial market volatility in connection with the outbreak of the global COVID-19 pandemic. In addition, the Company benefitted in 2020 from the restructuring and the related transfers of businesses with clients from EEA following the UK’s withdrawal from the EU.

Net interest income

Net interest income is primarily driven by negative interest income from deposits at central banks and securities purchased under agreements to resell, as well as negative interest expenses from collateral received and securities lending transactions

Net commission income

Net commission income of €162,092 thousand (2019: €96,015 thousand) mainly results from the commissions earned from securities transactions of € 96,688 (2019: €62,119 thousand) as well as investment banking services of €65,403 thousand (2019: €33,896 thousand).

Net expense of the trading portfolio

Net expense of the trading portfolio of €19,897 thousand (2019: €2,448 thousand) 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. This includes expenses for the settlement of trading transactions. In accordance with section 340e (3) of the German Commercial Code (Handelsgesetzbuch or "HGB"), the required risk discount based on the value-at-risk was increased by €8,330 thousand to €9,960 thousand in 2020. The increase results in particular from the expansion of trading activities in Euro interest rate swaps and Euro inflation products, the risk of which are managed within the Company.

Other operating income

Other operating income of €69,021 thousand (2019: €72,765 thousand) mainly includes intercompany charges of €45,244 thousand (2019: €61,772 thousand) from ongoing business with affiliated companies in Germany, the UK and the USA. Other operating expenses of €43,564 thousand (2019: €23,194 thousand) mainly consist of financial transaction taxes paid in France of €39,186 thousand (2019: €22,402 thousand), for which MSESE is tax debtor.

General administrative expenses

General administrative expenses mainly consist of personnel expense of €104,180 thousand (2019: €63,074 thousand) and other administrative expenses of €47,338 thousand (2019: €61,387 thousand).

Income Taxes

Income taxes consists of current income tax of €3,241 thousand (2019: €956 thousand) and taxes for prior years of €498 thousand (2019: €0 thousand).

Balance sheet

in €'000	31 December 2020	31 December 2019	Increase (+) decrease (-)	Variance in %
ASSETS				
Amounts due from credit institutions and customers	13,696,120	9,015,470	4,680,650	52%
Trading portfolio	23,932,255	4,563,603	19,368,652	> 100%
Investments in affiliated companies	695,180	602,880	92,300	15%
Other assets	85,823	41,771	44,052	> 100%
TOTAL ASSETS	38,409,378	14,223,724	24,185,654	> 100%
LIABILITIES				
Amounts due to credit institutions and customers	13,258,321	7.850.047	5,408,274	69%
Trading portfolio	21,056,204	4.084.600	16,971,604	> 100%
Subordinated liabilities	1,001,998	0	1.001,998	N.A.
Instruments for Additional Tier 1 Regulatory Capital	600,000	0	600,000	N.A.
Other liabilities	104,001	45.197	58,804	> 100%
TOTAL LIABILITIES	36,020,523	11,979,844	24,040,679	> 100%
EQUITY				
TOTAL EQUITY	2,388,854	2,243,880	144,974	6%
TOTAL LIABILITIES AND EQUITY	38,409,378	14,223,724	24,185,654	> 100%

The increase in total assets of the Company in 2020 is primarily attributed to the transfer of clients to MSESE and increased client activity. The increase is mainly reflected in Trading Portfolio assets and liabilities, Amounts due from credit institutions and customers and Amounts due to credit institutions and customers.

Amounts due to credit institutions and customers

Amounts due to credit institutions and customers of €6,256,033 thousand (2019: €3,310,982 thousand) include receivables on demand due from MSBAG of €4,404,949 thousand (2019: €2,303,185 thousand).

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

Trading portfolio

Trading portfolio assets and liabilities primarily include derivatives measured at fair value totalling €15,553,364 thousand (2019: €3,879,494 thousand) and €14,408,872 thousand (2019: €3,706,918 thousand) respectively.

Investments in affiliated companies

Investments in affiliated companies comprise of shares in MSBAG totalling € 602,880 thousand (2019: € 602,880 thousand) as well as shares in MSSV totalling € 92,300 thousand (2019: € 0 thousand) which transferred to the Company on 27 November 2020.

Other assets

Other assets mainly include goodwill of €47,259 thousand (2019: €0 thousand), which arose from the transfer of business operations to the Company.

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.

Subordinated liabilities and Instruments for Additional Tier 1 Regulatory Capital

In connection with restructuring, the Company issued €1,000,000 thousand subordinated debt and €600,000 thousand AT1 capital instruments to MSEHSE on 27 October 2020 and 29 October 2020, respectively.

Other liabilities

Other liabilities primarily consist of other provisions of € 62,692 thousand (2019: € 21,081 thousand), which are mainly personnel and pension related.

Capital Structure and Liquidity

The equity presented in the balance sheet consists of share capital, capital reserves and retained earnings. The increase of equity by €144,974 thousand is due to MSSV's and MSAB's cash contributions in the amount of €142,770 thousand as well as the retained earnings of €2,204 thousand. Furthermore, the Company issued Tier 2 instruments ("subordinated debt") in 2020 in the amount of €1,000,000 thousand and €600,000 thousand AT1 capital instruments to its direct parent MSEHSE.

Since 2019, a capital waiver in accordance with Article 7 and 8 of the CRR is granted to and activated by MSBAG and MSESE. The capital indicators were reported on the MSEHSE Group and liquidity indicators on the MSESE Group level.

The return on investment pursuant to Section 26a (1) Sentence 4 of the KWG as of 31 December 2020 is positive 0.04% (2019: negative 0.05%).

The Group complied with all of its regulatory capital requirements during the year.

Liquidity and Funding Management

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

Liquidity risk management framework

The Group's liquidity risk management policies and procedures are consistent with those of the Morgan Stanley Group. The Group's management boards are ultimately responsible for setting liquidity risk tolerance and ensuring that the Group's liquidity risk is appropriately managed. In addition to the internal liquidity risk management framework, the Group is subject to the liquidity regulations applicable in Germany and the EU. The Group has daily monitoring and reporting processes in place to ensure compliance with regulatory requirements.

The following principles guide the Group's management of liquidity and funding risk:

- Sufficient liquid assets should be maintained to cover maturing liabilities and other planned and contingent outflows;
- Maturity profile of assets and liabilities should be aligned, with limited reliance on short-term funding;
- Source, currency, region, and term of funding should be diversified; and
- Liquidity Stress Tests should anticipate, and account for, periods of limited access to funding.

Required liquidity framework

The Required Liquidity Framework establishes the amount of liquidity the Group must hold in both normal and stressed environments to ensure that it can meet its financial obligations in a timely manner with its liquid assets and thus that its financial position and overall soundness are not impaired. The Required Liquidity Framework considers the most constraining liquidity requirement to satisfy all regulatory and internal limits at a Morgan Stanley Group and legal entity level. In addition to monitoring of the MSEHSE Group requirements, given the Article 8 waiver, the liquidity resources are also monitored at MSESE Group level.

Liquidity stress tests

The Group uses Liquidity Stress Tests to model external and intercompany liquidity flows across multiple scenarios over a range of time horizons.

The methodology, implementation, production and analysis of the Group's Liquidity Stress Tests are important components of the Liquidity Risk Management Framework.

At 31 December 2020, the Group maintained sufficient liquidity to meet current and contingent funding obligations as modelled in its Liquidity Stress Tests and set out in its Required Liquidity Framework.

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 Central Bank Cash and high-quality unencumbered assets sourced from trading assets, other assets and securities received as collateral. Eligible unencumbered highly liquid securities include primarily Level 1 Government bonds and German Sub-sovereign obligations.

Regulatory liquidity framework

Liquidity Coverage Ratio ("LCR"), governed by the Delegated Act (EU) 2015/61 as a supplement to the CRR, is used as a standard metric in scope of liquidity risk supervision.

All risks relevant for liquidity management are identified by the Internal Liquidity Adequacy Assessment Process ("ILAAP"). The ILAAP is reviewed by the Joint Supervisory Teams ("JST") of the ECB, the German Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht, "BaFin") and the Deutsche

Bundesbank as part of the Supervisory Review and Evaluation Process (“SREP”).

Funding management

The Group manages its funding in a manner that reduces the risk of disruption to the Group’s operations. The Group has a stable funding profile, achieved through its strong capital base, secured and unsecured funding.

Balance sheet management

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 Group with flexibility in managing 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 and MSBAG, 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, ratings 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 2020, MSESE’s and MSBAG’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. In some cases, the derivative counterparties have contractual rights that require the Group to post collateral to them in the event that credit rating agencies downgrade the credit rating.

In measuring collateral call risks, all amounts of collateral that the Group could be required to post in accordance with the terms and conditions of the downgrade trigger clauses found in applicable legal agreements, are considered.

The impact of potential collateral calls related to the derivative exposures is inherently uncertain and would depend on a number of interrelated factors, including, among others, the magnitude of the downgrade, the rating relative to peers, the rating assigned by the relevant agency pre-downgrade, individual client behaviour and future mitigating actions that could be taken. The Group manages the risk of potential collateral calls on the derivative positions by employing a variety of risk mitigation strategies, including 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 and maintaining Liquidity Resources to enable the Company to meet unexpected collateral calls or other potentially adverse developments.

Recovery and Resolution Planning (“RRP”)

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

The Group is supervised by the Single Resolution Board (“SRB”) as well as 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 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 on a Group consolidated basis.

Financial and Nonfinancial Performance Indicators

The financial performance indicators include profit/ (loss) before tax, the credit rating and an adequate capitalization.

Nonfinancial performance indicators are based upon the Morgan Stanley Group core values of "Put Clients First", "Do the Right Thing", "Lead with Exceptional Ideas", and "Give Back". These core values underpin the overall activity of the Group and was strengthened in 2020 through the addition of a fifth core value, "Commit to Diversity and Inclusion".

Due to the restructuring carried out by the Morgan Stanley Group in 2020, the average number of employees of the Company has increased from 272 in 2019 to 412 in 2020. The Management Board would like to extend gratitude to all employees for their commitment and their contributions in 2020.

Outlook and Opportunities

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 COVID-19 pandemic and the related global economic crisis continue to represent significant uncertainty factors.

In 2021, global growth is expected to bounce back sharply to 6.5%, with a synchronous recovery taking hold across both developed and emerging markets. The Company expects that a

global surge in demand from March/April onwards will lift the global economy back onto its pre-COVID level in the second quarter of 2021.

A further prolongation of the pandemic, insufficient actions by governments and central banks, and a non-widespread distribution of effective vaccines would exacerbate the adverse impact on the global economy and could adversely affect the Group's future results of operations and financial condition.

The Company is not in a position to estimate the extent of the impact of an ongoing COVID-19 pandemic and the related global economic crisis on its future operating results.

Should these global market conditions worsen, or the pandemic lead to additional market disruptions, the Company could experience

reduced client activity and demand for products and services, impairments of other financial assets and other negative impacts on its financial position. This includes possible reductions in capital and liquidity, as well as a higher cost of capital, and possible changes or downgrades to credit ratings. A slowdown of commercial activity could cause overall sales and trading and investment banking revenues to decline.

The Morgan Stanley Group and the Company have benefitted from increased client and capital market activities in the Institutional Equity Division, Fixed Income Division and Investment Banking Division in 2020, which had a positive impact on net commission income. High levels of client and capital market activity during the year may not be repeated, however.

Although the Company has not experienced a decline in productivity as a result of performing professional work from home, there can be no assurance that this will not have a negative impact in the future. If significant portions of the workforce, including key employees, are unable to work effectively due to illness, regulatory actions, or other restrictions related to the pandemic, there could be negative business impacts from the pandemic.

As in past years, the overall strategy of the Morgan Stanley Group, into whose business activities the Company is fully integrated, is a key factor for its future growth and development. After the transition period, following the UK's decision to leave the EU as of 31 January 2020, the Company is Morgan Stanley's primary hub for the business units Institutional Equities Division, Fixed Income Division, Investment Banking Division and Real Assets in the EEA. 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.

In 2021, the Company expects that further clients and activities, currently transacted by the Morgan Stanley Group's UK licensed entities, will move to the Company. The extent and timing of these

moves will depend on client preferences and the legal framework conditions.

Opportunities

The intra-group restructuring and capital actions have strengthened the financial position of the Company which will enable the Company to benefit 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 further expand the business from 2021 onwards and thus to improve the income from ordinary activity. The Company expects to remain in compliance with all capital requirements as its business continues to grow. Furthermore, the Company expects that the good credit ratings will remain unchanged. 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.

Investment Firm Regulation/ Directive

In December 2019, the European Commission published the Investment Firm Regulation and Investment Firm Directive that introduce a tailored capital adequacy and liquidity framework for EU investment firms based on their size and type of business activity and make changes to governance and remuneration requirements.

Final rules are effective 25 December 2019, however, implementation dates are staggered over an 18-month period, with the majority of the new requirements applying from 26 June 2021.

The Company meets the criteria to be a large investment firm and will remain subject to existing requirements based on the CRR and CRD. As part of these requirements, the Company will need to be re-authorised as a CRR credit institution in 2021.

Risk Report

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 of the 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 Boards are responsible for overseeing the adoption of the Morgan Stanley Group's risk culture for the Group.

The Group's Management Boards have established a robust Risk Management Framework, including a comprehensive Committee Structure and a clearly defined "Three Lines of Defence". The model separately identifies risk owners from independent risk control functions and creates a clear delineation of responsibilities:

- **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, monitoring, measurement and reporting of credit, market, liquidity, operational and model risk. It reports to the Chief Risk Officer ("CRO") who is also a member of the Group's Management Boards.
- 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 team is part of Legal & Compliance and acts independently from the business units, reporting locally and directly to the Group's Management Boards. 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 Boards 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, manages and oversees 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 & Capital;
- Model Risk;
- Risk Control & Stress Testing and
- Risk Governance & COO.

The Risk Division assists the Group’s Management Boards in their 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 Boards are responsible for the establishment, implementation and oversight of an effective risk management framework. Therefore, the Management Boards have established a robust 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 Boards in the

oversight of the Group’s management of risk (including financial and non-financial risks). The Committee is responsible for (i) the development and implementation of a risk strategy, including risk appetite; (ii) risk identification and measurement; (iii) risk framework and policies; (iv) risk culture; and (v) financial resource management.

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 of the Group.

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 Boards determine 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 types 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 to ensure that the Group’s business activities are carried out in line with the approved risk appetite. The RAS and the underlying limits and tolerance frameworks are reviewed by the Group’s Management Boards when required (e.g. when the business strategy is amended by the Management Boards), but at least annually. The annual review takes into account changes in the Group’s business strategy and/or capital/liquidity resource situation or plans as well as any anticipated changes in risk appetite.

The Group has established a framework to identify material risks from the Group’s business activities on a quarterly basis (in accordance with Section 25c (4b) No. 2 of the 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. The following risk types 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;
- Leverage risk;
- Valuation risk;
- Earnings at risk and Strategic risk and
- Reputational risk.

The Group’s Management Boards have 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 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 Boards 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 cross-risk stress tests to ensure concentration risks are captured and measured across the material risk areas. These include a suite of severe but plausible macroeconomic scenarios which are designed to

comprehensively capture key portfolio vulnerabilities of the Group across market and credit risk. The Group's aggregate risk appetite for market and credit risk, expressed through the Macro Stress Loss Limit ("MSLL"), is monitored against the suite of macroeconomic scenarios. 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 to produce catastrophic losses for the Group thereby identifying potential business vulnerabilities. RST is a key input for recovery planning.

In addition, stress tests are also employed for risk area specific activities to identify and measure vulnerabilities and concentrations that may arise in a particular risk area, division, desk, country, industry, as appropriate. The combination of a granular risk identification framework together with a comprehensive 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 implemented pandemic-specific scenarios in order to be able 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 Boards, 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 Boards.

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, i.e. market, credit, operational, liquidity and model risk at different frequencies (daily, weekly, etc.).

More detailed information about the reporting for each of those risks is included in the respective risk chapters 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, planning and management process to ensure that all risks to which the Group is exposed to are appropriately capitalised and risk managed. The ICAAP is conducted annually in line with the business planning process and updated quarterly. The ICAAP comprises of two perspectives, the 'Normative Perspective' and the 'Economic Perspective'.

Normative Perspective

The assessment under the Normative Perspective is conducted over a three-year period, assessing the Group's ability to fulfil all of 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 their regulatory requirements at all times.

The following table summarises the capital ratios for both 2019 and 2020 year-end.

in € '000	2020	2019
<i>Normative Perspective</i>		
Common Equity Tier 1 ("CET1") Capital	2,845,726	2,196,733
Additional Tier 1 Capital	600,000	-
Tier 1 Capital	3,445,726	2,196,733
Tier 2 Capital	1,000,000	-
Total Own Funds	4,445,726	2,196,733
<hr/>		
Risk Weighted Assets ("RWAs")	11,879,867	4,813,339
CET1 Capital Ratio	23.95%	45.64%
Tier 1 Capital Ratio	29.00%	45.64%
Total Capital Ratio	37.42%	45.64%

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 under the Economic Perspective, the MSEHSE 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 under the Economic Perspective, the MSEHSE Group utilises an internal loss model.

To derive an aggregate loss distribution for the MSEHSE 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 under the Economic Perspective is primarily calculated using the Group's internal Management Value-at-Risk ("VaR") and Incremental Risk Charge. 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 ten-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 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 as of 31 December for both 2019 and 2020.

in € '000	2020	2019
<i>Economic Perspective</i>		
Risk Bearing Capacity	2,807,000	2,224,000
Capital Requirements	1,341,779	741,464
Credit risk	816,061	352,649
Market risk	151,237	22,205
Operational risk	315,410	312,583
Other	59,071	54,027

As of 31 December 2020, the Group was adequately capitalised and reported an economic capital adequacy ratio of 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 MSEHSE 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.

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 1) obligors' credit quality and 2) 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. Credit risk exposures are measured using a comprehensive 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 defined risk appetite, CRM has implemented a Credit Limits Framework to manage credit risk on a single name, portfolio (including country and industry concentrations) and product level. The Credit Limit Framework additionally defines different limit levels to ensure appropriate governance with the different levels comprising the Group's Management Boards, 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 Boards and other interested parties.

Consistent with its business and risk strategy, the Group's credit risk portfolio is dominated by investment grade quality obligors in the EEA. 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. This includes the application of standard risk mitigants such as collateral and netting where possible.

Lending risk arises primarily from the extension of relationship loans to corporate clients. Resulting credit risk is actively managed including through the application of risk mitigation.

The below table shows Risk Weighted Assets (“RWAs”) and EAD for credit and counterparty risk as of 31 December for both 2019 and 2020, including Credit Valuation Adjustment risk (“CVA”). The RWAs calculated via the advanced capital models (Foundation Internal Ratings Based, or “FIRB”, and Internal Model Method, or “IMM”) and under the standardised approach are shown separately.

in € '000	31 December 2020		31 December 2019	
	RWAs	EAD	RWAs	EAD
Credit risk	1,588,359	10,731,265	467,035	3,353,909
Of which internal models (FIRB)	1,340,825	10,551,978	247,225	3,193,611
Counterparty credit risk (excluding CVA) ⁽¹⁾	4,390,241	11,171,537	1,935,754	4,969,811
Of which internal models (IMM)	2,897,506	5,474,466	941,563	1,539,355
Total (excluding CVA and Settlement risk)	5,978,600	21,902,802	2,402,789	8,323,720
Credit Valuation Adjustment (CVA)	845,664	2,599,428	345,102	1,711,641
Settlement risk	58,166	52,952	36,777	15,538
Total	6,882,430	24,555,182	2,784,668	10,050,899

⁽¹⁾ Exposures to central counterparties and exposures subject to Equity IRB approach are reported under Counterparty credit risk.

In addition, the below table provides an overview about the credit portfolio breakdown per industry for both 2019 and 2020 at year-end. The below breakdown is based on industry classifications using Global Industry Classification Standards (“GICS”).

Breakdown per industry for 2020	EAD in € '000
Financials	10,278,385
Governments	9,597,551
All others	2,079,818
Total	21,955,754

Breakdown per industry for 2019	EAD in € '000
Financials	4,542,953
Governments	3,171,292
All others	625,013
Total	8,339,258

Impact of COVID-19: While increased market volatility due to the COVID-19 pandemic was observed during 2020, the Group’s credit risk remained well within risk appetite with no material credit losses. The impact of the pandemic on both credit risk exposures as well as obligors’ credit quality will remain a key focus throughout 2021.

Market Risk

Market risk is defined as the potential trading portfolio loss (or gain) that results from a change in the level of one or more market prices, rates, indices, volatilities, correlations or other market factors, such as liquidity. This also includes non-traded market risk, such as interest rate risk in the banking book and other interest rate or currency sensitive balance sheet positions.

The MRD, which is independent from the business units, is responsible for the assessment and monitoring of market risks. MRD has put in

place a comprehensive 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: In order 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 Boards 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. Interest Rate Risk in the Banking Book ("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 EVE") or Net Interest Income ("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 2020, IRRBB exposure is not a large component of the Group's market risk profile yet, but still benefit from dedicated limits, daily monitoring and regular reporting to management. As of 31 December 2020, IRRBB was less than 1% of CET1 capital at the end of the year under the Delta EVE-perspective.

The Group's business strategy is the execution of the Morgan Stanley Group's Institutional Securities business with clients in the EEA. Activities such as Euro interest rate swaps trading, Euro inflation trading, and automated market making for certain product are risk managed within the Group. Risk from Derivative Valuation Adjustments ("xVA") is also managed locally for Fixed Income by a dedicated trading desk which manages all exposures coming from counterparties such as credit and funding risk in particular. The main risk factors resulting from the xVA risks are usually credit, interest rates, basis, equity and foreign exchange related exposures.

The average total Group Management VaR for the year 2020 was € 933 thousand (2019: € 170 thousand), dominated by credit sensitivity from xVA.

The table below shows the market risk RWAs of 31 December for both 2019 and 2020, as calculated using advanced capital model (Internal Model Approach) and under the standardised approach, where applicable.

in € '000	RWAs as of 31 December 2020	RWAs as of 31 December 2019
Standardised approach	15,635	54,655
Internal model approach ⁽¹⁾	4,392,954	941,245
Total	4,408,589	995,900

⁽¹⁾ Including RWAs for Risk not in VaR ("RNIV").

Impact of COVID-19: Market risk indicators such as VaR increased during the peak of the COVID-19 pandemic due to the increased market volatility. There was however no need to increase risk appetite and limits because the overall risk of the entity was well contained at that time. During this period, xVA exposures were also impacted by the widening of credit spreads but appropriate mitigation measures such as hedging and risk reduction were taken by the desk helping the risk to stay within approved limits.

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 that may lead to insufficient stable sources of funding in the short-, medium- and long-term resulting in difficulties or the inability to meet financial obligations as they fall due.

The Liquidity Risk Department ("LRD") is independent from the business units and reports to the CRO. It is responsible for managing and overseeing liquidity risk arising from the Group's business activities. LRD has put in place a comprehensive 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 Testing ("ILST") results. Additionally, the new product approval ("NPA") process is leveraged to

identify and assess liquidity risks arising from new activities.

- (2) Risk Measurement: Liquidity risks are measured using well 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 regulatory Liquidity Coverage Ratio ("LCR") as well as 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 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 Boards and other stakeholders.

Liquidity risks from the Group's business activities primarily arise from OTC derivatives, foreign exchange, secured financing transactions, listed derivatives and lending. These liquidity risks are covered by the Group's liquidity resources. Throughout 2020, the Group held sufficient liquidity to cover its liquidity risk both relative to regulatory requirements as well as internal liquidity stress requirements

The LCR is a regulatory defined, generic stress test which defines the minimum amount of high-quality liquid assets ("HQLA") to ensure MSEHSE Group's ongoing ability to meet net payment obligations for a period of 30-days. The MSEHSE Group's LCR exceeded the regulatory minimum

requirement throughout 2020. The following table shows the LCR as of 31 December for both 2019 and 2020.

As an additional regulatory requirement, the Net Stable Funding Ratio (“NSFR”) is expected to become effective on 28 June 2021. The Group expects to be compliant with the NSFR requirement when it becomes effective.

in € '000	31 December 2020	31 December 2019
High Quality Liquid Assets	9,004,777	3,633,841
Cash Outflows	6,968,172	1,383,539
Cash Inflows	1,456,614	440,114
Net Outflow	5,511,558	943,425
LCR Ratio	163%	385%

Impact of COVID-19: Adequate excess liquidity was maintained throughout the year, even during times of increased market volatility as observed during March 2020 in the COVID-19 pandemic.

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). This includes legal and compliance risk.

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, to assess business environment as well as internal control factors and to perform scenario analysis.
- (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: In order to ensure that potential losses remain within the defined Board-level risk appetite the Group’s Management Boards have 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 Boards and other stakeholders.

The ORD scope also includes oversight of technology risk, cybersecurity risk, information security risk and fraud risk. ORD, in conjunction with Group’s Central Outsourcing Control Office (“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

The Fusion Resilience Center's mission is 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. Global programs for Business Continuity and Disaster Recovery are designed to mitigate risk and enable recovery from business continuity incidents impacting the Group. Business units within the Group maintain business continuity plans, identifying processes and strategies to continue business-critical processes during a business continuity incident. Business units also test the documented preparation to provide a reasonable expectation that, during a business continuity incident, the business unit will be able to continue its critical business processes and limit the impact of the incident to the Group and its clients. Technical recovery plans are maintained for critical technology assets and detail the steps to be implemented to recover from a disruption. Business continuity testing is performed to validate the recovery capability of these business critical technology assets.

Third Party Risk Management

In connection with its ongoing operations, the Group utilises the services of third party suppliers. 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 performance of due diligence, implementation of service level and other contractual agreements as well as consideration of operational risks and ongoing monitoring of the third party suppliers' performance. The Group maintains and continues to enhance the third party risk management program which includes appropriate governance, policies, procedures and technology that supports alignment with the Group's risk tolerance and is designed to meet regulatory requirements.

Capital requirements for operational risk are currently calculated under the Basic Indicator Approach ("BIA"). As of 31 December 2020, the Group's operational RWAs were € 589 million (2019: € 1,033 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. 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 COVID-19 pandemic has been contained. No material incidents or operational risk losses have been reported to date. Sustainability of current working environment has been an area of continued focus.

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: In order 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 as well as to other interested parties and provides a quarterly report on model risk to the MSEHSE Group ERC and the Group's Management Boards.

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 independent Compliance Division is responsible for the design and development of a Conduct Risk Framework and for the execution of Compliance's 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: Implemented internal controls and processes are established to manage conduct risks identified. CRIs will be identified and escalated through various sources 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 appetite for conduct risk, however, it acknowledges that it remains inherent in the Group's products, activities, processes and systems and, therefore, cannot be entirely eliminated.
- (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 reports to the Group's Management Boards 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 Boards hold executive management accountable for compliance with business conduct risk standards through a variety of measures and controls

Other material risks

Financial risks could arise from changes in the market, macroeconomic environment, or through other factors such as climate change.

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 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.

Final summary and outlook

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 2020 and as at 31 December 2020. In addition, the Group's capital and liquidity are deemed sufficient to exceed regulatory minimums under both normal and in stressed market environments as also evidenced by the results of the stress scenarios.

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. During the course of 2020 the Group has further strengthened this framework to ensure an appropriate management of risks resulting from the Group's activities. The Group's Risk management function is staffed appropriately with experienced risk managers.

The emergence of the COVID-19 pandemic leads to global economic and financial uncertainties that create operational challenges and can impact the Group's business operations. More information around the COVID-19 pandemic is presented in the Economic Report section of the Group Management Report.

In 2021, the Risk Division will further evolve the Group's Risk Management Framework consistent with size and complexity of the Group by i.e. incorporating climate risk in the Risk Management Framework. Further information regarding climate risk is presented in the following section. In addition, the Risk Division will continue to focus on regulatory engagements, such as the Comprehensive Assessment.

Climate Risk

Climate Risk Strategy

Climate change poses 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 price adjustments, disruption to market liquidity, as well as to financial institutions navigating rapidly changing consumer 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.

The MSEHSE Group continues to develop its climate risk strategy in alignment with the development of Morgan Stanley Group's strategy. As Morgan Stanley Group continues to develop climate change strategy, its priorities are:

- Support the transition to a low-carbon economy by mobilising capital toward low carbon solutions as well as publishing industry-leading research and thought leadership for an investor audience;
- Enhance the climate resilience of operations by minimising footprint and enhancing operational resiliency;
- Manage climate change risk by integrating climate change considerations into risk management processes and governance structures;
- Be transparent and provide relevant, timely information in the climate change report, sustainability report and regulatory filings.

Central to Morgan Stanley Group's strategy is the commitment, announced in September 2020, to reach net-zero financed emissions by 2050. Critical to this is Morgan Stanley Group's commitment to developing tools and methodologies needed to measure and manage carbon-related activities. As part of that effort,

Morgan Stanley Group recently joined the Steering Committee of the Partnership for Carbon Accounting Financials ("PCAF").

Due to the commitment to climate neutrality (net zero commitment), the Morgan Stanley Group is well positioned to contribute to the financing required to achieve net-zero emissions globally. The Morgan Stanley Group will continue to partner with clients and interested parties to mobilise capital at scale for the low carbon transition. By incorporating climate considerations into business activities, Morgan Stanley Group aims to manage business for the long term while providing value for clients and shareholders.

Climate change poses a number of risks to the MSEHSE Group, including but not limited to market and credit (financial risk), operational (including business continuity) and reputational (environmental and social). Overall, the MSEHSE Group's strategy to managing risks from climate change is closely aligned with Morgan Stanley Group strategy as articulated in Morgan Stanley Group's first report under the Taskforce on climate-related Financial Disclosures ("TCFD") published in October 2020, refer to https://www.morganstanley.com/assets/pdfs/Morgan_Stanley_TCFD_Report_2020.pdf.

The governance and risk management of the financial risk of climate change to the Group are in the process of being integrated with the overall risk governance framework of the Group and described in more detail in the following sections.

Governance

Morgan Stanley Group takes an integrated approach to climate change management, with oversight from leadership and input from across the business (For more detail see Morgan Stanley TCFD 2020, Governance). The CRO, who is a member of the MSEHSE Group Management Boards, is also a member of the MSI Group Climate Steering Committee. The Steering Committee oversees Morgan Stanley's

response to EMEA climate related regulatory guidance and requirements.

Financial risk management

In line with TCFD recommendations, Morgan Stanley Group divides the financial risk of climate change into two main categories: transition risks and physical risks.

- **Transition Risks:** Transitioning to a low-carbon economy may entail extensive 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 discrete events such as flooding (acute physical risks) or longer-term shifts in climate patterns such as more frequent and prolonged drought (chronic physical risks). Physical risks may have financial implications for organisations, such as direct damage to assets and indirect impacts from supply chain disruption. Financial performance may also be affected by changes in water availability, sourcing and quality, and food security and agricultural productivity. Extreme temperature changes may affect an organisation's physical locations, operations, supply chain, transport needs and employee safety.

The Morgan Stanley Group is deploying expertise and resources to explore how and where it may face potential transition and physical risks from the ongoing impacts of climate change.

To better equip the risk managers in Risk Management with a working functional knowledge of climate change in order to better identify and assess climate change risks, Global Sustainable Finance ("GSF") partnered with Risk Management to launch the Climate Change University ("CCU"), a program that aims to build a common understanding of climate change and its impact to the Morgan Stanley Group from a

business perspective. CCU was rolled out across the entire Morgan Stanley Group in early 2021.

In the previous year, GSF and Risk Management already partnered to develop a register of material climate-related risks by sector for risk managers engaged in Risk Management's credit analysis process. They analysed the academic and practitioner literature on climate risks and developed a sector-based risk register to be utilised by risk managers as a first step in understanding which risks were most material to the industries they cover.

This analysis is a key driver of the sector analysis in the MSEHSE Group. Under the MSEHSE Group plan, sector-based analysis will be deepened and training expanded to enhance the understanding of climate risk at an industry level allowing risk appetite to be set by sector.

The sector analysis will inform understanding of the vulnerabilities of individual counterparties and work has also been performed on deepening understanding of country vulnerability to both transition and physical risk. Rating methodologies for sovereigns and corporates are being enhanced to incorporate climate risk.

Scenario analysis is fundamental to understanding vulnerabilities related to climate change. Informed by the risk identification process, the MSEHSE Group will run both short- and long-term scenarios to test the MSEHSE Group's resilience to financial risks resulting from transition and physical risk. The short-term scenario analysis focuses primarily on transition risk while external publications will inform the longer-term scenario.

The incorporation of climate change into the analysis of risk at the portfolio, sector, country and counterparty level will allow the MSEHSE Group to measure its vulnerabilities and then establish climate risk related risk appetite. The deepening of the MSEHSE Group's understanding of its vulnerabilities will potentially inform business strategy, for example with regard to longer dated credit risk.

ANNUAL FINANCIAL STATEMENTS

- I. Balance Sheet as at
31 December 2020
- II. Income Statement for
the period from
1 January to
31 December 2020
- III. Notes

in €'000		31 Dec 2020	31 Dec 2019
Amounts due from credit institutions			
a) Due on demand	6,256,033		3,310,941
b) Other amounts due	<u>0</u>	6,256,033	41
Amounts due from customers		7,440,087	5,704,488
which include: Loans granted to local authorities €236,158 thousand (previous year: €308,637 thousand)			
Trading portfolio		23,932,255	4,563,603
Investments in affiliated companies		695,180	602,880
which include: credit institutions €602,880 thousand (previous year: €602,880 thousand)			
Intangible assets			
a) Concessions acquired against payment, industrial and similar rights and assets as well as licenses on such rights and assets	79		0
b) Goodwill	<u>47,260</u>	47,339	0
Property, plant and equipment		26,493	19,006
Other assets		11,223	22,730
Prepaid expenses and deferred charges		768	35
TOTAL ASSETS		38,409,378	14,223,724

in €'000		31 Dec 2020	31 Dec 2019
Amounts due to credit institutions			
a) Due on demand	1,799,481		518,930
b) With an agreed maturity/term	<u>0</u>	1,799,481	41
Amounts due to customers			
a) Other liabilities			
aa) Due on demand	3,996,652		6,830,041
ab) With an agreed maturity/term	<u>7,462,188</u>	11,458,840	501,035
Trading portfolio		21,056,204	4,084,600
Other liabilities		24,832	18,678
Deferred income		7,812	0
Provisions			
a) Provisions for pensions and similar obligations	8,553		4,482
b) Provisions for taxation	112		956
c) Other provisions	<u>62,692</u>	71,357	21,081
Subordinated liabilities		1,001,998	0
Instruments for Additional Tier 1 Regulatory Capital		600,000	0
Equity capital (shareholder's fund)			
a) Subscribed capital	451,000		451,000
b) Capital reserve	1,935,650		1,792,880
c) Retained earnings	<u>2,204</u>	2,388,854	0
TOTAL LIABILITIES AND EQUITY CAPITAL		38,409,378	14,223,724

in €'000		2020	2019
Interest income			
a) From credit and money market transactions thereof from negative interest income from credit and money market transactions €47,311 thousand (previous year: €19,059 thousand)	- 14,036		- 12,438
Interest expenses		- 26,171	<u>2,362</u>
Thereof from negative interest expenses €53,875 thousand (previous year: €10,332 thousand)			
		12,135	- 14,800
Commission income	162,092		96,015
Commission expenses	<u>15,330</u>		<u>13,928</u>
		146,762	82,086
Net expense of the trading portfolio		- 19,897	- 2,448
Other operating income		69,021	72,765
General administrative expenses			
a) Personnel expenses			
aa) Wages and salaries	87,272		53,721
ab) Social security and other pension costs and benefits which include: Pension scheme €8,501 thousand (previous year: €6,059 thousand)	<u>16,908</u>	104,180	9,353
b) Other administrative expenses	<u>47,338</u>		<u>61,387</u>
		151,518	124,461
Depreciation, amortisation and write-downs of intangible assets, and property, plant and equipment		4,707	2,434
Other operating expenses		43,564	23,194
Write-downs and valuation allowances on receivables and certain securities, as well as additions to provisions in the lending business		2,289	0
Expenses from loss assumption		0	5,071
Income from ordinary activities		5,943	- 17,556
Income taxes		- 3,739	- 956
Income from loss compensation		0	18,512
NET INCOME		2,204	0
RETAINED EARNINGS		2,204	0

General Information

1. Corporate information

Morgan Stanley Europe SE (the "Company" or "MSESE") is a stock corporation under European Law (European Company (Societas Europaea)) based in Frankfurt am Main and 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") and since 27 November 2020 of Morgan Stanley S.V., S.A.U., Madrid, Spain ("MSSV").

The Company established its business operations on 1 March 2019 and has since exercised its permission to provide banking and financial services as a securities trading bank pursuant to Section 1 (3d) Sentence 5 of the German Banking Act (Kreditwesengesetz or "KWG"). According to the Capital Requirements Regulation ("CRR"), MSESE is classified as a securities firm.

During 2020, MSESE continued to expand its business activities with clients from the European Economic Area ("EEA") within the business units Institutional Equities Division, Fixed Income Division, Investment Banking Division and Real Assets through the following intra-group restructurings:

- All shares of Morgan Stanley AB, Stockholm, Sweden ("MSAB") were transferred from Morgan Stanley International Limited, London, UK ("MSI") to MSESE on 5 June 2020. As of 30 October 2020, MSAB merged with and into MSESE as acquiring entity.
- On 27 November 2020, all shares of MSSV were transferred from MSI to MSESE. As of 31 March 2021 MSSV was merged with and into MSESE as acquiring entity.
- Certain parts of the business units Institutional Equities Division, Fixed

Income Division, Investment Banking Division and Real Assets were transferred from Morgan Stanley & Co. International plc, London, UK, ("MSIP"), Morgan Stanley Bank International plc, London, UK, ("MSBIL") and MSBAG to MSESE and its branches.

In addition, the following capital measures were issued by MSESE:

- Subordinated debt of €1,000,000 thousand on 27 October 2020 and
- Instruments for Additional Tier 1 regulatory capital of €600,000 thousand on 29 October 2020.

2. Basis of accounting

The financial statements as at 31 December 2020 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").

According to Section 291 (1) and (2) HGB, MSESE was 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 "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 for the financial year 2020:

- the valuation of the financial instruments of the trading portfolio was carried out without a risk discount,
- the valuation of provisions for pensions and similar obligations in the context of insurance-mathematical opinions was based on different valuation assumptions. The result is reported in IFRS consolidated financial statements in other comprehensive income,
- deferred tax assets were recognised in the balance sheet, and
- Additional Tier 1 capital instruments were accounted for within equity capital.

3. Accounting policies

Receivables

Amounts due to credit institutions and customers are stated at nominal value, including pro rata interests, and are reduced by necessary valuation allowances.

Trading activities

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. The most frequently observed input factors are used. 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 accordance with Section 340e (4) HGB, if an addition to the fund for general banking risks is required in the reporting year, this is deducted from net income of the trading portfolio. The contribution is calculated as 10% of the net income of the trading portfolio (after the risk discount) and shall be made until the fund for general banking risks has reached 50% of the five-year average of the net income of the trading portfolio after a risk

discount. The special item may only be wound up to offset a net expense of the trading stock or if it exceeds the 50% limit. In the financial year, there was no requirement to set up a fund for general banking risks.

Derivatives in the trading portfolio are offset against the associated cash collateral 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.

Loan loss provision

The Company recognises loan loss provisions for amounts due from credit institutions and customers.

Provisions for inherent credit risk are reflected in the form of general value adjustments in accordance with commercial law principles. A parameter-based Expected Credit Loss calculation in accordance of 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, macro-economic 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.

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. 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

Repurchase agreements are stated pursuant to Section 340b (2) and (4) HGB. Securities lent remain on the balance sheet as genuine repurchase agreements, while securities borrowed are not recognised in the balance sheet.

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 their acquisition or production cost less any depreciation or amortisation. The underlying useful lives are based on the economic useful life. Write-downs are made for any impairment that is likely to be permanent. Low-value assets are fully depreciated in the year in which they are acquired.

Goodwill reported within intangible assets was determined based on IDW S1 "Principles for the execution of company valuations" and are depreciated over the estimated useful life of 10 years in accordance with Section 253 (3) sentence 4 HGB. This is determined in particular by economic and organizational factors such as future growth and profit expectations, the nature and duration of synergy effects, the usability of customer relationships and the employee base of the acquired business.

Liabilities

Liabilities are recognised at their settlement amount, including accrued interest.

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 their required settlement amount according to reasonable commercial judgement. If the remaining term of the provision for contingent liabilities is longer than one year, the provision is discounted.

The valuation of compensation plans included in other provisions is performed using pro rate fair values distributed evenly over the vesting period for each eligible portion.

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 2.3%) as published by Deutsche Bundesbank according to Section 253 (2) HGB. The valuation difference between the 10-year average interest rate of 2.3% which was used in the financial statements, compared to the 7-year average interest rate of 1.6% amounted to €4,875 thousand (previous year: €3,862 thousand) as of 31 December 2020, which is subject to a distribution restriction pursuant to Section 253 (6) HGB. 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").

Instruments for Additional Tier 1 Regulatory Capital

The issued instruments for the additional regulatory capital are qualified as liabilities and

are valued 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 carryforwards. Deferred tax liabilities are netted against deferred tax assets and the remaining deferred tax assets were not reported in the balance sheet in accordance with the accounting option set out in Section 274 (1) sentence 2 HGB.

Loss-free valuation

Interest-related transactions of the banking book are examined annually in their entirety for a commitment surplus. For this purpose, the Company applies the present value/book value method. Similar to previous years the evaluation did not show any necessity to create a provision for anticipated losses.

Transfer pricing agreements

The Morgan Stanley Group has Global Transfer Pricing Policies in which the Company participates, which are particularly relevant to interest expenses, commission income, net expense of the trading portfolio, general administrative expenses and other operating income.

4. 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.

Notes to the Balance Sheet

5. Maturity structure

in €'000	31 Dec 2020	31 Dec 2019
Amounts due from credit institutions	6,256,033	3,310,982
with indefinite maturity	6,256,033	3,310,941
with a remaining maturity of		
up to three months	0	41
Amounts due from customers	7,440,087	5,704,448
with indefinite maturity	2,302,770	4,914,492
with a remaining maturity of		
up to three months	4,846,048	789,956
three months to one year	291,269	0
more than five years	0	0

in €'000	31 Dec 2020	31 Dec 2019
Amounts due to credit institutions	1,799,481	518,971
with indefinite maturity	1,799,481	518,930
with a remaining maturity of		
up to three months	0	41

in €'000	31 Dec 2020	31 Dec 2019
Other amounts due to customers	11,458,840	7,331,076
with indefinite maturity	3,996,652	6,830,041
with a remaining maturity of		
up to three months	7,436,296	501,035
three months to one year	22,188	0
from one year to five years	1,090	0
more than five years	2,614	0

6. Relationship with affiliated companies

in €'000	31 Dec 2020	31 Dec 2019
Amounts due from credit institutions	4,404,949	2,303,185
Amounts due from customers	2,651,374	3,337,461
Amounts due to credit institutions	39,387	49,343
Amounts due to customers	4,205,204	2,575,887
Subordinated liabilities	1,001,998	0
Instruments for Additional Tier 1 Regulatory Capital	600,000	0

7. Trading portfolio

The institutional specific criteria for the inclusion of financial instruments in the trading portfolio remained unchanged in the financial year. Due to the expansion of business activities as a securities trading bank, the trading portfolio increased significantly. The following tables further break down the trading portfolio:

in €'000	31 Dec 2020	31 Dec 2019
Derivative financial instruments	15,553,364	3,879,495
Receivables	7,299,028	480,944
Bonds and other fixed-income securities	1,078,902	195,216
Shares and other non-fixed-income securities	10,921	9,578
Risk discount value-at-risk	- 9,960	- 1,630
Total	23,932,255	4,563,603

in €'000	31 Dec 2020	31 Dec 2019
Derivative financial instruments	14,408,872	3,706,918
Liabilities	7,699,366	377,682
Total	22,108,238	4,084,600

The Company has derivatives within the trading portfolio with a positive fair value of €33,177,332 thousand (previous year: €7,421,943 thousand) and derivatives with a negative fair value of €34,575,790 thousand (previous year: €7,582,978 thousand) and corresponding cash collateral paid in the amount of €7,131,199 thousand (previous year: €527,357 thousand) and cash collateral received in the amount of €5,732,740 thousand (previous year: €281,718 thousand).

As at 31 December 2020, the nominal amount and the fair value of derivative financial instruments within assets and liabilities are classified according to their nature and volume as follows:

in €'000	Nominal amount
OTC traded products	
Interest-related transactions	1,015,114,214
Exchange-rate-related transactions	324,091,926
Equity-related transactions	54,962,270
Credit derivatives	10,559,774
Other transactions	6,983,055
Total	1,411,711,239

in €'000	Fair Value	
	Asset	Liability
OTC traded products		
Interest-related transactions	10,409,230	9,235,135
Exchange-rate-related transactions	4,003,580	4,003,337
Equity-related transactions	553,743	588,247
Credit derivatives	186,743	182,044
Other transactions	400,068	400,109
Total	15,553,364	14,408,872

8. Changes in fixed assets

Fixed assets consist mainly of goodwill, tenant installations, operating and business equipment and investments in affiliated companies. The following table shows changes in fixed assets during 2020:

in €'000	Intan- gible assets	Property, plant and equip- ment	Investments in affiliated companies
Acquisition/ production cost			
01 Jan 2020	0	21,502	602,880
Additions	48,354	16,826	92,300
Disposals	15	3,285	0
Acquisition/ production cost			
31 Dec 2020	48,339	35,043	695,180
Accumulated depreciation			
01 Jan 2020	0	2,496	0
Depreciation	986	3,720	0
Additions	14	2,334	0
Disposals	0	0	0
Accumulated depreciation			
31 Dec 2020	1,000	8,550	0
Carrying amount as at			
31 Dec 2019	0	19,006	602,880
Carrying amount as at			
31 Dec 2020	47,339	26,493	695,180

The goodwill included in intangible assets is based on IDW S1 "Principles for the Execution of Company Valuations" and is attributable to:

- the transferred business unit Investment Banking Division from MSAB to MSESE – Stockholm Branch of €24,141 on 5 June 2020,
- the transferred business unit Real Assets from MSBAG to the Company of €17,500 thousand, and

- the transferred business units Institutional Equities Division, Fixed Income Division, Investment Banking Division and Real Assets from MSBIL – Milan Branch to MSESE – Milan Branch of €6,150 thousand.

At the balance sheet date, shares in affiliated companies consist of shares in MSBAG and MSSV. Net income for the year as at 31 December 2020 was €11,375 thousand and €8,157 thousand, respectively, with equity of €614,255 thousand and of €47,890 thousand, respectively.

9. Other assets

Other assets of €11,223 thousand (previous year: €22,730 thousand) mainly consist of receivables from tax authorities of €10,118 thousand (previous year: €3,351 thousand). The previous year included a claim for loss compensation pursuant to Section 302 AktG of €18,512 thousand from the parent company MSEHSE.

10. Foreign currency volumes

As of the balance sheet date, assets denominated in foreign currencies amounted to €3,630,710 thousand (previous year: €3,705,011 thousand). Liabilities denominated in foreign currencies amounted to €5,043,618 thousand (previous year: €4,200,760 thousand).

11. Other liabilities

Other liabilities of €24,832 thousand (previous year: €18,678 thousand) mainly comprise liabilities to tax authorities of €13,479 thousand (previous year: € 9,280 thousand) and deferred interests not yet due of €5,013 thousand. The previous year included an obligation for loss compensation pursuant to Section 302 AktG of €5,071 thousand to the subsidiary MSBAG.

12. Provisions for pensions and similar obligations

Provisions for pensions and similar obligations developed as follows in the 2020 financial year:

in €'000	Obliga- tion	Plan assets	Net amount disclosed
1 Jan 2020	17,804	- 13,322	4,482
Pension plan expenses	4,575	0	4,575
Interest result	546	- 101	445
Transfer	1,358	-768	590
Payment of pension benefits	- 197	200	3
Addition to plan assets	0	- 1,572	- 1,572
31 Dec 2020	24,086	- 15,563	8,523

The transfer of pension obligations of €1,358 thousand as well as plan assets of €768 thousand result from the transfer of 10 employees of the business unit Real Assets from MSBAG to MSESE on 1 October 2020.

In addition, provisions for pensions and similar obligations include a pension obligation of €30 thousand for a branch.

13. Other provisions

Other provisions of €62,692 thousand (previous year: €21,081 thousand) mainly consist of provisions for personnel related expenses, which represent an additional component of employee compensation. These consist of variable, deferred and share-based compensations.

14. Subordinated liabilities

As of 31 December 2020, subordinated liabilities of €1,001,998 thousand (previous year: €0) consists of a subordinated loan with a variable interest rate on EURIBOR plus 1.6% and a 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 2020 includes interests not yet due of €1,998 thousand.

15. Instruments for Additional Tier 1 Regulatory Capital

In order to strengthen core regulatory capital, MSESE issued its first Additional Tier 1 Notes (the "AT1 Notes") in accordance with the CRR on 29 October 2020. The AT1 Notes were issued with a total nominal value of €600,000 thousand and a denomination per unit of €5,000.

The AT1 Notes represent the Company's perpetual, unsecured and subordinated liabilities. The AT1 Notes are interest bearing at a fixed annual interest rate of 4.7% from the date of issue until the first termination date. They do not have a due date. Interest expense on AT1 Notes at the end of 2020 includes interests not yet due of €5,013 thousand and were recognised within other liabilities.

16. Equity

MSEHSE is the sole shareholder of the Company. The subscribed capital amounts to €451,000 thousand and is entirely comprised of 451,000,000 no-par-value registered shares of €1 each.

Capital reserves of €1,935,650 thousand (previous year: €1,792,880 thousand) includes the transferred shares in MSSV of €92,300 thousand and MSAB of €50,470 thousand. The values obtained are based on an IDW S1 opinion "Principles for the Execution of Company Valuations".

By resolution of the Supervisory Board on 14 May 2020, the loss from ordinary activities for the year ended 31 December 2019 was fully transferred from the Company to the sole shareholder MSEHSE, on the basis of loss compensations within the domination agreement, in accordance with Section 302 AktG.

It is proposed to allocate the net profit for the year ended 31 December 2020 of €2,204 thousand to the capital reserves.

Notes to the Income Statement

17. 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.

18. Net expense of the trading portfolio

Net expense of the trading portfolio of €19,897 thousand (previous year: €2,448 thousand) is in line with the business strategy, that the majority of the market risks arising from client transactions are hedged within the Morgan Stanley Group on a "back-to-back" basis. Net expense of the trading portfolio also includes expenses for the settlement and clearing of commercial transactions. Pursuant to Section 340e (3) HGB, the required risk discount was increased by €8,330 thousand in the financial year based on the value at risk. The increase is mainly due to the expansion of trading activities in the area of Euro interest rate swaps and Euro inflation products, the risks of which are managed by the Company.

19. Commission income

Commission income in the total amount of €162,092 thousand (previous year: €96,015 thousand) results from the brokerage of financial products of €96,688 thousand (previous year: €62,119 thousand) and from advisory services in investment banking of €65,403 thousand (previous year: €33,896 thousand).

20. Other operating income and expenses

Other operating income of €69,021 thousand (previous year: €72,765 thousand) comprises primarily intra-group service charges of €45,244 thousand (previous year: €61,772 thousand) from ongoing operations with affiliated companies in Germany, the UK and the USA.

Other operating expenses of €43,564 thousand (previous year: €23,193 thousand) consist mainly of French financial transaction taxes of €39,186 thousand (previous year: €22,402 thousand), for which MSESE is liable for.

21. Income taxes

Income taxes are composed of the following:

in €'000	2020	2019
Corporation tax	2,229	956
Trade tax	967	0
Solidarity surcharge	45	0
Taxes relating to previous years	498	0
Total	3,739	956

Additional Comments

22. Valuation unit

In the financial year, the company traded derivatives on CO2 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 €'000	Nominal amount	Fair value	
		positive	negative
Underlying transaction	117,584	455	38,088
Hedging Instrument	117,584	38,088	455

23. Auditor's fees

We refer to the consolidated financial statements of MSEHSE.

24. Employees

The average number of employees by groups were as follows:

	2020	2019
Female employees	115	85
Full-time employees	109	69
Part-time employees	6	16
Male employees	178	149
Full-time employees	176	149
Part-time employees	2	0
Total employees	293	234

25. Management Board and Supervisory Board

During the financial year and at the time of the preparation of the financial statements, the following members belonged to the Management Board:

- Oliver Behrens,
Chairman of the Management Board
- Martin Borghetto,
Member of the Management Board,
appointed effective as of 1 January 2020
- Philipp Lingnau,
Member of the Management Board
- André Munkelt,
Member of the Management Board
- Dr. Hanns Christoph Siebold,
Member of the Management Board
- Dr. Jana Währisch,
Member of the Management Board

Dr. Hanns Christoph Siebold is a member of the Supervisory Board of Morgan Stanley (France) S.A., Paris, France. He resigned from the Supervisory Board of OOO Morgan Stanley Bank, Moscow, Russia, on 27 May 2020.

The total remuneration of the Management Board for the financial year amounted to €8,732 thousand (previous year: €5,466 thousand). Pension provisions for members of the Management Board amounted to €4.701 thousand (previous year: €2,887 thousand). Compensation was paid to members of the Supervisory Board of €312 thousand (previous year: €312 thousand).

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

During the financial year and at the time of the preparation of the financial statements, the following members belonged to the Supervisory Board:

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

26. Group relations

The company which prepares consolidated financial statements for the smallest group of affiliated companies is MSEHSE, and the company which prepares consolidated financial statements for the largest group of affiliated companies is Morgan Stanley, New York, USA. The consolidated financial statements of Morgan Stanley have been published by the SEC (Securities and Exchange Commission) in New York, USA, under the Central Index Key number 0000895421. Both sets of consolidated financial statements are available from the Company.

Frankfurt am Main, 27 April 2021

Morgan Stanley Europe SE

The Management Board

Oliver Behrens (Chairman)

Martin Borghetto

Philipp Lingnau

André Munkelt

Dr. Hanns Christoph Siebold

Dr. Jana Währisch

Independent Auditor's Report ¹

To Morgan Stanley Europe SE, Frankfurt am Main/Germany

Audit Opinions

We have audited the annual financial statements of Morgan Stanley Europe SE, Frankfurt am Main/Germany, which comprise the balance sheet as at 31 December 2020, the statement of profit and loss for the financial year from 1 January to 31 December 2020 as well as the notes to the financial statements, including the presentation of the recognition and measurement policies. In addition, we have audited the management report of Morgan Stanley Europe SE, Frankfurt am Main/Germany, for the financial year from 1 January to 31 December 2020.

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 and give a true and fair view of the assets, liabilities and financial position of the Company as at 31 December 2020 and of its financial performance for the financial year from 1 January to 31 December 2020 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.

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 of the management report.

Basis for the Audit Opinions

We conducted our audit of the annual financial statements and of the management report in accordance with Section 317 HGB 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 German commercial and professional law, and we have fulfilled our other German professional responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions on the annual financial statements and on the management report.

Other Information

The executive directors are responsible for the other information. The other information comprises all the remaining parts of the annual report, with the exception of the audited annual financial statements, the audited management report and our auditor's report thereon.

Our audit opinions on the annual financial statements and on 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 thereon.

¹ Translation; the German version prevails

In connection with our audit, our responsibility is to read the other information and, in so doing, to consider whether the other information

- is materially inconsistent with the annual financial statements, with the management report or our knowledge obtained in the course of the audit, or
- otherwise appears to be materially misstated.

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

The executive directors are responsible for the preparation of the annual financial statements that comply, in all material respects, with the requirements of German commercial law 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. In addition, the executive directors are responsible for such internal controls as they, in accordance with German Legally Required Accounting Principles, have determined necessary to enable the preparation of annual financial statements that are free from material misstatement, whether due to fraud or error.

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

Furthermore, the executive directors are responsible for the preparation of the management report that 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 executive directors are responsible for such arrangements and measures (systems) as they have considered necessary to enable the preparation of a management report that is 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 about whether the annual financial statements as a whole are free from material misstatement, whether due to fraud or error, and whether the management report as a whole provides an appropriate view of the Company's position and, in all material respects, is consistent with the annual financial statements and the knowledge obtained in 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 that includes our audit opinions on the annual financial statements and on 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 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 can arise from fraud or error and are considered material if, individually or in the aggregate, they

could reasonably be expected to influence the economic decisions of users taken on the basis of these annual financial statements and this management report.

We exercise professional judgment and maintain professional scepticism throughout the audit. We also

- identify and assess the risks of material misstatement in the annual financial statements and the management report, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide 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 internal control system relevant to the audit of the annual financial statements and of 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 accounting policies used by the executive directors and the reasonableness of estimates made by the executive directors and related disclosures.
- conclude on the appropriateness of the executive directors' use of the going concern basis of accounting 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 a material uncertainty exists, 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 conditions 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 assets, liabilities, financial position and financial performance of the Company 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 of the Company's position it provides.
- perform audit procedures on the prospective information presented by the executive directors in the management report. On the basis of sufficient appropriate audit evidence we evaluate, in particular, the significant assumptions used by the executive directors as a basis for the prospective information, and evaluate the proper derivation of the prospective information from these assumptions. We do not express a separate audit opinion on the prospective information and on the assumptions used as a basis. There is a substantial unavoidable risk that future events will differ materially from the prospective information.

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

MORGAN STANLEY EUROPE SE

ANNUAL REPORT 2020

Independent Auditor's Report

Frankfurt am Main/Germany, 25 May 2021

Deloitte GmbH

Wirtschaftsprüfungsgesellschaft

Signed: Martin Kopatschek
Wirtschaftsprüfer
(German Public Auditor)

Signed: Ehler Bühmann
Wirtschaftsprüfer
(German Public Auditor)

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

In 2020 the Supervisory Board of Morgan Stanley Europe SE (the “Company”) had a strong focus on the development of the Company as securities trading bank as well as its strategic direction as part of the intra-group restructuring in the European Union. There were five Supervisory Board meetings that took place. 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 2020 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 EUR 2,204,450.55 to be allocated to capital reserves.

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

The Supervisory Board subsequently approved the annual financial statements for the year ended 2020. 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 2020.