

**Registered number: 34161590**

Registered office:  
Luna Arena  
Herikerbergweg 238  
1101 CM  
Amsterdam  
The Netherlands

**MORGAN STANLEY B.V.**

**Report and financial statements**

**31 December 2018**

# **MORGAN STANLEY B.V.**

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## **MORGAN STANLEY B.V.**

### **DIRECTORS' REPORT**

The Directors present their report and financial statements (which comprise the statement of comprehensive income, the statement of changes in equity, the statement of financial position, the statement of cash flows, and the related notes, 1 to 24) for Morgan Stanley B.V. (the “Company”) for the year ended 31 December 2018.

### **RESULTS AND DIVIDENDS**

The profit for the year, after tax, was €900,000 (2017: €1,547,000).

During the year, no dividends were paid or proposed (2017: €nil).

### **PRINCIPAL ACTIVITY**

The principal activity of the Company is the issuance of financial instruments including notes, certificates and warrants (“Structured Notes”) and the hedging of the obligations arising pursuant to such issuances.

The Company was incorporated under Dutch law on 6 September 2001 and has its statutory seat in Amsterdam, The Netherlands. The business office of the Company is at Luna Arena, Herikerbergweg 238, 1101 CM, Amsterdam, The Netherlands.

The Company’s ultimate parent undertaking and controlling entity is Morgan Stanley, which, together with the Company and Morgan Stanley’s other subsidiary undertakings, form the “Morgan Stanley Group”.

### **FUTURE OUTLOOK**

There have not been any significant changes in the Company’s principal activity in the year under review and no significant change in the Company’s principal activity is expected.

### **BUSINESS REVIEW**

#### **Global market and economic conditions**

Global economic growth was strong at 3.7% in 2018. However, it was a year of two halves, with global growth clocking in at a strong 4% in the first half of the year before slowing to 3.6% in the second half. Growth accelerated in the United States (“US”) at 2.9% for the year as a whole. However, in the rest of the world, growth weakened considerably, particularly in the second half. A combination of lingering trade tensions, a slowdown in China and its spillovers, and a backdrop of tighter US Federal Reserve policy even as global growth began to soften and the associated tightening of financial conditions weighed on sentiment and economic activity. Global growth was also held back by slower growth in the Euro area and Japan, which in turn were weighed down by factors such as a switch in emission standards in Germany and natural disasters in Japan. In terms of policy, the US Federal Reserve continued to hike interest rates by a further 100bps and continued its balance sheet normalisation process. In Europe, the European Central Bank (“ECB”) halved the size of its quantitative easing (“QE”) program to monthly purchases of €15bn after September, and ended the QE program after December. Policymakers in China intensified its easing measures by cutting taxes and boosting infrastructure spending as labour market pressures began to build. Since November, the US Federal Reserve has begun to signal policy flexibility in response to a deteriorating growth outlook. Other major central banks have also begun to guide for a more dovish policy outlook in early 2019 following the weaker than expected growth momentum in the fourth quarter of 2018.

#### **United Kingdom withdrawal from the European Union**

On 23 June 2016, the United Kingdom (the “UK”) electorate voted to leave the European Union (the “EU”). On 29 March 2017, the UK invoked Article 50 of the Lisbon Treaty which triggered a two-year period, subject to extension (which would need the unanimous approval of the EU Member States), during which the UK government negotiated a form of withdrawal agreement with the EU.

**DIRECTORS' REPORT**

**BUSINESS REVIEW (CONTINUED)**

**United Kingdom withdrawal from the European Union (continued)**

On 22 March 2019, the UK and the other EU Member States agreed to an extension of the two-year period to 22 May 2019, (if the UK Parliament approved the withdrawal agreement by 29 March 2019) or 12 April 2019 (if it did not). On 11 April 2019, the UK and the other EU Member States agreed to a further extension to 31 October 2019 (or, if the withdrawal agreement is ratified by both parties before this date, until the first day of the following month). This further extension ceases to apply on 31 May 2019 in the event that the UK has not held elections to the European Parliament in accordance with applicable EU law and has not ratified the withdrawal agreement by 22 May 2019. Absent any further changes to this time schedule, the UK is expected to leave the EU by 31 October 2019 at the latest.

The Morgan Stanley Group is continuing to prepare its European operations regardless of whether or not a withdrawal or transition agreement is reached. However, the Company's principal activity and risks are expected to remain unchanged.

**Overview of 2018**

The issued Structured Notes expose the Company to the risk of changes in market prices of the underlying securities, interest rate risk and, where denominated in currencies other than Euros, the risk of changes in rates of exchange between the Euro and the other relevant currencies. The Company uses the contracts that it purchases from other Morgan Stanley Group undertakings to hedge the market price, interest rate and foreign currency risks associated with the issuance of the Structured Notes.

The statement of comprehensive income for the year is set out on page 11. The Company reported a profit before income tax of €1,190,000 for the year ended 31 December 2018, compared to a profit before income tax of €2,060,000 for the prior year.

The profit before income tax for the year ended 31 December 2018 primarily comprises management charges recognised in 'Other revenue' of €1,190,000 compared to €1,304,000 received in the prior year. The profit before income tax for the prior year also includes 2016 costs of €756,000 included in the calculation of the yield payable on Convertible Preferred Equity Certificates ("CPECs") recognised in 'Interest expense' as explained in note 11.

The Company has recognised a net expense of €618,323,000 in 'Net trading (expense)/ income' compared to a net income of €452,489,000 for the prior year, with a corresponding net income of €618,323,000 recognised in 'Net income/ (expense) on other financial instruments held at fair value' (2017: net expense of €452,489,000). This is due to fair value changes attributable to market movements on the securities underlying Structured Notes hedged by derivatives classified as trading financial instruments.

The statement of financial position for the Company is set out on page 13. The Company's total assets at 31 December 2018 are €9,494,539,000, an increase of €2,714,000 or 0.1% when compared to 31 December 2017. Total liabilities of €9,453,864,000 represent an increase of €11,822,000 or 0.1% when compared to total liabilities at 31 December 2017. These movements are primarily attributable to the value of issued Structured Notes and the related hedging instruments held at 31 December 2018. Structured Notes reflected in 'Debt and other borrowings' have increased since 31 December 2017 as a result of new issuances offset by fair value movements and maturities in the year. The net decrease in the value of the related hedging instruments is primarily the result of market movements.

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

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

**DIRECTORS' REPORT**

**BUSINESS REVIEW (CONTINUED)**

**Risk management**

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

Set out below is an overview of the Company's policies for the management of financial risk and other significant business risks. More detailed qualitative and quantitative disclosures about the Company's management of and exposure to financial risks are included in note 19 to the financial statements.

*Market risk*

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

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

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

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

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

*Credit risk*

Credit risk refers to the risk of loss arising when a borrower, counterparty or issuer does not meet its financial obligations to the Company. Further detail on the Morgan Stanley Group's management of country risk is set out below.

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

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

*Country risk exposure*

Country risk exposure is the risk that events in, or affecting, a foreign country might adversely affect the Company. "Foreign country" means any country other than The Netherlands. Sovereign risk, by contrast, is the risk that a government will be unwilling or unable to meet its debt obligations, or renege on the debt it guarantees. Sovereign risk is single-name risk for a sovereign government, its agencies and guaranteed entities.

**DIRECTORS' REPORT**

**BUSINESS REVIEW (CONTINUED)**

**Risk management (continued)**

*Country risk exposure (continued)*

The Company enters into the majority of its financial asset transactions with other Morgan Stanley Group undertakings, primarily in Luxembourg and the US. Both the Company and the other Morgan Stanley Group undertakings are wholly-owned subsidiaries of the same ultimate parent entity, Morgan Stanley. As a result of the implicit support that would be provided by Morgan Stanley, the Company's country risk is considered a component of the Morgan Stanley Group's credit risk.

Country risk exposure is measured in accordance with the Morgan Stanley Group's internal risk management standards and includes obligations from sovereign governments, corporations, clearing houses and financial institutions. The Morgan Stanley Group actively manages country risk exposure through a comprehensive risk management framework that combines credit and market fundamentals and allows the Morgan Stanley Group to effectively identify, monitor and limit country risk.

The Morgan Stanley Group conducts periodic stress testing that seeks to measure the impact on its credit and market risk stemming from negative economic or political scenarios. When deemed appropriate by the Morgan Stanley Group's risk managers, the stress test scenarios include possible contagion effects. The analysis, and the results of the stress tests, may result in the amendment of limits or exposure mitigation.

*Liquidity risk*

Liquidity risk refers to the risk that the Company will be unable to finance its operations due to a loss of access to the capital markets or difficulty in liquidating its assets. Liquidity risk encompasses the Company's ability (or perceived ability) to meet its financial obligations without experiencing significant business disruption or reputational damage that may threaten the Company's viability as a going concern. Liquidity risk also encompasses the associated funding risks triggered by the market or idiosyncratic stress events that may cause unexpected changes in funding needs or an inability to raise new funding.

The primary goal of the Morgan Stanley Group's liquidity risk management framework is to ensure that the Morgan Stanley Group, including the Company, has access to adequate funding across a wide range of market conditions and time horizons. The framework is designed to enable the Morgan Stanley Group to fulfil its financial obligations and support the execution of the Company's business strategies. The framework is further described in note 19.

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

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

*Operational risk*

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

The Company may incur operational risk across the full scope of its business activities.

**DIRECTORS' REPORT**

**BUSINESS REVIEW (CONTINUED)**

**Risk management (continued)**

*Operational risk (continued)*

The Company has established an operational risk framework to identify measure, monitor and control risk across the Company. This framework is consistent with the framework established by the Morgan Stanley Group and includes escalation to the Company's Board of Directors and appropriate senior management personnel. Effective operational risk management is essential to reducing the impact of operational risk incidents and mitigating legal and reputational risks. The framework is continually evolving to account for changes in the Company and to respond to the changing regulatory and business environment.

The Company has implemented operational risk data and assessment systems to monitor and analyse internal and external operational risk events, to assess business environment and internal control factors and to perform scenario analysis. The collected data elements are incorporated in the operational risk capital model. The model encompasses both quantitative and qualitative elements. Internal loss data and scenario analysis results are direct inputs to the capital model, while external operational incidents, business environment and internal control factors are evaluated as part of the scenario analysis process.

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

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

The Operational Risk Department provides independent oversight of operational risk management and assesses measures and monitors operational risk against tolerance. The Operational Risk Department works with the business divisions and control groups to help ensure a transparent, consistent and comprehensive framework for managing operational risk within each area and across the Company. The Operational Risk Department scope includes oversight of technology risk, cybersecurity risk, information security risk and data risk management programmes (e.g. cybersecurity), and fraud risk management and prevention programme and a third party risk management (supplier and risk oversight and assessment) programme. Furthermore, the Operational Risk Department supports the collection and reporting of operational risk incidents and the execution of operational risk assessments; provides the infrastructure needed for risk measurement and risk management; and ensures ongoing validation and verification of the Company's advanced measurement approach for operational risk capital.

**DIRECTORS' REPORT**

**BUSINESS REVIEW (CONTINUED)**

**Risk management (continued)**

*Operational risk (continued)*

Business Continuity Management maintains programmes for business continuity management and technology disaster recovery that facilitate activities designed to mitigate risk to the Morgan Stanley Group during a business continuity event. A business continuity event is an interruption with potential impact to normal business activity of the Company's people, operations, technology, suppliers and/ or facilities. The business continuity management programme's core functions are business continuity planning and crisis management. As part of business continuity planning, business divisions and control groups maintain business continuity plans identifying processes and strategies to continue business critical processes during a business continuity event. Crisis management is the process of identifying and managing the Company's operations during business continuity events. Disaster recovery plans supporting business continuity are in place for critical facilities and resources across the Company.

The Company maintains a programme that oversees our cyber and information security risks. Our cybersecurity and information security policies are designed to protect the Company's information assets against unauthorised disclosure, modification or misuse and are also designed to address regulatory requirements. These policies and procedures cover a broad range of areas, including: identification of internal and external threats, access control, data security protective controls, detection of malicious or unauthorised activity, incident response and recovery planning. The Company has also established policies, procedures and technologies to protect its computers and other assets from unauthorised access.

In connection with its ongoing operations, the Company utilises the services of third party suppliers, which it anticipates will continue and may increase in the future. These services include, for example, outsourced processing and support functions and consulting and other professional services. The Company's risk-based approach to managing exposure to these services includes the performance of due diligence, implementation of service level and other contractual agreements, consideration of operational risk and ongoing monitoring of the third party suppliers' performance. The Company maintains a third party risk programme with appropriate governance, policies, procedures, and technology that supports alignment with our risk tolerance and is designed to meet regulatory requirements. The third party risk programme includes the adoption of appropriate risk management controls and practices through the supplier management lifecycle including, but not limited to assessment of information security, service failure, financial stability, disaster recoverability, reputational risk, contractual risk and safeguards against corruption.

*Legal, regulatory and compliance risk*

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

The Company, principally through the Morgan Stanley Group's Legal and Compliance Division, has established procedures based on legal and regulatory requirements on a worldwide basis that are designed to facilitate compliance with applicable statutory and regulatory requirements and to require that the Company's policies relating to business conduct, ethics and practices are followed globally.

**DIRECTORS' REPORT**

**BUSINESS REVIEW (CONTINUED)**

**Risk management (continued)**

*Legal, regulatory and compliance risk (continued)*

In addition, the Company has established procedures to mitigate the risk that a counterparty's performance obligations will be unenforceable, including consideration of counterparty legal authority and capacity, adequacy of legal documentation, the permissibility of a transaction under applicable law and whether applicable bankruptcy or insolvency laws limit or alter contractual remedies. The heightened legal and regulatory focus on the financial services industry presents a continuing business challenge for the Company.

*Cyber and information security risk management*

As a general matter, the financial services industry faces increased global regulatory focus regarding cyber and information security risk management practices. Many aspects of the businesses are subject to cybersecurity legal and regulatory requirements enacted by US federal and state governments and other non-US jurisdictions in Europe and Asia. These laws are aimed at codifying basic cybersecurity protections and mandating data breach notification requirements.

The Morgan Stanley Group maintains a program that oversees its cyber and information security risks and is designed to address regulatory requirements. Cybersecurity and information security policies, procedures and technologies are designed to protect the Morgan Stanley Group's information assets against unauthorized disclosure, modification or misuse. These policies cover a broad range of areas, including: identification of internal and external threats, access control, data security, protective controls, detection of malicious or unauthorized activity, incident response and recovery planning.

Certain of the Morgan Stanley Group's businesses are also subject to privacy and data protection information security legal requirements concerning the use and protection of certain customer information. For example, the General Data Protection Regulation ("GDPR") became effective in the EU on 25 May 2018 as a replacement for the EU Data Protection Directive. The GDPR imposes mandatory breach notification obligations, including significant fines for noncompliance, enhanced governance and accountability requirements and has extraterritorial impact. In addition, other jurisdictions have adopted or are proposing to adopt GDPR or similar standards, such as Australia, Singapore, Japan, Columbia, Argentina, India, Turkey, Hong Kong and Switzerland.

**DIRECTORS' REPORT**

**BUSINESS REVIEW (CONTINUED)**

**Risk management (continued)**

*Culture, values and conduct of employees*

All employees of the Morgan Stanley Group are accountable for conducting themselves in accordance with the Morgan Stanley Group's core values *Putting Clients First, Doing the Right Thing, Leading with Exceptional Ideas, and Giving Back*. The Morgan Stanley Group is committed to reinforcing and confirming adherence to the core values through our governance framework, tone from the top, management oversight, risk management and controls, and a three lines of defence structure (business, control functions such as Risk Management and Compliance, and Internal Audit). The Morgan Stanley Group's Board is responsible for overseeing the Morgan Stanley Group's practices and procedures relating to culture, values and conduct, as set forth in the Morgan Stanley Group's Corporate Governance Policies. The Morgan Stanley Group's Culture, Values and Conduct Committee is the senior management committee that oversees the Firm-wide culture, values and conduct program. A fundamental building block of this program is the Morgan Stanley Group's Code of Conduct, which establishes standards for employee conduct that further reinforce the Morgan Stanley Group's commitment to integrity and ethical conduct. Every new hire and every employee annually must attest to their understanding of and adherence to the Code of Conduct. The Morgan Stanley UK Group's Conduct Risk Management Policy also sets out a consistent framework for managing Conduct Risk (i.e. the risk arising from misconduct by employees or contingent workers) and Conduct Risk incidents. The annual employee performance evaluation process includes an evaluation of employee conduct related to risk management practices and the Morgan Stanley Group's expectations. The Morgan Stanley Group also has several mutually reinforcing processes to identify employee conduct that may have an impact on employment status, current year compensation and/or prior year compensation. For example, the Global Incentive Compensation Discretion Policy sets forth standards for managers when making annual compensation decisions and specifically requires managers to consider whether their employees effectively managed and/ or supervised risk control practices during the performance year. Management committees from control functions periodically meet to discuss employees whose conduct does not meet the Firm's standards. These results are incorporated in the employees' performance evaluation, which links to compensation and promotion decisions. The Morgan Stanley Group's clawback and cancellation provisions, which permit recovery of deferred incentive compensation and cover a broad scope of employee conduct, including any act or omission (including with respect to direct supervisory responsibilities) that constitutes a breach of obligation to the Morgan Stanley Group or causes a restatement of the Morgan Stanley Group's financial results, constitutes a violation of the Morgan Stanley Group's global risk management principles, policies and standards, or causes a loss of revenue associated with a position on which the employee was paid and the employee operated outside of internal control policies.

**Going concern**

Retaining sufficient liquidity and capital to withstand market pressures remains central to the Morgan Stanley Group's and the Company's strategy. Additionally, the Company has access to further Morgan Stanley Group capital and liquidity.

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

**DIRECTORS' REPORT**

**DIRECTORS**

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

H. Herrmann  
S. Ibanez  
P.J.G. de Reus  
L.P.A. Rolfes  
TMF Management B.V.

The Company has taken notice of Dutch legislation effective as of 13 April 2017, as a consequence of which the Company should take into account as much as possible a balanced composition of the Board of Directors in terms of gender, when nominating or appointing Directors, to the effect that at least 30 percent of the positions should be held by women and at least 30 percent by men. Currently the composition of the Board of Directors deviates from the gender diversity objectives. When appointing a Director, the Board of Directors considers the gender diversity objectives, as appropriate.

**EVENTS AFTER THE REPORTING DATE**

There have been no significant events since the reporting date.

**AUDIT COMMITTEE**

The Company qualifies as an organisation of public interest pursuant to Dutch and EU law and has established its own audit committee which complies with the applicable corporate governance rules and composition requirements as detailed in the Articles of Association of the Company.

**AUDITOR**

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

Approved by the Board and signed on its behalf by:

23 April 2019

H. Herrmann

S. Ibanez

P.J.G. de Reus

L.P.A. Rolfes

TMF Management B.V.

**DIRECTORS' RESPONSIBILITIES STATEMENT**

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

- the financial statements have been prepared in accordance with International Financial Reporting Standards (“IFRSs”) as issued by the International Accounting Standards Board (“IASB”) and as endorsed by the EU and give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company; and
- the management report represented by the Directors’ report includes a fair review of the development and performance of the business and the position of the Company together with a description of the principal risks and uncertainties that the Company faces.

Approved by the Board and signed on its behalf by:

23 April 2019

H. Herrmann

S. Ibanez

P.J.G. de Reus

L.P.A. Rolfes

TMF Management B.V.

**MORGAN STANLEY B.V.**

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

	Note	2018 €'000	2017 €'000
Net trading (expense)/ income on financial assets		(293,195)	319,694
Net trading (expense)/ income on financial liabilities		(325,128)	132,795
<b>Net trading (expense)/ income</b>		<u>(618,323)</u>	<u>452,489</u>
Net (expense)/ income on other financial assets held at fair value		(32,708)	233,378
Net income/ (expense) on other financial liabilities held at fair value		651,031	(685,867)
<b>Net income/ (expense) on other financial instruments held at fair value</b>	5	<u>618,323</u>	<u>(452,489)</u>
Other revenue	6	1,622	1,304
Total non-interest revenues		<u>1,622</u>	<u>1,304</u>
Interest income		12,036	11,843
Interest expense		(12,289)	(4,511)
Net interest (expense)/ income	7	<u>(253)</u>	<u>7,332</u>
Net revenues		<u>1,369</u>	<u>8,636</u>
Non-interest expense:			
Other expense	8	(183)	(6,576)
Net reversal of impairment loss on financial instruments		4	-
<b>PROFIT BEFORE INCOME TAX</b>		<u>1,190</u>	<u>2,060</u>
Income tax	9	(290)	(513)
<b>PROFIT AND TOTAL COMPREHENSIVE INCOME FOR THE YEAR</b>		<u><u>900</u></u>	<u><u>1,547</u></u>

All operations were continuing in the current and prior year.

The notes on pages 15 to 70 form an integral part of the financial statements.

## MORGAN STANLEY B.V.

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

	<b>Share capital</b>	<b>Retained earnings</b>	<b>Total equity</b>
	<b>€'000</b>	<b>€'000</b>	<b>€'000</b>
Balance at 1 January 2017	15,018	23,218	38,236
Profit and total comprehensive income for the year	-	1,547	1,547
<b>Balance at 31 December 2017</b>	<u>15,018</u>	<u>24,765</u>	<u>39,783</u>
Impact of adoption of new accounting standards	4	(8)	(8)
Profit and total comprehensive income for the year	-	900	900
<b>Balance at 31 December 2018</b>	<u><u>15,018</u></u>	<u><u>25,657</u></u>	<u><u>40,675</u></u>

The notes on pages 15 to 70 form an integral part of the financial statements.

**MORGAN STANLEY B.V.**

Registered number: 34161590

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

	Note	2018 €'000	2017 €'000
<b>ASSETS</b>			
Cash and short-term deposits		903	432
Trading financial assets	10	271,266	592,979
Loan and advances	10	7,783,632	6,797,365
Trade and other receivables	12	1,434,349	2,086,238
Current tax assets		4,389	4,811
<b>TOTAL ASSETS</b>		<u>9,494,539</u>	<u>9,481,825</u>
<b>LIABILITIES AND EQUITY</b>			
Trading financial liabilities	10	752,153	319,651
Convertible preferred equity certificates	11	1,125,281	1,125,281
Trade and other payables	13	188,378	656,509
Debt and other borrowings	14	7,388,052	7,340,601
<b>TOTAL LIABILITIES</b>		<u>9,453,864</u>	<u>9,442,042</u>
<b>EQUITY</b>			
Share capital	15	15,018	15,018
Retained earnings		25,657	24,765
<b>Equity attributable to owners of the Company</b>		<u>40,675</u>	<u>39,783</u>
<b>TOTAL EQUITY</b>		<u>40,675</u>	<u>39,783</u>
<b>TOTAL LIABILITIES AND EQUITY</b>		<u>9,494,539</u>	<u>9,481,825</u>

These financial statements were approved by the Board and authorised for issue on 23 April 2019.

Signed on behalf of the Board

H. Herrmann

S. Ibanez

P.J.G. de Reus

L.P.A. Rolfes

TMF Management B.V

Director

The notes on pages 15 to 70 form an integral part of the financial statements.

# MORGAN STANLEY B.V.

## STATEMENT OF CASH FLOWS Year ended 31 December 2018

	Note	2018 €'000	2017 €'000
<b>NET CASH FLOWS FROM/ (USED IN) OPERATING ACTIVITIES</b>	16	<u>471</u>	<u>(284)</u>
<b>INVESTING ACTIVITIES</b>			
Repayment of loan and interest from another Morgan Stanley Group undertaking		1,163,538	-
Issue of loan to another Morgan Stanley Group undertaking		<u>(1,125,281)</u>	<u>-</u>
<b>NET CASH FLOWS FROM INVESTING ACTIVITIES</b>		<u>38,257</u>	<u>-</u>
<b>FINANCING ACTIVITIES</b>			
Yield paid on convertible preferred equity certificates		(54,313)	-
Financing received from another Morgan Stanley Group undertaking		<u>16,056</u>	<u>-</u>
<b>NET CASH FLOWS USED IN FINANCING ACTIVITIES</b>		<u>(38,257)</u>	<u>-</u>
<b>NET INCREASE/ (DECREASE) IN CASH AND CASH EQUIVALENTS</b>		471	(284)
<b>CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE YEAR</b>		<u>432</u>	<u>716</u>
<b>CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR</b>		<u><u>903</u></u>	<u><u>432</u></u>

The notes on pages 15 to 70 form an integral part of the financial statements.

# MORGAN STANLEY B.V.

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

### 1. CORPORATE INFORMATION

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

Luna Arena, Herikerbergweg 238, 1101 CM, Amsterdam, The Netherlands.

The Company is engaged in the issuance of Structured Notes and the hedging of the obligations arising pursuant to such issuances with prepaid equity securities contracts, loans designated at fair value through profit or loss and derivatives entered into with Morgan Stanley Group undertakings.

The issued Structured Notes expose the Company to the risk of changes in market prices of the underlying securities, interest rate risk and, where denominated in currencies other than Euros, the risk of changes in rates of exchange between the Euro and the other relevant currencies. The Company uses the contracts that it purchases from other Morgan Stanley Group undertakings to hedge the market price, interest rate and foreign currency risks associated with the issuance of the Structured Notes.

### 2. BASIS OF PREPARATION

#### Statement of compliance

The Company has prepared its annual financial statements in accordance with IFRSs issued by the IASB as adopted by the EU, Interpretations issued by the IFRS Interpretations Committee and Part 9 of Book 2 of the Dutch Civil Code.

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

The following standards, amendments to standards and interpretation relevant to the Company's operations were adopted during the year. Except where otherwise stated, these standards, amendments to standards and interpretations did not have a material impact on the Company's financial statements.

IFRS 9 '*Financial Instruments*' ("IFRS 9") was issued by the IASB in November 2009, reissued in October 2010, amended in November 2013, and revised and reissued by the IASB in July 2014. The standard was endorsed by the EU in November 2016. IFRS 9 is applicable retrospectively, except where otherwise prescribed by transitional provisions of the standard, and is effective for accounting periods beginning on or after 1 January 2018. The Company early adopted the requirements relating to the presentation of fair value movements due to changes in credit risk on financial liabilities designated at fair value through profit or loss ("FVPL"), and has adopted the remaining requirements of IFRS 9 from 1 January 2018.

A further amendment to IFRS 9, relating to the accounting treatment of financial instruments with prepayment features including negative compensation, was issued by the IASB in October 2017. The amendment is applicable retrospectively, except where otherwise prescribed by transitional provisions of the amendment, and is effective for accounting periods beginning on or after 1 January 2019. The amendment was endorsed by the EU in March 2018. The Company has early adopted this amendment from 1 January 2018.

The main aspects of IFRS 9 which impact the Company are its requirements relating to:

- Classification and measurement of financial assets

The classification and measurement of financial assets is determined based upon how these are managed (the Company's business model) and their contractual cash flow characteristics. Measurement will be at amortised cost or FVPL.

- Impairment of financial assets

The impairment requirements are based on Expected Credit Loss ("ECL") and apply to financial assets measured at amortised cost.

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

**2. BASIS OF PREPARATION (CONTINUED)**

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

As part of the implementation of IFRS 9, the Company has performed an evaluation of its business models and a review of the contractual terms of financial assets.

As a result of this evaluation, certain financial assets have moved from designated at FVPL under IAS 39 '*Financial Instruments: Recognition and Measurement*' ("IAS 39") to mandatorily at FVPL under IFRS 9. There is no impact of this on retained earnings as at 1 January 2018. No financial liabilities have changed classification.

As a result of the implementation of the ECL impairment approach the Company's retained earnings have decreased by €8,000, due to additional impairment expense recognition, in line with the transitional provisions of IFRS 9.

Under the transitional provisions of IFRS 9, the Company's opening balance sheet at the date of initial application (1 January 2018) has been restated, with no restatement of comparative periods. However, the Company has updated the presentation of its primary statements on transition to IFRS 9 to provide more relevant information to the users of the financial statements. The comparative period has been re-presented to align to the new format in the financial statements.

Note 3 provides the new accounting policies under IFRS 9 applicable from 1 January 2018, alongside the accounting policies applicable to 31 December 2017 under IAS 39.

To reflect the differences between IFRS 9 and IAS 39, IFRS 7 '*Financial Instruments: Disclosures*' ("IFRS 7") was updated by the IASB and the Company adopted the updated IFRS 7 for all reporting periods from 1 January 2018. The updated requirements include transition disclosures shown in note 4, in addition to qualitative and quantitative information about the ECL as set out in note 19.

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

**New standards and interpretations not yet adopted**

At the date of authorisation of these financial statements, the following standards, amendments to standards and interpretations relevant to the Company's operations were issued by the IASB but not mandatory for accounting periods beginning 1 January 2018. Except where otherwise stated, the Company does not expect that the adoption of the following standards, amendments to standards and interpretations will have a material impact on the Company's financial statements.

As part of the 2015-2017 Annual Improvements Cycle published in December 2017, the IASB made amendments to the following standard that is relevant to the Company's operations: IAS 12 '*Income Taxes*' for application in accounting periods beginning on or after 1 January 2019.

IFRIC 23 '*Uncertainty over Income Tax Treatments*' was issued by the IASB in June 2017 for application in accounting periods beginning on or after 1 January 2019.

**Basis of measurement**

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

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

No judgements other than those involving estimations noted below have been made in the process of applying the Company's accounting policies that have had a significant effect on the amounts recognised in the financial statements.

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

**2. BASIS OF PREPARATION (CONTINUED)**

**Key sources of estimation uncertainty**

The preparation of the Company's financial statements requires management to make judgements involving estimations and other assumptions regarding the valuation of certain financial instruments that affect the financial statements and related disclosures.

The critical sources of estimation uncertainty are as follows:

- *Valuation of L3 financial instruments:* Valuation techniques used to measure the fair value of instruments categorised in Level 3 of the fair value hierarchy are dependent on unobservable parameters, and as such require the application of judgement, involving estimations and assumptions. The fair value for these financial instruments has been determined using parameters appropriate for the valuation methodology based on prevailing market evidence. It is recognised that the unobservable parameters could have a range of reasonably possible alternative values. See accounting policy 3(d) and note 21 'Sensitivity of fair values to changing significant assumptions to reasonably possible alternatives'.

The Company believes that the estimates used in preparing the financial statements are reasonable, relevant and reliable. Actual results could differ from these estimates.

**The going concern assumption**

The Company's business activities, together with the factors likely to affect its future development, performance and position, are reflected in the Future Outlook and Business Review section of the Directors' report on pages 1 to 9. In addition, the notes to the financial statements include the Company's objectives, policies and processes for managing its capital; its financial risk management objectives; details of its financial instruments; and its exposures to credit risk and liquidity risk.

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

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

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

**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**a. Functional currency**

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

All currency amounts in the financial statements and Directors' report are rounded to the nearest thousand Euros.

**b. Foreign currencies**

All monetary assets and liabilities denominated in currencies other than Euros are translated into Euros at the rates ruling at the reporting date. Transactions and non-monetary assets and liabilities denominated in currencies other than Euros are recorded at the rates prevailing at the dates of the transactions. The amount of change in the fair value of financial liabilities designated at FVPL that is attributable to changes in the credit risk of these liabilities ("DVA") includes foreign exchange differences thereon. All other translation differences are taken through the statement of comprehensive income. Exchange differences recognised in the statement of comprehensive income are presented in 'Other revenue' or 'Other expense', except where noted in 3(c) below.

**c. Financial instruments**

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

**Trading financial instruments**

*Applicable both prior to and from 1 January 2018*

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

Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial instrument. Transaction costs are excluded from the initial fair value measurement of the financial instrument. These costs are recognised in the statement of comprehensive income in 'Other expense'.

**Non-trading financial assets at fair value through profit or loss**

*Applicable from 1 January 2018*

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

Transaction costs are excluded from the initial fair value measurement of the financial assets. These costs are recognised in the statement of comprehensive income in 'Other expense'.

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

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

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

**c. Financial instruments (continued)**

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

*Applicable from 1 January 2018*

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

*Applicable until 31 December 2017*

The Company designated certain financial instruments at FVPL when the financial instruments were managed, evaluated and reported internally on a fair value basis.

*Applicable until 31 December 2017 and from 1 January 2018*

From the date the transaction in a financial instrument designated at FVPL is entered into (trade date) until settlement date, the Company recognises any unrealised fair value changes in the contract as financial instruments designated at FVPL in the statement of financial position. On settlement date, the fair value of consideration given or received is recognised as a financial instrument designated at FVPL (see note 3(d) below).

All subsequent changes in fair value, foreign exchange differences, interest and dividends are reflected in the statement of comprehensive income in 'Net income/ (expense) on other financial instruments held at fair value' other than DVA on financial liabilities at FVPL which is recognised in the Debt valuation adjustment reserve where those changes do not create or enlarge an accounting mismatch.

Transaction costs are excluded from the initial fair value measurement of the financial instrument. These costs are recognised as incurred in the statement of comprehensive income in 'Other expense'.

Financial assets designated at FVPL include loans and financial liabilities designated at FVPL include Structured Notes.

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

*Applicable from 1 January 2018*

Financial assets classified at amortised cost include cash and short-term deposits and certain trade and other receivables. Financial liabilities classified at amortised cost include CPECs and trade and other payables.

Financial assets are recognised at amortised cost when the Company's business model objective is to collect the contractual cash flows of the assets and where these cash flows are solely payments of principal and interest ("SPPI") on the principal amount outstanding until maturity. Such assets are recognised when the Company becomes a party to the contractual provisions of the instrument. The instruments are initially measured at fair value (see note 3(d) below) and subsequently measured at amortised cost less ECL allowance. Interest is recognised in the statement of comprehensive income in 'Interest income', using the effective interest rate ("EIR") method as described below. Transaction costs that are directly attributable to the acquisition of the financial asset are added to the fair value on initial recognition.

ECL and reversals thereof are recognised in the statement of comprehensive income in 'Net impairment loss on financial instruments' or 'Net reversal of impairment loss on financial instruments'.

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

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

**c. Financial instruments (continued)**

**iii) Financial assets and financial liabilities at amortised cost (continued)**

*Applicable until 31 December 2017*

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

Financial assets classified as loans and receivables include cash and short-term deposits, trade receivables and other receivables.

*Applicable until 31 December 2017 and from 1 January 2018*

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

The CPECs issued by the Company are classified as financial liabilities at amortised cost in accordance with the substance of the contractual arrangement and IAS 32 '*Financial Instruments: Presentation – offsetting financial instruments*'. The yield on the CPECs is recognised in the statement of comprehensive income in 'Interest expense' using the EIR method as described below.

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

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

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

**d. Fair value**

*Fair value measurement*

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

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

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

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

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

- Level 1 – Quoted prices (unadjusted) in an active market for identical assets or liabilities  
Valuations based on quoted prices in active markets that the Morgan Stanley Group has the ability to access for identical assets or liabilities. Valuation adjustments and block discounts are not applied to Level 1 instruments. Since valuations are based on quoted prices that are readily and regularly available in an active market, valuation of these products does not entail a significant degree of judgement.
- Level 2 – Valuation techniques using observable inputs  
Valuations based on one or more quoted prices in markets that are not active or for which all significant inputs are observable, either directly or indirectly.
- Level 3 – Valuation techniques with significant unobservable inputs  
Valuations based on inputs that are unobservable and significant to the overall fair value measurement.

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

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

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

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

**d. Fair value (continued)**

*Fair value measurement (continued)*

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, the total fair value amount is disclosed in the level appropriate for the lowest level input that is significant to the total fair value of the asset or liability.

The Company incorporates Funding Valuation Adjustment (“FVA”) in the fair value measurements of over-the-counter (“OTC”) uncollateralised or partially collateralised derivatives, and in collateralised derivatives where the terms of the agreement do not permit the re-use of the collateral received. In general, the FVA reflects a market funding risk premium inherent in the noted derivative instruments. The methodology for measuring FVA leverages the Company’s existing credit-related valuation adjustment calculation methodologies, which apply to both assets and liabilities.

For assets and liabilities that are transferred between levels in the fair value hierarchy during the period, fair values are ascribed as if the assets or liabilities had been transferred as of the beginning of the period.

*Valuation techniques*

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

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

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

Adjustments for liquidity risk adjust model-derived mid-market levels of Level 2 and Level 3 financial instruments for the bid-mid or mid-ask spread required to properly reflect the exit price of a risk position. Bid-mid and mid-ask spreads are marked to levels observed in trade activity, broker quotes or other external third-party data. Where these spreads are unobservable for the particular position in question, spreads are derived from observable levels of similar positions.

The Company applies credit-related valuation adjustments to its borrowings (primarily Structured Notes) which are designated at fair value through profit or loss and to OTC derivatives. The Company considers the impact of changes in own credit spreads based upon observations of the secondary bond market spreads when measuring the fair value for borrowings. For OTC derivatives, the impact of changes in both the Company’s and the counterparty’s credit rating is considered when measuring fair value. In determining the expected exposure the Company simulates the distribution of the future exposure to a counterparty, then applies market-based default probabilities to the future exposure, leveraging external third-party credit default swap (“CDS”) spread data. Where CDS spread data are unavailable for a specific counterparty, bond market spreads, CDS spread data based on the counterparty’s credit rating or CDS spread data that reference a comparable counterparty may be utilised. The Company also considers collateral held and legally enforceable master netting agreements that mitigate its exposure to each counterparty.

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

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

**d. Fair value (continued)**

*Valuation techniques (continued)*

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

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

*Valuation process*

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

*Model Review.* VC, in conjunction with the Model Risk Management Department (“MRM”), which reports to the Chief Risk Officer of the Morgan Stanley Group (“CRO”), independently reviews valuation models’ theoretical soundness, the appropriateness of the valuation methodology and calibration techniques developed by the business units using observable inputs. Where inputs are not observable, VC reviews the appropriateness of the proposed valuation methodology to determine that it is consistent with how a market participant would arrive at the unobservable input. The valuation methodologies utilised in the absence of observable inputs may include extrapolation techniques and the use of comparable observable inputs. As part of the review, VC develops a methodology to independently verify the fair value generated by the business unit’s valuation models. The Company generally subjects valuations and models to a review process initially and on a periodic basis thereafter.

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

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

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

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

**d. Fair value (continued)**

*Valuation process (continued)*

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

VC reviews the models and valuation methodology used to price new material Level 2 and Level 3 transactions and both FCG and MRM must approve the fair value of the trade that is initially recognised.

*Level 3 Transactions.* VC reviews the business unit's valuation techniques to assess whether these are consistent with market participant assumptions.

*Gains and losses on inception*

In the normal course of business, the fair value of a financial instrument on initial recognition is the transaction price (i.e. the fair value of the consideration given or received). In certain circumstances, however, the fair value will be based on other observable current market transactions in the same instrument, without modification or repackaging, or on a valuation technique whose variables include only data from observable markets. When such evidence exists, the Company recognises a gain or loss on inception of the transaction.

During the year, the Company voluntarily changed its accounting policy with respect to fair value gains and losses on inception. When the use of unobservable market data has a significant impact on determining fair value at the inception of the transaction, the entire initial gain or loss indicated by the valuation technique as at the transaction date is not recognised immediately in the statement of comprehensive income but is deferred and recognised over the life of the instrument or at the earlier of when the unobservable market data either becomes observable, maturity or disposal of the instrument. Previously, any initial gain or loss was not amortised over the life of the instrument and was only recognised when the market data became observable or on maturity of the instrument. This change in accounting policy has been retrospectively applied and has no impact on the financial statements in the current or prior year.

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

***Applicable until 31 December and from 1 January 2018***

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

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

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

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

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

**e. Modification and derecognition of financial assets and liabilities (continued)**

The renegotiation or modification of the contractual cash flows of a financial asset can lead to derecognition where the modification is “substantial”, determined by qualitative assessment of whether the revised contractual terms of a financial asset, such as a loan, are significantly different from those of the original financial asset. In the event that the qualitative assessment is unclear, a quantitative 10% cash flow test is performed.

Where modifications do not result in derecognition of the asset, the gross carrying amount of the financial asset is recalculated and a modification gain/ (loss) is recognised in the statement of comprehensive income.

Upon derecognition of a financial asset, the difference between the previous carrying amount and the sum of any consideration received, together with the transfer of any cumulative gain/ loss previously recognised in equity, are recognised in the statement of comprehensive income within ‘Net gains/ (losses) on derecognition of financial assets measured at amortised cost.

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

**f. Impairment of financial instruments**

***Applicable from 1 January 2018***

The Company recognises loss allowances for ECL on financial assets measured at amortised cost.

*Measurement of ECL*

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

Where a financial asset is credit-impaired at the reporting date, the ECL is measured as the difference between the asset’s gross carrying amount and the present value of future cash flows, discounted at the original EIR.

The Company applies a three stage approach to measuring ECL based on the change in credit risk since initial recognition:

- Stage 1: if the credit risk of the financial instrument at the reporting date has not increased significantly since initial recognition, then the loss allowance is calculated as the lifetime cash shortfalls that will result if a default occurs in the next 12 months, weighted by the probability of that default occurring.
- Stage 2: if there has been a significant increase in credit risk (“SICR”) since initial recognition, the loss allowance is calculated as the ECL over the remaining life of the financial instrument. If it is subsequently determined that there has no longer been a SICR since initial recognition, then the loss allowance reverts to reflecting 12 month expected losses.
- Stage 3: if there has been a SICR since initial recognition and the financial instrument is deemed credit-impaired (see below for definition of credit-impaired), the loss allowance is calculated as the ECL over the remaining life of the financial instrument. If it is subsequently determined that there has no longer been a SICR since initial recognition, then the loss allowance reverts to reflecting 12 month expected losses.

The Company’s accounting policy is to not use the ‘low’ credit risk practical expedient. As a result, the Company monitors all financial instruments, which do not have a significant financing component that are subject to impairment for SICR, with the exception of trade receivables for which a lifetime ECL is always calculated.

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

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

**f. Impairment of financial instruments (continued)**

*Measurement of ECL (continued)*

In general, ECL are measured so that they reflect:

- a) A probability-weighted range of possible outcomes
- b) The time value of money
- c) Relevant information relating to past, current and future economic conditions.

When measuring ECL, the Company considers multiple scenarios, except where practical expedients are used to determine ECL. Practical expedients are used where they are consistent with the principles described above. ECL on certain trade receivables are calculated using a 'matrix' approach which reflects the previous history of credit losses on these financial assets, applying different provision levels based on the age of the receivable. Alternatively where there is a history of no credit losses and where this is expected to persist into the future for structural or other reasons, such as collateral or other credit enhancement, in which case it is determined that the ECL for a financial instrument is de minimis (highly immaterial) and it may not be necessary to recognise the ECL.

The Company measures ECL on an individual asset basis and has no purchased or originated credit-impaired financial assets.

If a financial asset has been the subject of modification which does not lead to its derecognition (refer accounting policy 3(e)), SICR is assessed by comparing the risk of default of the financial instrument, based on the modified terms at the reporting date, with the risk of default of the financial instrument at inception, based on the financial instrument's original, unmodified, terms.

Where the modification of contractual cash flows of a financial asset leads to its derecognition and the recognition of a new asset (refer accounting policy 3(e)), the date of modification is treated as the date of initial recognition for the new financial asset when determining whether a SICR has occurred for that modified financial asset. In rare circumstances, after modification, the new asset is considered to be credit impaired, in which case it is treated as an asset which was credit-impaired at origination.

More information on measurement of ECL is provided in note 19, Financial risk management.

*Presentation of ECL*

ECL is recognised in the statement of comprehensive income within 'Net impairment loss on financial instruments' or 'Net reversal of impairment loss on financial instruments'. ECL on financial assets measured at amortised cost are presented as an ECL allowance. The allowance reduces the net carrying amount on the face of the statement of financial position.

*Credit-impaired financial instruments*

In assessing the impairment of financial instruments under the ECL model, the Company defines credit-impaired financial instruments in accordance with the Credit Risk Management Department's policies and procedures. A financial instrument is credit-impaired when, based on current information and events, it is probable that the Company will be unable to collect all scheduled payments of principal or interest when due according to the contractual terms of the agreement.

*Definition of Default*

In assessing the impairment of financial instruments under the ECL model, the Company defines default in accordance with the Credit Risk Management Department's policies and procedures. This considers whether the borrower is unlikely to pay its credit obligations to the Company in full and takes into account qualitative indicators, such as breaches of covenants. The definition of default also includes a presumption that a financial asset which is more than 90 days past due ("DPD") has defaulted.

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

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

**f. Impairment of financial instruments (continued)**

*Write-offs*

Loans are written off (either partially or in full) when they are deemed uncollectible which generally occurs when all commercially reasonable means of recovering the loan balance have been exhausted. Such determination is based on an indication that the borrower can no longer pay the obligation, or that the proceeds from collateral will not be sufficient to pay the loan. Partial write-offs are made when a portion of the loan is uncollectable. However, financial assets that are written off could still be subject to enforcement activities for recoveries of amounts due. If the amount to be written off is greater than the accumulated loss allowance, the difference is reflected directly in the statement of comprehensive income within 'Net impairment loss on financial instruments' and is not recognised in the loss allowance account. Any subsequent recoveries are credited to 'Net reversal of impairment losses on financial instruments' within the statement of comprehensive income.

***Applicable until 31 December 2017***

At each reporting date, an assessment was made as to whether there was any objective evidence of impairment in the value of a financial asset classified as loans and receivables. Impairment losses were recognised if an event had occurred which would have had an adverse impact on the expected future cash flows of an asset and the expected impact could be reliably estimated.

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

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

**g. Cash and cash equivalents**

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

**h. Income tax**

The tax expense represents the sum of the tax currently payable.

The tax currently payable is calculated based on taxable profit for the year. Taxable profit may differ from profit before income tax as reported in the statement of comprehensive income because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Company's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the reporting date. Current tax is charged or credited in the statement of comprehensive income except when it relates to items charged or credited directly to other comprehensive income, in which case the current tax is also recorded within other comprehensive income.

Current tax assets are offset against current tax liabilities when there is a legally enforceable right to set off current tax assets against current tax liabilities and the Company intends to settle its current tax assets and current tax liabilities on a net basis or to realise the asset and settle the liability simultaneously.

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

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

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

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

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

**4. TRANSITION TO IFRS 9**

As discussed at note 2, the Company adopted a new standard from 1 January 2018, IFRS 9, which has resulted in a cumulative adjustment to retained earnings at the date of adoption of €8,000, reflected in the statement of changes in equity.

The disclosures below set out the impact of adopting IFRS 9 on the statement of financial position and retained earnings, including the effect of replacing IAS 39's incurred credit loss models with the ECL framework under IFRS 9.

**a. IFRS 9: Classification of financial instruments on the date of initial application**

The following table shows the original measurement categories in accordance with IAS 39 and the new measurement categories under IFRS 9 for the Company's financial assets and financial liabilities as at 1 January 2018 in accordance with the Company's updated accounting policies on the classification of financial instruments under IFRS 9 as set out in note 3(c).

			Original carrying amount under IAS 39	New carrying amount under IFRS 9	
	Note	Original classification under IAS 39	New classification under IFRS 9	€'000	€'000
<b>Financial assets</b>					
Cash and short term deposits		Loans and receivables	Financial assets at amortised cost	432	432
Trading financial assets		FVPL	FVPL (trading)	592,979	592,979
Loans and advances	a	FVPL (designated)	FVPL (designated)	6,797,365	6,797,365
Trade and other receivables	b	FVPL (designated)	FVPL (non-trading)	268,210	268,210
Trade and other receivables		Loans and receivables	Financial assets at amortised cost	1,818,028	1,818,020
<b>Total financial assets</b>				<u>9,477,014</u>	<u>9,477,006</u>
<b>Financial liabilities</b>					
Trading financial liabilities		FVPL	FVPL (trading)	319,651	319,651
Convertible preferred equity certificates		Financial liabilities at amortised cost	Financial liabilities at amortised cost	1,125,281	1,125,281
Trade and other payables		Financial liabilities at amortised cost	Financial liabilities at amortised cost	656,509	656,509
Debt and other borrowings		FVPL (designated)	FVPL (designated)	7,340,601	7,340,601
<b>Total financial liabilities</b>				<u>9,442,042</u>	<u>9,442,042</u>

The application of these policies resulted in the reclassifications set out in the table above and explained below.

- a. Certain loans were classified as financial assets designated at FVPL under IAS 39 as they were managed, evaluated and reported internally on a fair value basis. On transition to IFRS 9, there have been no changes to classification. These continue to be designated at FVPL in order to eliminate or significantly reduce an accounting mismatch which would otherwise arise.
- b. Prepaid equity securities contracts were designated at FVPL under IAS 39. On transition to IFRS 9, prepaid equity securities contracts assets are mandatorily at FVPL as they are held within a business model in which they are managed and their performance is evaluated on a fair value basis.

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

**4. TRANSITION TO IFRS 9 (CONTINUED)**

**a. IFRS 9: Classification of financial instruments on the date of initial application (continued)**

The following table reconciles the carrying amount under IAS 39 to the carrying amounts under IFRS 9 on transition to IFRS 9 on 1 January 2018 by showing where there has been a presentation reclassification and/or a carrying amount remeasurement.

	IAS 39 carrying amount 31 December 2017 €'000	Reclassification €'000	Remeasurement €'000	IFRS 9 carrying amount 1 January 2018 €'000	Retained earnings effect 1 January 2018 €'000
<b>Financial assets</b>					
Amortised cost:					
Cash and short term deposits	432	-	-	432	-
Trade and other receivables	1,818,028	-	(8)	1,818,020	8
<b>Total amortised cost</b>	<b>1,818,460</b>	<b>-</b>	<b>(8)</b>	<b>1,818,452</b>	<b>8</b>
<b>Trading financial assets at FVPL</b>					
	592,979	-	-	592,979	-
<b>FVPL (non-trading):</b>					
Trade and other receivables:					
From FVPL (designated)	-	268,210	-	268,210	-
<b>Total FVPL (non-trading)</b>	<b>-</b>	<b>268,210</b>	<b>-</b>	<b>268,210</b>	<b>-</b>
<b>FVPL (designated):</b>					
Loans and advances	6,797,365	-	-	6,797,365	-
Trade and other receivables: To FVPL (non-trading)	268,210	(268,210)	-	-	-
<b>Total FVPL (designated)</b>	<b>7,065,575</b>	<b>(268,210)</b>	<b>-</b>	<b>6,797,365</b>	<b>-</b>
<b>Financial liabilities</b>					
Amortised cost:					
Convertible preferred equity certificates	1,125,281	-	-	1,125,281	-
Trade and other payables	656,509	-	-	656,509	-
<b>Total amortised cost</b>	<b>1,781,790</b>	<b>-</b>	<b>-</b>	<b>1,781,790</b>	<b>-</b>
<b>FVPL (trading)</b>	<b>319,651</b>	<b>-</b>	<b>-</b>	<b>319,651</b>	<b>-</b>
<b>FVPL (designated)</b>	<b>7,340,601</b>	<b>-</b>	<b>-</b>	<b>7,340,601</b>	<b>-</b>

**b. IFRS 9: Expected credit losses**

The Company had no impairment provisions under IAS 39 at 31 December 2017. The opening ECL allowance determined in accordance with IFRS 9 as at 1 January was €8,000 on intercompany receivables measured at amortised cost and presented within 'Trade and other receivables' within the statement of financial position. The related impact on retained earnings was a decrease of €8,000.

## MORGAN STANLEY B.V.

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

#### 5. NET INCOME/ (EXPENSE) ON OTHER FINANCIAL INSTRUMENTS HELD AT FAIR VALUE

	2018 €'000	2017 €'000
Net income/ (expense) on:		
Non-trading financial assets at FVPL:		
Trade and other receivables:		
Prepaid equity securities contracts	(27,351)	-
Financial assets designated at FVPL:		
Loans and advances:		
Loans	(5,357)	168,095
Trade and other receivables:		
Prepaid equity securities contracts	-	65,283
Financial liabilities designated at FVPL:		
Debt and other borrowings:		
Issued Structured Notes	651,031	(685,867)
	<u>618,323</u>	<u>(452,489)</u>

#### 6. OTHER REVENUE

	2018 €'000	2017 €'000
Management charges to other Morgan Stanley Group undertakings	1,190	1,304
Net foreign exchange gains	432	-
	<u>1,622</u>	<u>1,304</u>

The Company actively manages its foreign currency exposure risk arising on its assets and liabilities in currencies other than Euro. Net foreign exchange gains includes translation differences that have arisen due to foreign exchange exposure created as a result of hedging assets and liabilities recognised from Morgan Stanley Group reporting purposes.

#### 7. INTEREST INCOME AND INTEREST EXPENSE

'Interest income' represents total interest generated from financial assets at amortised cost, while 'interest expense' represents total interest arising on financial liabilities at amortised cost, recognised using the EIR method.

No other gains or losses have been recognised in respect of financial assets measured at amortised cost other than as disclosed as 'Interest income', foreign exchange differences included within 'Other revenue' (note 6) or 'Other expense' (note 8) and reversal of ECL included within 'Net reversal of impairment loss on financial instruments'.

No other gains or losses have been recognised in respect of financial liabilities at amortised cost other than as disclosed as 'Interest expense' and foreign exchange differences included within 'Other revenue' (note 6) or 'Other expense' (note 8).

'Interest expense' includes the yield payable on CPECs (see note 11).

# MORGAN STANLEY B.V.

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

### 8. OTHER EXPENSE

	<b>2018</b>	<b>2017</b>
	<b>€'000</b>	<b>€'000</b>
Auditors' remuneration:		
Fees payable to the Company's auditor and its associates for the audit of the Company's financial statements	98	99
Bank charges	51	66
Net foreign exchange losses	-	3,303
Management charges from other Morgan Stanley Group undertakings	28	3,104
Other	6	4
	<u>183</u>	<u>6,576</u>

Audit fees of €98,000 (2017: €99,000) were paid to Deloitte Accountants B.V. and related to Deloitte member firms for audit services.

The Company employed no staff during the year (2017: none).

The Company actively manages its foreign currency exposure risk arising on its assets and liabilities in currencies other than Euro. Net foreign exchange losses include translation differences that have arisen due to foreign exchange exposure created as a result of hedging assets and liabilities recognised for Morgan Stanley Group reporting purposes.

### 9. INCOME TAX

	<b>2018</b>	<b>2017</b>
	<b>€'000</b>	<b>€'000</b>
<b>Current tax expense</b>		
Current year	298	515
Adjustment in respect of prior years	(8)	(2)
<b>Income tax</b>	<u>290</u>	<u>513</u>

#### Reconciliation of effective tax rate

The current year income tax expense is lower than (2017: lower than) that resulting from applying the average standard rate of corporation tax in The Netherlands for the year of 25% (2017: 25%). The main differences are explained below:

	<b>2018</b>	<b>2017</b>
	<b>€'000</b>	<b>€'000</b>
Profit before income tax	<u>1,190</u>	<u>2,060</u>
Income tax using the average standard rate of corporation tax in Netherlands of 25% (2017: 25%)	298	515
Impact on tax of:		
Tax over provided in prior years	(8)	(2)
<b>Total income tax expense in the statement of comprehensive income</b>	<u>290</u>	<u>513</u>

## MORGAN STANLEY B.V.

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

#### 9. INCOME TAX (CONTINUED)

The Company is included in a fiscal unity with Archimedes Investments Coöperatieve U.A. and is not a stand-alone taxpayer for Dutch corporate income tax purposes. If, and to the extent that, the Company would benefit from losses of other members of the fiscal unity, these may be settled via inter-company mechanisms.

Management are aware of the Dutch legislative proposals announced in 2018 as part of the tax budget for the 2019 fiscal year and are considering the impact on the funding of the Company. Any changes affecting the Company are expected to be effective from 1 January 2020.

#### 10. FINANCIAL ASSETS AND FINANCIAL LIABILITIES BY MEASUREMENT CATEGORY

The following table analyses financial assets and financial liabilities as at 31 December 2018 presented in the statement of financial position by IFRS 9 classification.

31 December 2018	FVPL (mandatorily) €'000	FVPL (designated) €'000	Amortised cost €'000	Total €'000
Cash and short-term deposits	-	-	903	903
Trading financial assets:				
Derivatives	271,266	-	-	271,266
Loans and advances:				
Loans	-	7,783,632	-	7,783,632
Trade and other receivables:				
Trade receivables	-	-	186,506	186,506
Other receivables	-	-	1,165,760	1,165,760
Prepaid equity securities contracts	82,083	-	-	82,083
<b>Total financial assets</b>	<b>353,349</b>	<b>7,783,632</b>	<b>1,353,169</b>	<b>9,490,150</b>
Trading financial liabilities:				
Derivatives	752,153	-	-	752,153
Convertible preferred equity certificates	-	-	1,125,281	1,125,281
Trade and other payables:				
Trade payables	-	-	20,229	20,229
Other payables	-	-	168,149	168,149
Debt and other borrowings:				
Issued Structured Notes	-	7,388,052	-	7,388,052
<b>Total financial liabilities</b>	<b>752,153</b>	<b>7,388,052</b>	<b>1,313,659</b>	<b>9,453,864</b>

# MORGAN STANLEY B.V.

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

### 10. FINANCIAL ASSETS AND FINANCIAL LIABILITIES BY MEASUREMENT CATEGORY (CONTINUED)

31 December 2017	FVPL (held for trading) €'000	FVPL (designated) €'000	Loans and receivables €'000	Financial liabilities at amortised cost €'000	Total €'000
Cash and short-term deposits	-	-	432	-	432
Trading financial assets:					
Derivatives	592,979	-	-	-	592,979
Loans and advances:					
Loans	-	6,797,365	-	-	6,797,365
Trade and other receivables:					
Trade receivables	-	-	25,724	-	25,724
Other receivables	-	-	1,792,304	-	1,792,304
Prepaid equity securities contracts	-	268,210	-	-	268,210
<b>Total financial assets</b>	<b>592,979</b>	<b>7,065,575</b>	<b>1,818,460</b>	<b>-</b>	<b>9,477,014</b>
Trading financial liabilities:					
Derivatives	319,651	-	-	-	319,651
Convertible preferred equity certificates	-	-	-	1,125,281	1,125,281
Trade and other payables:					
Trade payables	-	-	-	600,127	600,127
Other payables	-	-	-	56,382	56,382
Debt and other borrowings:					
Issued Structured Notes	-	7,340,601	-	-	7,340,601
<b>Total financial liabilities</b>	<b>319,651</b>	<b>7,340,601</b>	<b>-</b>	<b>1,781,790</b>	<b>9,442,042</b>

#### Financial assets and financial liabilities designated at FVPL

The financial assets and financial liabilities shown in the tables above which are designated at FVPL consist primarily of the following financial assets and financial liabilities:

*Structured Notes:* These relate to financial liabilities which arise from selling structured products generally in the form of notes, certificates and warrants. These instruments contain an embedded derivative which significantly modifies the cash flows of the issuance. The return on the instrument is linked to an underlying that is not clearly and closely related to the debt host including, but not limited to, equity-linked notes. These Structured Notes are designated at FVPL as the risks to which the Company is a contractual party are risk managed on a fair value basis as part of the Company's trading portfolio and the risk is reported to key management personnel on this basis.

*Prepaid equity securities contracts:* These contracts involve derivatives for which an initial payment is paid at inception. The contracts, along with the loans designated at fair value through profit or loss and the derivative contracts classified as trading financial instruments, are part of the hedging strategy for the obligations arising pursuant to the issuance of the Structured Notes. Until 31 December 2017, these prepaid equity securities contracts were designated at FVPL as the risks to which the Company is a contractual party are managed on a fair value basis as part of the Company's trading portfolio and the risk is reported to key management personnel on this basis. From 1 January 2018, prepaid equity securities contracts are mandatorily at FVPL as they are held in a business model in which they are managed and their performance is evaluated on a fair value basis.

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

**10. FINANCIAL ASSETS AND FINANCIAL LIABILITIES BY MEASUREMENT  
CATEGORY (CONTINUED)**

**Financial assets and financial liabilities designated at FVPL (continued)**

*Loans:* These are loans to other Morgan Stanley Group undertakings that, along with the prepaid equity securities contracts and the derivative contracts classified as mandatorily at FVPL, are part of the hedging strategy for the obligations arising pursuant to the issuance of the Structured Notes. Until 31 December 2017, these loans were designated at FVPL as they were managed, evaluated and reported internally on a fair value basis. From 1 January 2018 they continue to be designated at FVPL to eliminate or significantly reduce an accounting mismatch which would otherwise arise.

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

At initial recognition of a specific Structured Note issuance program, the Company's issuance process, and any planned hedging structure relating to the issuance of those Structured Notes, has been considered, to determine whether the presentation of fair value changes attributable to credit risk of those Structured Notes through other comprehensive income would create or enlarge an accounting mismatch in the income statement. If financial instruments, such as prepaid equity securities contracts, derivatives and loans held at FVPL, for which changes in fair value incorporating counterparty credit risk are reflected within the income statement, are traded to economically hedge the Structured Note issuances in full, the fair value incorporating any counterparty credit risk arising on the hedging instruments may materially offset any DVA applied to Structured Notes, where the counterparties of the hedging instruments are part of the Morgan Stanley Group. In such cases, the DVA of those structured notes is not reflected within other comprehensive income, and instead is presented in the income statement.

The following table presents the change in fair value and the cumulative change recognised in the statement of comprehensive income attributable to own credit risk for issued Structured Notes and counterparty credit risk for loans.

	Gain or (loss) recognised in the statement of comprehensive income		Cumulative gain or (loss) recognised in the statement of comprehensive income	
	2018 €'000	2017 <sup>(1)</sup> €'000	2018 €'000	2017 €'000
Issued Structured Notes	134,385	(35,593)	26,388	(107,997)
Loans	(134,385)	34,794	(26,388)	107,997
	-	(799)	-	-

(1) The net loss of €nil (31 December 2017: net loss of €799,000) and an offsetting net gain reflected in the fair value of the related prepaid equity securities contracts (31 December 2017: net gain of €799,000) are recognised in the statement of comprehensive income.

The carrying amount of financial liabilities designated at fair value was €62,928,000 lower than the contractual amount due at maturity (31 December 2017: €19,120,000 lower).

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

**10. FINANCIAL ASSETS AND FINANCIAL LIABILITIES BY MEASUREMENT CATEGORY (CONTINUED)**

**Financial assets and financial liabilities designated at FVPL (continued)**

The following tables present the carrying value of the Company's financial liabilities designated at FVPL, classified according to underlying security type, including, single name equities, equity indices and equity portfolio.

<b>2018</b>	<b>Single name equities €'000</b>	<b>Equity indices €'000</b>	<b>Equity portfolio €'000</b>	<b>Other<sup>(1)</sup> €'000</b>	<b>Total €'000</b>
Certificates and warrants	558,158	15,955	66,856	60,902	701,871
Notes	1,736,737	2,421,409	1,542,499	985,536	6,686,181
Total debt and other borrowings	<u>2,294,895</u>	<u>2,437,364</u>	<u>1,609,355</u>	<u>1,046,438</u>	<u>7,388,052</u>

<b>2017</b>	<b>Single name equities €'000</b>	<b>Equity indices €'000</b>	<b>Equity portfolio €'000</b>	<b>Other<sup>(1)</sup> €'000</b>	<b>Total €'000</b>
Certificates and warrants	1,820,496	13,016	363,591	-	2,197,103
Notes	643,469	2,573,278	988,971	937,780	5,143,498
Total debt and other borrowings	<u>2,463,965</u>	<u>2,586,294</u>	<u>1,352,562</u>	<u>937,780</u>	<u>7,340,601</u>

(1) Other includes Structured Notes that have coupon or repayment terms linked to the performance of funds, debt securities, currencies or commodities.

The majority of the Company's financial liabilities designated at FVPL provide exposure to an underlying single name equity, an equity index or portfolio of equities. The prepaid equity securities contracts, derivative contracts and loans held at FVPL that the Company enters into in order to hedge the Structured Notes are valued as detailed in note 3(d) and note 21(a) and have similar valuation inputs to the liabilities they hedge.

**11. CONVERTIBLE PREFERRED EQUITY CERTIFICATES**

On 30 March 2012, the Company issued 11,252,813 of CPECs of €100 each, classified as financial liabilities at amortised cost. The CPECs were issued to one of the Company's shareholders, Archimedes Investments Coöperatieve U.A. (a Morgan Stanley Group undertaking), in exchange for cash consideration of €1,125,281,000.

The CPECs carry no voting rights. The Company and the holder have the right to convert each issued CPEC into one ordinary share with a nominal value of €100.

On 27 February 2018, the maturity date of the CPECs was amended from 150 years to 49 years from the date of issuance. The CPECs may be redeemed earlier at the option of the Company or on liquidation of the Company.

The CPECs rank ahead of the ordinary shares in the event of liquidation.

The holder of the CPECs is entitled to receive an annual yield on a date agreed by the Company and the holder. The yield for each CPEC is calculated as income deriving from the Company's activities less the necessary amounts to cover the costs of the Company divided by the number of CPECs then in issue. Other income relating to management charges received from other Morgan Stanley Group undertakings and gains or losses from financial instruments designated or mandatorily at fair value through profit or loss are excluded from the calculation.

# MORGAN STANLEY B.V.

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

### 11. CONVERTIBLE PREFERRED EQUITY CERTIFICATES (CONTINUED)

On 29 March 2018, the Company paid the accrued yield of €54,313,000 to the holders of the CPECs. An accrued yield for the year ended 31 December 2018 of €12,591,000 has been recognised in the statement of comprehensive income in 'Interest expense' (2017: €4,490,000). The liability to the holders of the CPECs at 31 December 2018, recognised within 'Trade and other payables,' is €9,669,000 (31 December 2017: €51,391,000).

Additional costs of €756,000 included within 'Net foreign exchange losses' in 'Other expense' in the 2016 financial statements are taken into account when calculating the annual yield payable to the holder of CPECs for 2017.

### 12. TRADE AND OTHER RECEIVABLES

	2018 €'000	2017 €'000
<b>Trade and other receivables (amortised cost) <sup>(1)</sup></b>		
Trade receivables:		
Amounts due from other Morgan Stanley Group undertakings	186,506	25,724
Other receivables:		
Amounts due from other Morgan Stanley Group undertakings	1,165,764	1,792,304
Less: ECL allowance	(4)	-
	<u>1,165,760</u>	<u>1,792,304</u>
Total trade and other receivables (amortised cost)	<u>1,352,266</u>	<u>1,818,028</u>
<b>Trade and other receivables (non-trading at FVPL)</b>		
Prepaid equity securities contracts	82,083	-
<b>Financial assets designated at FVPL</b>		
Prepaid equity securities contracts	-	268,210
	<u>1,434,349</u>	<u>2,086,238</u>

(1) In 2017 Trade and other receivables at amortised cost were classified as 'Loans and receivables' under IAS 39.

### 13. TRADE AND OTHER PAYABLES

	2018 €'000	2017 €'000
<b>Trade and other payables (amortised cost)</b>		
Trade payables:		
Amounts due to other Morgan Stanley Group undertakings	20,229	600,127
Other payables:		
Amounts due to other Morgan Stanley Group undertakings	168,149	56,382
	<u>188,378</u>	<u>656,509</u>

# MORGAN STANLEY B.V.

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

### 14. DEBT AND OTHER BORROWINGS

	<b>2018</b> <b>€'000</b>	<b>2017</b> <b>€'000</b>
Issued Structured Notes	7,388,052	7,340,601
<b>Debt and other borrowings (designated at FVPL)</b>	<b>7,388,052</b>	<b>7,340,601</b>

Refer to note 10 for details of issued Structured Notes included within debt and other borrowings designated at FVPL.

### 15. EQUITY

#### Ordinary share capital

	<b>Ordinary shares of €100 each €'000</b>
<b>Issued and fully paid</b>	
At 1 January 2017, 31 December 2017 and 31 December 2018	<u>15,018</u>

On 9 December 2013 the Articles of Association of the Company were amended whereby the concept of authorised share capital was abolished. Each share confers the right to cast one vote, provided that subject to mandatory law, all resolutions of the General Meeting shall be adopted by unanimous vote in a meeting in which the entire share capital is present or represented.

The holders of ordinary shares are entitled to receive dividends as declared from time to time.

#### Reserves

The Company uses the contracts that it purchases from other Morgan Stanley Group undertakings to hedge the market price, interest rate, foreign currency and other market risks associated with the issuance of the Structured Notes, consistent with the Company's risk management strategy. Both the contracts and the Structured Note issuances are valued at fair value through profit or loss and no net cumulative gain or loss is expected to be realised over the life of the financial instrument contracts. Therefore, a legal revaluation reserve under Part 9, Book 2 of the Dutch Civil Code (BW2, article 390(1)) is not necessary.

#### Appropriation of the net result for the year

The statement of financial position is presented after the proposed appropriation of net result for the year ended 31 December 2018. The Directors propose to add the profit to retained earnings as part of the equity shareholders' funds.

# MORGAN STANLEY B.V.

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

### 16. ADDITIONAL CASH FLOW INFORMATION

#### 16.1. Cash and cash equivalents

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

	2018 €'000	2017 €'000
Cash and short-term deposits	903	432
	<u>903</u>	<u>432</u>

#### 16.2. Reconciliation of cash flows from operating activities

	2018 €'000	2017 €'000
Profit for the year	900	1,547
<i>Adjustments for:</i>		
Impairment loss on financial instruments	(4)	-
Interest income	(12,036)	(11,843)
Interest expense	12,289	4,511
Income tax expense	290	513
Operating cash flows before changes in operating assets and liabilities	<u>1,439</u>	<u>(5,272)</u>
Changes in operating assets		
Decrease/ (increase) in trading financial assets	321,713	(2,800)
Decrease/ (increase) in loans and advances	(986,267)	104,545
Decrease/ (increase) in trade and other receivables	609,560	(372)
	<u>(54,994)</u>	<u>101,373</u>
Changes in operating liabilities		
Increase/ (decrease) in trading financial liabilities	432,502	(194,651)
(Decrease)/ increase in trade and other payables	(426,106)	113,042
(Decrease)/ increase in debt and other borrowings	47,451	(11,425)
	<u>53,847</u>	<u>(93,034)</u>
Interest received	48	43
Interest paid	(1)	(282)
Income taxes paid	132	(3,112)
<b>Net cash flows from operating activities</b>	<u>471</u>	<u>(284)</u>

# MORGAN STANLEY B.V.

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

### 17. EXPECTED MATURITY OF ASSETS AND LIABILITIES

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

#### At 31 December 2018

	Less than or equal to twelve months €'000	More than twelve months €'000	Total €'000
<b>ASSETS</b>			
Cash and short-term deposits	903	-	903
Trading financial assets	163,013	108,253	271,266
Loans and advances	3,088,162	4,695,470	7,783,632
Trade and other receivables	309,068	1,125,281	1,434,349
Current tax assets	4,389	-	4,389
	<u>3,565,535</u>	<u>5,929,004</u>	<u>9,494,539</u>
<b>LIABILITIES</b>			
Trading financial liabilities	347,053	405,100	752,153
Convertible preferred equity certificates	-	1,125,281	1,125,281
Trade and other payables	188,378	-	188,378
Debt and other borrowings	2,989,429	4,398,623	7,388,052
	<u>3,524,860</u>	<u>5,929,004</u>	<u>9,453,864</u>

#### At 31 December 2017

	Less than or equal to twelve months €'000	More than twelve months €'000	Total €'000
<b>ASSETS</b>			
Cash and short-term deposits	432	-	432
Trading financial assets	332,896	260,083	592,979
Loans and advances	2,849,506	3,947,859	6,797,365
Trade and other receivables	1,931,560	154,678	2,086,238
Current tax assets	4,811	-	4,811
	<u>5,119,205</u>	<u>4,362,620</u>	<u>9,481,825</u>
<b>LIABILITIES</b>			
Trading financial liabilities	204,265	115,386	319,651
Convertible preferred equity certificates	-	1,125,281	1,125,281
Trade and other payables	656,509	-	656,509
Debt and other borrowings	3,093,367	4,247,234	7,340,601
	<u>3,954,141</u>	<u>5,487,901</u>	<u>9,442,042</u>

# MORGAN STANLEY B.V.

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

### 18. SEGMENT REPORTING

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

#### Business segments

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

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

#### Geographical segments

The Company operates in three geographic regions as listed below:

- Europe, Middle East and Africa ("EMEA")
- Americas
- Asia

The following table presents selected statement of comprehensive income and statement of financial position information of the Company's operations by geographic area. The external revenues (net of interest expense) and total assets disclosed in the following table reflect the regional view of the Company's operations, on a managed basis. The basis for attributing external revenues (net of interest expense) and total assets is determined by trading desk location.

	EMEA		Americas		Asia		Total	
	2018	2017	2018	2017	2018	2017	2018	2017
	€'000	€'000	€'000	€'000	€'000	€'000	€'000	€'000
External revenues net of interest	875	8,353	374	142	120	141	1,369	8,636
Profit before income tax	696	1,777	374	142	120	141	1,190	2,060
Total assets	4,892,850	6,184,767	3,470,628	2,134,732	1,131,061	1,162,326	9,494,539	9,481,825

Of the Company's external revenue, 100% (2017: 100%) arises from transactions with other Morgan Stanley Group undertakings. Further details of such transactions are disclosed in the related party disclosures in note 24.

# MORGAN STANLEY B.V.

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

### 19. FINANCIAL RISK MANAGEMENT

#### **Risk management procedures**

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

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

#### **Credit risk**

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

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

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

#### *Collateral and other credit enhancements*

The Company has entered into collateral arrangements with other Morgan Stanley Group undertakings to mitigate credit risk. Collateral held is managed in accordance with the Morgan Stanley Group's guidelines and the relevant underlying agreements.

#### *Exposure to credit risk*

The maximum exposure to credit risk ("gross credit exposure") of the Company as at 31 December 2018 is the carrying amount of the financial assets held in the statement of financial position. Within the table below, financial instruments subject to accounting ECL are distinguished from those that are not. Those financial instruments that bear credit risk but are not subject to ECL are subsequently measured at fair value. This table does not include receivables arising from pending securities transactions with market counterparties as credit risk is considered insignificant. Where the Company enters into credit enhancements, including receiving cash as collateral and master netting agreements, to manage the credit exposure on these financial instruments, the financial effect of the credit enhancements is also disclosed below. The net credit exposure represents the credit exposure remaining after the effect of the credit enhancements.

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

# MORGAN STANLEY B.V.

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

### 19. FINANCIAL RISK MANAGEMENT (CONTINUED)

#### Credit risk (continued)

Exposure to credit risk by class

31 December 2018

	Gross credit exposure <sup>(1)</sup> €'000	Credit enhancements €'000	Net credit exposure <sup>(2)</sup> €'000
<b>Subject to ECL:</b>			
Cash and short-term deposits	903	-	903
Trade and other receivables <sup>(4)</sup>	1,352,266	-	1,352,266
<b>Not subject to ECL<sup>(3)</sup>:</b>			
Trading financial assets			
Derivatives	271,266	(238,097)	33,169
Loans and advances	7,783,632	-	7,783,632
Trade and other receivables <sup>(4)</sup> :			
Prepaid equity securities contracts	82,083	(82,083)	-
	9,490,150	(320,180)	9,169,970

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

(2) Of the residual net credit exposure, intercompany cross product netting arrangements are in place which would allow for an additional €nil to be offset in the event of default by certain Morgan Stanley counterparties.

(3) Financial assets measured at FVPL are not subject to ECL.

(4) Trade and other receivables include net cash collateral pledged of €172,489,000 against derivatives classified as trading financial assets/liabilities and prepaid equity securities contracts. In 2017, cash collateral received of €575,669,000 was recognised in trade and other payables in the statement of financial position. Cash collateral is determined and settled on a net basis.

Maximum exposure to credit risk for 2017 is presented below:

31 December 2017

	Gross credit exposure <sup>(1)</sup> €'000	Credit enhancements €'000	Net credit exposure <sup>(2)</sup> €'000
Cash and short-term deposits	432	-	432
Trade and other receivables	2,086,238	(268,210)	1,818,028
Loans and advances	6,797,365	-	6,797,365
Trading financial assets:			
Derivatives	592,979	(565,399)	27,580
	9,477,014	(833,609)	8,643,405

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

(2) Of the residual net credit exposure, intercompany cross product netting arrangements are in place which would allow for an additional €nil to be offset in the event of default by certain Morgan Stanley counterparties.

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

**19. FINANCIAL RISK MANAGEMENT (CONTINUED)**

**Credit risk (continued)**

*ECL measurement*

a. Assessment of SICR

As explained in note 3(f), in order to assess whether an instrument is subject to a 12 month ECL or to a lifetime ECL and therefore its appropriate staging, the Company determines whether there has been a SICR since initial recognition.

When making this assessment, the Company considers both quantitative and qualitative information and analysis based on the Company's historical experience and expert credit risk assessment, including forward-looking information.

Credit risk is considered to have increased significantly if the probability of default ("PD") has significantly deteriorated at the reporting date relative to the PD of the facility at the date of initial recognition. The PD is derived from internal credit rating grades (based on available information about the borrower) and multiple forward-looking macroeconomic scenarios which are probability weighted.

The assessment of whether a change in PD is "significant" is based both on a consideration of the relative change in PD and on qualitative indicators of the credit risk of the facility, which indicate whether a loan is performing or in difficulty. In addition, as a backstop, the Company considers that SICR has occurred in all cases when an asset is more than 30 DPD.

b. Calculation of ECL

ECL are calculated using three main components:

- PD: for accounting purposes, the 12 month and lifetime PD represent the expected point-in-time probability of a default over the next 12 months and over the remaining lifetime of the financial instrument respectively, based on conditions existing at the balance sheet date and future economic conditions.
- Loss given default ("LGD"): the LGD represents expected loss conditional on default, taking into account the mitigating effect of collateral, including the expected value of the collateral when realised and the time value of money.
- Exposure at default ("EAD"): this represents the expected EAD, taking into account the expected repayment of principal and interest from the balance sheet date to the default event together with any expected drawdowns of the facility over that period.

These parameters are generally derived from internally developed statistical models, incorporating historical, current and forward-looking macro-economic data.

The 12 month ECL is equal to the sum over the next 12 months of quarterly PD multiplied by LGD and EAD, with such expected losses being discounted at the EIR. Lifetime ECL is calculated using the discounted present value of total quarterly PDs multiplied by LGD and EAD, over the full remaining life of the facility.

c. Incorporation of forward looking information

The Company uses internal macro-economic research and country risk expert judgement to support the calculation of ECL. The macro-economic scenarios are reviewed quarterly.

There have been no changes made to estimation techniques or significant assumptions for estimating impairment, during the year.

# MORGAN STANLEY B.V.

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

### 19. FINANCIAL RISK MANAGEMENT (CONTINUED)

#### Credit risk (continued)

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

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

##### *a. Recognised financial instruments subject to ECL*

The following table provides an analysis of the credit risk exposure by ECL stage per class of recognised financial instrument subject to ECL, based on the following internal credit rating grades:

Investment grade: internal grades AAA - BBB

Non-investment grade: internal grades BB - CCC

Default: internal grades D

31 December 2018

	ECL staging	
	Stage 1 12-month ECL €'000	Stage 2 Lifetime ECL €'000
<i>External financial institutions:</i>		
<b>Cash:</b>		
<b>Credit grade</b>		
Investment grade	903	-
	903	-
<i>Other Morgan Stanley Group undertaking:</i>		
<b>Trade and other receivables: <sup>(1)</sup></b>		
<b>Credit grade</b>		
Investment grade gross carrying amount	-	1,352,270
Loss allowance	-	(4)
Carrying amount	-	1,352,266

(1) There are no trade receivables at stage 1, as the Company's accounting policy is to measure lifetime credit losses on trade receivables under the simplified approach.

At 31 December 2018 there were no financial assets past due but not impaired or individually impaired (31 December 2017: nil).

##### *b. Recognised financial instruments not subject to ECL*

The following table sets out the credit quality of financial assets measured at FVPL.

##### *Maximum exposure to credit risk by credit rating<sup>(1)</sup>*

Credit rating	Gross credit exposure	
	2018 €'000	2017 €'000
<i>Other Morgan Stanley Group undertakings</i>		
A	240,865	7,108,534
BBB	7,896,116	550,020
Total	8,136,981	7,658,554

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

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

**19. FINANCIAL RISK MANAGEMENT (CONTINUED)**

**Liquidity risk**

Liquidity risk refers to the risk that the Company will be unable to finance its operations due to a loss of access to the capital markets or difficulty in liquidating its assets. Liquidity risk encompasses the risk that the Company's ability (or perceived ability) to meet its financial obligations without experiencing significant business disruption or reputational damage that may threaten the Company's viability as a going concern. Liquidity risk also encompasses the associated funding risks triggered by the market or idiosyncratic stress events that may cause unexpected changes in funding needs or an inability to raise new funding. Generally, the Company incurs liquidity risk as a result of its trading, lending, investing and client facilitation activities.

The Morgan Stanley Group's Liquidity Risk Management Framework is critical to helping ensure that the Company maintains sufficient liquidity reserves and durable funding sources to meet its daily obligations and to withstand unanticipated stress events. The Liquidity Risk Department is a distinct area in Risk Management, which oversees and monitors liquidity risk. The Liquidity Risk Department ensures transparency of material liquidity risks, compliance with established risk limits and escalation of risk concentrations to appropriate senior management. To execute these responsibilities, the Liquidity Risk Department:

- Establishes limits in line with the Morgan Stanley Group's risk appetite;
- Identifies and analyses emerging liquidity risks to ensure such risks are appropriately mitigated;
- Monitors and reports risk exposures against metrics and limits, and;
- Reviews the methodologies and assumptions underpinning the Morgan Stanley Group's Liquidity Stress Tests to ensure sufficient liquidity and funding under a range of adverse scenarios.

The liquidity risks identified by these processes are summarised in reports produced by the Liquidity Risk Department that are circulated to and discussed with senior management, as appropriate.

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

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

The primary goal of the Company's liquidity risk management framework is to ensure that the Company has access to adequate funding across a wide range of market conditions and time horizons. The framework is designed to enable the Company to fulfil its financial obligations and support the execution of its business strategies.

The following principles guide the Company's liquidity risk management framework:

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

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

**19. FINANCIAL RISK MANAGEMENT (CONTINUED)**

**Liquidity risk (continued)**

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

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

*Required Liquidity Framework*

The Required Liquidity Framework establishes the amount of liquidity the Company must hold in both normal and stressed environments to ensure that its financial condition and overall soundness is not adversely affected by an inability (or perceived inability) to meet its financial obligations in a timely manner. The Required Liquidity Framework considers the most constraining liquidity requirement to satisfy all regulatory and internal limits at a Morgan Stanley Group and legal entity level.

*Liquidity Stress Tests*

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

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

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

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

# MORGAN STANLEY B.V.

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

### 19. FINANCIAL RISK MANAGEMENT (CONTINUED)

#### Liquidity risk (continued)

##### *Global Liquidity Reserve*

The Morgan Stanley Group maintains sufficient liquidity reserves (“the Global Liquidity Reserve”) to cover daily funding needs and to meet strategic liquidity targets sized by the Required Liquidity Framework and Liquidity Stress Tests. The size of the Global Liquidity Reserve is actively managed by the Morgan Stanley Group considering the following components: unsecured debt maturity profile; balance sheet size and composition; funding needs in a stressed environment inclusive of contingent cash outflows; and collateral requirements. In addition, the Morgan Stanley Group’s Global Liquidity Reserve includes a discretionary surplus based on the Morgan Stanley Group’s risk tolerance and is subject to change depending on market and firm-specific events. The Global Liquidity Reserve consists of cash and unencumbered securities sourced from trading assets, investment securities and securities received as collateral.

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

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

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

##### *Funding management*

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

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

##### *Balance sheet management*

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

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

**19. FINANCIAL RISK MANAGEMENT (CONTINUED)**

**Liquidity risk (continued)**

*Maturity analysis*

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

	On demand €'000	Less than one year €'000	Equal to or more than one year but less than two years €'000	Equal to or more than two years but less than five years €'000	Equal to or more than five years €'000	Total €'000
<b>31 December 2018</b>						
<b>Financial assets</b>						
Cash and short-term deposits	903	-	-	-	-	903
Trading financial assets:						
Derivatives	85,766	80,671	18,328	46,112	40,389	271,266
Loans and advances:						
Loans	574,322	2,612,638	769,402	1,933,928	1,893,342	7,783,632
Trade and other receivables:						
Trade receivables	186,506	-	-	-	-	186,506
Other receivables	1,165,760	-	-	-	-	1,165,760
Prepaid equity securities contracts	82,083	-	-	-	-	82,083
<b>Total financial assets</b>	<b>2,095,340</b>	<b>2,693,309</b>	<b>787,730</b>	<b>1,980,040</b>	<b>1,933,731</b>	<b>9,490,150</b>
<b>Financial liabilities</b>						
Trading financial liabilities:						
Derivatives	72,785	291,118	68,697	164,610	154,943	752,153
Convertible preferred equity certificates	1,125,281	-	-	-	-	1,125,281
Trade and other payables:						
Trade payables	20,229	-	-	-	-	20,229
Other payables	168,149	-	-	-	-	168,149
Debt and other borrowings:						
Issued Structured Notes	672,610	2,402,191	719,033	1,815,430	1,778,788	7,388,052
<b>Total financial liabilities</b>	<b>2,059,054</b>	<b>2,693,309</b>	<b>787,730</b>	<b>1,980,040</b>	<b>1,933,731</b>	<b>9,453,864</b>

**MORGAN STANLEY B.V.**

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

**19. FINANCIAL RISK MANAGEMENT (CONTINUED)**

**Liquidity risk (continued)**

*Maturity analysis (continued)*

	On demand €'000	Less than one year €'000	Equal to or more than one year but less than two years €'000	Equal to or more than two years but less than five years €'000	Equal to or more than five years €'000	Total €'000
<b>31 December 2017</b>						
<b>Financial assets</b>						
Cash and short-term deposits	432	-	-	-	-	432
Trading financial assets:						
Derivatives	318,742	67,235	53,895	89,405	63,702	592,979
Loans and advances:						
Loans	1,853,180	1,171,057	554,268	1,748,583	1,470,277	6,797,365
Trade and other receivables:						
Trade receivables	25,724	-	-	-	-	25,724
Other receivables	1,792,304	-	-	-	-	1,792,304
Prepaid equity securities contracts	42,688	113,034	-	112,488	-	268,210
<b>Total financial assets</b>	<b>4,033,070</b>	<b>1,351,326</b>	<b>608,163</b>	<b>1,950,476</b>	<b>1,533,979</b>	<b>9,477,014</b>
<b>Financial liabilities</b>						
Trading financial liabilities:						
Derivatives	169,944	37,513	12,506	39,951	59,737	319,651
Convertible preferred equity certificates	1,125,281	-	-	-	-	1,125,281
Trade payables and other payables:						
Trade payables	600,127	-	-	-	-	600,127
Other payables	56,382	-	-	-	-	56,382
Debt and other borrowings:						
Issued Structured Notes	2,046,364	1,313,813	595,657	1,910,525	1,474,242	7,340,601
<b>Total financial liabilities</b>	<b>3,998,098</b>	<b>1,351,326</b>	<b>608,163</b>	<b>1,950,476</b>	<b>1,533,979</b>	<b>9,442,042</b>

# MORGAN STANLEY B.V.

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

### 19. FINANCIAL RISK MANAGEMENT (CONTINUED)

#### Market risk

Market risk is defined by IFRS 7 '*Financial Instruments – Disclosures*' as the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices.

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

To execute these responsibilities, the Morgan Stanley Group monitors the market risk of the firm against limits on aggregate risk exposures, performs a variety of risk analyses, including monitoring Value-at-risk ("VaR") and stress testing analyses, routinely reports risk summaries and maintains the VaR and scenario analysis methodologies. The Company is managed within the Morgan Stanley Group's global framework. The market risk management policies and procedures of the Company include performing risk analyses and reporting material risks identified to appropriate senior management of the Company.

#### *Equity price sensitivity analysis*

The sensitivity analysis below is determined based on the exposure to equity price risk at 31 December 2018 and 31 December 2017 respectively.

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

	Impact on Total Comprehensive Income Gains/(Losses)	
	2018	2017
	€'000	€'000
Trading financial instruments	(730,598)	(707,239)
Trade and other receivables – at FVPL	(8,208)	(26,821)
Debt and other borrowings	738,806	734,060
	<u>-</u>	<u>-</u>

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

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

The issued Structured Notes expose the Company to the risk of changes in market prices of the underlying securities, interest rate risk and, where denominated in currencies other than Euros, the risk of changes in rates of exchange between the Euro and the other relevant currencies. The Company uses the contracts that it purchases from other Morgan Stanley Group undertakings to hedge the market price, interest rate and foreign currency risks associated with the issuance of the Structured Notes, consistent with the Company's risk management strategy. As such, the Company is not exposed to any net market risk on these financial instruments.

The net foreign exchange gains recognised in 'Other income' have arisen as a result of exposure to hedging on assets and liabilities recognised for Morgan Stanley Group purposes, under the Morgan Stanley Group's local reporting requirements.

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

**20. FINANCIAL ASSETS AND FINANCIAL LIABILITIES SUBJECT TO OFFSETTING**

In order to manage credit exposure arising from its business activities, the Company applies various credit risk management policies and procedures, see note 19 for further details. Primarily in connection with derivative contracts, prepaid equity securities contracts and issued Structured Notes, the Company enters into master netting arrangements and collateral arrangements with its counterparties. These agreements provide the Company with the right, in the ordinary course of business and/ or in the event of a counterparty default (such as bankruptcy or a counterparty's failure to pay or perform), to net a counterparty's rights and obligations under such agreement and, in the event of counterparty default, set off collateral held by the Company against the net amount owed by the counterparty. However, in certain circumstances, the Company may not have such an agreement in place; the relevant insolvency regime (which is based on type of counterparty entity and the jurisdiction of organisation of the counterparty) may not support the enforceability of the agreement; or the Company may not have sought legal advice to support the enforceability of the agreement. In cases where the Company has not determined an agreement to be enforceable, the related amounts are not offset in the tabular disclosures.

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

The following tables present information about the offsetting of financial instruments and related collateral amounts. The effect of master netting arrangements, collateral agreements and other credit enhancements on the Company's exposure to credit risk is disclosed in note 19.

NOTES TO THE FINANCIAL STATEMENTS  
Year ended 31 December 2018

20. FINANCIAL ASSETS AND FINANCIAL LIABILITIES SUBJECT TO OFFSETTING  
(CONTINUED)

	Gross and net amounts presented in the statement of financial position <sup>(1)</sup>	Amounts not offset in the statement of financial position <sup>(2) (4)</sup>		Net exposure <sup>(5)</sup>
		Financial instruments	Cash collateral <sup>(3)</sup>	
	€'000	€'000	€'000	€'000
<b>31 December 2018</b>				
<b>Assets</b>				
Trading financial assets:				
Derivatives	271,266	(1,384)	(236,713)	33,169
Trade and other receivables:				
Prepaid equity securities contracts	82,083	-	(82,083)	-
<b>TOTAL</b>	<b>353,349</b>	<b>(1,384)</b>	<b>(318,796)</b>	<b>33,169</b>
<b>Liabilities</b>				
Trading financial liabilities:				
Derivatives	752,153	(1,384)	(482,751)	268,018
Debt and other borrowings:				
Issued Structured Notes	7,388,052	-	-	7,388,052
<b>TOTAL</b>	<b>8,140,205</b>	<b>(1,384)</b>	<b>(482,751)</b>	<b>7,656,070</b>

- (1) Amounts include €28,483,000 of trading financial assets – derivatives, €nil of trade and other receivables – prepaid equity securities contracts, €238,501,000 of trading financial liabilities – derivatives and €6,973,725,000 of debt and other borrowings – issued Structured Notes which are either not subject to master netting agreements or collateral agreements or are subject to such agreements but the Company has not determined the agreements to be legally enforceable.
- (2) Amounts relate to master netting arrangements and collateral arrangements which have been determined by the Company to be legally enforceable, but do not meet all criteria required for net presentation within the statement of financial position.
- (3) Cash collateral used to mitigate credit risk on exposures arising under derivatives contracts and prepaid equity securities contracts is determined and settled on a net basis and has been recognised in the statement of financial position within 'Trade and other receivables'.
- (4) In addition to the balances disclosed in the table above, certain 'Trade and other receivables' and 'Trade and other payables' of €9,595,000 not presented net within the statement of financial position have legally enforceable master netting agreements in place and can be offset in the ordinary course of business and/ or in the event of default.
- (5) Of the residual net exposure, intercompany cross-product legally enforceable netting arrangements are in place which would allow for an additional €nil to be offset in the ordinary course of business and/ or in the event of default.

NOTES TO THE FINANCIAL STATEMENTS  
Year ended 31 December 2018

20. FINANCIAL ASSETS AND FINANCIAL LIABILITIES SUBJECT TO OFFSETTING  
(CONTINUED)

	Gross and net amounts presented in the statement of financial position <sup>(1)</sup> €'000	Amounts not offset in the statement of financial position <sup>(2)(4)</sup>		Net exposure <sup>(5)</sup> €'000
		Financial instruments €'000	Cash collateral <sup>(3)</sup> €'000	
<b>31 December 2017</b>				
<b>Assets</b>				
Trading financial assets:				
Derivatives	592,979	(11,447)	(553,952)	27,580
Trade and other receivables:				
Prepaid equity securities contracts	268,210	-	(268,210)	-
<b>TOTAL</b>	<b>861,189</b>	<b>(11,447)</b>	<b>(822,162)</b>	<b>27,580</b>
<b>Liabilities</b>				
Trading financial liabilities:				
Derivatives	319,651	(11,447)	(251,558)	56,646
Debt and other borrowings:				
Issued Structured Notes	7,340,601	-	-	7,340,601
<b>TOTAL</b>	<b>7,660,252</b>	<b>(11,447)</b>	<b>(251,558)</b>	<b>7,397,247</b>

- (1) Amounts include €27,580,000 of trading financial assets – derivatives, €nil of trade and other receivables – prepaid equity securities contracts, €34,108,000 of trading financial liabilities – derivatives and €6,229,321,000 of debt and other borrowings – issued Structured Notes which are either not subject to master netting agreements or collateral agreements or are subject to such agreements but the Company has not determined the agreements to be legally enforceable.
- (2) Amounts relate to master netting arrangements and collateral arrangements which have been determined by the Company to be legally enforceable but do not meet all criteria required for net presentation within the statement of financial position.
- (3) Cash collateral used to mitigate credit risk on exposures arising under derivative contracts and prepaid equity securities contracts is determined and settled on a net basis and has been recognised in the statement of financial position within 'Trade and other payables'.
- (4) In addition to the balances disclosed in the table above, certain 'Trade and other receivables' and 'Trade and other payables' of €22,280,000 not presented net within the statement of financial position have legally enforceable master netting agreements in place and can be offset in the ordinary course of business and/ or in the event of default.
- (5) Of the residual net exposure, intercompany cross-product legally enforceable netting arrangements are in place which would allow for an additional €nil to be offset in the ordinary course of business and/ or in the event of default.

**MORGAN STANLEY B.V.**

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

**21. ASSETS AND LIABILITIES MEASURED AT FAIR VALUE**

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

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

**31 December 2018**

	<b>Quoted prices in active market (Level 1) €'000</b>	<b>Valuation techniques using observable inputs (Level 2) €'000</b>	<b>Valuation techniques with significant unobservable inputs (Level 3) €'000</b>	<b>Total €'000</b>
<b>Trading financial assets:</b>				
Derivatives				
Interest rate contracts	-	989	15,533	16,522
Equity contracts	-	231,965	21,586	253,551
Foreign exchange contracts	-	1	-	1
Commodity contracts	-	241	951	1,192
<b>Total trading financial assets</b>	<b>-</b>	<b>233,196</b>	<b>38,070</b>	<b>271,266</b>
<b>Trade and other receivables:</b>				
Prepaid equity securities contracts	-	18,331	63,752	82,083
<b>Loans and advances:</b>				
Loans	-	7,783,632	-	7,783,632
<b>Total financial assets measured at fair value</b>	<b>-</b>	<b>8,035,159</b>	<b>101,822</b>	<b>8,136,981</b>
<b>Trading financial liabilities:</b>				
Derivatives				
Interest rate contracts	-	37,953	21,501	59,454
Equity contracts	-	570,523	115,826	686,349
Foreign exchange contracts	-	1,540	-	1,540
Commodity contracts	-	359	4,451	4,810
<b>Total trading financial liabilities</b>	<b>-</b>	<b>610,375</b>	<b>141,778</b>	<b>752,153</b>
<b>Debt and other borrowings:</b>				
Certificates and warrants	-	630,988	70,883	701,871
Notes	-	6,227,559	458,622	6,686,181
<b>Total debt and other borrowings</b>	<b>-</b>	<b>6,858,547</b>	<b>529,505</b>	<b>7,388,052</b>
<b>Total financial liabilities measured at fair value</b>	<b>-</b>	<b>7,468,922</b>	<b>671,283</b>	<b>8,140,205</b>

**MORGAN STANLEY B.V.**

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

**21. ASSETS AND LIABILITIES MEASURED AT FAIR VALUE (CONTINUED)**

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

31 December 2017

	Quoted prices in active market (Level 1) €'000	Valuation techniques using observable inputs (Level 2) €'000	Valuation techniques with significant unobservable inputs (Level 3) €'000	Total €'000
Trading financial assets:				
Derivatives				
Interest rate contracts	-	3,168	22,370	25,538
Equity contracts	-	551,198	13,759	564,957
Foreign exchange contracts	-	76	1,607	1,683
Commodities contracts	-	539	262	801
<b>Total trading financial assets</b>	<b>-</b>	<b>554,981</b>	<b>37,998</b>	<b>592,979</b>
Loans and advances:				
Loans	-	6,797,365	-	6,797,365
Trade and other receivables:				
Prepaid equity securities contracts	-	268,210	-	268,210
<b>Total financial assets measured at fair value</b>	<b>-</b>	<b>7,620,556</b>	<b>37,998</b>	<b>7,658,554</b>
Trading financial liabilities				
Derivatives:				
Interest rate contracts	-	38,009	6,757	44,766
Equity contracts	-	243,537	23,429	266,966
Foreign exchange contracts	-	3,400	1,533	4,933
Commodities contracts	-	1,050	1,936	2,986
<b>Total trading financial liabilities</b>	<b>-</b>	<b>285,996</b>	<b>33,655</b>	<b>319,651</b>
Debt and other borrowings:				
Certificates and warrants	-	2,197,103	-	2,197,103
Notes	-	4,779,994	363,504	5,143,498
<b>Total debt and other borrowings</b>	<b>-</b>	<b>6,977,097</b>	<b>363,504</b>	<b>7,340,601</b>
<b>Total financial liabilities measured at fair value</b>	<b>-</b>	<b>7,263,093</b>	<b>397,159</b>	<b>7,660,252</b>

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

**21. ASSETS AND LIABILITIES MEASURED AT FAIR VALUE (CONTINUED)**

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

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

<b>Derivatives</b>	
<b>Asset and Liability / Valuation Technique</b>	<b>Valuation Hierarchy Classification</b>
<i>Derivatives</i>	
<p><i>OTC Derivative Contracts</i></p> <ul style="list-style-type: none"> <li>• OTC derivative contracts include forward, swap and option contracts related to interest rates, foreign currencies, credit standing of reference entities, equity prices or commodity prices.</li> <li>• Depending on the product and the terms of the transaction, the fair value of OTC derivative products can be modeled using a series of techniques, including closed-form analytic formulas, such as the Black-Scholes option-pricing model, simulation models or a combination thereof. Many pricing models do not entail material subjectivity as the methodologies employed do not necessitate significant judgment, since model inputs may be observed from actively quoted markets, as is the case for generic interest rate swaps, many equity, commodity and foreign currency option contracts, and certain CDSs. In the case of more established derivative products, the pricing models used by the Company are widely accepted by the financial services industry.</li> <li>• More complex OTC derivative products are typically less liquid and require more judgment in the implementation of the valuation technique since direct trading activity or quotes are unobservable. This includes certain types of interest rate derivatives with both volatility and correlation exposure, equity, commodity or foreign currency derivatives that are either longer-dated or include exposure to multiple underlyings, and credit derivatives, including CDSs on certain mortgage- or asset-backed securities and basket CDSs. Where required these inputs are unobservable, relationships to observable data points, based on historical and/ or implied observations, may be employed as a technique to estimate the model input values.</li> </ul>	<ul style="list-style-type: none"> <li>• Generally Level 2 - OTC derivative products valued using observable inputs, or where the unobservable input is not deemed significant.</li> <li>• Level 3 - OTC derivative products for which the unobservable input is deemed significant</li> </ul>
<b>Prepaid OTC contracts and issued Structured Notes</b>	
<p><i>Prepaid equity securities contracts and issued Structured Notes designated at fair value through profit or loss</i></p> <ul style="list-style-type: none"> <li>• The Company issues Structured Notes and trades prepaid OTC contracts which are primarily composed of instruments whose payments and redemption values are linked to the performance of a specific index, a basket of stocks, a specific security, a commodity, a credit exposure or basket of credit exposures, and instruments with various interest-rate-related features including step-ups, step-downs, and zero coupons.</li> <li>• Fair value of Structured Notes and traded prepaid equity securities contracts is determined using valuation models for the derivative and debt portions of the Structured Notes and traded prepaid equity securities contracts. These models incorporate observable inputs referencing identical or comparable securities, including prices to which the notes are linked, interest rate yield curves, option volatility and currency rates, and commodity or equity prices.</li> <li>• Independent, external and traded prices for the notes are considered as well as the impact of the Company's own credit spreads which are based on observed secondary bond market spreads.</li> </ul>	<ul style="list-style-type: none"> <li>• Generally Level 2</li> <li>• Level 3 - in instances where the unobservable inputs are deemed significant</li> </ul>

# MORGAN STANLEY B.V.

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

### 21. ASSETS AND LIABILITIES MEASURED AT FAIR VALUE (CONTINUED)

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

##### Prepaid OTC contracts and issued structured notes (continued)

<p><i>Notes</i></p> <ul style="list-style-type: none"> <li>Notes give a risk exposure tailored to market views and risk appetite and mainly provide exposure to the underlying single name equity, equity index or portfolio of equities. Typically, the redemption payment of the note is significantly dependent on the value of embedded equity derivatives. In general, call and put options, digital options, straddles and callability features are combined to create a bespoke coupon rate or redemption payoff for each note issuance, with risk exposure to one or more equity underlyings or indices. The Company values the embedded derivatives using market standard models, which are assessed for appropriateness at least annually. Model inputs, such as equity forward rates, equity implied volatility and equity correlations are marked such that the fair value of the derivatives match prices observable in the inter-dealer markets. In arriving at fair value, the Company uses discount rates appropriate to the funding rates specific to the instrument. In general, this results in overnight rates being used to discount the Company assets and liabilities. In addition, since the notes bear Morgan Stanley's credit risk, the Company considers this when assessing the fair value of the notes, by adjusting the discount rates to reflect the prevailing credit spread at the reporting date.</li> <li>The Company has a small number of notes where the cash flows due on the notes is dependent on embedded derivatives linked to the interest rate, foreign exchange or commodity markets. The Company values these notes in the same way as for equity-linked notes, by using market standard models and marking the inputs to match prices observed in the inter-dealer OTC markets. Similarly to equity-linked notes, these issuances bear Morgan Stanley's credit risk, and the valuation is assessed accordingly.</li> </ul>	<ul style="list-style-type: none"> <li>Generally Level 2</li> <li>Level 3 - Notes with significant unobservable inputs</li> </ul>
<p><i>Certificates and warrants</i></p> <ul style="list-style-type: none"> <li>Certificates and warrants provide exposure to the underlying single name equity, equity index or portfolio of equities. They therefore provide risk exposure to the value of the underlying position and to the dividends paid or received. The Company values the underlying position using observable data where available (for instance, exchange closing prices), or alternatively using information from third parties (for example net asset values obtained from fund administrators) or using Morgan Stanley's own valuation assumptions if required. The Company estimates future dividend payments using a variety of available data, including market prices for forwards and futures, analytical review and estimates of future tax rates, incorporating the Company's own assumptions where required. The certificates and warrants can typically be redeemed at short notice and so the certificates and warrants provide minimal exposure to the credit risk of Morgan Stanley.</li> </ul>	<ul style="list-style-type: none"> <li>Level 2</li> <li>Level 3 - in instances where the unobservable inputs are deemed significant</li> </ul>
<p><i>Loans</i></p> <ul style="list-style-type: none"> <li>The fair value of loans to other Morgan Stanley Group undertakings is estimated based on the present value of expected future cash flows using its best estimate of interest rate yield curves.</li> </ul>	<ul style="list-style-type: none"> <li>Level 2</li> </ul>

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

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

**NOTES TO THE FINANCIAL STATEMENTS**

**Year ended 31 December 2018**

**21. ASSETS AND LIABILITIES MEASURED AT FAIR VALUE (CONTINUED)**

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

The following tables present the changes in the fair value of the Company's Level 3 financial assets and financial liabilities for the years ended 31 December 2018 and 31 December 2017. Level 3 instruments may be hedged with instruments classified in Level 2. As a result, the realised and unrealised gains/ (losses) for assets and liabilities within the Level 3 category presented in the following tables do not reflect the related realised and unrealised gains/ (losses) on hedging instruments that have been classified by the Company within the Level 2 category.

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

# MORGAN STANLEY B.V.

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

### 21. ASSETS AND LIABILITIES MEASURED AT FAIR VALUE (CONTINUED)

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

31 December 2018

	Balance at 1 January 2018 €'000	Total gains or (losses) recognised in statement of comprehensive income <sup>(1)</sup> €'000	Purchases €'000	Issuances €'000	Settlements €'000	Net transfers in and/ or out of Level 3 <sup>(2)</sup> €'000	Balance at 31 December 2018 €'000	Unrealised gains or (losses) for Level 3 assets /(liabilities) outstanding as at 31 December 2018 <sup>(3)</sup> €'000
Trading financial assets:								
Net derivative contracts <sup>(4)</sup>	4,343	(106,536)	-	-	904	(2,419)	(103,708)	(102,072)
Trade and other receivables:								
Prepaid equity securities contracts	-	(665)	61,159	-	-	3,258	63,752	(665)
<b>Total financial assets measured at fair value</b>	<b>4,343</b>	<b>(107,201)</b>	<b>61,159</b>	<b>-</b>	<b>904</b>	<b>839</b>	<b>(39,956)</b>	<b>(102,737)</b>
Debt and other borrowings:								
Issued Structured Notes	(363,504)	77,189	-	(298,878)	34,919	20,769	(529,505)	76,837
<b>Total financial liabilities measured at fair value</b>	<b>(363,504)</b>	<b>77,189</b>	<b>-</b>	<b>(298,878)</b>	<b>34,919</b>	<b>20,769</b>	<b>(529,505)</b>	<b>76,837</b>

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

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

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

(4) Net derivative contracts represent trading financial assets – derivative contracts net of trading financial liabilities – derivative contracts.

During the year, the Company reclassified approximately €2,001,000 of net derivative contracts (2017: €2,273,000), €3,258,000 of prepaid equity securities (2017: nil) and €90,159,000 of issued Structured Notes (2017: €45,311,000) from Level 2 to Level 3. The reclassifications were due to a reduction in the volume of recently executed transactions or a lack of available broker quotes for these instruments, such that certain significant inputs became unobservable.

During the year, the Company reclassified approximately €110,928,000 of issued Structured Notes (2017: €157,242,000) from Level 3 to Level 2. The reclassifications were due to the availability of market data for these or comparable instruments, or available broker quotes, or consensus data such that certain significant inputs became observable. There were no other material transfers from Level 3 to Level 2 of the fair value hierarchy (31 December 2017: €2,383,000 of net derivative contracts).

NOTES TO THE FINANCIAL STATEMENTS  
Year ended 31 December 2018

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

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

31 December 2017

	Balance at 1 January 2017 €'000	Total gains or (losses) recognised in statement of comprehensive income <sup>(1)</sup> €'000	Purchases €'000	Issuances €'000	Settlements €'000	Net transfers in and/ or out of Level 3 <sup>(2)</sup> €'000	Balance at 31 December 2017 €'000	Unrealised gains or (losses) for Level 3 assets /(liabilities) outstanding as at 31 December 2017 <sup>(3)</sup> €'000
Trading financial assets:								
Net derivative contracts <sup>(4)</sup>	16,213	(6,654)	-	-	(5,326)	110	4,343	(2,996)
<b>Total financial assets measured at fair value</b>	<b>16,213</b>	<b>(6,654)</b>	<b>-</b>	<b>-</b>	<b>(5,326)</b>	<b>110</b>	<b>4,343</b>	<b>(2,996)</b>
Debt and other borrowings:								
Issued Structured Notes	(298,875)	(9,596)	-	(234,018)	67,054	111,931	(363,504)	(4,725)
<b>Total financial liabilities measured at fair value</b>	<b>(298,875)</b>	<b>(9,596)</b>	<b>-</b>	<b>(234,018)</b>	<b>67,054</b>	<b>111,931</b>	<b>(363,504)</b>	<b>(4,725)</b>

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

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

(3) Amounts represent unrealised gains or (losses) for the year ended 31 December 2017 related to assets and liabilities still outstanding at 31 December 2017. The unrealised gains or (losses) are recognised in the statement of comprehensive income as detailed in the financial instruments accounting policy (note 3(c)).

(4) Net derivative contracts represent trading financial assets– derivative contracts net of trading financial liabilities – derivative contracts.

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

**21. ASSETS AND LIABILITIES MEASURED AT FAIR VALUE (CONTINUED)**

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

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

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

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

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

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

**21. ASSETS AND LIABILITIES MEASURED AT FAIR VALUE (CONTINUED)**

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

31 December 2018	Fair value €'000	Predominant valuation techniques/ Significant unobservable inputs	Range <sup>(2)</sup> (Averages) <sup>(3)</sup>
<b>ASSETS</b>			
<b>Trade and other receivables:</b>			
- Prepaid equity securities contracts	63,752	Option model At the money volatility	4% (4%)
<b>LIABILITIES</b>			
- Net derivative contracts: <sup>(1)</sup>			
- Interest rate	(5,968)	Option model Interest rate - Foreign exchange correlation  Interest rate - Interest rate correlation	-5% to 37% (mean 21%, median 29%)  41% to 97% (mean 71%, median 73% )
- Equity	(94,240)	Net asset value ("NAV") NAV Option model At the money volatility Volatility skew Equity – Equity correlation Equity – Foreign exchange correlation	100% (100%)  5% to 43% (22%) -2% to 0% (-1%) 36% to 98% (77%) -63% to 25% (-31%)
- Commodities	(3,500)	Option model Commodity volatility	-15% to 15% (4%)
<b>Debt and other borrowings:</b>			
- Issued Structured Notes	(529,505)	Option model At the money volatility Volatility skew Equity – Equity correlation Equity – Foreign exchange correlation Interest rate - Foreign exchange correlation  Interest rate - Interest rate correlation  NAV NAV	4% to 43% (23%) -2% to 0% (-1%) 38% to 98% (78%) -51% to 50% (-30%) -5% to 37% (mean 21%, median 29%)  41% to 97% (mean 71%, median 73% )  100% (100%)

(1) Net derivative contracts represent trading financial liabilities – derivative contracts net of trading financial assets – derivative contracts.

(2) The ranges of significant unobservable inputs are represented in percentages.

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

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

**21. ASSETS AND LIABILITIES MEASURED AT FAIR VALUE (CONTINUED)**

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

31 December 2017	Fair value €'000	Predominant valuation techniques/ Significant unobservable inputs	Range <sup>(2)</sup> (Averages) <sup>(3)</sup>
<b>ASSETS</b>			
<b>Trading financial assets:</b>			
- Net derivative contracts: <sup>(1)</sup>			
- Interest rate	15,613	Option model Interest rate - Foreign exchange correlation	18% to 38% (25%)
		NAV	
		NAV	100% (100%)
- Equity	(9,670)	Option model At the money volatility	4% to 42% (18%)
		Volatility skew	-2% to 0% (0%)
		Equity – Equity correlation	35% to 89% (60%)
		Equity – Foreign exchange correlation	-57% to 30% (-40%)
- Commodities	(1,674)	Option model Commodity volatility	15% to 18% (17%)
<b>LIABILITIES</b>			
<b>Debt and other borrowings:</b>			
- Issued Structured Notes	(363,504)	Option model At the money volatility	6% to 42% (21%)
		Volatility skew	-2% to 0% (-1%)
		Equity – Equity correlation	41% to 88% (53%)
		Equity – Foreign exchange correlation	-60% to -17% (-39%)
		Interest rate - Foreign exchange correlation	18% to 38% (25%)
		Commodity volatility	15% to 18% (17%)
		NAV	
		NAV	100% (100%)

(1) Net derivative contracts represent financial assets classified as held for trading – derivative contracts net of financial liabilities classified as held for trading – derivative contracts.

(2) The ranges of significant unobservable inputs are represented in percentages.

(3) Amounts represent weighted averages which are calculated by weighting each input by the fair value of the respective financial instruments except for derivative instruments where inputs are weighted by risks.

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

**21. ASSETS AND LIABILITIES MEASURED AT FAIR VALUE (CONTINUED)**

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

An increase (decrease) to the following inputs would generally result in an impact to the fair value, but the magnitude and direction of the impact would depend on whether the Company is long or short the exposure:

- **Correlation:** A pricing input where the payoff is driven by more than one underlying risk. Correlation is a measure of the relationship between the movements of two variables (i.e. how the change in one variable influences a change in the other variable).
- **Volatility:** The measure of the variability in possible returns for an instrument given how much that instrument changes in value over time. Volatility is a pricing input for options, and, generally, the lower the volatility, the less risky the option. The level of volatility used in the valuation of a particular option depends on a number of factors, including the nature of the risk underlying that option, the tenor and the strike price of the option.
- **Volatility skew:** The measure of the difference in implied volatility for options with identical underliers and expiry dates but with different strikes.
- **NAV:** A pricing input that is the value of an entity's assets minus the value of its liabilities, often in relation to open-end or mutual funds, since shares of such funds registered with the US Securities and Exchange Commission are redeemed at their net asset value. Shares and interests in such funds are not traded between investors, but are issued by the fund to each new investor and redeemed by the fund when an investor withdraws. A fund will issue and redeem shares and interests at a price calculated by reference to the NAV of the fund, with the intention that new investors receive a fair proportion of the fund and redeeming investors receive a fair proportion of the fund's value in cash.

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

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

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

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

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

**21. ASSETS AND LIABILITIES MEASURED AT FAIR VALUE (CONTINUED)**

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

The following table presents the potential impact of both favourable and unfavourable changes, both of which would be reflected in statement of comprehensive income:

	2018 <sup>(2)(3)</sup>		2017	
	Favourable changes €'000	Unfavourable changes €'000	Favourable changes €'000	Unfavourable changes €'000
Trade and other receivables:				
Prepaid equity securities contracts	30	(12)	-	-
Trading financial liabilities:				
Net derivatives contracts <sup>(1)</sup>	7,751	(10,821)	(859)	(291)
Debt and other borrowings:				
Issued Structured Notes	8,484	(7,711)	(3,257)	4,315
	<u>16,265</u>	<u>(18,544)</u>	<u>(4,116)</u>	<u>4,024</u>

(1) Net derivative contracts represent trading financial assets – derivative contracts net of trading financial liabilities – derivative contracts. The reasonably possible alternative assumptions are applied to derivative assets and derivative liabilities separately when assessing potential variability of the fair value measurement.

(2) The increase in the potential impact of favourable and unfavourable changes compared to the prior year is primarily driven by an increase in the carrying value of financial assets and financial liabilities classified as Level 3 in the fair value hierarchy, as well as increased uncertainty in the equity markets at the end of 2018.

(3) The difference between the total favourable and total unfavourable changes is primarily a result of net derivative contracts classified as Level 3 in the fair value hierarchy hedging issued Structured Notes which can be classified as either Level 2 or Level 3 in the fair value hierarchy.

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

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

# MORGAN STANLEY B.V.

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

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

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

Regarding the CPECs, their carrying value including the accrued yield in 'Trade and other payables', as detailed in note 11, is considered in aggregate as an approximation of their fair value.

### 23. CAPITAL MANAGEMENT

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

The Morgan Stanley Group's required capital ("Required Capital") estimation is based on the Required Capital Framework, an internal capital adequacy measure. This framework is a risk-based and leverage use-of-capital measure, which is compared with the Morgan Stanley Group's regulatory capital to ensure that the Morgan Stanley Group maintains an amount of going concern capital after absorbing potential losses from stress events where applicable, at a point in time. The Morgan Stanley Group defines the difference between its total average common equity and the sum of the average common equity amounts allocated to our business segments as Parent common equity. The Morgan Stanley Group generally holds Parent common equity for prospective regulatory requirements, organic growth, acquisitions and other capital needs.

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

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

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

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

The Company manages the following items as capital:

	<b>2018</b>	<b>2017</b>
	<b>€'000</b>	<b>€'000</b>
Share capital	15,018	15,018
Reserves	25,657	24,765
	<u>40,675</u>	<u>39,783</u>

## MORGAN STANLEY B.V.

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

#### 24. RELATED PARTY DISCLOSURES

##### *Parent and ultimate controlling entity*

The Company's immediate parent undertaking is Archimedes Investments Coöperatieve U.A. which is registered in The Netherlands.

The ultimate parent undertaking and controlling entity and the largest group of which the Company is a member and for which group financial statements are prepared is Morgan Stanley. Morgan Stanley is incorporated in the State of Delaware, the United States of America. Copies of its financial statements can be obtained from [www.morganstanley.com/investorrelations](http://www.morganstanley.com/investorrelations).

##### **Key management compensation**

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

Key management personnel compensation comprised the following:

	<b>2018</b>	<b>2017</b>
	<b>€'000</b>	<b>€'000</b>
Short-term employee benefits	25	24
Post-employment benefits	1	1
Share-based payments	1	2
Other long-term employee benefits	1	1
	<u>28</u>	<u>28</u>

The share-based payment costs disclosed above reflect the amortisation of equity-based awards granted to key management personnel over the last three years and are therefore not directly aligned with other staff costs in the current year.

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

In addition to the above TMF Management B.V., not in the Morgan Stanley Group, provided key management personnel services to the Company for which a fee of €501,000 was charged for the year (2017: €456,000) and of which €nil was accrued at 31 December 2018 (2017: €nil).

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

**24. RELATED PARTY DISCLOSURES (CONTINUED)**

**Transactions with related parties**

The Morgan Stanley Group conducts business for clients globally through a combination of both functional and legal entity organisational structures. Accordingly, the Company is closely integrated with the operations of the Morgan Stanley Group and enters into transactions with other Morgan Stanley Group undertakings on an arm's length basis for the purposes of utilising financing, trading and risk management, and infrastructure services. The nature of these relationships along with information about the transactions and outstanding balances is given below. All the amounts outstanding as disclosed below are unsecured and will be settled via inter-company mechanisms.

In addition, the management and execution of business strategies on a global basis results in many Morgan Stanley transactions impacting a number of Morgan Stanley Group undertakings. The Morgan Stanley Group operates a number of intra-group policies to ensure that, where possible, revenues and related costs are matched. For the year ended 31 December 2018, a net loss of €1,401,000 (2017: €4,287,000) was recognised in the statement of comprehensive income arising from such policies.

*Funding*

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

*General funding*

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

*Other funding*

Other funding includes CPECs issued to the Company's direct parent undertaking, Archimedes Investments Coöperatieve U.A.. The specific terms of the related yield are detailed in note 11.

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

# MORGAN STANLEY B.V.

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

### 24. RELATED PARTY DISCLOSURES (CONTINUED)

#### Transactions with related parties (continued)

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

	2018		2017	
	Interest €'000	Balance €'000	Interest €'000	Balance €'000
Amounts due from the Company's indirect parent undertaking	12,020	1,134,595	8,605	1,163,051
Amounts due from other Morgan Stanley Group undertakings	47	31,165	3,190	629,253
	<u>12,067</u>	<u>1,165,760</u>	<u>11,795</u>	<u>1,792,304</u>
Amounts due to the Company's direct and indirect parent undertakings	12,591	1,135,453	4,490	1,176,672
Amounts due to other Morgan Stanley Group undertakings	764	157,978	680	4,991
	<u>13,355</u>	<u>1,293,431</u>	<u>5,170</u>	<u>1,181,663</u>

#### Trading and risk management

The Company issues Structured Notes and hedges the obligations arising from the issuance by entering into prepaid equity securities contracts, derivative contracts and loans designated at fair value through profit or loss with other Morgan Stanley Group undertakings. All such transactions are entered into on an arm's length basis. The total amounts receivable and payable on issued Structured Notes, prepaid equity securities contracts, derivative contracts and loans designated at fair value through profit or loss were as follows:

	2018		2017	
	Interest €'000	Balance €'000	Interest €'000	Balance €'000
Amounts due from other Morgan Stanley Group undertakings	79	8,323,486	5	7,684,278
Amounts due to other Morgan Stanley Group undertakings	(1,066)	1,186,755	(941)	2,036,776

The Company has pledged cash collateral of €172,489,000 to and received cash collateral of €8,534,000 from other Morgan Stanley Group undertakings (2017: received €575,669,000) in order to mitigate credit risk on exposures arising under derivatives contracts and prepaid equity securities contracts between the Company and other Morgan Stanley Group undertakings.

#### Infrastructure services

The Company uses infrastructure services including the provision of office facilities, operated by other Morgan Stanley Group undertakings at no charge.

## **MORGAN STANLEY B.V.**

### **ADDITIONAL INFORMATION** **Year ended 31 December 2018**

#### **Independent auditor's report**

The independent auditor's report is recorded on the next page.

#### **Statutory rules concerning appropriation of the net result**

The Articles of Association of the Company provide that the net result for the year is at the disposition of the General Meeting of Shareholders.

Distribution can only be made to the extent that the Shareholder's equity exceeds the reserves provided for by the Articles of Association. The Board of Directors must grant its approval which it can only withhold in the event that it knows or reasonably should have known that, following the distribution, the Company will not be able to continue with the payments of its debts becoming due and payable in the foreseeable future.

#### **Subsequent events**

There have been no significant events since the reporting date.

## Independent auditor's report

To the shareholders of Morgan Stanley B.V.

### REPORT ON THE AUDIT OF THE FINANCIAL STATEMENTS 2018 INCLUDED IN THE ANNUAL REPORT

#### Our opinion

We have audited the accompanying financial statements 2018 of Morgan Stanley B.V., based in Amsterdam.

In our opinion the accompanying financial statements give a true and fair view of the financial position of Morgan Stanley B.V. as at 31 December 2018, and of its result and its cash flows for 2018 in accordance with International Financial Reporting Standards as adopted by the European Union (EU-IFRS) and with Part 9 of Book 2 of the Dutch Civil Code.

The financial statements comprise:

1. The statement of financial position as at 31 December 2018.
2. The following statements for 2018: the income statement, the statements of comprehensive income, changes in equity and cash flows.
3. The notes comprising a summary of the significant accounting policies and other explanatory information.

#### Basis for our opinion

We conducted our audit in accordance with Dutch law, including the Dutch Standards on Auditing. Our responsibilities under those standards are further described in the "Our responsibilities for the audit of the financial statements" section of our report.

We are independent of Morgan Stanley B.V. in accordance with the EU Regulation on specific requirements regarding statutory audit of public-interest entities, the "Wet toezicht accountantsorganisaties" (Wta, Audit firms supervision act), the "Verordening inzake de onafhankelijkheid van accountants bij assurance-opdrachten" (ViO, Code of Ethics for Professional Accountants, a regulation with respect to independence) and other relevant independence regulations in the Netherlands. Furthermore, we have complied with the "Verordening gedrags- en beroepsregels accountants" (VGBA, Dutch Code of Ethics).

We believe the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

#### Materiality

Based on our professional judgement we determined the materiality for the financial statements as a whole at EUR 94,945,000. The materiality is based on 1% of Total Assets. We have also taken into account misstatements and/or possible misstatements that in our opinion are material for the users of the financial statements for qualitative reasons.

We agreed with the Board of Directors that misstatements in excess of EUR 1,898,900 which are identified during the audit, would be reported to them, as well as smaller misstatements that in our view must be reported on qualitative grounds.

## **Our key audit matters**

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements. We have communicated the key audit matters to the Board of Directors. The key audit matters are not a comprehensive reflection of all matters discussed.

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

### Financial Instruments, including valuation and accounting

#### *Key audit matter*

The risk associated with the valuation assertion relates to the valuation of fair value hierarchy level 3 issuances because this can require significant management judgment. We note that although the entity does not apply hedge accounting, it reduces profit and loss volatility through economic hedging and recording the financial instruments held on the balance at fair value. Valuation of level 3 financial instruments often requires the usage of bespoke valuation models and unobservable inputs to determine the fair value which can be highly subjective. The valuations of these instruments are typically more complex and may not be readily observable due to illiquid markets or low trading volumes, and accordingly, are more difficult to estimate. The subjectivity involved in the valuation of level 3 inventory means there is an inherently greater risk of material misstatement. Reference is made to notes 2, 3.d and 21 of the financial statements of Morgan Stanley B.V. as at 31 December 2018.

#### *Response*

Our testing over the valuation assertion has included procedures in relation to the controls over positions carried at fair value, procedures in relation to model controls and the performance of substantive testing through independent revaluations, methodology reviews and testing of key inputs for a sample of positions. As part of these procedures we challenged management assumptions in the determination of the valuation models with the support of internal financial instrument valuation experts.

#### *Observation*

We consider the disclosure notes 2, 3.d and 21 of the financial statements regarding the estimation uncertainty being involved in the valuation of level 3 financial instruments to be adequate, and in compliance with the relevant accounting requirements.

## **REPORT ON THE OTHER INFORMATION INCLUDED IN THE ANNUAL REPORT**

In addition to the financial statements and our auditor's report thereon, the annual report contain other information that consists of:

- Directors' Report.
- Directors' Responsibility Statement.
- Other information, including but not limited to the topics prescribed by Dutch Civil Code 2:392.

Based on the following procedures performed, we conclude that the other information:

- Is consistent with the financial statements and does not contain material misstatements.
- Contains the information as required by Part 9 of Book 2 of the Dutch Civil Code.

We have read the other information. Based on our knowledge and understanding obtained through our audit of the financial statements or otherwise, we have considered whether the other information contains material misstatements.

By performing these procedures, we comply with the requirements of Part 9 of Book 2 of the Dutch Civil Code and the Dutch Standard 720. The scope of the procedures performed is substantially less than the scope of those performed in our audit of the financial statements.

Management is responsible for the preparation of the other information, including the Directors' Report in accordance with Part 9 of Book 2 of the Dutch Civil Code, and the other information as required by Part 9 of Book 2 of the Dutch Civil Code and the Directors' Responsibility Statement.

## **REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS**

### **Engagement**

We were engaged by the Board of Directors as auditor of Morgan Stanley B.V. as of the year 2001 and have operated as statutory auditor ever since that financial year.

### **No prohibited non-audit services**

We have not provided prohibited non-audit services as referred to in Article 5(1) of the EU Regulation on specific requirements regarding statutory audit of public-interest entities.

## **DESCRIPTION OF RESPONSIBILITIES REGARDING THE FINANCIAL STATEMENTS**

### **Responsibilities of management for the financial statements**

Management is responsible for the preparation and fair presentation of the financial statements in accordance with EU-IFRS and Part 9 of Book 2 of the Dutch Civil Code. Furthermore, management is responsible for such internal control as management determines is necessary to enable the preparation of the financial statements that are free from material misstatement, whether due to fraud or error.

As part of the preparation of the financial statements, management is responsible for assessing the company's ability to continue as a going concern. Based on the financial reporting frameworks mentioned, management should prepare the financial statements using the going concern basis of accounting unless management either intends to liquidate the company or to cease operations or has no realistic alternative but to do so.

Management should disclose events and circumstances that may cast significant doubt on the company's ability to continue as a going concern in the financial statements.

The audit committee is responsible for overseeing the company's financial reporting process.

## **Our responsibilities for the audit of the financial statements**

Our objective is to plan and perform the audit assignment in a manner that allows us to obtain sufficient and appropriate audit evidence for our opinion.

Our audit has been performed with a high, but not absolute, level of assurance, which means we may not detect all material errors and fraud during our audit.

Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements. The materiality affects the nature, timing and extent of our audit procedures and the evaluation of the effect of identified misstatements on our opinion.

We have exercised professional judgement and have maintained professional skepticism throughout the audit, in accordance with Dutch Standards on Auditing, ethical requirements and independence requirements. Our audit included e.g.:

- Identifying and assessing the risks of material misstatement of the financial statements, whether due to fraud or error, designing and performing audit procedures responsive to those risks, and obtaining audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for 1 resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtaining an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the company's internal control.
- Evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Concluding on the appropriateness of management's 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 our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. 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 continue as a going concern.
- Evaluating the overall presentation, structure and content of the financial statements, including the disclosures.
- Evaluating whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with management regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant findings in internal control that we identified during our audit. In this respect we also submit an additional report to the audit committee in accordance with Article 11 of the EU Regulation on specific requirements regarding statutory audit of public-interest entities. The information included in this additional report is consistent with our audit opinion in this auditor's report.

From the matters communicated with the Board of Directors, we determine the key audit matters: those matters that were of most significance in the audit of the financial statements. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, not communicating the matter is in the public interest.

Amsterdam, 23 April 2019

Deloitte Accountants B.V.

Signed on the original: M. van Luijk