

**Registered number: 35857**

Registered office:  
47 Esplanade  
St. Helier  
JE1 0BD  
Jersey

**MORGAN STANLEY FINANCE II LIMITED**

**Report and financial statements**

**31 December 2021**

# **MORGAN STANLEY FINANCE II LIMITED**

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## **MORGAN STANLEY FINANCE II LIMITED**

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 16) for Morgan Stanley Finance II Limited (the “Company”) for the year ended 31 December 2021.

### **RESULTS AND DIVIDENDS**

The loss for the year, after tax, was \$4,000 (2020: profit \$10,000).

During the year, no dividends were paid or proposed (2020: \$nil).

### **PRINCIPAL ACTIVITY**

The principal activity of the Company is the issuance of financial instruments and the hedging of the obligations arising pursuant to such issuances.

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

On 11 March 2021, the Company changed from being a private company to a public company and subsequently recommenced trading in May 2021. As the Company was a private Company for the year ended 31 December 2020 the results have not been audited. The Company did not trade during the year ended 31 December 2020.

### **BUSINESS REVIEW**

#### **Business environment**

During the course of 2021, the Company has been impacted by factors in the global environment in which it operates, each of which introduces risks and uncertainties that may adversely affect the results of operations of the Company. In particular:

#### **COVID-19**

Although the global economy has begun to recover from the COVID-19 pandemic, as many health and safety restrictions have been lifted and vaccine distribution continues to increase, certain adverse consequences of the pandemic continue to impact the global economy and may persist for some time. These include labour shortages and disruptions of global supply chains. The growth in economic activity and demand for goods and services, alongside labour shortages and supply chain complications, has also contributed to rising inflationary pressures. Should these ongoing effects of the pandemic continue for an extended period or worsen, the Company could experience reduced client activity and demand for products and services.

Morgan Stanley and the Company continue to be fully operational and, recognising that local conditions vary for offices around the world and that the trajectory of the virus continues to be uncertain, employees are able to work from home and in offices as deemed necessary. If significant portions of the workforce, including key personnel, are unable to work effectively because of illness, government actions, or other restrictions in connection with the pandemic, the impact of the pandemic on the Company’s business could be exacerbated.

The extent to which the consequences of the COVID-19 pandemic affects the Company’s business, results of operations and financial condition, as well as its regulatory capital and liquidity ratios and ability to take capital actions, will depend on future developments that remain uncertain. This includes the rate of distribution and administration of vaccines globally, the severity and duration of any resurgence of COVID-19 variants, future actions taken by governmental authorities, central banks and other third party service providers.

#### **Escalation of War in Ukraine**

The Group has limited direct exposure to Russia and Ukraine. There may be negative effects to the global economy due to the current disruption to the financial markets, global trade payment systems and capital flows as well as from the impact of sanctions. The extent to which the impact to the global economy affects the Group will depend on future developments that are highly uncertain and cannot be predicted. The Group will continue to closely monitor events and their potential impact.

## **MORGAN STANLEY FINANCE II LIMITED**

### **BUSINESS REVIEW (CONTINUED)**

#### **Overview of 2021**

The statement of comprehensive income is set out on page 10. The loss for the year is \$4,000, which primarily represents net interest expense for the year (2020: profit of \$10,000, driven by interest income). The Company was in liquidation from 30 July 2020 and taken out of liquidation on 17 November 2020 to recommence trading. The trading income for the year is \$nil which is consistent with the Company's principal activity.

The statement of financial position is set out on page 12. Total assets and total liabilities as at 31 December 2021 were \$313,895,000 (2020: \$483,000) and \$313,416,000 (2020: \$nil) respectively. The increase in total assets and total liabilities from 31 December 2020 is due to the commencement of trading in structured notes, classified in financial liabilities designated at fair value through profit or loss, and the related hedging instruments, classified in financial assets designated at fair value through profit or loss.

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.

#### **Risk management**

The Directors consider that the Company's key financial risks are credit risk, primarily its concentration of exposure to other Morgan Stanley Group undertakings and liquidity risk. The Company leverages the Morgan Stanley Group's credit and liquidity risk frameworks to identify, measure, monitor and control credit risk and to ensure that the Company has access to adequate funding.

The Company also has some limited exposure to country, operational and legal, regulatory and compliance risks.

The Company leverages the risk management policies and procedures of the Morgan Stanley Group.

Note 12 provides more detailed qualitative disclosures on the Company's exposure to financial risks in addition to narrative disclosures on exposure to operational risk.

#### **Going Concern**

Business risks associated with the uncertain market and economic conditions are being actively monitored and managed by the Group. Retaining sufficient capital and liquidity to withstand these market pressures remains central to the Group's strategy. In particular, the Group's capital and liquidity is deemed sufficient to exceed regulatory minimums under both a normal and in a stressed market environment, including the current and potential stresses of the war in Ukraine and the COVID-19 pandemic for the foreseeable future. The existing and potential effects of the war in Ukraine and of COVID-19 on the business of the Group have been considered as part of the going concern analysis, including impact on operational capacity, access to liquidity and capital, contractual obligations, asset valuations and other critical accounting judgements and key sources of estimation uncertainty. The Group has access to further Morgan Stanley Group capital and liquidity as required.

Taking all of these factors into consideration, the Directors believe it is reasonable to assume that the Group 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 reports and financial statements.

## **MORGAN STANLEY FINANCE II LIMITED**

### **BUSINESS REVIEW (CONTINUED)**

#### **DIRECTORS**

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

D Cole	Director	(appointed 7 January 2021 / resigned 1 November 2021)
Z Dewhurst	Director	(appointed 1 November 2021)
H Herrmann	Director	
S Keams	Director	(appointed 7 January 2021)
C Schmuck	Director	(resigned 7 January 2021)
S Hopkins	Alternate Director	(resigned 7 January 2021)

#### **EVENTS AFTER THE REPORTING DATE**

Following Russia's invasion of Ukraine on 24 February 2022, the European and global financial markets have been and are expected to continue to be significantly impacted in 2022. However, the Company/Group has limited direct exposure to Russia and Ukraine. The Company/Group will continue to closely monitor events and their potential impact.

Approved by the Board and signed on its behalf by



Director

29 April 2022

## **MORGAN STANLEY FINANCE II LIMITED**

### **DIRECTORS' RESPONSIBILITIES STATEMENT**

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

Companies (Jersey) Law 1991 requires the Directors to prepare financial statements for each financial year. Under that law the Directors have prepared the financial statements in accordance with International Financial Reporting Standards ("IFRSs") as issued by International Accounting Standards Board ("IASB") as adopted by the European Union ("EU"). The financial statements are required by law to give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period.

International Accounting Standard ("IAS") 1 'Presentation of financial statements' requires that financial statements present fairly for each financial year the Company's financial position, financial performance and cash flows. This requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the IASB 'Framework for the preparation and presentation of financial statements'. In virtually all circumstances, a fair presentation will be achieved by compliance with all applicable IFRSs. However, Directors are also required to:

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

The Directors are responsible for keeping adequate accounting records that disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with Companies (Jersey) Law 1991. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Approved by the Board and signed on its behalf by



Director

29 April 2022

## **INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF MORGAN STANLEY FINANCE II LIMITED**

### **Report on the audit of the financial statements**

#### **Opinion**

In our opinion the financial statements of Morgan Stanley Finance II Limited (the 'company'):

- give a true and fair view of the state of the company's affairs as at 31 December 2021 and of its profit for the year then ended;
- have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union and IFRSs issued by the International Accounting Standards Board (IASB); and
- have been properly prepared in accordance with the Companies (Jersey) Law 1991.

We have audited the financial statements which comprise:

- the statement of comprehensive income;
- the statement of changes in equity;
- the statement of financial position;
- the statement of cashflows; and
- the related notes 1 to 16.

The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union and IFRSs issued by the International Accounting Standards Board (IASB).

#### **Basis for Opinion**

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the auditor's responsibilities for the audit of the financial statements section of our report.

We are independent of the company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the Financial Reporting Council's (the 'FRC's') Ethical Standard, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

#### **Conclusions relating to going concern**

In auditing the financial statements, we have concluded that the directors' use of the going concern basis of accounting in the preparation of the financial statements is appropriate.

Based on the work we have performed, we have not identified any material uncertainties relating to events or conditions that, individually or collectively, may cast significant doubt on the company's ability to continue as a going concern for a period of at least twelve months from when the financial statements are authorised for issue.

Our responsibilities and the responsibilities of the directors with respect to going concern are described in the relevant sections of this report.

#### **Other information**

The other information comprises the information included in the annual report, other than the financial statements and our auditor's report thereon. The directors are responsible for the other information contained within the annual report. Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

Our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the course of the audit, or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether this gives rise to a material misstatement in the financial statements themselves. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

## **INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF MORGAN STANLEY FINANCE II LIMITED**

*We have nothing to report in this regard.*

### **Responsibilities of directors**

As explained more fully in the Directors' responsibilities statement, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the Directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Directors are responsible for assessing the company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the company or to cease operations, or have no realistic alternative but to do so.

### **Auditor's responsibilities for the audit of the financial statements**

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the FRC's website at: [www.frc.org.uk/auditorsresponsibilities](http://www.frc.org.uk/auditorsresponsibilities). This description forms part of our auditor's report.

### **Extent to which the audit was considered capable of detecting irregularities, including fraud**

Irregularities, including fraud, are instances of non-compliance with laws and regulations. We design procedures in line with our responsibilities, outlined above, to detect material misstatements in respect of irregularities, including fraud. The extent to which our procedures are capable of detecting irregularities, including fraud is detailed below.

We considered the nature of the company's industry and its control environment, and reviewed the company's documentation of their policies and procedures relating to fraud and compliance with laws and regulations. We also enquired of management, internal audit and the audit committee about their own identification and assessment of the risks of irregularities. We obtained an understanding of the legal and regulatory frameworks that the company operates in, and identified the key laws and regulations that:

- had a direct effect on the determination of material amounts and disclosures in the financial statements. The key laws and regulations we considered in this context included the Companies (Jersey) Law 1991 and tax legislation; and
- do not have a direct effect on the financial statements but compliance with which may be fundamental to the company's ability to operate or to avoid a material penalty.

We discussed among the audit engagement team including relevant internal specialists such as tax, IT and industry specialists regarding the opportunities and incentives that may exist within the organisation for fraud and how and where fraud might occur in the financial statements.

In common with all audits under ISAs (UK), we are also required to perform specific procedures to respond to the risk of management override. In addressing the risk of fraud through management override of controls, we tested the appropriateness of journal entries and other adjustments; assessed whether the judgements made in making accounting estimates are indicative of a potential bias; and evaluated the business rationale of any significant transactions that are unusual or outside the normal course of business.



## **INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF MORGAN STANLEY FINANCE II LIMITED**

In addition to the above, our procedures to respond to the risks identified included the following:

- reviewing financial statement disclosures by testing to supporting documentation to assess compliance with provisions of relevant laws and regulations described as having a direct effect on the financial statements;
- performing analytical procedures to identify any unusual or unexpected relationships that may indicate risks of material misstatement due to fraud;
- enquiring of management, internal audit and in-house legal counsel concerning actual and potential litigation and claims, and instances of non-compliance with laws and regulations; and
- reading minutes of meetings of those charged with governance, reviewing internal audit reports and reviewing correspondence with Revenue Jersey and HMRC; and
- in addressing the risk of fraud through management override of controls, testing the appropriateness of journal entries and other adjustments; assessing whether the judgements made in making accounting estimates are indicative of a potential bias; and evaluating the business rationale of any significant transactions that are unusual or outside the normal course of business.

### **Report on other legal and regulatory requirements**

#### **Matters on which we are required to report by exception**

Under the Companies (Jersey) Law 1991 we are required to report in respect of the following matters if, in our opinion:

- proper accounting records have not been kept, or proper returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or
- we have not received all the information and explanations we require for our audit.

*We have nothing to report in respect of these matters.*

#### **Other matter**

As the Company was a private company in the prior year and therefore exempt from audit under section 113 of Companies (Jersey) Law 1991 and the Directors did not require an audit for the prior year, we have not audited the corresponding amounts for that year.

#### **Use of our report**

This report is made solely to the company's members, as a body, in accordance with Article 113A of the Companies (Jersey) Law 1991. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.



Fiona Walker, FCA (Senior Statutory Auditor)

For and on behalf of Deloitte LLP

Statutory Auditor

London, United Kingdom

29 April 2022

**MORGAN STANLEY FINANCE II LIMITED**

**STATEMENT OF COMPREHENSIVE INCOME**  
**Year ended 31 December 2021**

	Note	2021 \$'000	(unaudited) 2020 \$'000
Net gains on financial instruments held mandatorily at fair value through profit or loss ("FVPL")		187	-
Net losses on financial instruments designated at fair value through profit or loss		<u>(187)</u>	<u>-</u>
Net result from financial instruments held at fair value		-	-
Interest income	4	27	10
Interest expense	4	<u>(30)</u>	<u>-</u>
Net interest (expense)/ income		(3)	10
Non-interest expense	5	<u>(1)</u>	<u>-</u>
<b>(LOSS)/ PROFIT BEFORE INCOME TAX</b>		(4)	10
Income tax	6	-	-
<b>(LOSS)/ PROFIT AND TOTAL COMPREHENSIVE INCOME FOR THE YEAR</b>		<u><u>(4)</u></u>	<u><u>10</u></u>

All results were derived from continuing operations.

The notes on pages 14 to 38 form an integral part of the financial statements.

## MORGAN STANLEY FINANCE II LIMITED

### STATEMENT OF CHANGES IN EQUITY Year ended 31 December 2021

	Note	Share capital \$'000	Retained earnings \$'000	Total equity \$'000
<b>Balance at 1 January 2020 (unaudited)</b>		14	459	473
Profit and total comprehensive income for the year (unaudited)		-	10	10
<b>Balance at 1 January 2021 (unaudited)</b>		14	469	483
Loss and total comprehensive loss for the year		-	(4)	(4)
<b>Balance at 31 December 2021</b>		<u>14</u>	<u>465</u>	<u>479</u>

The notes on pages 14 to 38 form an integral part of the financial statements.

**MORGAN STANLEY FINANCE II LIMITED**

Registered number: 35857

**STATEMENT OF FINANCIAL POSITION****As at 31 December 2021**

	Note	2021 \$'000	(unaudited) 2020 \$'000
<b>ASSETS</b>			
Cash and short-term deposits	7	981	-
Loans and advances	7	311,810	-
Trading financial assets	7	1,104	-
Trade and other receivables	8	-	483
<b>TOTAL ASSETS</b>		<u>313,895</u>	<u>483</u>
<b>LIABILITIES AND EQUITY</b>			
<b>LIABILITIES</b>			
Trading financial liabilities	7	55,308	-
Debt and other borrowings	9	<u>258,108</u>	-
<b>TOTAL LIABILITIES</b>		<u>313,416</u>	-
<b>EQUITY</b>			
Stated capital	16	14	14
Retained earnings		<u>465</u>	<u>469</u>
<b>Equity attributable to owners of the Company</b>		<u>479</u>	<u>483</u>
<b>TOTAL EQUITY</b>		<u>479</u>	<u>483</u>
<b>TOTAL LIABILITIES AND EQUITY</b>		<u>313,895</u>	<u>483</u>

These financial statements were approved by the Board and authorised for issue on 28 April 2022.

Signed on behalf of the Board



Director

The notes on pages 14 to 38 form an integral part of the financial statements.

## MORGAN STANLEY FINANCE II LIMITED

### STATEMENT OF CASH FLOWS Year ended 31 December 2021

	2021 \$'000	(unaudited) 2020 \$'000
<b>OPERATING ACTIVITIES</b>		
(Loss)/ Profit for the year	(4)	10
Adjustments for:		
Interest (expense)/ income	<u>3</u>	<u>(10)</u>
Operating cash flows before changes in operating assets and liabilities	<u>(1)</u>	<u>-</u>
Changes in operating assets:		
Increase in loans and advances	(311,810)	-
Increase in trading financial assets	(1,104)	-
Decrease in trade and other receivables	<u>483</u>	<u>-</u>
	<u>(312,431)</u>	<u>-</u>
Changes in operating liabilities:		
Increase in debt and other borrowings	258,108	-
Increase in trading financial liabilities	<u>55,305</u>	<u>-</u>
	<u>313,413</u>	<u>-</u>
<b>NET CASH FLOWS FROM OPERATING ACTIVITIES</b>	<u>981</u>	<u>-</u>
<b>NET INCREASE IN CASH AND CASH EQUIVALENTS</b>	981	-
<b>CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE YEAR</b>	<u>-</u>	<u>-</u>
<b>CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR</b>	<u><u>981</u></u>	<u><u>-</u></u>

All cash is available for use by management.

The notes on pages 14 to 38 form an integral part of the financial statements.

## MORGAN STANLEY FINANCE II LIMITED

### NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2021

#### 1. CORPORATE INFORMATION

The Company is incorporated and domiciled in Jersey, at the following address 47 Esplanade, St Helier, Jersey, JE1 0BD. The Company is engaged in the issuance of financial instruments and the hedging of the obligations arising pursuant to such issuances. The Company did not trade during the year ended 31 December 2020.

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

#### 2. BASIS OF PREPARATION

##### Statement of compliance

The Company prepares its annual financial statements in accordance with IFRSs issued by the International Accounting Standards Board ("IASB") as adopted by the EU, Interpretations issued by the IFRS Interpretations Committee ("IFRIC") and Companies (Jersey) Law 1991.

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

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

Amendments to ("IFRS 9") '*Financial Instruments*', IAS 39 '*Financial Instruments: Recognition and Measurement*' and IFRS 7 '*Financial Instruments: Disclosures*' were issued by the IASB in August 2020. The amendments outline the accounting and disclosure requirements for the financial instruments which are transitioned to alternative benchmark rates. The amendments are applicable retrospectively and are effective from and will be applied for annual periods beginning on or after 1 January 2021. The amendments were endorsed by the EU in January 2021.

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

##### New standards and interpretations not yet adopted

At the date of authorisation of these financial statements, the following amendments to standards relevant to the Company's operations have been issued by the IASB but were not mandatory for accounting periods beginning 1 January 2021. The Company does not expect that the adoption of the following amendments to standards will have a material impact on the Company's financial statements.

Amendments to IAS 1 '*Presentation of Financial Statements*': Classification of Liabilities as Current or Non-current were issued by the IASB in January 2020 and revised in July 2020, for retrospective application in accounting periods beginning on or after 1 January 2023.

Amendments to IAS 37 '*Provisions, Contingent Liabilities and Contingent Assets*' ('IAS 37'): Onerous Contracts – Cost of Fulfilling a Contract were issued by the IASB in May 2020, for modified retrospective application in accounting periods beginning on or after 1 January 2022. Early application is permitted. [The amendments were endorsed by the EU in July 2021.]

As part of the 2018-2020 Annual Improvements Cycle published in May 2020, the IASB made an amendment to IFRS 9, relating to the treatment of fees in the assessment of whether financial liabilities are modified or exchanged, where such transactions occur on or after 1 January 2022. Early application is permitted. The amendments were endorsed by the EU in July 2021.

## MORGAN STANLEY FINANCE II LIMITED

### NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2021

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

##### **New standards and interpretations not yet adopted (continued)**

Amendments to IAS 8 '*Accounting Policies, Changes in Accounting Estimates and Errors*': Definition of Accounting Estimates were issued by the IASB in February 2021, for prospective application in accounting periods beginning on or after 1 January 2023. Early application is permitted.

Amendments to IAS 1 '*Presentation of Financial Statements*': Disclosure of Accounting Policies were issued by the IASB in February 2021, for prospective application in accounting periods beginning on or after 1 January 2023. Early application is permitted.

Amendments to IAS 12 '*Income taxes*': Deferred tax related to Assets and Liabilities arising from a Single Transaction' were issued by the IASB in May 2021, for prospective application in accounting periods beginning on or after 1 January 2023. Early application is permitted.

##### **Critical accounting judgements and key sources of estimation uncertainty**

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

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

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

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

##### **The going concern assumption**

The Company's business activities, together with the factors likely to affect its future development, performance and position, are reflected in the Business Review section of the Directors' report on pages 3 to 5. 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.

The existing and potential effects of COVID-19 on the operational capacity of the business, access to liquidity and capital, contractual obligations have been considered on page 3.

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

## MORGAN STANLEY FINANCE II LIMITED

### NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2021

#### 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

##### a. Functional currency

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

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

##### b. Foreign currencies

All monetary assets and liabilities denominated in currencies other than US dollars are translated into US dollars at the rates ruling at the reporting date. Transactions and non-monetary assets and liabilities denominated in currencies other than US dollars are recorded at the rates prevailing at the dates of the transactions. All translation differences are taken through the statement of comprehensive income. Exchange differences recognised in the statement of comprehensive income are presented in 'Other revenue' or 'Other expense', except where noted in 3(c) below.

##### c. Financial instruments

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

Trading financial instruments, including all derivatives, are initially recorded on trade date at fair value. All subsequent changes in fair value, foreign exchange differences, interest and dividends are reflected in the statement of comprehensive income in 'Net gains on financial instruments held mandatorily at fair value through profit or loss'.

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'.

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

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

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.

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.

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 financial instruments designated at fair value'.



## MORGAN STANLEY FINANCE II LIMITED

### NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2021

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

##### c. Financial instruments (continued)

##### iii) Financial assets at amortised cost

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

Financial assets are recognised at amortised cost when the Company's business model objective is to collect the contractual cash flows of the assets and where these cash flows are 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 expected credit loss ("ECL") allowance. Interest is recognised in the income statement in 'Interest income', using the 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 income statement in 'Net impairment loss on financial instruments'.

##### 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 that requires the most observable inputs be used when available.

Observable inputs are inputs that market participants would use in pricing the asset or liability that were developed based on market data obtained from sources independent of the Company. Unobservable inputs are inputs that reflect assumptions the Company believes other market participants would use in pricing the asset or liability, that are developed based on the best information available in the circumstances.

## MORGAN STANLEY FINANCE II LIMITED

### NOTES TO THE FINANCIAL STATEMENTS Year ended 31 December 2021

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

##### d. Fair value (continued)

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, block discounts and discounts for equity-specific restrictions that would not transfer to market participants are not applied to Level 1 instruments. Since valuations are based on quoted prices that are readily and regularly available in an active market, valuation of these products does not entail a significant degree of judgement.

- Level 2 - Valuation techniques using observable inputs

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

- Level 3 - Valuation techniques with significant unobservable inputs

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

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

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

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

The Company incorporates Funding Valuation Adjustment (“FVA”) into 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.

## MORGAN STANLEY FINANCE II LIMITED

### NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2021

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

##### d. Fair value (continued)

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

##### *Valuation techniques*

Many cash instruments and 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 and funding in order to arrive at fair value.

Adjustments for liquidity risk adjust model-derived mid-market amounts 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 which are designated at FVPL 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.

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.

## MORGAN STANLEY FINANCE II LIMITED

### NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2021

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

##### d. Fair value (continued)

###### *Valuation process*

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

###### *Model Review.*

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

###### *Independent Price Verification.*

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

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

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

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

## MORGAN STANLEY FINANCE II LIMITED

### NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2021

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

##### d. Fair value (continued)

###### *Gains and losses on inception*

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

When the use of unobservable market data has a significant impact on determining fair value at the inception of the transaction, the entire initial gain or loss indicated by the valuation technique as at the transaction date is not recognised immediately in the income statement, but is deferred and recognised over the life of the instrument or at the earlier of when the unobservable market data become observable, maturity or disposal of the instrument.

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

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

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 continues 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.

The renegotiation or modification of the contractual cash flows of a financial instrument can lead to derecognition where the modification is “substantial”, determined by qualitative assessment of whether the revised contractual terms of a financial instrument, such as a loan, are significantly different from those of the original financial instrument. 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 financial instrument, the gross carrying amount of the financial instrument is recalculated and a modification gain/(loss) is recognised in the income statement.

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 income statement within ‘Net gains/(losses) on derecognition of financial assets measured at amortised cost and FVOCI’.

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

##### f. Impairment of financial assets

The Company recognises loss allowances for expected credit losses (“ECL”) for its financial assets classified at amortised cost. ECLs are the present value of cash shortfalls over the expected life of the financial instrument discounted at the assets Effective Interest Rate (“EIR”). ECL are recognised in the statement of comprehensive income within ‘Net impairment loss on financial instruments’ and is reflected against the carrying amount of the impaired asset on the statement of financial position as an ECL allowance. Where there has been a reduction in ECL, this will be recognised within ‘Net reversal of impairment loss on financial instruments’.

## **MORGAN STANLEY FINANCE II LIMITED**

### **NOTES TO THE FINANCIAL STATEMENTS**

**Year ended 31 December 2021**

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

##### **g. Cash and cash equivalents**

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

##### **h. Offsetting of financial assets and financial liabilities**

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

#### **4. INTEREST INCOME/ EXPENSE**

All interest income/expense relates to financial assets at amortised cost and is calculated using the EIR method.

#### **5. OTHER EXPENSES**

Other expenses of \$1,000 relates to bank charges. In addition, audit fees of \$67,000 and administration fees of \$42,000 have been borne by another Morgan Stanley Group undertaking in the current year.

The Company employed no staff during the year (2020: nil).

#### **6. INCOME TAX**

The Company is subject to Jersey income tax at the rate 0.00% (2020: 0.00%).

## MORGAN STANLEY FINANCE II LIMITED

### NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2021

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

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

31 December 2021	FVPL (mandatorily) \$'000	FVPL (designated) \$'000	Amortised cost \$'000	Total \$'000
Cash and short-term deposits	-	-	981	981
Loans and advances:				
Loans	-	311,810	-	311,810
Trading financial assets:				
Derivatives	1,104			1,104
<b>Total financial assets</b>	<b>1,104</b>	<b>311,810</b>	<b>981</b>	<b>313,895</b>
Trading financial assets:				
Derivatives	55,308	-	-	55,308
Debt and other borrowings:				
Issued Structured Notes	-	257,583	-	257,583
Loans	-	-	525	525
<b>Total financial liabilities</b>	<b>55,308</b>	<b>257,583</b>	<b>525</b>	<b>313,416</b>

There are no terms and conditions of any trading financial assets or liabilities that may individually significantly affect the amount, timing and certainty of future cash flows for the Company.

All assets as at 31 December 2020 of \$483,000 were measured at amortised cost.

#### 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:

*Issued 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.

*Loans:* These are loans to other Morgan Stanley Group undertakings that, along with 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. These loans are designated at FVPL to eliminate or significantly reduce an accounting mismatch which would otherwise arise.

## MORGAN STANLEY FINANCE II LIMITED

### NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2021

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

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

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.

The carrying amount of financial liabilities held at fair value was \$48,000 higher than the contractual amount due at maturity (31 December 2020: not applicable).

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 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 changes in the credit risk of these liabilities ("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.

#### 8. TRADE AND OTHER RECEIVABLES

	2021 \$'000	2020 \$'000
<b>Trade and other receivables (amortised cost)</b>		
Amounts due from other Morgan Stanley Group undertakings	-	483

#### 9. DEBT AND OTHER BORROWINGS

	2021 \$'000	2020 \$'000
<b>Debt and other borrowings</b>		
Issued structured notes (designated FVPL)	257,583	-
Loans (amortised cost)	525	-
	<u>258,108</u>	<u>-</u>

Refer to note 7 for details of issued Structured Notes included within debt and other borrowings designated at FVPL.



## MORGAN STANLEY FINANCE II LIMITED

### NOTES TO THE FINANCIAL STATEMENTS Year ended 31 December 2021

#### 10. EQUITY

##### Ordinary share capital

	Ordinary shares of £1 each Number	Ordinary shares of £1 each \$'000
<b>Issued and fully paid</b>		
At 1 January 2020, 31 December 2020 and 31 December 2021	10,000	14

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

All ordinary shares are recorded at the rates of exchange ruling at the date the shares were paid up.

#### 11. EXPECTED MATURITY OF ASSETS AND LIABILITIES

The Company has loans of \$525,000 (2020: \$none) expected to mature in greater than 12 months. None of the Company's other assets and liabilities are expected to be recovered or settled more than twelve months after the reporting period (2020: \$none).

#### 12. SEGMENT REPORTING

Segment information is presented in respect of the Company's business and geographical segments.

##### 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 two geographic regions being the Americas and Asia.

The following table presents selected statement of financial position information of the Company's operations by geographic area. The total assets disclosed in the following table reflect the regional view of the Company's operations, on a managed basis. The attribution of total assets is determined by trading desk location.

	Americas		Asia		Total	
	31 December 2021 \$'000	31 December 2020 \$'000	31 December 2021 \$'000	31 December 2020 \$'000	31 December 2021 \$'000	31 December 2020 \$'000
Assets	312,466	483	1,429	-	313,895	483

## MORGAN STANLEY FINANCE II LIMITED

### NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2021

#### 13. 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 leveraged the risk management policy framework of the Morgan Stanley Group. The risk management policy framework includes 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.

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. Primarily its concentration of exposure is to other Morgan Stanley group undertakings.

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.

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

##### Exposure to credit risk

The maximum exposure to credit risk ("gross credit exposure") of the Company as at 31 December 2021 is the carrying amount of the financial assets held in the statement of financial position. The Company has not entered into any credit enhancements to manage its exposure to credit risk. The Company does not have any significant exposure arising from items not recognised on the statement of financial position.

*Exposure to credit risk by class*

Class	Gross credit exposure <sup>(1)</sup>	
	2021 \$'000	2020 \$'000
<b>Subject to ECL:</b>		
Cash and short-term deposits	981	-
Trade and other receivables	-	483
<b>Not subject to ECL<sup>(2)</sup>:</b>		
Loans and advances	311,810	
<b>Trading financial assets</b>		
Derivatives	1,104	-
	<u>313,895</u>	<u>483</u>

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

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

## MORGAN STANLEY FINANCE II LIMITED

### NOTES TO THE FINANCIAL STATEMENTS Year ended 31 December 2021

#### 13. RISK MANAGEMENT (CONTINUED)

##### **Exposure to credit risk (continued)**

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

##### **Credit quality**

*Exposure to credit risk by internal rating grades*

Internal credit ratings, as below, are derived using methodologies generally consistent with those used by external agencies:

Investment grade: AAA - BBB

Non-investment grade: BB - CCC

Default: D

All gross carrying amounts have an internal rating grade of A. All exposures subject to ECL are Stage 1.

##### **Liquidity risk**

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

## MORGAN STANLEY FINANCE II LIMITED

### NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2021

#### 13. RISK MANAGEMENT (CONTINUED)

##### Liquidity risk (continued)

The primary goal of the Company's liquidity risk and funding management framework is to ensure that the Company has access to adequate funding across a wide range of market conditions 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 account for stressed liquidity requirements and the amount of liquidity held should be greater than those stressed requirements.

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 Liquidity Resources (as defined below), 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 liquidity flows across multiple scenarios and a range of time horizons. These scenarios contain various combinations of idiosyncratic and market 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.

## MORGAN STANLEY FINANCE II LIMITED

### NOTES TO THE FINANCIAL STATEMENTS Year ended 31 December 2021

#### 13. RISK MANAGEMENT (CONTINUED)

##### Liquidity risk (continued)

###### *Liquidity Stress Tests (continued)*

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

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

###### *Liquidity Resources*

The Morgan Stanley Group maintains sufficient liquidity resources, which consist of unencumbered highly liquid securities and cash deposits with banks (including central banks) (“Liquidity Resources”) to cover daily funding needs and to meet strategic liquidity targets sized by the Required Liquidity Framework and Liquidity Stress Tests. The Morgan Stanley Group actively manages the amount of its Liquidity Resources 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. The amount of Liquidity Resources within the Morgan Stanley Group is based on the Morgan Stanley Group’s risk tolerance and is subject to change depending on market and firm-specific events. Unencumbered highly liquid securities consist of netted trading assets, investment securities and securities received as collateral.

The Morgan Stanley Group’s Liquidity Resources, 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.

Liquidity Resources may fluctuate from period to period based on the overall size and composition of the balance sheet, the maturity profile of our unsecured debt and estimates of funding needs in a stressed environment, among other factors.

The ability to monetise assets during a liquidity crisis is critical. The Morgan Stanley Group believes that the assets held in its Liquidity Resources 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.

## MORGAN STANLEY FINANCE II LIMITED

### NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2021

#### 13. RISK MANAGEMENT (CONTINUED)

##### Liquidity risk (continued)

###### Balance sheet management

In managing both the Morgan Stanley Group's and the Company's funding risk the composition and size of the entire balance sheet, not just financial liabilities, is monitored and evaluated. 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.

###### 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 2021. 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.

31 December 2021	On demand \$'000	Less than 1 year \$'000	More than 1 year \$'000	Total \$'000
<b>Financial assets</b>				
Cash and short term deposits	981	-	-	981
Loans and advances:				
Loans	-	311,810	-	311,810
Trading financial assets				
Derivatives	-	1,104	-	1,104
<b>Total financial assets</b>	<u>981</u>	<u>312,914</u>	<u>-</u>	<u>313,895</u>
	<b>\$'000</b>	<b>\$'000</b>	<b>\$'000</b>	<b>\$'000</b>
<b>Financial liabilities</b>				
Trading financial liabilities:				
Derivatives	-	55,308	-	55,308
Debt and other borrowings				
Issued Structured Notes	-	257,583	-	257,583
Loans	-	-	525	525
<b>Total financial liabilities</b>	<u>-</u>	<u>312,891</u>	<u>525</u>	<u>313,416</u>

All financial assets were repayable on demand as at 31 December 2020.

## MORGAN STANLEY FINANCE II LIMITED

### NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2021

#### 13. RISK MANAGEMENT (CONTINUED)

##### Market risk

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

The Company manages the market risk associated with its trading activities at both division and an individual product level, and includes consideration of market risk at the legal entity level.

Sound market risk management is an integral part of the Company's culture. The Company is responsible for ensuring that market risk exposure is 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 exposure, 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

The Company is exposure to equity investments price risk under this definition.

##### *Equity price sensitivity analysis*

The sensitivity analysis below is determined based on the exposure to equity price risk as at 31 December 2021. There was no exposure to equity price risk as at 31 December 2020.

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)	
	2021	2020
	\$'000	\$'000
Trading financial instruments	(25,758)	-
Debt and other borrowings	25,758	-
	<u>-</u>	<u>-</u>

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

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 US Dollars, 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.

## MORGAN STANLEY FINANCE II LIMITED

### NOTES TO THE FINANCIAL STATEMENTS Year ended 31 December 2021

#### 13. RISK MANAGEMENT (CONTINUED)

##### *Operational risk*

Operational risk refers to the risk of loss, or of damage to the Company's reputation, resulting from inadequate or failed processes or systems, 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.

The scope also includes oversight of technology risk, cybersecurity risk, information security risk, and third party risk management (supplier and affiliate risk).

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. The framework is continually evolving to reflect 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 established 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 such 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.



## MORGAN STANLEY FINANCE II LIMITED

### NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2021

#### 13. RISK MANAGEMENT (CONTINUED)

##### *Operational risk (continued)*

The Operational Risk Department provides independent oversight of operational risk and assesses, measures and monitors operational risk against tolerance. The Operational Risk Department works with the business divisions and control groups to help ensure a transparent, consistent and comprehensive framework for managing operational risk within each area and across the Company.

The Operational Risk Department scope includes oversight of technology risk, cybersecurity risk, information security risk, the fraud risk management and prevention programme and third party risk management (supplier and affiliate risk oversight and assessment) programme. Furthermore, the Operational Risk Department supports the collection and reporting of operational risk incidents and the execution of operational risk assessments; provides the infrastructure needed for risk measurement and risk management; and ensures ongoing validation and verification of the Company's advanced measurement approach for operational risk capital.

The Company Business Continuity and Disaster recovery programs are designed to provide assurance of business continuity in the event of disruptions impacting the Company's people, technology, facilities and third parties, and to comply with regulatory requirements. The key elements of these programs include crisis management, business continuity planning, disaster recovery, testing verification, and process improvement. Business units within the Morgan Stanley Group maintain business continuity plans, including identifying processes and strategies to continue business critical processes during a business continuity incident. The business units also test the documented preparation to provide a reasonable expectation that, during a business continuity incident, the business unit will be able to continue its critical business processes and limit the impact of the incident to the Morgan Stanley Group and its clients. Technical recovery plans are maintained for critical technology assets and detail the steps to be implemented to recover from a disruption impacting the assets' primary location. Disaster recovery testing is performed to validate the recovery capability of these critical technology assets.

The Company maintains a programme that oversees our cyber and information security risks. Our cybersecurity and information security policies, procedures and technologies are designed to protect the 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.

In connection with its ongoing operations, the Company utilises third-party suppliers, which it anticipates that such usage 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 third-party suppliers' performance. The Company maintains a third-party risk programme which is designed to align with our risk tolerance and meet regulatory requirements. The program includes governance, policies, procedures, and enabling. The third-party risk programme includes the adoption of appropriate risk management controls and practices throughout the third-party management lifecycle to manage risk of service failure, risk of data loss and reputational risk, among others.

## MORGAN STANLEY FINANCE II LIMITED

### NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2021

#### 13. RISK MANAGEMENT (CONTINUED)

##### *Legal, regulatory and compliance risk*

Legal, regulatory and compliance risk includes the risk of legal or regulatory sanctions, material financial loss; including fines, penalties, judgements, damages and/ or settlements, limitations on our business, 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.

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 and banking industries globally presents a continuing business challenge for the Company.

#### 14. ASSETS AND LIABILITIES MEASURED AT FAIR VALUE

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

All financial assets and financial liabilities recognised at fair value on a recurring basis as at 31 December 2021 are classified as level 2 (valuation techniques using observable inputs). There were no financial instruments recognised at fair value on a recurring basis at 31 December 2020.

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:

## MORGAN STANLEY FINANCE II LIMITED

### NOTES TO THE FINANCIAL STATEMENTS Year ended 31 December 2021

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

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

Asset and Liability / Valuation Technique	Valuation Hierarchy Classification
<p><i>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 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 is determined using 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> <li>Structured 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 underlying 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> </ul>	<ul style="list-style-type: none"> <li>Generally Level 2</li> </ul>
<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> </ul>	<ul style="list-style-type: none"> <li>Level 2</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>

## MORGAN STANLEY FINANCE II LIMITED

### NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2021

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

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

There were no transfers between levels of the fair value hierarchy during the current or prior year.

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

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

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.

#### 15. 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 Company equity. The Morgan Stanley Group generally holds Parent Company equity for prospective regulatory requirements, organic growth, potential future 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 changes in 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 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 adjust its capital base to in reaction to 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.

## MORGAN STANLEY FINANCE II LIMITED

### NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 December 2021

#### 15. CAPITAL MANAGEMENT (CONTINUED)

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:

	2021	2020
	\$'000	\$'000
Stated capital	14	14
Reserves	465	469
	<u>479</u>	<u>483</u>

#### 16. RELATED PARTY DISCLOSURES

The Company's immediate and 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).

In January 2021 Crestbridge Limited replaced Sanne Fiduciary Services Limited and its subsidiary Sanne Secretaries Limited ("SSL") as the provider of administration and secretarial services respectively to the Company at commercial rates. Z Dewhurst and S Kearns are Directors and/or employees of Crestbridge Limited and should be regarded as interested in any transaction with any member of Crestbridge Limited.

##### 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.

The Company has one director who is employed by another Morgan Stanley Group undertaking. The Director's services to the Company are considered to be incidental to their other responsibilities within the Morgan Stanley Group and as such, their remuneration for key management personnel services to the Company is \$nil for the current and prior year.

In addition to the above, Crestbridge Limited, not in the Morgan Stanley Group, provided key management personnel services to the Company for which a fee of \$42,000 (2020 \$19,000 - SSL) was charged for the year and of which \$nil was accrued at 31 December 2021 (2020 \$nil).

Key management personnel compensation is borne by other Morgan Stanley Group undertakings in the current and prior year. None of the Directors received remuneration from the Company during the current or prior year.

##### Transactions with related parties

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

The Company has not recognised any expense and has made no provision for impairment relating to the amount of outstanding balances from related parties (31 December 2020: \$nil).

## MORGAN STANLEY FINANCE II LIMITED

### NOTES TO THE FINANCIAL STATEMENTS Year ended 31 December 2021

#### 16. RELATED PARTY DISCLOSURES (CONTINUED)

##### Transactions with related parties (continued)

###### *Funding*

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

###### *General funding*

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

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

	2021		2020	
	Interest \$'000	Balance \$'000	Interest \$'000	Balance \$'000
Amounts due from the Company's direct parent undertakings	27	-	10	483
Amounts due to the Company's direct parent undertakings	(30)	525	-	-

###### *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 the above financial instruments were as follows:

	2021		2020	
	Net Gains/ Losses \$'000	Balance \$'000	Net Gains/ losses \$'000	Balance \$'000
Amounts due from the Company's direct parent undertakings	187	312,914	-	-
Amounts due to the Company's direct parent undertakings	-	55,308	-	-

See note 7 for a breakdown of related party balances by type.

###### *Infrastructure services*

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

Amounts outstanding at the reporting date are included within the general funding balances disclosed above.