MORGAN STANLEY
Form 10-Q
October 10, 2007
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended August 31, 2007

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from ________ to ________

Commission file number 1-11758

Morgan Stanley

(Exact Name of Registrant as Specified in its Charter)

Delaware	**36-3145972**
(State of Incorporation)	**(I.R.S. Employer Identification No.)**
1585 Broadway	
New York, NY	**10036**
(Address of Principal Executive Offices)	**(Zip Code)**

Registrant s telephone number, including area code: (212) 761-4000

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer x Accelerated Filer ¨ Non-Accelerated Filer ¨

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

As of September 30, 2007, there were 1,061,228,375 shares of the Registrant s Common Stock, par value $.01 per share, outstanding.

Table of Contents

MORGAN STANLEY

INDEX TO QUARTERLY REPORT ON FORM 10-Q

Quarter Ended August 31, 2007

		Page
Part I Financial Information		
Item 1.	Financial Statements (unaudited)	
	Condensed Consolidated Statements of Financial Condition August 31, 2007 and November 30, 2006	1
	Condensed Consolidated Statements of Income Three and Nine Months Ended August 31, 2007 and 2006	3
	Condensed Consolidated Statements of Comprehensive Income Three and Nine Months Ended August 31, 2007 and 2006	4
	Condensed Consolidated Statements of Cash Flows Nine Months Ended August 31, 2007 and 2006	5
	Notes to Condensed Consolidated Financial Statements	6
	Report of Independent Registered Public Accounting Firm	48
Item 2.	Management s Discussion and Analysis of Financial Condition and Results of Operations	49
Item 3.	Quantitative and Qualitative Disclosures About Market Risk	85
Item 4.	Controls and Procedures	93
Part II Other Information		
Item 1.	Legal Proceedings	94
Item 1A.	Risk Factors	95
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	95
Item 6.	Exhibits	96

Table of Contents

AVAILABLE INFORMATION

Morgan Stanley files annual, quarterly and current reports, proxy statements and other information with the Securities and Exchange Commission (the SEC). You may read and copy any document we file with the SEC at the SEC s public reference room at 100 F Street, NE, Washington, DC 20549. Please call the SEC at 1-800-SEC-0330 for information on the public reference room. The SEC maintains an internet site that contains annual, quarterly and current reports, proxy and information statements and other information that issuers (including Morgan Stanley) file electronically with the SEC. Morgan Stanley s electronic SEC filings are available to the public at the SEC s internet site, *www.sec.gov*.

Morgan Stanley s internet site is *www.morganstanley.com*. You can access Morgan Stanley s Investor Relations webpage at *www.morganstanley.com/about/ir*. Morgan Stanley makes available free of charge, on or through our Investor Relations webpage, its proxy statements, Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and any amendments to those reports filed or furnished pursuant to the Securities Exchange Act of 1934, as amended (the Exchange Act), as soon as reasonably practicable after such material is electronically filed with, or furnished to, the SEC. Morgan Stanley also makes available, through its Investor Relations webpage, via a link to the SEC s internet site, statements of beneficial ownership of Morgan Stanley s equity securities filed by its directors, officers, 10% or greater shareholders and others under Section 16 of the Exchange Act.

Morgan Stanley has a Corporate Governance webpage. You can access information about Morgan Stanley s corporate governance at *www.morganstanley.com/about/company/governance*. Morgan Stanley posts the following on its Corporate Governance webpage:

- Composite Certificate of Incorporation;
- Bylaws;
- Charters for our Audit Committee, Compensation, Management Development and Succession Committee and Nominating and Governance Committee;
- Corporate Governance Policies;
- Policy Regarding Communication with the Board of Directors;
- Policy Regarding Director Candidates Recommended by Shareholders;
- Policy Regarding Corporate Political Contributions;
- Policy Regarding Shareholder Rights Plan;
- Code of Ethics and Business Conduct; and
- Integrity Hotline.

Morgan Stanley s Code of Ethics and Business Conduct applies to all directors, officers and employees, including its Chief Executive Officer, its Chief Financial Officer and its Controller and Principal Accounting Officer. Morgan Stanley will post any amendments to the Code of Ethics and Business Conduct and any waivers that are required to be disclosed by the rules of either the SEC or the New York Stock Exchange, Inc. (NYSE) on its internet site. You can request a copy of these documents, excluding exhibits, at no cost, by contacting Investor Relations, 1585 Broadway, New York, NY 10036 (212-761-4000). The information on Morgan Stanley s internet site is not incorporated by reference into this report.

Table of Contents

Item 1.

MORGAN STANLEY

CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

(dollars in millions, except share data)

	August 31, 2007 (unaudited)	November 30, 2006
Assets		
Cash and cash equivalents	$ 36,588	$ 20,606
Cash and securities deposited with clearing organizations or segregated under federal and other regulations or requirements (including securities at fair value of $13,865 at August 31, 2007 and $8,648 at November 30, 2006)	43,229	29,565
Financial instruments owned (approximately $155 billion and $125 billion were pledged to various parties at August 31, 2007 and November 30, 2006, respectively):		
U.S. government and agency securities	40,333	39,352
Other sovereign government obligations	34,822	27,305
Corporate and other debt	159,971	158,864
Corporate equities	102,846	86,058
Derivative contracts	62,488	55,443
Investments	12,921	4,725
Physical commodities	2,704	3,031
Total financial instruments owned	416,085	374,778
Securities received as collateral	92,212	64,588
Collateralized agreements:		
Securities purchased under agreements to resell	176,910	175,787
Securities borrowed	257,032	299,631
Receivables:		
Consumer loans (net of allowances of $831 at November 30, 2006)		22,915
Customers	89,080	82,923
Brokers, dealers and clearing organizations	20,911	7,633
Other loans	16,127	11,908
Fees, interest and other	9,307	8,937
Other investments	12,722	3,232
Office facilities and other equipment, at cost (net of accumulated depreciation of $3,516 at August 31, 2007 and $3,645 at November 30, 2006)	4,193	4,086
Goodwill	2,554	2,792
Intangible assets (net of accumulated amortization of $159 at August 31, 2007 and $109 at November 30, 2006)	897	651
Other assets	7,284	11,160
Total assets	$ 1,185,131	$ 1,121,192

Table of Contents

MORGAN STANLEY

CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION (Continued)

(dollars in millions, except share data)

	August 31, 2007 (unaudited)	November 30, 2006
Liabilities and Shareholders Equity		
Commercial paper and other short-term borrowings	$ 30,845	$ 29,092
Deposits	23,268	28,343
Financial instruments sold, not yet purchased:		
U.S. government and agency securities	19,480	26,168
Other sovereign government obligations	26,791	28,961
Corporate and other debt	9,796	10,336
Corporate equities	57,483	59,399
Derivative contracts	62,088	57,491
Physical commodities	459	764
Total financial instruments sold, not yet purchased	176,097	183,119
Obligation to return securities received as collateral	92,212	64,588
Collateralized financings:		
Securities sold under agreements to repurchase	253,989	267,566
Securities loaned	145,145	150,257
Other secured financings	37,340	45,556
Payables:		
Customers	171,316	134,907
Brokers, dealers and clearing organizations	10,812	7,635
Interest and dividends	5,177	4,746
Other liabilities and accrued expenses	28,466	24,975
Long-term borrowings	175,214	144,978
	1,149,881	1,085,762
Capital Units		66
Commitments and contingencies		
Shareholders equity:		
Preferred stock	1,100	1,100
Common stock, $0.01 par value;		
Shares authorized: 3,500,000,000 at August 31, 2007 and November 30, 2006;		
Shares issued: 1,211,701,552 at August 31, 2007 and November 30, 2006;		
Shares outstanding: 1,062,450,986 at August 31, 2007 and 1,048,877,006 at November 30, 2006	12	12
Paid-in capital	1,471	2,213
Retained earnings	42,043	41,422
Employee stock trust	5,738	4,315
Accumulated other comprehensive loss	(95)	(35)
Common stock held in treasury, at cost, $0.01 par value;		
149,250,566 shares at August 31, 2007 and 162,824,546 shares at November 30, 2006	(9,281)	(9,348)
Common stock issued to employee trust	(5,738)	(4,315)

Total shareholders equity	35,250	35,364
Total liabilities and shareholders equity	$ 1,185,131	$ 1,121,192

See Notes to Condensed Consolidated Financial Statements.

Table of Contents

MORGAN STANLEY

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(dollars in millions, except share and per share data)

	Three Months Ended August 31, 2007	Three Months Ended August 31, 2006	Nine Months Ended August 31, 2007	Nine Months Ended August 31, 2006
	(unaudited)		(unaudited)	
Revenues:				
Investment banking	$ 1,659	$ 1,138	$ 4,799	$ 3,252
Principal transactions:				
Trading	1,381	2,843	10,377	9,488
Investments	558	300	2,442	1,229
Commissions	1,264	880	3,392	2,794
Asset management, distribution and administration fees	1,701	1,312	4,776	3,901
Interest and dividends	14,405	12,021	43,976	31,483
Other	262	119	855	367
Total revenues	21,230	18,613	70,617	52,514
Interest expense	13,272	11,549	42,141	30,524
Net revenues	7,958	7,064	28,476	21,990
Non-interest expenses:				
Compensation and benefits	3,596	3,085	13,365	10,682
Occupancy and equipment	279	233	818	658
Brokerage, clearing and exchange fees	459	339	1,186	971
Information processing and communications	302	274	865	805
Marketing and business development	190	147	542	422
Professional services	507	459	1,436	1,281
Other	360	283	1,019	716
Total non-interest expenses	5,693	4,820	19,231	15,535
Income from continuing operations before (losses) gains from unconsolidated investees and income taxes	2,265	2,244	9,245	6,455
(Losses) gains from unconsolidated investees	(19)	20	(65)	25
Provision for income taxes	772	676	3,029	2,127
Income from continuing operations	1,474	1,588	6,151	4,353
Discontinued operations:				
Gain from discontinued operations	111	399	1,024	1,435
Provision for income taxes	(42)	(136)	(378)	(522)
Gain on discontinued operations	69	263	646	913
Net income	$ 1,543	$ 1,851	$ 6,797	$ 5,266
Preferred stock dividend requirements	$ 17	$	$ 50	$
Earnings applicable to common shareholders	$ 1,526	$ 1,851	$ 6,747	$ 5,266
Earnings per basic common share:				
Income from continuing operations	$ 1.45	$ 1.57	$ 6.08	$ 4.29
Gain on discontinued operations	0.07	0.26	0.65	0.90

Earnings per basic common share	$ 1.52	$ 1.83	$ 6.73	$ 5.19
Earnings per diluted common share:				
Income from continuing operations	$ 1.38	$ 1.50	$ 5.79	$ 4.12
Gain on discontinued operations	0.06	0.25	0.61	0.87
Earnings per diluted common share	$ 1.44	$ 1.75	$ 6.40	$ 4.99
Average common shares outstanding:				
Basic	1,002,330,181	1,010,468,365	1,002,687,312	1,014,846,804
Diluted	1,057,495,875	1,055,664,392	1,053,683,836	1,055,811,711

See Notes to Condensed Consolidated Financial Statements.

3

Table of Contents

MORGAN STANLEY

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(dollars in millions)

	Three Months Ended August 31, 2007	Three Months Ended August 31, 2006	Nine Months Ended August 31, 2007	Nine Months Ended August 31, 2006
	(unaudited)		(unaudited)	
Net income	$ 1,543	$ 1,851	$ 6,797	$ 5,266
Other comprehensive income (loss), net of tax:				
Foreign currency translation adjustments	97	22		152
Net change in cash flow hedges	4	(10)	15	70
Unrealized losses on securities available for sale	(77)		(77)	
Minimum pension liability adjustment			2	
Comprehensive income	$ 1,567	$ 1,863	$ 6,737	$ 5,488

See Notes to Condensed Consolidated Financial Statements.

4

Table of Contents

MORGAN STANLEY

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(dollars in millions)

	Nine Months Ended August 31, 2007 (unaudited)	Nine Months Ended August 31, 2006 (unaudited)
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 6,797	$ 5,266
Adjustments to reconcile net income to net cash used for operating activities:		
Losses (gains) from unconsolidated investees	65	(25)
Compensation payable in common stock and options	2,132	1,742
Depreciation and amortization	478	538
Provision for consumer loan losses	472	517
Gain on sale of Quilter Holdings Ltd.	(168)	
Aircraft-related charges		125
Changes in assets and liabilities:		
Cash and securities deposited with clearing organizations or segregated under federal and other regulations or requirements	(13,661)	(3,856)
Financial instruments owned, net of financial instruments sold, not yet purchased	(42,669)	(67,756)
Securities borrowed	42,599	(38,783)
Securities loaned	(5,112)	18,544
Receivables and other assets	(23,204)	(11,019)
Payables and other liabilities	44,864	37,938
Securities purchased under agreements to resell	(1,123)	2,542
Securities sold under agreements to repurchase	(14,212)	9,678
Net cash (used for) operating activities	(2,742)	(44,549)
CASH FLOWS FROM INVESTING ACTIVITIES		
Net proceeds from (payments for):		
Office facilities and aircraft under operating leases	(1,228)	1,327
Business acquisitions, net of cash acquired	(1,169)	(1,676)
Sale of Quilter Holdings Ltd.	476	
Net principal disbursed on consumer loans	(4,776)	(10,145)
Sales of consumer loans	5,301	10,698
Purchases of securities available for sale	(13,194)	
Sales of securities available for sale	4,216	
Net cash (used for) provided by investing activities	(10,374)	204
CASH FLOWS FROM FINANCING ACTIVITIES		
Net proceeds from (payments for):		
Short-term borrowings	4,624	(5,122)
Derivatives financing activities	298	1,002
Other secured financings	(14,663)	14,408
Deposits	15,188	6,512
Tax benefits associated with stock-based awards	242	60
Net proceeds from:		
Issuance of preferred stock		1,097
Issuance of common stock	784	390
Issuance of long-term borrowings	54,426	33,263
Payments for:		
Repayments of long-term borrowings	(21,970)	(14,888)
Redemption of Capital Units	(66)	
Repurchases of common stock	(3,237)	(2,381)
Cash distribution in connection with the Discover Spin-off	(5,615)	
Cash dividends	(913)	(864)

Net cash provided by financing activities	29,098	33,477
Net increase (decrease) in cash and cash equivalents	15,982	(10,868)
Cash and cash equivalents, at beginning of period	20,606	29,414
Cash and cash equivalents, at end of period	$ 36,588	$ 18,546

See Notes to Condensed Consolidated Financial Statements.

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

1. Introduction and Basis of Presentation.

The Company. Morgan Stanley (the Company) is a global financial services firm that maintains significant market positions in each of its business segments Institutional Securities, Global Wealth Management Group and Asset Management.

A summary of the activities of each of the Company s business segments is as follows:

Institutional Securities includes capital raising; financial advisory services, including advice on mergers and acquisitions, restructurings, real estate and project finance; corporate lending; sales, trading, financing and market-making activities in equity securities and related products and fixed income securities and related products, including foreign exchange and commodities; benchmark indices and risk management analytics; research; and investment activities.

Global Wealth Management Group provides brokerage and investment advisory services covering various investment alternatives; financial and wealth planning services; annuity and other insurance products; credit and other lending products; banking and cash management services; retirement services; and trust and fiduciary services.

Asset Management provides global asset management products and services in equity, fixed income and alternative investments, which includes private equity, infrastructure, real estate, fund of funds and hedge funds, to institutional and retail clients through proprietary and third party retail distribution channels, intermediaries and the Company s institutional distribution channel. Asset Management also engages in investment activities.

Discontinued Operations.

Discover. On June 30, 2007, the Company completed the spin-off (the Discover Spin-off) of Discover Financial Services (DFS). The results of DFS prior to the Discover Spin-off are reported as discontinued operations for all periods presented.

Quilter Holdings Ltd. The results of Quilter Holdings Ltd. (Quilter) are reported as discontinued operations for all periods presented through its sale on February 28, 2007. The results of Quilter were formerly included in the Global Wealth Management Group business segment.

Aircraft Leasing. The results of the Company s aircraft leasing business are reported as discontinued operations for all periods presented through its sale on March 24, 2006. The results of the Company s aircraft leasing business were formerly included in the Institutional Securities business segment.

See Note 15 for additional information on discontinued operations.

Basis of Financial Information. The condensed consolidated financial statements are prepared in accordance with accounting principles generally accepted in the U.S., which require the Company to make estimates and assumptions regarding the valuations of certain financial instruments, the outcome of litigation and tax matters, incentive-based compensation accruals and other matters that affect the condensed consolidated financial statements and related disclosures. The Company believes that the estimates utilized in the preparation of the condensed consolidated financial statements are prudent and reasonable. Actual results could differ materially from these estimates.

In connection with the Company s application of Staff Accounting Bulletin No. 108, Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements in fiscal 2006,

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

the Company adjusted its opening retained earnings for fiscal 2006 and its financial results for the first two quarters of fiscal 2006. See Note 24 to the consolidated financial statements for the fiscal year ended November 30, 2006, included in the Company s Current Report on Form 8-K dated April 10, 2007 (the Form 8-K).

All material intercompany balances and transactions have been eliminated.

The condensed consolidated financial statements should be read in conjunction with the Company s consolidated financial statements and notes thereto included in the Form 8-K. The condensed consolidated financial statements reflect all adjustments (consisting only of normal recurring adjustments) that are, in the opinion of management, necessary for the fair statement of the results for the interim period. The results of operations for interim periods are not necessarily indicative of results for the entire year.

Reclassifications.

Deferred Compensation plans. The Company maintains various deferred compensation plans for the benefit of certain employees. Beginning December 1, 2006, increases or decreases in assets or earnings associated with such plans are reflected in net revenues, and increases or decreases in liabilities associated with such plans are reflected in compensation expense. Previously, the increases or decreases in assets and liabilities associated with these plans were both recorded in net revenues. The amount of the reclassification that was recorded within net revenues was $172 million and $358 million for the quarter and nine month period ended August 31, 2006.

Investments and Loans. During the second quarter of fiscal 2007, the Company reclassified investments that are accounted for at fair value from Other assets to Financial instruments owned Investments in the condensed consolidated statement of financial condition. Gains and losses associated with these investments are reflected in Principal transactions investments in the condensed consolidated statements of income.

During the second quarter of fiscal 2007, the Company reclassified investments that are not accounted for at fair value (such as investments accounted for under the equity or cost method) from Other assets to Other investments. Gains and losses associated with these investments are primarily reflected in (Losses) gains from unconsolidated investees.

During the second quarter of fiscal 2007, the Company reclassified certain structured loan products and other loans that are accounted for on an accrual basis to Receivables Other loans. Previously, these amounts were included in Financial instruments owned Corporate and other debt, Receivables Customers and Receivables Fees, interest and other. In addition, certain mortgage lending products accounted for at fair value that were previously included in Consumer loans have been reclassified to Financial instruments owned Corporate and other debt.

These reclassifications were primarily made in order to enhance the presentation of financial instruments on the Company s condensed consolidated statement of financial condition in connection with the Company s adoption of Statement of Financial Accounting Standards (SFAS) No. 157, Fair Value Measurements (SFAS No. 157).

Segments. Beginning in the second quarter of fiscal 2007, the Company s real estate investing business is included within the results of the Asset Management business segment. Previously, this business was included in the Institutional Securities business segment. Real estate advisory activities and certain passive limited

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

partnership interests remain within Institutional Securities. Income before taxes associated with the real estate investing activities that were transferred to the Asset Management business segment was $46 million and $102 million for the quarter and nine months ended August 31, 2006. In addition, activities associated with certain shareholder recordkeeping services are included within the Global Wealth Management Group business segment. Previously, these activities were included within the Asset Management business segment. These changes were made in order to reflect the manner in which these segments are currently managed.

For all of the above reclassifications, prior periods have been adjusted to conform to the current year s presentation.

Consolidation. The condensed consolidated financial statements include the accounts of the Company, its wholly-owned subsidiaries and other entities in which the Company has a controlling financial interest.

For entities where (1) the total equity investment at risk is sufficient to enable the entity to finance its activities independently, and (2) the equity holders bear the economic residual risks of the entity and have the right to make decisions about the entity s activities, the Company consolidates those entities it controls through a majority voting interest or otherwise. For entities that do not meet these criteria, commonly known as variable interest entities (VIE), the Company consolidates those entities where the Company absorbs a majority of the expected losses or a majority of the expected residual returns, or both, of such entities.

Notwithstanding the above, certain securitization vehicles, commonly known as qualifying special purpose entities, are not consolidated by the Company if they meet certain criteria regarding the types of assets and derivatives they may hold, the types of sales they may engage in, and the range of discretion they may exercise in connection with the assets they hold.

For investments in entities in which the Company does not have a controlling financial interest, but has significant influence over operating and financial decisions, the Company generally applies the equity method of accounting, except in instances where the Company has elected to fair value certain investments that had previously been accounted for under the equity method (see Note 18).

Equity and partnership interests held by entities qualifying for accounting purposes as investment companies are carried at fair value.

The Company s U.S. and international subsidiaries include Morgan Stanley & Co. Incorporated (MS&Co.), Morgan Stanley & Co. International plc (MSIP), Morgan Stanley Japan Securities Co., Ltd. (MSJS) and Morgan Stanley Investment Advisors Inc. On April 1, 2007, the Company merged Morgan Stanley DW Inc. (MSDWI) into MS&Co. Upon completion of the merger, the surviving entity, MS&Co., became the Company s principal U.S. broker-dealer.

Income Statement Presentation. The Company, through its subsidiaries and affiliates, provides a wide variety of products and services to a large and diversified group of clients and customers, including corporations, governments, financial institutions and individuals. In connection with the delivery of the various products and services to clients, the Company manages its revenues and related expenses in the aggregate. As such, when assessing the performance of its businesses, the Company considers its principal trading, investment banking, commissions and interest and dividend income, along with the associated interest expense, as one integrated activity for each of the Company s separate businesses.

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

The Company s cost infrastructure supporting its businesses varies by activity. In some cases, these costs are directly attributable to one line of business, and, in other cases, such costs relate to multiple businesses. As such, when assessing the performance of its businesses, the Company does not consider these costs separately, but rather assesses performance in the aggregate along with the related revenues.

Therefore, the Company s pricing structure considers various items, including the level of expenses incurred directly and indirectly to support the cost infrastructure, the risk it incurs in connection with a transaction, the overall client relationship and the availability in the market for the particular product and/or service. Accordingly, the Company does not manage or capture the costs associated with the products or services sold or its general and administrative costs by revenue line, in total or by product.

Revenue Recognition.

Investment Banking. Underwriting revenues and fees for mergers, acquisitions and advisory assignments are recorded when services for the transactions are determined to be completed, generally as set forth under the terms of the engagement. Transaction-related expenses, primarily consisting of legal, travel and other costs directly associated with the transaction, are deferred and recognized in the same period as the related investment banking transaction revenue. Underwriting revenues are presented net of related expenses. Non-reimbursed expenses associated with advisory transactions are recorded within Non-interest expenses.

Commissions. The Company generates commissions from executing and clearing customer transactions on stock, options and futures markets. Commission revenues are recorded in the accounts on trade date.

Asset Management, Distribution and Administration Fees. Asset management, distribution and administration fees are recognized over the relevant contract period, generally quarterly or annually. In certain management fee arrangements, the Company is entitled to receive performance-based fees (also referred to as incentive fees) when the return on assets under management exceeds certain benchmark returns or other performance targets. In such arrangements, performance fee revenue is accrued (or reversed) quarterly based on measuring account/fund performance to date versus the performance benchmark stated in the investment management agreement.

Financial Instruments. The Company s financial instruments owned and financial instruments sold, not yet purchased are recorded at fair value. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

In connection with the Company s adoption of SFAS No. 157 effective December 1, 2006, the Company categorizes its assets and liabilities that are accounted for at fair value in the condensed consolidated statements of financial condition into a fair value hierarchy as defined by SFAS No. 157. The fair value hierarchy is directly related to the amount of subjectivity associated with the inputs utilized to determine the fair value of these assets and liabilities. See Note 18 for further information about the fair value hierarchy and the Company s assets and liabilities that are accounted for at fair value.

As a result of the Company s adoption of SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities (SFAS No. 159), on December 1, 2006, the Company elected the fair value option for certain instruments. Such instruments included loans and other financial instruments held by subsidiaries that are not registered broker-dealers as defined in the AICPA Audit and Accounting Guide, *Brokers and Dealers in Securities*, or that are not held by investment companies as defined in the AICPA Audit and Accounting Guide, *Investment Companies*. A substantial portion of these positions, as well as the financial instruments included within Other secured financings, had been accounted for by the Company at fair value prior to the adoption of SFAS No. 159. Changes in the fair value of these positions are included within Principal transactions trading revenues in the Company s condensed consolidated statements of income.

Financial Instruments Used for Trading. Financial instruments owned and Financial instruments sold, not yet purchased, which include cash and derivative products, are recorded at fair value in the condensed consolidated statements of financial condition, and gains and losses are reflected net in Principal transactions trading

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

revenues in the condensed consolidated statements of income. Interest income and expense and dividend income are recorded within the condensed consolidated statements of income depending on the nature of the instrument and related market conventions.

The fair value of the Company s financial instruments are generally based on or derived from bid prices or parameters for Financial instruments owned and ask prices or parameters for Financial instruments sold, not yet purchased.

A substantial percentage of the fair value of the Company s financial instruments used for trading is based on observable market prices, observable market parameters, or is derived from such prices or parameters. The availability of observable market prices and pricing parameters can vary from product to product. Where available, observable market prices and pricing parameters in a product (or a related product) may be used to derive a price without requiring significant judgment. In certain markets, such as for products that are less actively traded, observable market prices or market parameters are not available, and fair value is determined using techniques appropriate for each particular product. These techniques can, at times, involve a significant degree of judgment.

In the case of financial instruments transacted on recognized exchanges, the observable prices represent quotations for completed transactions from the exchange on which the financial instrument is principally traded. Also as a result of the adoption of SFAS No. 157 on December 1, 2006, the Company no longer utilizes block discounts in cases where it has large holdings of unrestricted financial instruments with quoted prices that are readily and regularly available in an active market.

In the case of over-the-counter (OTC) derivative contracts, fair value is derived primarily using pricing models, which may require multiple market input parameters. Where appropriate, valuation adjustments are made to account for various factors, including credit quality and market liquidity. These adjustments are applied on a consistent basis and are based upon observable market data where available. The Company also uses pricing models to manage the risks introduced by OTC derivatives. 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 formulae, such as the Black-Scholes option pricing model, simulation models or a combination thereof, applied consistently. In the case of more established derivative products, the pricing models used by the Company are widely accepted by the financial services industry. Pricing models take into account the contract terms, including the maturity, as well as market parameters such as interest rates, volatility and the creditworthiness of the counterparty. As a result of the Company s adoption of SFAS No. 157, the impact of the Company s own credit spreads are also considered when measuring the fair value of liabilities, including OTC derivative contracts.

Prior to the adoption of SFAS No. 157, the Company followed the provisions of Emerging Issues Task Force (EITF) Issue No. 02-3, Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities (EITF Issue No. 02-3). See also Note 18. Under EITF Issue No. 02-3, in the absence of observable market prices or parameters in an active market, observable prices or parameters of other comparable current market transactions, or other observable data supporting a fair value based on a pricing model at the inception of a contract, revenue recognition at the inception of an OTC derivative financial instrument was not permitted. Such revenue was recognized in income at the earlier of when there was market value observability or at the end of the contract period. In the absence of observable market prices or parameters in an active market, observable prices or parameters of other comparable current market transactions, or other observable data supporting a fair value based on a pricing model at the inception of a contract, fair value was based on the transaction price. With the adoption of SFAS No. 157, the Company is no longer applying the revenue recognition criteria of EITF Issue No. 02-3.

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

Purchases and sales of financial instruments and related expenses are recorded on trade date. The fair value of OTC financial instruments, including derivative contracts related to financial instruments and commodities, are presented in the accompanying condensed consolidated statements of financial condition on a net-by-counterparty basis, when appropriate.

The Company nets cash collateral paid or received against its derivatives inventory under credit support annexes, which the Company views as conditional contracts, pursuant to legally enforceable master netting agreements.

Investment Activities. Substantially all equity and debt investments purchased in connection with private equity and other investment activities are recorded at fair value and are included within Financial instruments owned Investments in the condensed consolidated statements of financial condition, and gains and losses are primarily reflected in Principal transactions investment revenues. The carrying value of such investments reflects expected exit values based upon appropriate valuation techniques applied on a consistent basis. Such techniques employ various market, income and cost approaches to determine fair value at the measurement date. The Company s partnership interests are included within Financial instruments owned Investments in the condensed consolidated statements of financial condition and are recorded at fair value, which considers the fair value of the underlying partnership s net assets.

Financial Instruments Used for Asset and Liability Management. The Company applies hedge accounting to various derivative financial instruments used to hedge interest rate, foreign exchange and credit risk arising from assets, liabilities and forecasted transactions. These instruments are included within Financial instruments owned Derivative contracts or Financial instruments sold, not yet purchased Derivative contracts within the condensed consolidated statements of financial condition.

These hedges are designated and qualify for accounting purposes as one of the following types of hedges: hedges of changes in fair value of assets and liabilities due to the risk being hedged (fair value hedges), hedges of the variability of future cash flows from forecasted transactions and floating rate assets and liabilities due to the risk being hedged (cash flow hedges) and hedges of net investments in foreign operations whose functional currency is different from the reporting currency of the parent company (net investment hedges).

For all hedges where hedge accounting is being applied, effectiveness testing and other procedures to ensure the ongoing validity of the hedges are performed at least monthly. The impact of hedge ineffectiveness on the condensed consolidated statements of income, primarily related to fair value hedges, was a gain of $67 million and $133 million for the quarter and nine month period ended August 31, 2007, respectively. The amount excluded from the assessment of hedge effectiveness was immaterial. If a derivative is de-designated as a hedge, it is thereafter accounted for as a financial instrument used for trading.

Fair Value Hedges Interest Rate Risk.

In the first quarter of fiscal 2007, the Company began using regression analysis to perform an ongoing prospective and retrospective assessment of the effectiveness of these hedging relationships (i.e., the Company applied the long-haul method of hedge accounting). A hedging relationship is deemed to be effective if the fair values of the hedging instrument (derivative) and the hedged item (debt liability) change inversely within a range of 80% to 125%.

Previously, the Company s designated fair value hedges consisted primarily of interest rate swaps designated as fair value hedges of changes in the benchmark interest rate of fixed rate borrowings, including both certificates of deposit and senior long-term borrowings. For these hedges, the Company ensured that the terms of the hedging instruments and hedged items matched and other accounting criteria were met so that the hedges were assumed

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

to have no ineffectiveness (i.e., the Company applied the shortcut method of hedge accounting). The Company also used interest rate swaps as fair value hedges of the benchmark interest rate risk of host contracts of equity-linked notes that contained embedded derivatives. For these hedging relationships, regression analysis was used for the prospective and retrospective assessments of hedge effectiveness.

For qualifying fair value hedges of benchmark interest rates, the changes in the fair value of the derivative and the changes in the fair value of the hedged liability provide offset of one another and, together with any resulting ineffectiveness, are recorded in Interest expense. When a derivative is de-designated as a hedge, any basis adjustment remaining on the hedged liability is amortized to Interest expense over the life of the liability using the effective interest method.

Fair Value Hedges Credit Risk.

The Company has designated a portion of the credit derivative embedded in a non-recourse structured note liability as a fair value hedge of the credit risk arising from a loan receivable to which the structured note liability is specifically linked. Regression analysis is used to perform prospective and retrospective assessments of hedge effectiveness for this hedge relationship. The changes in the fair value of the derivative and the changes in the fair value of the hedged item provide offset of one another and, together with any resulting ineffectiveness, are recorded in Principal transactions trading revenues.

Cash Flow Hedges.

Before the sale of the aircraft leasing business (see Note 15), the Company applied hedge accounting to interest rate swaps used to hedge variable rate long-term borrowings associated with this business. Changes in the fair value of the swaps were recorded in Accumulated other comprehensive income (loss) in Shareholders equity, net of tax effects, and then reclassified to Interest expense as interest on the hedged borrowings was recognized.

In connection with the sale of the aircraft leasing business, the Company de-designated the interest rate swaps associated with this business effective August 31, 2005 and no longer accounts for them as cash flow hedges. Amounts in Accumulated other comprehensive income (loss) related to those interest rate swaps continue to be reclassified to Interest expense since the related borrowings remain outstanding.

Net Investment Hedges.

The Company utilizes forward foreign exchange contracts and non-U.S. dollar-denominated debt to manage the currency exposure relating to its net investments in non-U.S. dollar functional currency operations. No hedge ineffectiveness is recognized in earnings since the notional amounts of the hedging instruments equal the portion of the investments being hedged, and, where forward contracts are used, the currencies being exchanged are the functional currencies of the parent and investee; where debt instruments are used as hedges, they are denominated in the functional currency of the investee. The gain or loss from revaluing hedges of net investments in foreign operations at the spot rate is deferred and reported within Accumulated other comprehensive income (loss) in Shareholders equity, net of tax effects. The forward points on the hedging instruments are recorded in Interest and dividend revenues.

Securitization Activities. The Company engages in securitization activities related to commercial and residential mortgage loans, corporate bonds and loans, U.S. agency collateralized mortgage obligations and other types of financial assets (see Note 3). The Company may retain interests in the securitized financial assets as one or more tranches of the securitization. The exposure to credit losses from securitized loans is limited to the Company s

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

retained contingent risk, which represents the Company s retained interest in securitized loans. The gain or loss on the sale of financial assets depends, in part, on the previous carrying amount of the assets involved in the transfer allocated between the assets sold and the retained interests based upon their respective fair values at the date of sale. To determine fair values, observable market prices are used if available. However, observable market prices may not be available for certain retained interests so the Company estimates fair value based on the present value of expected future cash flows using its best estimates of the key assumptions, including forecasted credit losses, payment rates, forward yield curves and discount rates commensurate with the risks involved.

In connection with the adoption of SFAS No. 156, Accounting for Servicing of Financial Assets, an amendment of FASB Statement No. 140 (SFAS No. 156) on December 1, 2006, the Company has elected to fair value mortgage servicing rights (see Note 3).

Securities Available for Sale. In the second quarter of fiscal 2007, the Company purchased certain debt securities that have been classified as securities available for sale . Securities available for sale are reported at fair value within Other Investments in the condensed consolidated statement of financial condition with unrealized gains and losses reported in Other Comprehensive Income (net of tax). Realized gains and losses and other-than-temporary impairments associated with securities available for sale are reported in Other revenues in the condensed consolidated statement of income (see Note 19).

Stock-Based Compensation. The Company early adopted SFAS No. 123R, Share-Based Payment, using the modified prospective approach as of December 1, 2004. SFAS No. 123R revised the fair value-based method of accounting for share-based payment liabilities, forfeitures and modifications of stock-based awards and clarified guidance in several areas, including measuring fair value, classifying an award as equity or as a liability and attributing compensation cost to service periods.

For stock-based awards issued prior to the adoption of SFAS No. 123R, the Company s accounting policy for awards granted to retirement-eligible employees is to recognize compensation cost over the service period specified in the award terms. The Company accelerates any unrecognized compensation cost for such awards if and when a retirement-eligible employee leaves the Company.

For fiscal 2005 year-end stock-based compensation awards that were granted to retirement-eligible employees in December 2005, the Company recognized the compensation cost for such awards at the date of grant instead of over the service period specified in the award terms. As a result, the Company recorded non-cash incremental compensation expenses of approximately $378 million in the first quarter of fiscal 2006 for stock-based awards granted to retirement-eligible employees as part of the fiscal 2005 year-end award process and for awards granted to retirement-eligible employees, including new hires, in the first quarter of fiscal 2006. These incremental expenses were included within Compensation and benefits expense and reduced income before taxes within the Institutional Securities ($270 million), Global Wealth Management Group ($80 million) and Asset Management ($28 million) business segments.

Consolidated Statements of Cash Flows. For purposes of these statements, cash and cash equivalents consist of cash and highly liquid investments not held for resale with maturities, when purchased, of three months or less. In connection with business acquisitions, the Company assumed liabilities of $7,704 million and $30 million in the nine months ended August 31, 2007 and August 31, 2006, respectively. In connection with the Discover Spin-off, net assets of approximately $5,558 million were distributed to shareholders (see Note 15).

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

2. Goodwill and Net Intangible Assets.

The Company completed its annual goodwill impairment testing, in accordance with SFAS No. 142, Goodwill and Other Intangible Assets as of December 1, 2006 and 2005. During the quarter ended August 31, 2007, the Company changed the date of its annual goodwill impairment testing to June 1 in order to move the impairment testing outside of the Company s normal year-end reporting process to a date when resources are less constrained. The Company believes that the resulting change in accounting principle related to the annual testing date will not delay, accelerate, or avoid an impairment charge. Goodwill impairment tests performed as of June 1, 2007 and December 1, 2006 and 2005 concluded that no impairment charges were required as of those dates. The Company determined that the change in accounting principle related to the annual testing date is preferable under the circumstances and does not result in adjustments to the Company s financial statements when applied retrospectively.

Changes in the carrying amount of the Company s goodwill and intangible assets for the nine month period ended August 31, 2007 were as follows:

	Institutional Securities	Global Wealth Management Group	Asset Management	Discover	Total
		(dollars in millions)			
Goodwill:					
Balance as of November 30, 2006	$ 701	$ 589	$ 968	$ 534	$ 2,792
Translation adjustments		9		2	11
Goodwill acquired during the period and other(1)	415	3	132		550
Goodwill disposed during the period(2)	(8)	(255)		(536)	(799)
Balance as of August 31, 2007	$ 1,108	$ 346	$ 1,100	$	$ 2,554

	Institutional Securities	Global Wealth Management Group	Asset Management	Discover	Total
		(dollars in millions)			
Intangible assets(3):					
Balance as of November 30, 2006	$ 447	$	$ 3	$ 201	$ 651
Intangible assets acquired during the period and other(1)	341		205	5	551
Intangible assets disposed during the period(2)	(39)			(200)	(239)
Amortization expense and other(4)	(51)		(9)	(6)	(66)
Balance as of August 31, 2007	$ 698	$	$ 199	$	$ 897

(1) Institutional Securities activity primarily represents goodwill and intangible assets acquired in connection with the Company s acquisitions of Saxon Capital, Inc. and CityMortgage Bank. Asset Management activity represents goodwill and intangible assets acquired in connection with the Company s acquisitions of FrontPoint Partners, Brookville Capital Management and Affinity Asset Management.

(2) Global Wealth Management Group activity primarily represents goodwill disposed of in connection with the Company s sale of Quilter. Discover activity represents goodwill and intangible assets disposed of in connection with the Discover Spin-off (see Note 15).

(3) Effective December 1, 2006, mortgage servicing rights have been included in net intangible assets. Amounts as of November 30, 2006 have been reclassified to conform with the current presentation. See Note 3 for further information on the Company s mortgage servicing rights.

(4) Amortization expense for Discover is included in discontinued operations.

14

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

3. Collateralized and Securitization Transactions.

Securities purchased under agreements to resell (reverse repurchase agreements) and Securities sold under agreements to repurchase (repurchase agreements), principally government and agency securities, are carried at the amounts at which the securities subsequently will be resold or reacquired as specified in the respective agreements; such amounts include accrued interest. Reverse repurchase agreements and repurchase agreements are presented on a net-by-counterparty basis, when appropriate. The Company s policy is to take possession of securities purchased under agreements to resell. Securities borrowed and Securities loaned are carried at the amounts of cash collateral advanced and received in connection with the transactions. Other secured financings include the liabilities related to transfers of financial assets that are accounted for as financings rather than sales, consolidated variable interest entities where the Company is deemed to be the primary beneficiary and certain equity-referenced securities and loans where in all instances these liabilities are payable solely from the cash flows of the related assets accounted for as Financial instruments owned.

The Company pledges its financial instruments owned to collateralize repurchase agreements and other securities financings. Pledged securities that can be sold or repledged by the secured party are identified as Financial instruments owned (pledged to various parties) in the condensed consolidated statements of financial condition. The carrying value and classification of securities owned by the Company that have been loaned or pledged to counterparties where those counterparties do not have the right to sell or repledge the collateral were as follows:

	At August 31, 2007	At November 30, 2006
	(dollars in millions)	
Financial instruments owned:		
U.S. government and agency securities	$ 10,191	$ 12,111
Other sovereign government obligations	893	893
Corporate and other debt	44,185	44,237
Corporate equities	3,910	6,662
Total	$ 59,179	$ 63,903

The Company enters into reverse repurchase agreements, repurchase agreements, securities borrowed and securities loaned transactions to, among other things, acquire securities to cover short positions and settle other securities obligations, to accommodate customers needs and to finance the Company s inventory positions. The Company also engages in securities financing transactions for customers through margin lending. Under these agreements and transactions, the Company either receives or provides collateral, including U.S. government and agency securities, other sovereign government obligations, corporate and other debt, and corporate equities. The Company receives collateral in the form of securities in connection with reverse repurchase agreements, securities borrowed and derivative transactions, and customer margin loans. In many cases, the Company is permitted to sell or repledge these securities held as collateral and use the securities to secure repurchase agreements, to enter into securities lending and derivative transactions or for delivery to counterparties to cover short positions. At August 31, 2007 and November 30, 2006, the fair value of securities received as collateral where the Company is permitted to sell or repledge the securities was $987 billion and $942 billion, respectively, and the fair value of the portion that has been sold or repledged was $771 billion and $780 billion, respectively.

The Company additionally receives securities as collateral in connection with certain securities for securities transactions in which the Company is the lender. In instances where the Company is permitted to sell or repledge these securities, the Company reports the fair value of the collateral received and the related obligation to return

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

the collateral in the condensed consolidated statement of financial condition. At August 31, 2007 and November 30, 2006, $92 billion and $65 billion, respectively, were reported as Securities received as collateral and an Obligation to return securities received as collateral in the condensed consolidated statements of financial condition. Collateral received in connection with these transactions that was subsequently repledged was approximately $80 billion and $45 billion at August 31, 2007 and November 30, 2006, respectively.

The Company manages credit exposure arising from reverse repurchase agreements, repurchase agreements, securities borrowed and securities loaned transactions by, in appropriate circumstances, entering into master netting agreements and collateral arrangements with counterparties that provide the Company, in the event of a customer default, the right to liquidate collateral and the right to offset a counterparty s rights and obligations. The Company also monitors the fair value of the underlying securities as compared with the related receivable or payable, including accrued interest, and, as necessary, requests additional collateral to ensure such transactions are adequately collateralized. Where deemed appropriate, the Company s agreements with third parties specify its rights to request additional collateral. Customer receivables generated from margin lending activity are collateralized by customer-owned securities held by the Company. For these transactions, adherence to the Company s collateral policies significantly limits the Company s credit exposure in the event of customer default. The Company may request additional margin collateral from customers, if appropriate, and, if necessary, may sell securities that have not been paid for or purchase securities sold, but not delivered from customers.

In connection with its Institutional Securities business, the Company engages in securitization activities related to residential and commercial mortgage loans, U.S. agency collateralized mortgage obligations, corporate bonds and loans, and other types of financial assets. These assets are carried at fair value, and any changes in fair value are recognized in the condensed consolidated statements of income. The Company may act as underwriter of the beneficial interests issued by securitization vehicles. Underwriting net revenues are recognized in connection with these transactions. The Company may retain interests in the securitized financial assets as one or more tranches of the securitization. These retained interests are included in the condensed consolidated statements of financial condition at fair value. Any changes in the fair value of such retained interests are recognized in the condensed consolidated statements of income. Retained interests in securitized financial assets associated with the Institutional Securities business were approximately $6.4 billion at August 31, 2007, the majority of which were related to residential mortgage loan, U.S. agency collateralized mortgage obligation and commercial mortgage loan securitization transactions. Net gains at the time of securitization were $69 million in the nine month period ended August 31, 2007. The assumptions that the Company used to determine the fair value of its retained interests at the time of securitization related to those transactions that occurred during the quarter and nine month period ended August 31, 2007 were not materially different from the assumptions included in the table below.

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

The following table presents information on the Company s residential mortgage loan, commercial mortgage loan and U.S. agency collateralized mortgage obligation securitization transactions. Key economic assumptions and the sensitivity of the current fair value of the retained interests to immediate 10% and 20% adverse changes in those assumptions at August 31, 2007 were as follows (dollars in millions):

	Residential Mortgage Loans	Commercial Mortgage Loans	U.S. Agency Collateralized Mortgage Obligations
Investment grade retained interests	$ 572	$ 1,058	$ 1,411
Non-investment grade retained interests	2,518	646	
Total retained interests (carrying amount/fair value)	$ 3,090	$ 1,704	$ 1,411
Weighted average life (in months)	51	60	74
Credit losses (rate per annum)	0.00 - 8.00%	0.00 - 5.20%	
Impact on fair value of 10% adverse change	$ (264)	$ (4)	$
Impact on fair value of 20% adverse change	$ (517)	$ (8)	$
Weighted average discount rate (rate per annum)	11.46%	7.55%	5.69%
Impact on fair value of 10% adverse change	$ (101)	$ (22)	$ (40)
Impact on fair value of 20% adverse change	$ (193)	$ (44)	$ (77)
Prepayment speed assumption(1)(2)	194-7500 PSA		152-362 PSA
Impact on fair value of 10% adverse change	$ (190)	$	$ (5)
Impact on fair value of 20% adverse change	$ (282)	$	$ (10)

(1) Amounts for residential mortgage loans exclude positive valuation effects from immediate 10% and 20% changes.
(2) Commercial mortgage loans typically contain provisions that either prohibit or economically penalize the borrower from prepaying the loan for a specified period of time.

The table above does not include the offsetting benefit of any financial instruments that the Company may utilize to hedge risks inherent in its retained interests. In addition, the sensitivity analysis is hypothetical and should be used with caution. Changes in fair value based on a 10% or 20% variation in an assumption generally cannot be extrapolated because the relationship of the change in the assumption to the change in fair value may not be linear. Also, the effect of a variation in a particular assumption on the fair value of the retained interests is calculated independent of changes in any other assumption; in practice, changes in one factor may result in changes in another, which might magnify or counteract the sensitivities. In addition, the sensitivity analysis does not consider any corrective action that the Company may take to mitigate the impact of any adverse changes in the key assumptions.

In connection with its Institutional Securities business, during the nine month periods ended August 31, 2007 and 2006, the Company received proceeds from new securitization transactions of $55.9 billion and $52.8 billion, respectively, and cash flows from retained interests in securitization transactions of $4.1 billion and $3.9 billion, respectively.

Mortgage Servicing Rights. In connection with its Institutional Securities business, the Company may retain servicing rights to certain mortgage loans that are sold through its securitization activities. These transactions create an asset referred to as mortgage servicing rights (MSRs), which are included within Intangible assets in the condensed consolidated statements of financial condition.

In March 2006, the Financial Accounting Standards Board (the FASB) issued SFAS No. 156, which requires all separately recognized servicing assets and servicing liabilities to be initially measured at fair value, if

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

practicable. The standard permits an entity to subsequently measure each class of servicing assets or servicing liabilities at fair value and report changes in fair value in the statement of income in the period in which the changes occur. The Company adopted SFAS No. 156 on December 1, 2006 and has elected to fair value MSRs held as of the date of adoption. This election did not have a material impact on the Company s opening balance of Retained earnings as of December 1, 2006. The Company also elected to fair value MSRs acquired after December 1, 2006.

The following table presents information about the Company s MSRs, which relate to its mortgage loan business activities (dollars in millions):

	Three Months Ended August 31, 2007	Nine Months Ended August 31, 2007
	(dollars in millions)	
Fair value as of the beginning of the period	$ 338	$ 93
Additions:		
Purchases of servicing assets(1)	15	283
Servicing assets that result from transfers of financial assets	251	388
Total Additions	266	671
Subtractions:		
Sales/Disposals	(208)	(317)
Changes in fair value(2)	(39)	(90)
Fair value as of the end of the period	$ 357	$ 357
Amount of contractually specified(2):		
Servicing fees	$ 46	$ 122
Late fees	7	19
Ancillary fees		1
	$ 53	$ 142

(1) Includes MSRs obtained in connection with the Company s acquisition of Saxon Capital, Inc. (see Note 16).
(2) These amounts are recorded within Other revenues in the Company s condensed consolidated statements of income.

	Three Months Ended August 31, 2007	Nine Months Ended August 31, 2007
Assumptions Used in Measuring Fair Value:		

Weighted average discount rate	16.64%	16.80%
Weighted average prepayment speed assumption	641 PSA	641 PSA

The Company generally utilizes information provided by third parties in order to determine the fair value of its MSRs. The valuation of MSRs consist of projecting servicing cash flows and discounting such cash flows using an appropriate risk-adjusted discount rate. These valuations require estimation of various assumptions, including future servicing fees, credit losses and other related costs, discount rates and mortgage prepayment speeds. The Company also compares the estimated fair values of the MSRs from the valuations with observable trades of similar instruments or portfolios. Due to subsequent changes in economic and market conditions, the actual rates of prepayments, credit losses and the value of collateral may differ significantly from the Company s original estimates. Such differences could be material. If actual prepayment rates and credit losses were higher than those

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

assumed, the value of the Company s MSRs could be adversely affected. The Company may hedge a portion of its MSRs through the use of financial instruments, including certain derivative contracts.

4. Consumer Loans.

Consumer loans (net of allowances of $831 million) totaled $22,915 million at November 30, 2006 and were primarily related to general purpose credit card and consumer installment loans of DFS. The Company completed the Discover Spin-off in June 2007 (see Note 15). See Note 5 of the Form 8-K for information on Consumer loans as of November 30, 2006.

5. Long-Term Borrowings and Capital Units.

Long-term Borrowings. Long-term borrowings at August 31, 2007 scheduled to mature within one year aggregated $22,984 million.

During the nine month period ended August 31, 2007, the Company issued senior notes with a carrying value at quarter end aggregating $55,551 million, including non-U.S. dollar currency notes aggregating $23,728 million. Maturities in the aggregate of these notes by fiscal year are as follows: 2007, $318 million; 2008, $5,418 million; 2009, $4,774 million; 2010, $9,479 million; 2011, $1,654 million; and thereafter, $33,908 million. In the nine month period ended August 31, 2007, $21,970 million of senior notes were repaid.

The weighted average maturity of the Company s long-term borrowings, based upon stated maturity dates, was approximately 5.6 years at August 31, 2007.

Capital Units. The Company redeemed all $66 million of the outstanding Capital Units on February 28, 2007.

6. Shareholders Equity.

Regulatory Requirements. On April 1, 2007, the Company merged MSDWI into MS&Co. Upon completion of the merger, the surviving entity, MS&Co., became the Company s principal U.S. broker-dealer. MS&Co. is a registered broker-dealer and registered futures commission merchant and, accordingly, subject to the minimum net capital requirements of the Securities and Exchange Commission (the SEC), the New York Stock Exchange, Inc. and the Commodity Futures Trading Commission. MS&Co. has consistently operated in excess of these requirements. MS&Co. s net capital totaled $6,446 million at August 31, 2007, which exceeded the amount required by $4,876 million. MSIP, a London-based broker-dealer subsidiary, is subject to the capital requirements of the Financial Services Authority, and MSJS, a Tokyo-based broker-dealer subsidiary, is subject to the capital requirements of the Financial Services Agency. MSIP and MSJS consistently operated in excess of their respective regulatory capital requirements.

Under regulatory capital requirements adopted by the Federal Deposit Insurance Corporation (the FDIC) and other bank regulatory agencies, FDIC-insured financial institutions must maintain (a) 3% to 4% of Tier 1 capital, as defined, to average assets (leverage ratio), (b) 4% of Tier 1 capital, as defined, to risk-weighted assets (Tier 1 risk-weighted capital ratio) and (c) 8% of total capital, as defined, to risk-weighted assets (total risk-weighted capital ratio). At August 31, 2007, the leverage ratio, Tier 1 risk-weighted capital ratio and total risk-weighted capital ratio of each of the Company s FDIC-insured financial institutions exceeded these regulatory minimums.

Certain other U.S. and non-U.S. subsidiaries are subject to various securities, commodities and banking regulations, and capital adequacy requirements promulgated by the regulatory and exchange authorities of the

19

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

countries in which they operate. These subsidiaries have consistently operated in excess of their local capital adequacy requirements. Morgan Stanley Derivative Products Inc. and Cournot Financial Products LLC, which are triple-A rated derivative products subsidiaries, maintain certain operating restrictions that have been reviewed by various rating agencies.

The Company is a consolidated supervised entity (CSE) as defined by the SEC. As such, the Company is subject to group-wide supervision and examination by the SEC and to minimum capital requirements on a consolidated basis. As of August 31, 2007, the Company was in compliance with the CSE capital requirements.

MS&Co. is required to hold tentative net capital in excess of $1 billion and net capital in excess of $500 million in accordance with the market and credit risk standards of Appendix E of Rule 15c3-1. MS&Co. is also required to notify the SEC in the event that its tentative net capital is less than $5 billion. As of August 31, 2007, MS&Co. had tentative net capital in excess of the minimum and the notification requirements.

Treasury Shares. During the nine month period ended August 31, 2007, the Company purchased approximately $3.2 billion of its common stock (approximately 42 million shares) through publicly announced plans or programs at an average cost of $76.23 per share, which includes the actual price of shares purchased prior to the Discover Spin-off. During the nine month period ended August 31, 2006, the Company purchased approximately $2.4 billion of its common stock through publicly announced plans or programs at an average cost of $61.76 per share.

7. Earnings per Common Share.

Basic earnings per share (EPS) is computed by dividing income available to common shareholders by the weighted average number of common shares outstanding for the period. Diluted EPS reflects the assumed conversion of all dilutive securities. The following table presents the calculation of basic and diluted EPS (in millions, except for per share data):

	Three Months Ended August 31,		Nine Months Ended August 31,	
	2007	2006	2007	2006
Basic EPS:				
Income from continuing operations	$ 1,474	$ 1,588	$ 6,151	$ 4,353
Gain on discontinued operations	69	263	646	913
Preferred stock dividend requirements	(17)		(50)	
Net income applicable to common shareholders	$ 1,526	$ 1,851	$ 6,747	$ 5,266
Weighted average common shares outstanding	1,002	1,010	1,003	1,015
Earnings per basic common share:				
Income from continuing operations	$ 1.45	$ 1.57	$ 6.08	$ 4.29
Gain on discontinued operations	0.07	0.26	0.65	0.90
Earnings per basic common share	$ 1.52	$ 1.83	$ 6.73	$ 5.19
Diluted EPS:				
Net income applicable to common shareholders	$ 1,526	$ 1,851	$ 6,747	$ 5,266

Weighted average common shares outstanding	1,002	1,010	1,003	1,015
Effect of dilutive securities:				
Stock options and restricted stock units	55	46	51	41
Weighted average common shares outstanding and common stock equivalents	1,057	1,056	1,054	1,056
Earnings per diluted common share:				
Income from continuing operations	$ 1.38	$ 1.50	$ 5.79	$ 4.12
Gain on discontinued operations	0.06	0.25	0.61	0.87
Earnings per diluted common share	$ 1.44	$ 1.75	$ 6.40	$ 4.99

20

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

The following securities were considered antidilutive and therefore were excluded from the computation of diluted EPS:

	Three Months Ended August 31,		Nine Months Ended August 31,	
	2007	2006	2007	2006
	(shares in millions)			
Number of antidilutive securities (including stock options and restricted stock units) outstanding at end of period	19	40	19	41

Cash dividends declared per common share were $0.27 and $0.81 for the quarter and nine month periods ended August 31, 2007 and 2006, respectively.

8. Commitments and Contingencies.

The Company s commitments as of August 31, 2007 are summarized below by period of expiration. Since commitments may expire unused, the amounts shown do not necessarily reflect the actual future cash funding requirements:

	Years to Maturity				
	Less than 1	1-3	3-5	Over 5	Total
	(dollars in millions)				
Letters of credit and other financial guarantees(1)	$ 10,739	$ 1	$	$	$ 10,740
Investment activities(2)	402	185	3	854	1,444
Investment grade corporate lending commitments(3)	18,759	7,703	22,148	1,770	50,380
Non-investment grade corporate lending commitments(3)	3,812	823	4,425	26,615	35,675
Sales and trading-related commitments(4)	677	1,549	1,090	8,369	11,685
Commitments for secured lending transactions(5)	8,199	3,695	1,248	2,601	15,743
Commitments to purchase mortgage loans(6)	222				222
Commitments to originate mortgage loans(7)	869				869
Commitments to extend credit for mortgage lending(8)	3,985				3,985
Commitments to municipal bond trusts(9)	16,020				16,020
Other commitments(10)	1,221	42	4		1,267
Total	$ 64,905	$ 13,998	$ 28,918	$ 40,209	$ 148,030

(1) This amount represents the Company s outstanding letters of credit and other financial guarantees, which are primarily used to satisfy various collateral requirements.
(2) This amount represents commitments associated with the Company s real estate, private equity and principal investment activities.
(3) The Company s investment grade and non-investment grade lending commitments are made in connection with corporate lending and other business activities. Credit ratings for commitments are determined by the Company s Institutional Credit Department using methodologies generally consistent with those employed by external rating agencies. Obligor credit ratings of BB+ or lower are considered non-investment grade.

(4) This amount represents commitments associated with the Company s Institutional Securities sales and trading activities.

(5) This amount represents lending commitments extended by the Company to companies that are secured by assets of the borrower. Loans made under these arrangements typically are at variable rates and generally provide for over-collateralization based upon the creditworthiness of the borrower. This amount also includes commitments to asset-backed commercial paper conduits of $1,974 million, which primarily have maturities of less than 3 years.

(6) This amount represents the Company s forward purchase contracts involving mortgage loans.

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

(7) This amount represents residential mortgage loan commitments to individuals.
(8) This amount represents residential home equity lines of credit.
(9) This amount represents commitments to municipal bond trusts in connection with the Company s Institutional Securities business.
(10) This amount includes commercial loan commitments to small businesses and commitments related to securities-based lending activities in connection with the Company s Global Wealth Management Group business.

In the ordinary course of business, the Company guarantees the debt and/or certain trading obligations (including obligations associated with derivatives, foreign exchange contracts and the settlement of physical commodities) of certain subsidiaries. These guarantees generally are entity or product specific and are required by investors or trading counterparties. The activities of the subsidiaries covered by these guarantees (including any related debt or trading obligations) are included in the Company s condensed consolidated financial statements.

At August 31, 2007, the Company had commitments to enter into reverse repurchase and repurchase agreements of approximately $99 billion and $50 billion, respectively.

Legal. In the normal course of business, the Company has been named, from time to time, as a defendant in various legal actions, including arbitrations, class actions and other litigation, arising in connection with its activities as a global diversified financial services institution. Certain of the actual or threatened legal actions include claims for substantial compensatory and/or punitive damages or claims for indeterminate amounts of damages. In some cases, the issuers that would otherwise be the primary defendants in such cases are bankrupt or in financial distress.

The Company is also involved, from time to time, in other reviews, investigations and proceedings (both formal and informal) by governmental and self-regulatory agencies regarding the Company s business, including, among other matters, accounting and operational matters, certain of which may result in adverse judgments, settlements, fines, penalties, injunctions or other relief. The number of reviews, investigations and proceedings has increased in recent years with regards to many firms in the financial services industry, including the Company.

The Company contests liability and/or the amount of damages as appropriate in each pending matter. In view of the inherent difficulty of predicting the outcome of such matters, particularly in cases where claimants seek substantial or indeterminate damages or where investigations and proceedings are in the early stages, the Company cannot predict with certainty the loss or range of loss, if any, related to such matters, how or if such matters will be resolved, when they will ultimately be resolved, or what the eventual settlement, fine, penalty or other relief, if any, might be. Subject to the foregoing, and except for the pending matter described in the paragraphs below, the Company believes, based on current knowledge and after consultation with counsel, that the outcome of the pending matters will not have a material adverse effect on the condensed consolidated financial condition of the Company, although the outcome of such matters could be material to the Company s operating results and cash flows for a particular future period, depending on, among other things, the level of the Company s revenues or income for such period. Legal reserves have been established in accordance with SFAS No. 5, Accounting for Contingencies (SFAS No. 5). Once established, reserves are adjusted when there is more information available or when an event occurs requiring a change.

Coleman Litigation. On May 8, 2003, Coleman (Parent) Holdings Inc. (CPH) filed a complaint against the Company in the Circuit Court of the Fifteenth Judicial Circuit for Palm Beach County, Florida. The complaint relates to the 1998 merger between The Coleman Company, Inc. (Coleman) and Sunbeam, Inc. (Sunbeam). The complaint, as amended, alleges that CPH was induced to agree to the transaction with Sunbeam based on certain financial misrepresentations, and it asserts claims against the Company for aiding and abetting fraud, conspiracy and punitive damages. Shortly before trial, which commenced in April 2005, the trial court granted, in part, a motion for entry of a default judgment against the Company and ordered that portions of CPH s

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

complaint, including those setting forth CPH s primary allegations against the Company, be read to the jury and deemed established for all purposes in the action. In May 2005, the jury returned a verdict in favor of CPH and awarded CPH $604 million in compensatory damages and $850 million in punitive damages. On June 23, 2005, the trial court issued a final judgment in favor of CPH in the amount of $1,578 million, which included prejudgment interest and excluded certain payments received by CPH in settlement of related claims against others.

On June 27, 2005, the Company filed a notice of appeal with the District Court of Appeal for the Fourth District of Florida (the Court of Appeal) and posted a supersedeas bond, which automatically stayed execution of the judgment pending appeal.

On March 21, 2007, the Court of Appeal issued an opinion reversing the trial court s award for compensatory and punitive damages and remanding the case to the trial court for entry of a judgment for the Company. On June 4, 2007, the Court of Appeal s March 21, 2007 opinion became final when the Court of Appeal issued an order denying CPH s motions for rehearing, rehearing *en banc* and for certification of certain questions for review by the Florida Supreme Court (the Supreme Court). On June 11, 2007, the trial court issued an order cancelling the supersedeas bond that the Company had posted. On July 2, 2007 CPH filed a petition with the Supreme Court asking that court to review the Court of Appeal s decision. On July 25, 2007, the Company filed a brief with the Supreme Court in opposition to CPH s request that the Supreme Court review the March 21, 2007 decision of the Court of Appeal. The Company is maintaining a reserve for the Coleman litigation. The reserve is presently $360 million, which the Company believes to be a reasonable estimate, under SFAS No. 5, of the low end of the range of its probable exposure in the event the Court of Appeal s March 21, 2007 opinion is reversed or modified as a result of further appellate proceedings and the case remanded for a new trial. If the trial court s compensatory and/or punitive awards are ultimately upheld on appeal, in whole or in part, the Company may incur an additional expense equal to the difference between the amount affirmed on appeal (and post-judgment interest thereon) and the amount of the reserve. While the Company cannot predict with certainty the amount of such additional expense, such additional expense could have a material adverse effect on the condensed consolidated financial condition of the Company and/or the Company s or Institutional Securities operating results and cash flows for a particular future period, and the upper end of the range could exceed $1.5 billion.

Income Taxes. For information on contingencies associated with income tax examinations, see Note 17.

9. Derivative Contracts.

In the normal course of business, the Company enters into a variety of derivative contracts related to financial instruments and commodities. The Company uses these instruments for trading and investment purposes, as well as for asset and liability management. These instruments generally represent future commitments to swap interest payment streams, exchange currencies, or purchase or sell commodities and other financial instruments on specific terms at specified future dates. Many of these products have maturities that do not extend beyond one year, although swaps, options and equity warrants typically have longer maturities. For further discussion of these matters, refer to Note 11 to the consolidated financial statements for the fiscal year ended November 30, 2006, included in the Form 8-K.

Future changes in interest rates, foreign currency exchange rates or the fair values of the financial instruments, commodities or indices underlying these contracts ultimately may result in cash settlements exceeding fair value amounts recognized in the condensed consolidated statements of financial condition. The amounts in the following table represent the fair value of exchange traded and OTC options and other contracts (including interest rate, foreign exchange, and other forward contracts and swaps) for derivatives for trading and investment

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

and for asset and liability management, net of offsetting positions in situations where netting is appropriate. The asset amounts are not reported net of non-cash collateral, which the Company obtains with respect to certain of these transactions to reduce its exposure to credit losses.

Credit risk with respect to derivative instruments arises from the failure of a counterparty to perform according to the terms of the contract. The Company s exposure to credit risk at any point in time is represented by the fair value of the contracts reported as assets. The Company monitors the creditworthiness of counterparties to these transactions on an ongoing basis and requests additional collateral when deemed necessary.

The Company s derivatives (both listed and OTC), net of cash collateral, at August 31, 2007 and November 30, 2006 are summarized in the table below, showing the fair value of the related assets and liabilities by product:

	At August 31, 2007		At November 30, 2006	
Product Type	Assets	Liabilities	Assets	Liabilities
	(dollars in millions)			
Interest rate and currency swaps, interest rate options, credit derivatives and other fixed income securities contracts	$ 26,437	$ 17,122	$ 19,444	$ 15,688
Foreign exchange forward contracts and options	5,952	6,775	7,325	7,725
Equity securities contracts (including equity swaps, warrants and options)	18,570	27,604	16,705	23,155
Commodity forwards, options and swaps	11,529	10,587	11,969	10,923
Total	$ 62,488	$ 62,088	$ 55,443	$ 57,491

10. Segment Information.

The Company structures its segments primarily based upon the nature of the financial products and services provided to customers and the Company s management organization. The Company provides a wide range of financial products and services to its customers in each of its business segments: Institutional Securities, Global Wealth Management Group and Asset Management. For further discussion of the Company s business segments, see Note 1. Certain reclassifications have been made to prior-period amounts to conform to the current period s presentation.

Revenues and expenses directly associated with each respective segment are included in determining their operating results. Other revenues and expenses that are not directly attributable to a particular segment are allocated based upon the Company s allocation methodologies, generally based on each segment s respective net revenues, non-interest expenses or other relevant measures.

As a result of treating certain intersegment transactions as transactions with external parties, the Company includes an Intersegment Eliminations category to reconcile the segment results to the Company s consolidated results. Income before taxes in Intersegment Eliminations primarily represents the effect of timing differences associated with the revenue and expense recognition of commissions paid by Asset Management to the Global Wealth Management Group associated with sales of certain products and the related compensation costs paid to the Global Wealth Management Group s global representatives.

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

Selected financial information for the Company s segments is presented below:

Three Months Ended August 31, 2007	Institutional Securities	Global Wealth Management Group	Asset Management	Intersegment Eliminations(4)	Total
			(dollars in millions)		
Net revenues excluding net interest	$ 4,049	$ 1,488	$ 1,372	$ (84)	$ 6,825
Net interest	934	195	(8)	12	1,133
Net revenues	$ 4,983	$ 1,683	$ 1,364	$ (72)	$ 7,958
Income from continuing operations before losses from unconsolidated investees and income taxes	$ 1,501	$ 287	$ 491	$ (14)	$ 2,265
Losses from unconsolidated investees	(19)				(19)
Provision for income taxes	483	119	174	(4)	772
Income from continuing operations(2)	$ 999	$ 168	$ 317	$ (10)	$ 1,474

Three Months Ended August 31, 2006	Institutional Securities(1)	Global Wealth Management Group(1)	Asset Management(1)	Intersegment Eliminations(1)	Total
			(dollars in millions)		
Net revenues excluding net interest	$ 4,575	$ 1,235	$ 835	$ (53)	$ 6,592
Net interest	319	136	10	7	472
Net revenues	$ 4,894	$ 1,371	$ 845	$ (46)	$ 7,064
Income from continuing operations before gains from unconsolidated investees and income taxes	$ 1,915	$ 161	$ 155	$ 13	$ 2,244
Gains from unconsolidated investees	20				20
Provision for income taxes	556	54	61	5	676
Income from continuing operations(2)	$ 1,379	$ 107	$ 94	$ 8	$ 1,588

Nine Months Ended August 31, 2007	Institutional Securities(1)	Global Wealth Management Group(1)	Asset Management(1)	Intersegment Eliminations(1)(4)	Total
			(dollars in millions)		
Net revenues excluding net interest	$ 18,243	$ 4,346	$ 4,260	$ (208)	$ 26,641

Net interest	1,331		490		(19)		33		1,835
Net revenues	$ 19,574	$	4,836	$	4,241	$	(175)	$	28,476
Income from continuing operations before losses from unconsolidated investees and income taxes	$ 7,296	$	777	$	1,173	$	(1)	$	9,245
Losses from unconsolidated investees	(65)								(65)
Provision for income taxes	2,293		308		428				3,029
Income from continuing operations(2)	$ 4,938	$	469	$	745	$	(1)	$	6,151

25

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

Nine Months Ended August 31, 2006	Institutional Securities(1)	Global Wealth Management Group(1)	Asset Management(1)	Intersegment Eliminations(1)(4)	Total
			(dollars in millions)		
Net revenues excluding net interest	$ 15,057	$ 3,707	$ 2,467	$ (200)	$ 21,031
Net interest	578	353	13	15	959
Net revenues	$ 15,635	$ 4,060	$ 2,480	$ (185)	$ 21,990
Income from continuing operations before gains from unconsolidated investees and income taxes	$ 5,521	$ 339	$ 583	$ 12	$ 6,455
Gains from unconsolidated investees	25				25
Provision for income taxes	1,778	114	230	5	2,127
Income from continuing operations(2)	$ 3,768	$ 225	$ 353	$ 7	$ 4,353

Net Interest(1)	Institutional Securities	Global Wealth Management Group	Asset Management	Intersegment Eliminations(4)	Total
			(dollars in millions)		
Three Months Ended August 31, 2007					
Interest and dividends	$ 14,141	$ 321	$ 14	$ (71)	$ 14,405
Interest expense	13,207	126	22	(83)	13,272
Net interest	$ 934	$ 195	$ (8)	$ 12	$ 1,133
Three Months Ended August 31, 2006					
Interest and dividends	$ 11,852	$ 265	$ 21	$ (117)	$ 12,021
Interest expense	11,533	129	11	(124)	11,549
Net interest	$ 319	$ 136	$ 10	$ 7	$ 472
Nine Months Ended August 31, 2007					
Interest and dividends	$ 43,355	$ 893	$ 57	$ (329)	$ 43,976
Interest expense	42,024	403	76	(362)	42,141
Net interest	$ 1,331	$ 490	$ (19)	$ 33	$ 1,835
Nine Months Ended August 31, 2006					
Interest and dividends	$ 31,012	$ 711	$ 37	$ (277)	$ 31,483
Interest expense	30,434	358	24	(292)	30,524

Net interest	$	578	$	353	$	13	$	15	$	959

Total Assets(1)(3)	**Institutional Securities**		**Global Wealth Management Group**		**Asset Management**		**Discover**		**Total**
					(dollars in millions)				
At August 31, 2007	$ 1,151,453	$	23,134	$	10,544	$			$ 1,185,131
At November 30, 2006	$ 1,063,985	$	21,232	$	6,908	$	29,067		$ 1,121,192

(1) Certain reclassifications have been made to prior-period amounts to conform to the current period s presentation.
(2) See Note 15 for a discussion of discontinued operations.
(3) Corporate assets have been fully allocated to the Company s business segments.

26

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

(4) Included in the results for the quarter and nine months ended August 31, 2007 is a $25 million advisory fee related to the Discover Spin-off that was eliminated in consolidation. The results for the nine months ended August 31, 2006 included a $30 million advisory fee related to the Company s sale of the aircraft leasing business that was eliminated in consolidation.

The Company operates in both U.S. and non-U.S. markets. The Company s non-U.S. business activities are principally conducted through European and Asian locations. The following table presents net revenues of the Company s operations by geographic area:

	Three Months Ended August 31, 2007	Three Months Ended August 31, 2006	Nine Months Ended August 31, 2007	Nine Months Ended August 31, 2006
	(dollars in millions)			
Regional revenues(1):				
Americas	$ 4,172	$ 4,528	$ 16,374	$ 13,909
Europe, Middle East, and Africa	2,439	1,825	8,125	5,780
Asia	1,347	711	3,977	2,301
Total	$ 7,958	$ 7,064	$ 28,476	$ 21,990

(1) Reflects the regional view of the Company s consolidated net revenues, on a managed basis, based on the following methodology:
Institutional Securities: investment banking client location, equity capital markets client location, debt capital markets revenue recording location, sales & trading trading desk location. Global Wealth Management Group: global representative location. Asset Management: client location, except for the real estate investing business, which is based on asset location.

11. Variable Interest Entities.

FASB Interpretation No. 46, as revised (FIN 46R), Consolidation of Variable Interest Entities, applies to certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties (variable interest entities). Variable interest entities are required to be consolidated by their primary beneficiaries if they do not effectively disperse risks among parties involved. The primary beneficiary of a VIE is the party that absorbs a majority of the entity s expected losses, receives a majority of its expected residual returns, or both, as a result of holding variable interests. The Company is involved with various entities in the normal course of business that may be deemed to be VIEs and may hold interests therein, including debt securities, interest-only strip investments and derivative instruments that may be considered variable interests. Transactions associated with these entities include asset- and mortgage-backed securitizations and structured financings (including collateralized debt, bond or loan obligations and credit-linked notes). The Company engages in these transactions principally to facilitate client needs and as a means of selling financial assets. The Company consolidates entities in which it is deemed to be the primary beneficiary. For those entities deemed to be qualifying special purpose entities (as defined in SFAS No. 140), the Company does not consolidate the entity.

The Company purchases and sells interests in entities that may be deemed to be VIEs in the ordinary course of its business. As a result of these activities, it is possible that such entities may be consolidated and deconsolidated at various points in time. Therefore, the Company s variable interests described below may not be held by the Company at the end of future quarterly reporting periods.

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

At August 31, 2007, in connection with its Institutional Securities business, the aggregate size of VIEs for which the Company was the primary beneficiary of the entities was approximately $28.5 billion, which is the carrying amount of the consolidated assets that are collateral for the entities obligations. The nature and purpose of these entities that the Company consolidated were to issue a series of notes to investors that provides the investors a return based on the holdings of the entities. These transactions were executed to facilitate client investment objectives and as a means of selling financial assets. The Company consolidates those entities where it holds either the entire class or a majority of the class of subordinated notes or has entered into a derivative instrument with the VIE, such that it bears the majority of the expected losses or receives a majority of the expected residual returns of the entities. The Company accounts for the assets held by the entities as Financial instruments owned and the liabilities of the entities as Other secured financings.

The following table presents information about VIEs at August 31, 2007 which the Company consolidates:

	VIE Assets that the Company Consolidates	Maximum Exposure to Loss to Consolidated VIEs(1)
	(dollars in millions)	
Mortgage and asset-backed securitizations	$ 9,922	$ 1,050
Municipal bond trusts	837	836
Credit and real estate	6,832	6,218
Commodities financing	1,690	324
Structured transactions	9,240	8,717
Total	$ 28,521	$ 17,145

(1) The Company s maximum exposure to loss often differs from the carrying value of the VIE s assets. The maximum exposure to loss is dependent on the nature of the Company s variable interest in the VIEs and is limited to the notional amounts of certain liquidity facilities, other credit support, total return swaps, written put options, and the fair value of certain other derivatives and investments the Company has made in the VIEs.

At August 31, 2007, also in connection with its Institutional Securities business, the aggregate size of the entities for which the Company holds significant variable interests, which consist of subordinated and other classes of beneficial interests, derivative instruments, limited partnership investments and secondary guarantees, was approximately $41.5 billion. The Company s variable interests associated with these entities were approximately $20.9 billion consisting primarily of senior beneficial interests, which represent the Company s maximum exposure to loss at August 31, 2007. The Company may hedge the risks inherent in its variable interest holdings, thereby reducing its exposure to loss. The Company s maximum exposure to loss does not include the offsetting benefit of any financial instruments that the Company utilizes to hedge these risks.

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

The following table presents information about entities in which the Company holds significant variable interests at August 31, 2007 but does not consolidate:

	VIE Assets for which the Company Holds Significant Variable Interests But Does Not Consolidate	Maximum Exposure to Loss to Non-consolidated VIEs
	(dollars in millions)	
Mortgage and asset-backed securitizations	$ 6,297	$ 249
Credit and real estate	26,610	18,869
Structured transactions	8,634	1,732
Total	$ 41,541	$ 20,850

12. Guarantees.

The Company has certain obligations under certain guarantee arrangements, including contracts and indemnification agreements that contingently require a guarantor to make payments to the guaranteed party based on changes in an underlying measure (such as an interest or foreign exchange rate, security or commodity price, an index or the occurrence or non-occurrence of a specified event) related to an asset, liability or equity security of a guaranteed party. Also included as guarantees are contracts that contingently require the guarantor to make payments to the guaranteed party based on another entity s failure to perform under an agreement, as well as indirect guarantees of the indebtedness of others. The Company s use of guarantees is disclosed below by type of guarantee:

Derivative Contracts. Certain derivative contracts meet the accounting definition of a guarantee, including certain written options, contingent forward contracts and credit default swaps. Although the Company s derivative arrangements do not specifically identify whether the derivative counterparty retains the underlying asset, liability or equity security, the Company has disclosed information regarding all derivative contracts that could meet the accounting definition of a guarantee. The maximum potential payout for certain derivative contracts, such as written interest rate caps and written foreign currency options, cannot be estimated, as increases in interest or foreign exchange rates in the future could possibly be unlimited. Therefore, in order to provide information regarding the maximum potential amount of future payments that the Company could be required to make under certain derivative contracts, the notional amount of the contracts has been disclosed.

The Company records all derivative contracts at fair value. For this reason, the Company does not monitor its risk exposure to such derivative contracts based on derivative notional amounts; rather, the Company manages its risk exposure on a fair value basis. Aggregate market risk limits have been established, and market risk measures are routinely monitored against these limits. The Company also manages its exposure to these derivative contracts through a variety of risk mitigation strategies, including, but not limited to, entering into offsetting economic hedge positions. The Company believes that the notional amounts of the derivative contracts generally overstate its exposure.

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

Financial Guarantees to Third Parties. In connection with its corporate lending business and other corporate activities, the Company provides standby letters of credit and other financial guarantees to counterparties. Such arrangements represent obligations to make payments to third parties if the counterparty fails to fulfill its obligation under a borrowing arrangement or other contractual obligation.

Market Value Guarantees. Market value guarantees are issued to guarantee return of principal invested to fund investors associated with certain European equity funds and to guarantee timely payment of a specified return to investors in certain affordable housing tax credit funds. The guarantees associated with certain European equity funds are designed to provide for any shortfall between the market value of the underlying fund assets and invested principal and a stipulated return amount. The guarantees provided to investors in certain affordable housing tax credit funds are designed to return an investor s contribution to a fund and the investor s share of tax losses and tax credits expected to be generated by a fund.

Liquidity Facilities. The Company has entered into liquidity facilities with special purpose entities and other counterparties, whereby the Company is required to make certain payments if losses or defaults occur. The Company often may have recourse to the underlying assets held by the special purpose entities in the event payments are required under such liquidity facilities.

The table below summarizes certain information regarding these guarantees at August 31, 2007:

Type of Guarantee	Maximum Potential Payout/Notional Years to Maturity Less than 1	1-3	3-5	Over 5	Total	Carrying Amount	Collateral/ Recourse
	(dollars in millions)						
Notional amount of derivative contracts	$ 1,063,254	$ 978,674	$ 2,311,668	$ 1,887,950	$ 6,241,546	$ 133,468	$ 123
Standby letters of credit, sales and trading and other financial guarantees	4,663	617	1,099	4,555	10,934	20	1,951
Market value guarantees	39	113		601	753	44	108
Liquidity facilities(1)	17,247	275		90	17,612		18,580

(1) Includes commitments to municipal bond trusts.

Indemnities. In the normal course of its business, the Company provides standard indemnities to counterparties for certain contingent exposures and taxes, including U.S. and foreign withholding taxes, on interest and other payments made on derivatives, securities and stock lending transactions, certain annuity products and other financial arrangements. These indemnity payments could be required based on a change in the tax laws or change in interpretation of applicable tax rulings or a change in factual circumstances. Certain contracts contain provisions that enable the Company to terminate the agreement upon the occurrence of such events. The maximum potential amount of future payments that the Company could be required to make under these indemnifications cannot be estimated. The Company has not recorded any contingent liability in the condensed consolidated financial statements for these indemnifications and believes that the occurrence of any events that would trigger payments under these contracts is remote.

Exchange/Clearinghouse Member Guarantees. The Company is a member of various U.S. and non-U.S. exchanges and clearinghouses that trade and clear securities and/or futures contracts. Associated with its membership, the Company may be required to pay a proportionate share of the financial obligations of another member who may default on its obligations to the exchange or the clearinghouse. While the rules governing different exchange or clearinghouse memberships vary, in general the Company s guarantee obligations would arise only if the exchange or clearinghouse had previously exhausted its resources. In addition, any such guarantee obligation would be apportioned among the other non-defaulting members of the exchange or clearinghouse. Any potential contingent liability under these membership agreements cannot be estimated. The Company has not recorded any contingent liability in the condensed consolidated financial statements for these agreements and believes that any potential requirement to make payments under these agreements is remote.

General Partner Guarantees. As a general partner in certain private equity and real estate partnerships, the Company receives distributions from the partnerships according to the provisions of the partnership agreements. The Company may, from time to time, be required to return all or a portion of such distributions to the limited partners in the event the limited partners do not achieve a certain return as specified in various partnership agreements, subject to certain limitations. The maximum potential amount of future payments that the Company could be required to make under these provisions at August 31, 2007 and November 30, 2006 was $473 million and $320 million, respectively. As of August 31, 2007 and November 30, 2006, the Company s accrued liability for distributions that the Company has determined is probable it will be required to refund based on the applicable refund criteria specified in the various partnership agreements was $19 million and $25 million, respectively.

Securitized Asset Guarantees. As part of the Company s Institutional Securities securitization activities, the Company provides representations and warranties that certain securitized assets conform to specified guidelines. The Company may be required to repurchase such assets or indemnify the purchaser against losses if the assets do not meet certain conforming guidelines. Due diligence is performed by the Company to ensure that asset guideline qualifications are met, and, to the extent the Company has acquired such assets to be securitized from other parties, the Company seeks to obtain its own representations and warranties regarding the assets. The maximum potential amount of future payments the Company could be required to make would be equal to the current outstanding balances of all assets subject to such securitization activities. Also, in connection with originations of residential mortgage loans under the Company s FlexSource® program, the Company may permit borrowers to pledge marketable securities as collateral instead of requiring cash down payments for the purchase of the underlying residential property. Upon sale of the residential mortgage loans, the Company may provide a surety bond that reimburses the purchasers for shortfalls in the borrowers securities accounts up to certain limits if the collateral maintained in the securities accounts (along with the associated real estate collateral) is insufficient to cover losses that purchasers experience as a result of defaults by borrowers on the underlying residential mortgage loans. The Company requires the borrowers to meet daily collateral calls to ensure the marketable securities pledged in lieu of a cash down payment are sufficient. At August 31, 2007 and November 30, 2006, the maximum potential amount of future payments the Company may be required to make under its surety bond was $113 million and $121 million, respectively. The Company has not recorded any contingent liability in the condensed consolidated financial statements for these representations and warranties and reimbursement agreements and believes that the probability of any payments under these arrangements is remote.

Other. The Company may, from time to time, in its role as investment banking advisor be required to provide guarantees in connection with certain European merger and acquisition transactions. If required by the regulating authorities, the Company provides a guarantee that the acquirer in the merger and acquisition transaction has or will have sufficient funds to complete the transaction and would then be required to make the acquisition payments in the event the acquirer s funds are insufficient at the completion date of the transaction. These arrangements generally cover the time frame from the transaction offer date to its closing date and therefore are generally short term in nature. The maximum potential amount of future payments that the Company could be

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

required to make cannot be estimated. The Company believes the likelihood of any payment by the Company under these arrangements is remote given the level of the Company s due diligence associated with its role as investment banking advisor.

13. Investments in Unconsolidated Investees.

The Company invests in unconsolidated investees that own synthetic fuel production plants and in certain structured transactions not integral to the operations of the Company. The Company accounts for these investments under the equity method of accounting.

Losses from these investments were $(19) million and $(65) million for the quarter and nine month period ended August 31, 2007, respectively, compared with gains of $20 million and $25 million for the quarter and nine month period ended August 31, 2006, respectively.

Synthetic Fuel Production Plants. The Company s share of the operating losses generated by these investments is recorded within (Losses) gains from unconsolidated investees, and the tax credits and the tax benefits associated with these operating losses are recorded within the Provision for income taxes.

The table below provides information regarding the losses from unconsolidated investees, tax credits and tax benefits on the losses:

	Three Months Ended August 31,		Nine Months Ended August 31,	
	2007	2006	2007	2006
	(dollars in millions)			
Losses from unconsolidated investees	$ 43	$ 2	$ 145	$ 174
Tax credits	36	14	158	88
Tax benefits on losses	17	1	57	68

Under the current tax law, synthetic fuels tax credits are granted under Section 45K of the Internal Revenue Code. Synthetic fuels tax credits are available in full only when the price of oil is less than a base price specified by the tax code, as adjusted for inflation (Base Price). The Base Price for each calendar year is determined by the Secretary of the Treasury by April 1 of the following year. If the annual average price of a barrel of oil in 2007 or future years exceeds the applicable Base Price, the synthetic fuels tax credits generated by the Company s synthetic fuel facilities will be phased out, on a ratable basis, over the phase-out range. Based on fiscal year to date and futures prices at August 31, 2007, the Company estimates that there will be a partial phase-out of tax credits earned in fiscal 2007. The impact of this partial phase-out is included within (Losses) gains from unconsolidated investees and the Provision for income taxes for the quarter and nine months ended August 31, 2007.

The Company has entered into derivative contracts designed to reduce its exposure to rising oil prices and the potential phase-out of the synthetic fuels tax credits. Changes in fair value relative to these derivative contracts are included within Principal transactions trading revenues.

Structured Transactions. Gains from unconsolidated investees associated with investments in certain structured investments were $24 million and $80 million for the quarter and nine month period ended August 31, 2007, respectively, compared with gains of $22 million and $199 million for the quarter and nine month period ended August 31, 2006, respectively.

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

14. Employee Benefit Plans.
The Company maintains various pension and benefit plans for eligible employees.

The components of the Company s net periodic benefit expense for its pension and postretirement plans were as follows:

	Three Months Ended August 31,		Nine Months Ended August 31,	
	2007	2006	2007	2006
	(dollars in millions)			
Service cost, benefits earned during the period	$ 29	$ 30	$ 87	$ 91
Interest cost on projected benefit obligation	33	33	100	98
Expected return on plan assets	(31)	(30)	(93)	(89)
Net amortization and other	10	13	26	36
Net periodic benefit expense	$ 41	$ 46	$ 120	$ 136

15. Discontinued Operations.
Discover. On June 30, 2007, the Company completed the Discover Spin-off. The Company distributed all of the outstanding shares of DFS common stock, par value $0.01 per share, to the Company s stockholders of record as of June 18, 2007. The Company s stockholders received one share of DFS common stock for every two shares of the Company s common stock. Stockholders received cash in lieu of fractional shares for amounts less than one full DFS share. The Company received a tax ruling from the Internal Revenue Service that, based on customary representations and qualifications, the distribution was tax-free to the Company s stockholders for U.S. federal income tax purposes.

The Discover Spin-off allows the Company to focus its efforts on more closely aligned firm-wide strategic priorities within its Institutional Securities, Global Wealth Management Group and Asset Management business segments.

The results of DFS prior to the Discover Spin-off are included within discontinued operations for all periods presented.

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

The following is a summary of the assets and liabilities associated with DFS as of November 30, 2006 (dollars in millions):

Assets	
Cash and cash equivalents	$ 869
Financial instruments owned U.S. government and agency securities	65
Financial instruments owned Derivative contracts	33
Consumer loans	22,915
Fees, interest and other	166
Office facilities and other equipment, at cost, net	661
Goodwill and net intangible assets	735
Other assets	3,623
Total	$ 29,067
Liabilities and Shareholders Equity	
Commercial paper and other short-term borrowings	$ 3,100
Deposits	13,277
Financial instruments sold, not yet purchased Derivative contracts	28
Interest and dividends payables	129
Other liabilities and accrued expenses	6,508
Long-term borrowings	250
Total	23,292
Net assets	$ 5,775

The net assets that were distributed to shareholders on the date of the Discover Spin-off were $5,558 million, which was recorded as a reduction to the Company s retained earnings.

Net revenues included in discontinued operations related to DFS were $332 million and $2,392 million in the quarter and nine month period ended August 31, 2007 compared with net revenues of $1,047 million and $3,327 million in the quarter and nine month period ended August 31, 2006. The amounts for the periods ended August 31, 2007 include the results of DFS through June 30, 2007.

The results of discontinued operations include interest expense that was allocated based upon borrowings that were specifically attributable to DFS s operations through intercompany transactions existing prior to the Discover Spin-off. For the three months ended August 31, 2007 and 2006, the amount of interest expense reclassified to discontinued operations was approximately $14 million and $74 million, respectively. Interest expense reclassified to discontinued operations in the nine months ended August 31, 2007 and 2006 was approximately $159 million and $186 million, respectively.

Quilter. On February 28, 2007, the Company sold Quilter, its standalone U.K. mass affluent business. The results of Quilter are included within discontinued operations for all periods presented through the date of sale. The results for discontinued operations in the quarter ended February 28, 2007 also included a pre-tax gain of $168 million ($109 million after-tax) on disposition.

Aircraft Leasing. On March 24, 2006, the Company sold its aircraft leasing business to Terra Firma, a European private equity group. The results for discontinued operations in the quarter ended February 28, 2006 included a loss of $125 million ($75 million after-tax) related to the impact of the finalization of the sales proceeds and balance sheet adjustments related to the closing.

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

Summarized financial information for the Company s discontinued operations:

The table below provides information regarding amounts included within discontinued operations:

	Three Months Ended August 31, 2007	Three Months Ended August 31, 2006	Nine Months Ended August 31, 2007	Nine Months Ended August 31, 2006
	(dollars in millions)			
Pre-tax gain/(loss) on discontinued operations				
DFS	$ 111	$ 394	$ 850	$ 1,457
Quilter		5	174	20
Aircraft leasing				(42)
	$ 111	$ 399	$ 1,024	$ 1,435

16. Acquisitions and Sale of Minority Interest.

MSCI. On July 31, 2007, the Company announced that it would sell a minority interest in its subsidiary, MSCI Inc. (MSCI) in an initial public offering. MSCI is a provider of investment decision support tools to equity, fixed income and multi-asset class investment institutions globally. MSCI is included within the Institutional Securities business segment.

JM Financial. In October 2007, the Company dissolved its India joint ventures with JM Financial. The Company purchased the joint venture s institutional equities sales, trading and research platform by acquiring JM Financial s 49% interest and sold the Company s 49% interest in the joint venture s investment banking, fixed income and retail operation to JM Financial.

CityMortgage Bank. On December 21, 2006, the Company acquired CityMortgage Bank (CityMortgage), a Moscow-based mortgage bank that specializes in originating, servicing and securitizing residential mortgage loans in the Russian Federation. Since the acquisition date, the results of CityMortgage have been included within the Institutional Securities business segment.

Olco Petroleum Group Inc. On December 15, 2006, the Company acquired a 60% equity stake in Olco Petroleum Group Inc. (Olco), a petroleum products marketer and distributor based in eastern Canada. Since the acquisition date, the results of Olco have been included within the Institutional Securities business segment.

Saxon Capital, Inc. On December 4, 2006, the Company acquired Saxon Capital, Inc. (Saxon), a servicer and originator of residential mortgages. Since the acquisition date, the results of Saxon have been included within the Institutional Securities business segment.

FrontPoint Partners. On December 4, 2006, the Company acquired FrontPoint Partners (FrontPoint), a provider of absolute return investment strategies. Since the acquisition date, the results of FrontPoint have been included within the Asset Management business segment.

The proforma impact of each of the above business acquisitions individually and in the aggregate was not material to the condensed consolidated financial statements. In addition, in certain cases the allocations of the purchase prices are preliminary and subject to further adjustment as the valuations of certain intangible assets are still in process.

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

17. Income Tax Examinations.

The Company is under continuous examination by the Internal Revenue Service (the IRS) and other tax authorities in certain countries, such as Japan and the U.K., and states in which the Company has significant business operations, such as New York. The tax years under examination vary by jurisdiction; for example, the current IRS examination covers 1999-2005. The Company regularly assesses the likelihood of additional assessments in each of the taxing jurisdictions resulting from these and subsequent years examinations. The Company has established tax reserves that the Company believes are adequate in relation to the potential for additional assessments. Once established, the Company adjusts tax reserves only when more information is available or when an event occurs necessitating a change to the reserves. The Company believes that the resolution of tax matters will not have a material effect on the condensed consolidated financial condition of the Company, although a resolution could have a material impact on the Company s condensed consolidated statement of income for a particular future period and on the Company s effective income tax rate for any period in which such resolution occurs.

18. Fair Value Disclosures.

Effective December 1, 2006 the Company early adopted SFAS No. 157 and SFAS No. 159, which require disclosures about the Company s assets and liabilities that are measured at fair value. Further information about such assets and liabilities is presented below.

Fair Value Measurements. In September 2006, the FASB issued SFAS No. 157, which defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. In addition, SFAS No. 157 disallows the use of block discounts for large holdings of unrestricted financial instruments where quoted prices are readily and regularly available in an active market, and nullifies select guidance provided by EITF Issue No. 02-3, which prohibited the recognition of trading gains or losses at the inception of a derivative contract, unless the fair value of such derivative is obtained from a quoted market price, or other valuation technique that incorporates observable market data. SFAS No. 157 also requires the Company to consider its own credit spreads when measuring the fair value of liabilities, including derivatives. Effective December 1, 2006, the Company elected early adoption of SFAS No. 157. In accordance with the provisions of SFAS No. 157 related to block discounts and EITF Issue No. 02-3, the Company recorded a cumulative effect adjustment of approximately $80 million after-tax as an increase to the opening balance of Retained earnings as of December 1, 2006, which was primarily related to EITF Issue No. 02-3. The impact of considering the Company s own credit spreads when measuring the fair value of liabilities, including derivatives, did not have a material impact on fair value measurements at the date of adoption.

The Company s assets and liabilities recorded at fair value have been categorized based upon a fair value hierarchy in accordance with SFAS No. 157. The levels of the fair value hierarchy are described below:

Level 1 inputs utilize quoted prices (unadjusted) in active markets for identical assets or liabilities that the Company has the ability to access. Financial assets and liabilities utilizing Level 1 inputs include active exchange-traded equity securities, listed derivatives, most U.S. Government and agency securities, and certain other sovereign government obligations.

Level 2 inputs utilize inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. Level 2 inputs include quoted prices for similar assets and liabilities in active markets, and inputs other than quoted prices that are observable for the asset or liability, such as interest rates and yield curves that are observable at commonly quoted intervals. Financial assets and liabilities utilizing Level 2 inputs include restricted stock, infrequently-traded corporate and municipal bonds, most over-the-counter derivatives and certain mortgage loans.

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

Level 3 inputs are unobservable inputs for the asset or liability, and include situations where there is little, if any, market activity for the asset or liability. Financial assets and liabilities utilizing Level 3 inputs include real estate funds, private equity investments, certain residential and commercial mortgage loans and complex derivatives, including certain credit default swaps and other instruments associated with the Company s credit products and securitized products activities, certain foreign exchange options and long dated options on gas and power.

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, the level in the fair value hierarchy within which the fair value measurement in its entirety falls has been determined based on the lowest level input that is significant to the fair value measurement in its entirety. The Company s assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the asset or liability.

Both observable and unobservable inputs may be used to determine the fair value of positions that the Company has classified within the Level 3 category. As a result, the unrealized gains and losses for assets and liabilities within the Level 3 category presented in the tables below may include changes in fair value that were attributable to both observable (e.g., changes in market interest rates) and unobservable (e.g., changes in unobservable long-dated volatilities) inputs.

The Company also employs various hedging techniques in order to manage risks associated with certain positions, including those that have been classified within the Level 3 category. Such techniques may include the purchase or sale of financial instruments that are classified within the Level 1 and/or Level 2 categories. As a result, the realized and unrealized gains and losses for assets and liabilities within the Level 3 category presented in the tables below do not reflect the related realized or unrealized gains and losses on hedging instruments that have been classified by the Company within the Level 1 and/or Level 2 categories.

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

The following tables present information about the Company s assets and liabilities measured at fair value on a recurring basis as of August 31, 2007, and indicates the fair value hierarchy of the valuation techniques utilized by the Company to determine such fair value.

Assets and Liabilities Measured at Fair Value on a Recurring Basis as of August 31, 2007

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Counterparty and Cash Collateral Netting	Balance as of August 31, 2007
			(dollars in millions)		
Assets					
Cash and securities deposited with clearing organizations or segregated under federal and other regulations or requirements(3)	$ 13,865	$	$	$	$ 13,865
Financial instruments owned:					
U.S. government and agency securities	17,454	20,703	2,176		40,333
Other sovereign government obligations	27,094	7,655	73		34,822
Corporate and other debt		116,626	43,345		159,971
Corporate equities	100,877	283	1,686		102,846
Derivative contracts	3,512	439,608	29,543	(410,175)	62,488
Investments	877	655	11,389		12,921
Physical commodities		2,704			2,704
Total financial instruments owned	149,814	588,234	88,212	(410,175)	416,085
Other investments(1)(3)		7,214	1,635		8,849
Intangible assets(2)(3)		354	3		357
Liabilities					
Commercial paper and other short-term borrowings(3)	$	$ 2,666	$	$	$ 2,666
Deposits(3)		3,166			3,166
Financial instruments sold, not yet purchased:					
U.S. government and agency securities	19,467	13			19,480
Other sovereign government obligations	19,363	7,428			26,791
Corporate and other debt	1	8,371	1,424		9,796
Corporate equities	57,368	79	36		57,483
Derivative contracts	5,198	436,766	21,639	(401,515)	62,088
Physical commodities		459			459
Total financial instruments sold, not yet purchased	101,397	453,116	23,099	(401,515)	176,097
Other secured financings		29,905	7,435		37,340
Long-term borrowings(3)		30,224	417		30,641

(1) Amount represents securities available for sale (see Note 19).
(2) Amount represents MSRs accounted for at fair value (see Note 3).

(3) The difference between the total assets and liabilities as of August 31, 2007 presented in the table above and the related amounts in the condensed consolidated statement of financial condition are primarily related to the following:

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

Cash and securities deposited with clearing organizations or segregated under federal and other regulations and requirements cash and cash equivalents which approximate fair value.

Other investments investments in unconsolidated subsidiaries that are accounted for under the equity method.

Intangible assets amortizable intangible assets that are not accounted for at fair value.

Commercial paper and other short-term borrowings, Deposits and Long-term borrowings instruments that are accounted for at historical amounts.

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

The following table presents additional information about assets and liabilities measured at fair value on a recurring basis and for which the Company has utilized Level 3 inputs to determine fair value:

Changes in Level 3 Assets and Liabilities Measured at Fair Value on a Recurring Basis for the Nine Months ended August 31, 2007

		Total Realized and Unrealized Gains or (Losses) included in Income							
	Beginning Balance	Principal Transactions: Trading	Principal Transactions: Investments	Other Revenues	Total Unrealized Losses Included in Other Comprehensive Income	Total Realized and Unrealized Gains or (Losses)	Purchases, Sales, Other Settlements and Issuances, net	Net Transfers In and/or (Out) of Level 3	Ending Balance
				(dollars in millions)					
Assets									
Financial instruments owned:									
U.S. government and agency securities	$ 2	$ 5	$	$		$ 5	$ 2,150	$ 19	$ 2,176
Other sovereign government obligations	162	11				11	654	(754)	73
Corporate and other debt(1)	33,941	(3,015)				(3,015)	8,929	3,490	43,345
Corporate equities	1,040	75				75	328	243	1,686
Net derivative contracts(1)(2)	30	7,155				7,155	(701)	1,420	7,904
Investments(3)	3,879		1,978	11		1,989	5,504	17	11,389
Other investments					(22)	(22)	1,603	54	1,635
Intangible assets								3	3
Other assets(4)	2,154			32		32	(2,186)		
Liabilities									
Financial instruments sold, not yet purchased:									
Corporate and other debt(1)	185	(716)				(716)	200	323	1,424
Corporate equities	9	(9)				(9)	14	4	36
Other secured financings	4,724						2,711		7,435
Long-term borrowings	464	(76)				(76)	(123)		417

(1) The net gains from Net derivative contracts and the net losses from Corporate and other debt resulted from market movements primarily associated with credit products and various credit linked instruments, respectively.

The net gains in Level 3 Net derivative contracts were primarily driven by certain credit default swaps and other instruments associated with the Company s credit products and securitized products activities. The net losses in Level 3 Corporate and other debt were primarily driven by certain asset backed securities, including residential and commercial mortgage loans, and by corporate loans and loan commitments.

These results are only a component of the overall trading strategies of these businesses, and do not take into consideration any related financial instruments that have been classified by the Company within the Level 1 and/or Level 2 categories. For example, the Company recorded offsetting net losses in Level 2 Net derivative contracts, which were primarily associated with the Company s credit products and securitized products activities.

(2) Amounts represent Financial instruments owned derivative contracts net of Financial instruments sold, not yet purchased derivative contracts.

(3) The net gains from Financial instruments owned investments were primarily related to investments associated with the Company s real estate products and private equity portfolio.

(4) These assets were disposed of in connection with the Discover Spin-off.

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

The following table presents additional information about assets and liabilities measured at fair value on a recurring basis and for which the Company has utilized Level 3 inputs to determine fair value:

Changes in Level 3 Assets and Liabilities Measured at Fair Value on a Recurring Basis for the Three Months ended August 31, 2007

	Beginning Balance	Total Realized and Unrealized Gains or (Losses) included in Income: Principal Transactions: Trading	Total Realized and Unrealized Gains or (Losses) included in Income: Principal Transactions: Investments	Total Unrealized Losses Included in Other Comprehensive Income (Loss)	Total Realized and Unrealized Gains or (Losses)	Purchases, Sales, Other Settlements and Issuances, net	Net Transfers In and/or (Out) of Level 3	Ending Balance
	(dollars in millions)							
Assets								
Financial instruments owned:								
U.S. government and agency securities	$ 63	$ 15	$	$	$ 15	$ 2,071	$ 27	$ 2,176
Other sovereign government obligations	24	1			1		48	73
Corporate and other debt(1)	35,264	(1,798)			(1,798)	6,383	3,496	43,345
Corporate equities	1,504	(50)			(50)	(30)	262	1,686
Net derivative contracts(1)(2)	1,918	5,347			5,347	(482)	1,121	7,904
Investments(3)	8,528		555		555	2,163	143	11,389
Other investments				(22)	(22)	1,603	54	1,635
Intangible assets							3	3
Other assets(4)	2,446					(2,446)		
Liabilities								
Financial instruments sold, not yet purchased:								
Corporate and other debt(1)	89	(613)			(613)	586	136	1,424
Corporate equities	63	1			1	(25)	(1)	36
Other secured financings	8,348					(913)		7,435
Long-term borrowings	446	28			28	(1)		417

(1) The net gains from Net derivative contracts and the net losses from Corporate and other debt resulted from market movements primarily associated with credit products and various credit linked instruments, respectively.

The net gains in Level 3 Net derivative contracts were primarily driven by certain credit default swaps and other instruments associated with the Company s credit products and securitized products activities. The net losses in Level 3 Corporate and other debt were primarily driven by certain asset backed securities, including residential and commercial mortgage loans, and by corporate loans and loan commitments.

These results are only a component of the overall trading strategies of these businesses, and do not take into consideration any related financial instruments that have been classified by the Company within the Level 1 and/or Level 2 categories. For example, the Company recorded offsetting net losses in Level 2 Net derivative contracts, which were primarily associated with the Company s credit products and securitized products activities.

(2) Amounts represent Financial instruments owned derivative contracts net of Financial instruments sold, not yet purchased derivative contracts.

(3) The net gains from Financial instruments owned investments were primarily related to investments associated with the Company s real estate products and private equity portfolio.
(4) These assets were disposed of in connection with the Discover Spin-off.

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

The following table presents the amounts of unrealized gains or (losses) for the three and nine months ended August 31, 2007 relating to those assets and liabilities for which the Company utilized significant Level 3 inputs to determine fair value and that were still held by the Company at August 31, 2007:

Unrealized Gains (Losses) for Level 3 Assets and Liabilities Still Held at August 31, 2007

	Three Months Ended August 31, 2007				Nine Months Ended August 31, 2007			
	Principal Transactions: Trading	Principal Transactions: Investments	Other Revenues	Other Comprehensive Income	Principal Transactions: Trading	Principal Transactions: Investments	Other Revenues	Other Comprehensive Income
	(dollars in millions)							
Assets								
Financial instruments owned:								
U.S. government and agency securities	$ 1	$	$	$	$	$		$
Other sovereign government obligations					3			
Corporate and other debt	(1,705)				(1,337)			
Corporate equities	39				362			
Investments		433				1,549	11	
Net derivative contracts	5,386				8,503			
Other investments				(22)				(22)
Liabilities								
Financial instruments sold, not yet purchased:								
Corporate and other debt	$ (615)	$	$	$	$ (770)		$	$
Corporate equities	(3)				(2)			
Long-term borrowings	27				(76)			

Table of Contents

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

Fair Value Option. In February 2007, the FASB issued SFAS No. 159, which provides a fair value option election that allows companies to irrevocably elect fair value as the initial and subsequent measurement attribute for certain financial assets and liabilities, with changes in fair value recognized in earnings as they occur. SFAS No. 159 permits the fair value option election on an instrument by instrument basis at initial recognition of an asset or liability or upon an event that gives rise to a new basis of accounting for that instrument. Effective December 1, 2006, the Company elected early adoption of SFAS No. 159. As a result of the adoption of SFAS No. 159, the Company recorded a cumulative effect adjustment of approximately $166 million ($102 million after-tax) as an increase to the opening balance of Retained earnings as of December 1, 2006.

The following table presents information about the eligible instruments for which the Company elected the fair value option and for which a transition adjustment was recorded as of December 1, 2006:

	Carrying Value of Instrument at December 1, 2006	Transition Adjustment to Retained Earnings Gain/(Loss)	Carrying Value of Instrument at December 1, 2006 (After Adoption of SFAS No. 159)
		(dollars in millions)	
Financial instruments owned:			
Corporate lending(1)	$ 8,587	$ 16	$ 8,603
Mortgage lending(2)	1,258	7	1,265
Investments(3)	1,305	13	1,318
Commercial paper and other short-term borrowings(4)	946	(1)	947
Deposits(5)	3,143	1	3,142
Long-term borrowings(4)	14,354	130	14,224
Pretax cumulative effect of adoption of the fair value option		166	
Deferred taxes		64	
Cumulative effect of adoption of the fair value option		$ 102	

The transition adjustments were primarily related to the following:

(1) Loans and loan commitments made in connection with Institutional Securities corporate lending activities. The fair value option was elected for these positions as they are generally risk-managed on a fair value basis.
(2) Certain mortgage lending products which are risk-managed by the Institutional Securities business segment on a fair value basis. The Company did not elect the fair value option for other eligible mortgage lending products that were managed by the Discover business segment prior to the Discover Spin-off.
(3) Certain investments that had been previously accounted for under the equity method, as well as certain interests in clearinghouses. The fair value option was elected only for positions that are risk-managed on a fair value basis.
(4) Structured notes and other hybrid long-term debt instruments. The fair value option was elected for these positions as they are risk-managed on a fair value basis. The fair value option was elected for all such instruments issued after December 1, 2006, and a portion of the portfolio of instruments outstanding as of December 1, 2006. The fair value option was not elected for the remaining portion of the portfolio that existed as of December 1, 2006 due to cost-benefit considerations, including the operational effort involved.
(5)

Brokered and callable certificates of deposit issued by certain of the Company s bank subsidiaries. The fair value option was elected for these positions as they are risk-managed on a fair value basis. The Company did not elect the fair value option for other eligible instruments within Deposits that were managed by the Discover business segment prior to the Discover Spin-off.

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

The following table presents gains and (losses) due to changes in fair value for items measured at fair value pursuant to election of the fair value option for the three and nine months ended August 31, 2007:

Three months ended August 31, 2007	Principal Transactions: Trading	Net Interest Revenue	Gains/ (Losses) Included in the Three Months Ended August 31, 2007(1)
		(dollars in millions)	
Commercial paper and other short-term borrowings	(44)	(6)	(50)
Deposits	(2)		(2)
Long-term borrowings	107	(90)	17

Nine months ended August 31, 2007	Principal Transactions: Trading	Net Interest Revenue	Gains/ (Losses) Included in the Nine Months Ended August 31, 2007(1)
		(dollars in millions)	
Commercial paper and other short-term borrowings	(144)	(11)	(155)
Deposits	(1)		(1)
Long-term borrowings	83	(268)	(185)

(1) In addition to these amounts, as discussed in Note 1, all of the instruments within Financial instruments owned and Financial instruments sold, not yet purchased, are measured at fair value, either through the election of SFAS No. 159 or as required by other accounting pronouncements. Changes in the fair value of these instruments are recorded in Principal transactions trading and Principal transactions investment revenues.

Interest income and expense and dividend income are recorded within the condensed consolidated statements of income depending on the nature of the instrument and related market conventions. When interest and dividends are included as a component of the instruments fair value, interest and dividends are included within Principal transactions trading revenues. Otherwise, they are included within Interest and dividend income or Interest expense.

As of August 31, 2007, the aggregate contractual principal amount of loans and long-term receivables for which the fair value option was elected exceeded the fair value of such loans and long-term receivables by approximately $27,569 million. The aggregate fair value of loans that were 90 or more days past due as of August 31, 2007 was $3,694 million. The aggregate contractual principal amount of such loans exceeded their fair value by approximately $22,419 million.

For the quarter and nine months ended August 31, 2007, the estimated changes in the fair value of the Company s short-term and long-term borrowings, including structured notes, for which the fair value option was elected that were attributable to changes in instrument-specific credit spreads were gains of approximately $390 million. This gain was attributable to the widening of the Company s credit spreads and was determined based upon observations related to secondary market transactions. As of August 31, 2007, the aggregate contractual principal amount of long-term debt instruments for which the fair value option was elected exceeded the fair value of such instruments by approximately $570 million. The estimated change in the fair value of other liabilities for which the fair value option was elected that were attributable to changes in instrument-specific credit spreads were losses of approximately $750 million in the quarter and nine months ended August 31, 2007. This loss was primarily related to leveraged loan contingent commitments and was attributable to the illiquid market conditions that existed late in the quarter. It was generally determined based on the differential between estimated expected client yields at August 31, 2007 and contractual yields.

44

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

For the quarter and nine months ended August 31, 2007, changes in the fair value of loans and other receivables for which the fair value option was elected that were attributable to changes in instrument-specific credit spreads were losses of $1,309 million and $1,093 million, respectively. Instrument-specific credit losses were determined by excluding the non-credit components of gains and losses, such as those due to changes in interest rates.

Hybrid Financial Instruments. In February 2006, the FASB issued SFAS No. 155, Accounting for Certain Hybrid Financial Instruments (SFAS No. 155), which amends SFAS No. 133 and SFAS No. 140. SFAS No. 155 permits hybrid financial instruments that contain an embedded derivative that would otherwise require bifurcation to irrevocably be accounted for at fair value, with changes in fair value recognized in the statement of income. The fair value election may be applied on an instrument-by-instrument basis. SFAS No. 155 also eliminates a restriction on the passive derivative instruments that a qualifying special purpose entity may hold. The Company adopted SFAS No. 155 on December 1, 2006. Since SFAS No. 159 incorporates accounting and disclosure requirements that are similar to SFAS No. 155, the Company decided to apply SFAS No. 159, rather than SFAS No. 155, to its fair value elections for hybrid financial instruments.

19. Other Investments.

The following table presents the composition of Other investments:

	At August 31, 2007	At November 30, 2006
	(dollars in millions)	
Securities available for sale	$ 8,849	$
Other	3,873	3,232
Total	$ 12,722	$ 3,232

Securities Available for Sale

In the second quarter of fiscal 2007, the Company purchased certain debt securities that have been classified as securities available for sale in accordance with SFAS No. 115, Accounting for Certain Investments in Debt and Equity Securities . The following table presents information about the Company s securities available for sale:

	At August 31, 2007			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(dollars in millions)			
Securities available for sale	$ 8,978	$	$ (129)	$ 8,849

The Securities available for sale portfolio consists of asset-backed securities related to auto, credit card and mortgage loans.

The Company uses the first in-first out method to determine the cost of securities sold. The average yield on the securities available for sale portfolio as of August 31, 2007 was 6.86%.

At August 31, 2007, the Securities available for sale portfolio has been in an unrealized loss position for less than 12 months. In the third quarter of fiscal 2007, the Company recorded an immaterial other-than-temporary impairment on certain mortgage-backed securities.

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

Other.

Other investments primarily include investments in unconsolidated investees that are accounted for under the equity method of accounting (see Note 13).

20. Other Accounting Developments.

In June 2005, the FASB ratified the consensus reached in EITF Issue No. 04-5, Determining Whether a General Partner, or the General Partners as a Group, Controls a Limited Partnership or Similar Entity When the Limited Partners Have Certain Rights (EITF Issue No. 04-5). Under the provisions of EITF Issue No. 04-5, a general partner in a limited partnership is presumed to control that limited partnership and, therefore, should include the limited partnership in its consolidated financial statements, regardless of the amount or extent of the general partner s interest unless a simple majority of the limited partners can vote to dissolve or liquidate the partnership or otherwise remove the general partner without having to show cause or the limited partners have substantive participating rights that can overcome the presumption of control by the general partner. EITF Issue No. 04-5 was effective immediately for all newly formed limited partnerships and existing limited partnerships for which the partnership agreements have been modified. For all other existing limited partnerships for which the partnership agreements have not been modified, the Company adopted EITF Issue No. 04-5 on December 1, 2006. The adoption of EITF Issue No. 04-5 on December 1, 2006 did not have a material impact on the Company s condensed consolidated financial statements.

In July 2006, the FASB issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109 (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in a company s financial statements and prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in an income tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective for the Company as of December 1, 2007. The Company is currently evaluating the potential impact of adopting FIN 48.

In September 2006, the FASB issued SFAS No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132(R) (SFAS No. 158). Among other items, SFAS No. 158 requires recognition of the overfunded or underfunded status of the Company s defined benefit and postretirement plans as an asset or liability in the financial statements for the fiscal year ending November 30, 2007. SFAS No. 158 also requires the measurement of defined benefit and postretirement plan assets and obligations as of the end of the fiscal year. SFAS No. 158 s requirement to recognize the funded status in the financial statements is effective for fiscal years ending after December 15, 2006, and its requirement to use the fiscal year-end date as the measurement date is effective for fiscal years ending after December 15, 2008. The Company expects to adopt a fiscal year-end measurement date for its fiscal year ending November 30, 2008. Based on information currently available, the Company expects to record an after-tax charge of approximately $200 million to Shareholders equity as of November 30, 2007 upon the adoption of SFAS No. 158. The effect of the measurement date change is not expected to be material.

In April 2007, the FASB issued FSP No. FIN 39-1, Amendment of FASB Interpretation No. 39 , (FSP FIN 39-1). FSP FIN 39-1 amends certain provisions of FIN 39, Offsetting of Amounts Related to Certain Contracts and permits companies to offset fair value amounts recognized for cash collateral receivables or payables against fair value amounts recognized for net derivative positions executed with the same counterparty under the same master netting arrangement. FSP FIN 39-1 is effective for fiscal years beginning after

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

November 15, 2007, with early application permitted. The guidance in this FSP is consistent with the Company s current accounting practice.

In June 2007, the American Institute of Certified Public Accountants (AICPA) issued Statement of Position (SOP) 07 1, Clarification of the Scope of the Audit and Accounting Guide *Investment Companies* and Accounting by Parent Companies and Equity Method Investors for Investments in Investment Companies (SOP 07-1). SOP 07-1 provides guidance for determining whether an entity is within the scope of the AICPA Audit and Accounting Guide *Investment Companies* (the Guide). SOP 07-1 addresses whether the specialized industry accounting principles of the Guide should be retained by a parent company in consolidation. In addition, SOP 07-1 includes certain disclosure requirements for parent companies and equity method investors in investment companies that retain investment company accounting in the parent company s consolidated financial statements or the financial statements of an equity method investor. SOP 07-1 is effective for the Company as of December 1, 2008. In May 2007, the FASB issued FASB Staff Position (FSP) FIN 46R-7, Application of FIN 46R to Investment Companies, which amends FIN 46R to make permanent the temporary deferral of the application of FIN 46R to entities within the scope of the revised audit guide under SOP 07-1. FSP FIN No. 46R-7 is effective upon adoption of SOP 07-1. The Company is currently evaluating the potential impact of adopting SOP 07-1 and FSP FIN 46R-7.

In June 2007, the EITF reached consensus on Issue No. 06-11, Accounting for Income Tax Benefits of Dividends on Share-Based Payment Awards. EITF Issue No. 06-11 requires that the tax benefit related to dividend equivalents paid on restricted stock units that are expected to vest be recorded as an increase to additional paid-in capital. The Company currently accounts for this tax benefit as a reduction to its income tax provision. EITF Issue No. 06-11 is to be applied prospectively for tax benefits on dividends declared in fiscal years beginning after December 15, 2007. The Company is currently evaluating the potential impact of adopting EITF Issue No. 06-11.

21. Subsequent Event.

In October 2007, the Company announced that it was restructuring its residential mortgage business to reflect current market conditions and to position the business for long-term growth. The plan reduces origination capacity to a level appropriate for the existing market. The restructuring will result in a net reduction-in-force of approximately 600 employees. The costs associated with the restructuring are not expected to be material.

Table of Contents

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of

Morgan Stanley:

We have reviewed the accompanying condensed consolidated statement of financial condition of Morgan Stanley and subsidiaries (the Company) as of August 31, 2007, and the related condensed consolidated statements of income and comprehensive income for the three-month and nine-month periods ended August 31, 2007 and 2006, and condensed consolidated statements of cash flows for the nine-month periods ended August 31, 2007 and 2006. These interim financial statements are the responsibility of the management of Morgan Stanley.

We conducted our reviews in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to such condensed consolidated interim financial statements for them to be in conformity with accounting principles generally accepted in the United States of America.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated statement of financial condition of Morgan Stanley and subsidiaries as of November 30, 2006, and the related consolidated statements of income, comprehensive income, cash flows and changes in shareholders equity for the fiscal year then ended (not presented herein) included in Morgan Stanley s Current Report on Form 8-K; and in our report dated February 12, 2007 (April 10, 2007 for the effects of the discontinued operations as described in Note 30 to such financial statements), which report contains an explanatory paragraph relating to the adoption, in fiscal 2005, of Statement of Financial Accounting Standards No. 123(R), Share-Based Payment and effective December 1, 2005, the change in accounting policy for recognition of equity awards granted to retirement-eligible employees and an explanatory paragraph relating to, in fiscal 2006, the application of Staff Accounting Bulletin No. 108, Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements , we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated statement of financial condition as of November 30, 2006 is fairly stated, in all material respects, in relation to the consolidated statement of financial condition from which it has been derived.

As discussed in Note 18 to the condensed consolidated interim financial statements, effective December 1, 2006, the Company adopted SFAS No. 157, Fair Value Measurement and SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115.

As discussed in Note 1 to the condensed consolidated interim financial statements, effective June 30, 2007, the Company completed the spin-off of Discover Financial Services.

/s/ Deloitte & Touche LLP
New York, New York
October 9, 2007

Table of Contents

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations.

Introduction.

Morgan Stanley (the Company) is a global financial services firm that maintains significant market positions in each of its business segments Institutional Securities, Global Wealth Management Group and Asset Management. The Company, through its subsidiaries and affiliates, provides a wide variety of products and services to a large and diversified group of clients and customers, including corporations, governments, financial institutions and individuals. A summary of the activities of each of the segments follows:

Institutional Securities includes capital raising; financial advisory services, including advice on mergers and acquisitions, restructurings, real estate and project finance; corporate lending; sales, trading, financing and market-making activities in equity securities and related products and fixed income securities and related products, including foreign exchange and commodities; benchmark indices and risk management analytics; research; and investment activities.

Global Wealth Management Group provides brokerage and investment advisory services covering various investment alternatives; financial and wealth planning services; annuity and other insurance products; credit and other lending products; banking and cash management services; retirement services; and trust and fiduciary services.

Asset Management provides global asset management products and services in equity, fixed income and alternative investments, which includes private equity, infrastructure, real estate, fund of funds and hedge funds, to institutional and retail clients through proprietary and third party retail distribution channels, intermediaries and the Company s institutional distribution channel. Asset Management also engages in investment activities.

The discussion of the Company s results of operations below may contain forward-looking statements. These statements, which reflect management s beliefs and expectations, are subject to risks and uncertainties that may cause actual results to differ materially. For a discussion of the risks and uncertainties that may affect the Company s future results, please see Forward-Looking Statements immediately preceding Part I, Item 1, Competition and Regulation in Part I, Item 1, Risk Factors in Part I, Item 1A and Certain Factors Affecting Results of Operations in Part II, Item 7 of the Company s Annual Report on Form 10-K for the fiscal year ended November 30, 2006 (the Form 10-K), Management s Discussion and Analysis of Financial Condition and Results of Operations in the Company s 2007 Quarterly Reports on Form 10-Q and other items throughout the Form 10-K, Forms 10-Q and the Company s 2007 Current Reports on Form 8-K.

Beginning in the second quarter of fiscal 2007, the Company s real estate investing business is included within the results of the Asset Management business segment. Previously, this business was included in the Institutional Securities business segment. Real estate advisory activities and certain passive limited partnership interests remain within the Institutional Securities business segment. In addition, activities associated with certain shareholder recordkeeping services are included within the Global Wealth Management Group business segment. Previously, these activities were included within the Asset Management business segment. Prior periods have been adjusted to conform to the current year s presentation.

The Company s results of operations for the three and nine month periods ended August 31, 2007 and 2006 are discussed below.

Discontinued Operations.

On June 30, 2007, the Company completed the spin-off (the Discover Spin-off) of Discover Financial Services (DFS) (see Other Items Discontinued Operations Discover herein). DFS s results are included within discontinued operations for all periods presented through the date of the Discover Spin-off s completion. The results of Quilter Holdings Ltd. (Quilter), Global Wealth Management Group s former mass affluent business in the U.K., are reported as discontinued operations for all periods presented through its sale on February 28, 2007. The results of the Company s aircraft leasing business, which was sold on March 24, 2006, are also reported as discontinued operations through its date of sale (see Other Items Discontinued Operations herein).

Table of Contents

Results of Operations.

Executive Summary.

Financial Information.

	Three Months Ended August 31, 2007	Three Months Ended August 31, 2006(1)	Nine Months Ended August 31, 2007	Nine Months Ended August 31, 2006(1)
Net revenues (dollars in millions):				
Institutional Securities	$ 4,983	$ 4,894	$ 19,574	$ 15,635
Global Wealth Management Group	1,683	1,371	4,836	4,060
Asset Management	1,364	845	4,241	2,480
Intersegment Eliminations	(72)	(46)	(175)	(185)
Consolidated net revenues	$ 7,958	$ 7,064	$ 28,476	$ 21,990
Income before taxes (dollars in millions)(2):				
Institutional Securities	$ 1,501	$ 1,915	$ 7,296	$ 5,521
Global Wealth Management Group	287	161	777	339
Asset Management	491	155	1,173	583
Intersegment Eliminations	(14)	13	(1)	12
Consolidated income before taxes	$ 2,265	$ 2,244	$ 9,245	$ 6,455
Consolidated net income (dollars in millions)	$ 1,543	$ 1,851	$ 6,797	$ 5,266
Earnings applicable to common shareholders (dollars in millions)(3)	$ 1,526	$ 1,851	$ 6,747	$ 5,266
Earnings per basic common share:				
Income from continuing operations	$ 1.45	$ 1.57	$ 6.08	$ 4.29
Discontinued operations	0.07	0.26	0.65	0.90
Earnings per basic common share	$ 1.52	$ 1.83	$ 6.73	$ 5.19
Earnings per diluted common share:				
Income from continuing operations	$ 1.38	$ 1.50	$ 5.79	$ 4.12
Discontinued operations	0.06	0.25	0.61	0.87
Earnings per diluted common share	$ 1.44	$ 1.75	$ 6.40	$ 4.99
Regional revenues(4):				
Americas	$ 4,172	$ 4,528	$ 16,374	$ 13,909
Europe, Middle East, and Africa	2,439	1,825	8,125	5,780
Asia	1,347	711	3,977	2,301
Total	$ 7,958	$ 7,064	$ 28,476	$ 21,990

Statistical Data.

	Three Months Ended August 31, 2007	Three Months Ended August 31, 2006(1)	Nine Months Ended August 31, 2007	Nine Months Ended August 31, 2006(1)
Book value per common share(5)	$ 32.14	$ 31.24	$ 32.14	$ 31.24
Average common equity (dollars in billions)(6):				

Institutional Securities	$ 25.1	$ 18.6	$ 22.6	$ 17.5
Global Wealth Management Group	1.7	2.8	1.7	3.1
Asset Management	3.6	2.5	3.3	2.3
Unallocated capital	3.5	3.4	4.2	3.1
Total from continuing operations	33.9	27.3	31.8	26.0
Discontinued operations	1.9	5.3	4.4	5.1
Total	$ 35.8	$ 32.6	$ 36.2	$ 31.1

Table of Contents

Statistical Data (Continued).

	Three Months Ended August 31, 2007	Three Months Ended August 31, 2006(1)	Nine Months Ended August 31, 2007	Nine Months Ended August 31, 2006(1)
Return on average common equity(6):				
Consolidated	17%	23%	25%	23%
Institutional Securities	16%	30%	29%	29%
Global Wealth Management Group	39%	15%	37%	10%
Asset Management	35%	15%	30%	20%
Effective income tax rate from continuing operations	34.4%	29.9%	33.0%	32.8%
Worldwide employees	47,713	41,416	47,713	41,416
Consolidated assets under management or supervision by asset class (dollars in billions)(7):				
Equity	$ 333	$ 289	$ 333	$ 289
Fixed income	118	109	118	109
Money market	109	83	109	83
Alternatives(8)	101	53	101	53
Subtotal	661	534	661	534
Unit trusts	15	13	15	13
Other(9)	57	58	57	58
Total assets under management or supervision(10)	$ 733	$ 605	$ 733	$ 605
Share of minority interest assets(11)	6		6	
Total	$ 739	$ 605	$ 739	$ 605
Institutional Securities:				
Mergers and acquisitions completed transactions (dollars in billions)(12):				
Global market volume	$ 184.6	$ 175.4	$ 690.7	$ 465.6
Market share	22.6%	26.0%	31.5%	27.1%
Rank	2	5	1	2
Mergers and acquisitions announced transactions (dollars in billions)(12):				
Global market volume	$ 286.2	$ 167.4	$ 967.6	$ 517.7
Market share	24.0%	23.3%	29.6%	25.8%
Rank	2	4	2	4
Global equity and equity-related issues (dollars in billions)(12):				
Global market volume	$ 18.5	$ 10.5	$ 44.6	$ 34.4
Market share	8.2%	8.5%	7.8%	8.4%
Rank	4	4	4	3
Global debt issues (dollars in billions)(12):				
Global market volume	$ 76.6	$ 89.4	$ 277.0	$ 267.7
Market share	4.9%	5.6%	5.6%	6.0%
Rank	7	7	5	5
Global initial public offerings (dollars in billions)(12):				
Global market volume	$ 6.4	$ 5.2	$ 14.5	$ 14.3
Market share	8.0%	11.1%	7.8%	10.3%
Rank	3	1	2	1
Pre-tax profit margin(13)	30%	39%	37%	35%

Table of Contents

Statistical Data (Continued).

	Three Months Ended August 31,		Nine Months Ended August 31,	
	2007	2006(1)	2007	2006(1)
Global Wealth Management Group:				
Global representatives	8,341	7,982	8,341	7,982
Annualized net revenue per global representative (dollars in thousands)(14)	$ 817	$ 682	$ 796	$ 629
Client assets by segment (dollars in billions):				
$10 million or more	$ 228	$ 176	$ 228	$ 176
$1 million $10 million	265	229	265	229
Subtotal $1 million or more	493	405	493	405
$100,000 $1 million	182	180	182	180
Less than $100,000	24	28	24	28
Client assets excluding corporate and other accounts	699	613	699	613
Corporate and other accounts	35	29	35	29
Total client assets	$ 734	$ 642	$ 734	$ 642
Fee-based assets as a percentage of total client assets(15)	29%	29%	29%	29%
Client assets per global representative (dollars in millions)(16)	$ 88	$ 80	$ 88	$ 80
Bank deposit program (dollars in millions)(17)	$ 19,409	$ 9,839	$ 19,409	$ 9,839
Pre-tax profit margin(13)	17%	12%	16%	8%
Asset Management:				
Assets under management or supervision (dollars in billions)(18)	$ 577	$ 463	$ 577	$ 463
Percent of fund assets in top half of Lipper rankings(19)	41%	39%	41%	39%
Pre-tax profit margin(13)	36%	18%	28%	24%

(1) Certain prior-period information has been reclassified to conform to the current period s presentation.

(2) Amounts represent income from continuing operations before gains/(losses) from unconsolidated investees, income taxes and gain/(loss) from discontinued operations.

(3) Earnings applicable to common shareholders are used to calculate earnings per share information.

(4) Reflects the regional view of the Company s consolidated net revenues, on a managed basis, based on the following methodology: Institutional Securities: investment banking client location, equity capital markets client location, debt capital markets revenue recording location, sales and trading trading desk location. Global Wealth Management Group: global representative location. Asset Management: client location, except for the real estate investing business, which is based on asset location.

(5) Book value per common share equals common shareholders equity of $34,150 million at August 31, 2007 and $33,072 million at August 31, 2006, divided by common shares outstanding of 1,062 million at August 31, 2007 and 1,059 million at August 31, 2006.

(6) The computation of average common equity for each business segment is based upon an economic capital model that the Company uses to determine the amount of equity capital needed to support the risk of its business activities and to ensure that the Company remains adequately capitalized. Economic capital is defined as the amount of capital needed to run the business through the business cycle and satisfy the requirements of regulators, rating agencies and the market. The Company s methodology is based on an approach that assigns economic capital to each segment based on regulatory capital usage plus additional capital for stress losses, goodwill and intangible assets, and principal investment risk. The economic capital model and allocation methodology may be enhanced over time in response to changes in the business and regulatory environment. The effective tax rates used in the computation of segment return on average common equity were determined on a separate entity basis.

(7) Amounts reported for the real estate funds reflect the Company s invested equity in those funds.

(8) Includes a range of alternative investment products such as real estate funds, hedge funds, private equity funds, funds of hedge funds and funds of private equity funds.

(9) Amounts include assets under management or supervision associated with the Global Wealth Management Group business segment.

(10) Revenues and expenses associated with these assets are included in the Company s Asset Management, Global Wealth Management Group and Institutional Securities business segments.

(11) Amount represents Asset Management s proportional share of assets managed by entities in which it owns a minority interest.

(12) Source: Thomson Financial, data as of September 5, 2007 The data for the three months ended August 31, 2007 and 2006 are for the periods from June 1 to August 31, 2007 and June 1 to August 31, 2006, respectively. The data for the nine months ended August 31 are

52

for the periods from January 1 to August 31, 2007 and January 1 to August 31, 2006, respectively, as Thomson Financial presents these data on a calendar-year basis.

(13) Percentages represent income from continuing operations before gains/(losses) from unconsolidated investees and income taxes as a percentage of net revenues.

(14) Annualized net revenue per global representative amounts equal Global Wealth Management Group s net revenues divided by the quarterly average global representative headcount for the periods presented.

(15) Pursuant to a recent court decision vacating an SEC rule that permitted fee-based brokerage, the Company s fee-based brokerage program was terminated in the U.S. on October 1, 2007. Assets that were in such program are now largely in commission-based brokerage accounts, although some clients elected to move assets to fee-based advisory programs. Accordingly, as a result of these changes, fee-based assets as a percentage of total client assets have recently declined.

(16) Client assets per global representative equal total period-end client assets divided by period-end global representative headcount.

(17) Bank deposits are held at certain of the Company s Federal Deposit Insurance Corporation insured depository institutions for the benefit of retail clients through their brokerage accounts.

(18) Amount includes Asset Management s proportional share of assets managed by entities in which it owns a minority interest.

(19) Source: Lipper, one-year performance excluding money market funds as of August 31, 2007 and 2006, respectively.

Third Quarter 2007 Performance.

Company Results. The Company recorded income from continuing operations of $1,474 million and diluted earnings per share from continuing operations of $1.38 for the quarter ended August 31, 2007, decreases of 7% and 8%, respectively, from the comparable fiscal 2006 period. Net revenues (total revenues less interest expense) increased 13% to $7,958 million. Non-interest expenses of $5,693 million increased 18% from the prior-year period, primarily due to higher compensation costs. The annualized return on average common equity from continuing operations was 17.2% compared with 23.3% in the third quarter of last year.

For the nine month period ended August 31, 2007, income from continuing operations was $6,151 million, a 41% increase from $4,353 million a year ago. Net revenues rose 29% to $28,476 million and non-interest expenses increased 24% to $19,231 million. Diluted earnings per share from continuing operations were a record $5.79 compared with $4.12 a year ago. The annualized return on average common equity from continuing operations for the nine month period was 25.5% compared with 22.4% in the prior-year period.

The Company s effective income tax rate from continuing operations was 34.4% and 33.0% in the quarter and nine month period ended August 31, 2007 compared with 29.9% and 32.8% in the quarter and nine month period ended August 31, 2006. The increase in the quarter primarily reflected the geographic mix of earnings.

Including discontinued operations, net income for the quarter ended August 31, 2007 was $1,543 million, a decrease of 17% from $1,851 million in the comparable fiscal 2006 period. For the nine month period ended August 31, 2007, net income was a record $6,797 million, a 29% increase from $5,266 million a year ago. Diluted earnings per share were $1.44 for the quarter compared with $1.75 in the third quarter of fiscal 2006, and the annualized return on average common equity for the third quarter was 17.1% compared with 22.7% a year ago. For the nine month period ended August 31, 2007, diluted earnings per share were a record $6.40 compared with $4.99 a year ago, and the annualized return on average common equity was 24.9% compared with 22.6% last year. The results for the nine month period ended August 31, 2007 included a gain of $168 million ($109 million after-tax) in discontinued operations related to the sale of Quilter on February 28, 2007. Discontinued operations in the first quarter of fiscal 2006 included a loss of $125 million ($75 million after-tax) related to the sale of the Company s aircraft leasing business (see Other Items Discontinued Operations herein).

Institutional Securities. Institutional Securities recorded income from continuing operations before (losses)/gains from unconsolidated investees and income taxes of $1,501 million, a 22% decrease from last year s third quarter. Net revenues rose 2% to $4,983 million. Non-interest expenses increased 17% to $3,482 million, reflecting higher compensation accruals and non-compensation expenses.

Investment banking revenues increased 45% from last year s third quarter to $1,439 million. Advisory fees from merger, acquisition and restructuring transactions were $664 million, an increase of 50% from last year s third quarter. Underwriting revenues rose 41% from last year s third quarter to $775 million.

Table of Contents

Fixed income sales and trading revenues were $2,197 million, down 3% from the third quarter of fiscal 2006. The decrease was driven by significantly lower credit product revenues and lower results in commodities, partially offset by record results in interest rate and currency products. The decline in credit product revenues primarily reflected spread widening, lower liquidity and higher volatility, which resulted in lower origination, securitization and trading results across most credit product groups. Commodity revenues decreased primarily due to lower trading results from oil liquids, partially offset by higher revenues from electricity and natural gas products. Interest rate and currency product revenues benefited from stronger revenues in interest rate and foreign exchange products. Fixed income sales and trading revenues also benefited from the widening of the Company s credit spreads on certain of its long-term borrowings, such as structured notes. Equity sales and trading revenues increased 16% to $1,761 million in the third quarter of fiscal 2007. The increase was driven by higher revenues from derivative, financing and cash products and prime brokerage, partially offset by trading losses in quantitative strategies.

Other sales and trading net revenues in the third quarter of fiscal 2007 included losses of approximately $940 million due to the impact of mark-to-market valuations associated with loans and loan commitments associated with the Company s corporate lending activities. These losses include $726 million of mark downs of leveraged loan commitments associated with acquisition financing transactions that were accepted by the borrower but not yet closed. These losses were primarily related to the illiquid market conditions that existed during the period and reflected the deterioration of the credit markets that occurred in the latter portion of the quarter.

Global Wealth Management Group. The Global Wealth Management Group recorded income from continuing operations before income taxes of $287 million, a 78% increase from last year s third quarter. Net revenues increased 23% from last year s third quarter to $1,683 million reflecting higher transactional revenues due to increased underwriting activity, higher asset management revenues reflecting growth in fee-based products and higher net interest revenue from growth in the bank deposit program. Total non-interest expenses increased 15% from a year ago to $1,396 million. Compensation and benefits expense increased, primarily reflecting higher incentive-based compensation accruals due to higher net revenues and investment in the business. Non-compensation costs remained flat from a year ago. Total client assets increased to $734 billion, up 14% from last year s third quarter. In addition, client assets in fee-based accounts rose 15% to $211 billion at August 31, 2007 and represented 29% of total client assets. At quarter-end, the number of global representatives was 8,341, an increase of 4% from a year ago.

Asset Management. Asset Management recorded income before income taxes of $491 million in the quarter ended August 31, 2007 compared with $155 million in the prior year period. Net revenues increased 61% from last year s third quarter to $1,364 million driven by higher investment revenues, primarily in the real estate and private equity business, and higher asset management, distribution and administration fees, primarily due to an increase in assets under management and higher performance fees from the alternatives business. Non-interest expenses increased 27% to $873 million, due to higher incentive-based compensation accruals associated with increased net revenues, as well as higher non-compensation expenses due to higher levels of business investment and business activity. Assets under management or supervision within Asset Management of $577 billion were up $114 billion, or 25%, from the third quarter of last year, primarily due to market appreciation and positive net flows.

Global Market and Economic Conditions in the Quarter and Nine Month Period Ended August 31, 2007.

In the U.S., the moderate pace of economic growth that occurred during the first half of fiscal 2007 showed signs of slowing during the third quarter of fiscal 2007, primarily reflecting the difficult conditions in the residential real estate and credit markets. Concerns about the impact of sub-prime loans caused the broader credit markets to deteriorate considerably over the course of the quarter, with increased volatility, significant spread widening and lower levels of liquidity and price transparency. The U.S. unemployment rate at the end of the quarter increased modestly to 4.6% from 4.5% at the end of fiscal 2006. Conditions in the U.S. equity markets were also volatile, and major equity market indices declined during the quarter, primarily as a result of the developments in the credit markets. The Federal Reserve Board (the Fed) lowered the discount rate by 0.50% during the quarter.

Table of Contents

Subsequent to quarter end, in September 2007, the Fed lowered both the benchmark interest rate and discount rate by 0.50% in order to provide additional liquidity and stability to the financial markets and to contain the economic impact related to the correction in the residential real estate market. The Fed had not changed the benchmark interest rate since June 2006.

In Europe, economic growth continued to be strong, reflecting momentum in domestic demand and exports. According to corporate business surveys, there were, however, indications that growth in Europe may be slowing. Major equity market indices in Europe decreased during the quarter, primarily due to the difficult conditions in the credit markets. The European Central Bank raised the benchmark interest rate by 0.25% during the quarter and by an aggregate of 0.75% in the nine month period. The Bank of England raised the benchmark interest rate by 0.25% during the quarter and by an aggregate of 0.75% in the nine month period.

In Japan, moderate economic growth continued to be driven by exports and domestic demand. The level of unemployment also remained relatively low. Japanese equity market indices decreased during the third quarter primarily due to tighter global credit conditions. The Bank of Japan left rates unchanged during the third quarter of fiscal 2007 but had raised the benchmark interest rate from 0.25% to 0.50% during the nine month period. Economies elsewhere in Asia also expanded, particularly in China, which benefited from strength in exports, domestic demand and continued globalization. In China, equity market indices rose during the third quarter of fiscal 2007. The People s Bank of China raised the benchmark lending rate by 0.45% during the quarter and by an aggregate of 0.90% in the nine month period. Subsequent to quarter end, in September 2007, the People s Bank of China raised the benchmark lending rate by 0.27%.

Business Segments.

The remainder of Results of Operations is presented on a business segment basis before discontinued operations. Substantially all of the operating revenues and operating expenses of the Company can be directly attributed to its business segments. Certain revenues and expenses have been allocated to each business segment, generally in proportion to its respective revenues or other relevant measures.

As a result of treating certain intersegment transactions as transactions with external parties, the Company includes an Intersegment Eliminations category to reconcile the segment results to the Company s consolidated results. Income before taxes in Intersegment Eliminations represents the effect of timing differences associated with the revenue and expense recognition of commissions paid by Asset Management to the Global Wealth Management Group associated with sales of certain products and the related compensation costs paid to the Global Wealth Management Group s global representatives. Income (loss) before taxes recorded in Intersegment Eliminations was $(14) million and $13 million in the quarters ended August 31, 2007 and 2006, respectively, and $(1) and $12 million in the nine month periods ended August 31, 2007 and 2006, respectively. Included in the results of Intersegment Eliminations for the quarter and nine months ended August 31, 2007 is a $25 million advisory fee related to the Discover Spin-off that was eliminated in consolidation. The results for the nine months ended August 31, 2006 included a $30 million advisory fee related to the Company s sale of the aircraft leasing business that was eliminated in consolidation.

Certain reclassifications have been made to prior-period amounts to conform to the current period s presentation, including the reporting of DFS and Quilter within discontinued operations for all periods presented, the transfer of the real estate investing business from the Institutional Securities business segment to the Asset Management business segment, and the transfer of certain shareholder recordkeeping services from the Asset Management business segment to the Global Wealth Management Group business segment.

Table of Contents

INSTITUTIONAL SECURITIES

INCOME STATEMENT INFORMATION

	Three Months Ended August 31, 2007	Three Months Ended August 31, 2006	Nine Months Ended August 31, 2007	Nine Months Ended August 31, 2006
	(dollars in millions)			
Revenues:				
Investment banking	$ 1,439	$ 992	$ 4,175	$ 2,919
Principal transactions:				
Trading	1,236	2,728	9,970	9,133
Investments	217	114	963	746
Commissions	911	630	2,368	1,933
Asset management, distribution and administration fees	24	19	74	56
Interest and dividends	14,141	11,852	43,355	31,012
Other	222	92	693	270
Total revenues	18,190	16,427	61,598	46,069
Interest expense	13,207	11,533	42,024	30,434
Net revenues	4,983	4,894	19,574	15,635
Total non-interest expenses	3,482	2,979	12,278	10,114
Income from continuing operations before (losses) gains from unconsolidated investees and income taxes	1,501	1,915	7,296	5,521
(Losses) gains from unconsolidated investees	(19)	20	(65)	25
Provision for income taxes	483	556	2,293	1,778
Income from continuing operations	$ 999	$ 1,379	$ 4,938	$ 3,768

Investment Banking. Investment banking revenues for the quarter ended August 31, 2007 increased 45% from the comparable period of fiscal 2006. The increase was due to higher revenues from merger, acquisition and restructuring activities and fixed income and equity underwriting transactions. Advisory fees from merger, acquisition and restructuring transactions were $664 million, an increase of 50% from the comparable period of fiscal 2006. Underwriting revenues were $775 million, an increase of 41% from the comparable period of fiscal 2006. Equity underwriting revenues increased 81% to $429 million. Fixed income underwriting revenues increased 11% to $346 million, although revenues from high yield and leveraged loan transactions were adversely affected by the difficult market conditions that existed during the quarter.

At August 31, 2007, the backlog of merger, acquisition and restructuring transactions and equity underwriting transactions were higher, while the backlog of fixed income underwriting transactions was lower, as compared with the third quarter of fiscal 2006. The backlog of merger, acquisition and restructuring transactions and equity and fixed income underwriting transactions is subject to the risk that transactions may not be completed due to challenging or unforeseen economic or market conditions, adverse developments regarding one of the parties to the transaction, a failure to obtain required regulatory approval or a decision on the part of the parties involved not to pursue a transaction.

Investment banking revenues in the nine month period ended August 31, 2007 increased 43% from the comparable period of fiscal 2006. The increase was due to higher revenues from merger, acquisition and restructuring activities and equity and fixed income underwriting transactions.

Table of Contents

Sales and Trading. Sales and trading revenues are composed of principal transaction trading revenues, commissions and net interest revenues (expenses). In assessing the profitability of its sales and trading activities, the Company views principal trading, commissions and net interest revenues in the aggregate. In addition, decisions relating to principal transactions are based on an overall review of aggregate revenues and costs associated with each transaction or series of transactions. This review includes, among other things, an assessment of the potential gain or loss associated with a transaction, including any associated commissions, dividends, the interest income or expense associated with financing or hedging the Company s positions and other related expenses.

Total sales and trading revenues decreased 16% in the quarter ended August 31, 2007 from the comparable period of fiscal 2006. Sales and trading revenues were adversely affected by the difficult market conditions that existed during the quarter ended August 31, 2007. The credit markets deteriorated considerably over the course of the quarter with increased volatility, significant spread widening, lower levels of liquidity and reduced price transparency. These factors affected the leveraged lending markets, the effectiveness of hedging strategies, subprime mortgage markets, including the market for collateralized debt obligations, and other structured credit product markets. This credit environment significantly impacted the Company s corporate lending and credit sales and trading activities. In addition, such conditions contributed to increased volatility and deleveraging in the equity markets, which affected the Company s quantitative trading strategies.

Sales and trading revenues include the following:

	Three Months Ended August 31,		Nine Months Ended August 31,	
	2007(1)	2006(1)	2007(1)	2006(1)
	(dollars in millions)			
Equity	$ 1,761	$ 1,520	$ 6,186	$ 4,845
Fixed income	2,197	2,257	8,523	7,039
Other	(877)	(100)	(1,040)	(240)
Total sales and trading revenues	$ 3,081	$ 3,677	$ 13,669	$ 11,644

(1) Includes Principal transactions-trading, Commissions, and Net interest revenues. Equity and fixed income sales and trading revenues include certain funding costs that were not previously allocated to those businesses. Other sales and trading net revenue primarily includes results related to investment banking, corporate lending and other corporate activities. All prior period amounts have been reclassified to conform to the current period s presentation.

Equity sales and trading revenues increased 16% to $1,761 million in the third quarter of fiscal 2007 from the comparable period of fiscal 2006. The increase was driven by higher revenues from derivative products, financing products, cash products and prime brokerage, partially offset by trading losses in quantitative strategies. Record revenues from derivative products benefited from strong customer flows and increased market volatility. Prime brokerage generated record revenues reflecting continued growth in global client asset balances. Record revenues from financing products were primarily due to higher commission revenues driven by strong market volumes. Although commission revenues increased, revenues continued to be affected by intense competition, particularly in the U.S., and a continued shift toward electronic trading. Equity sales and trading revenues also benefited from the widening of the Company s credit spreads on certain of its long-term borrowings, such as structured notes, which increased revenues by approximately $100 million. Such revenues represent the decrease in the fair value of the Company s long-term borrowings that was attributable to the widening of the Company s credit spreads during the quarter. The Company has accounted for these instruments at fair value since its adoption of SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities (SFAS No. 159) on December 1, 2006 (see Note 18 to the condensed consolidated financial statements). These increases were partially offset by trading losses in quantitative strategies of approximately $480 million resulting from unfavorable positioning as the market significantly reduced leverage late in the quarter.

Table of Contents

Fixed income sales and trading revenues decreased 3% to $2,197 million in the third quarter of fiscal 2007 from the comparable period of fiscal 2006. The decrease was driven by significantly lower credit product revenues and lower results in commodities, partially offset by record results in interest rate and currency products. Credit product revenues decreased 54%, primarily due to lower revenues from corporate credit and structured products. Spread widening, lower liquidity and higher volatility resulted in lower origination, securitization and trading results across most credit product groups and also affected the performance of the Company s hedging strategies. In particular, trading losses were sustained on certain high yield structured credit positions, which resulted from unfavorable positioning, widening credit spreads and the difficult market conditions that existed during the quarter. Lower revenues from the Company s residential and commercial mortgage loan activities also contributed to the decline in credit product revenues, reflecting the difficult market conditions referred to above, as well as continued concerns in the sub-prime mortgage loan sector. Commodity revenues decreased 29%, primarily due to lower trading results from oil liquids, partially offset by higher revenues from electricity and natural gas products. Interest rate and currency product revenues increased 142%, reflecting higher revenues from interest rate and foreign exchange products. Fixed income sales and trading revenues also benefited from the widening of the Company s credit spreads on certain of its long-term borrowings, such as structured notes, which increased revenues by approximately $290 million. Such revenues represent the decrease in the fair value of the Company s long-term borrowings that was attributable to the widening of the Company s credit spreads during the quarter. The Company has accounted for these instruments at fair value since its adoption of SFAS No. 159 on December 1, 2006 (see Note 18 to the condensed consolidated financial statements). Fixed income sales and trading revenues also benefited from gains on certain derivatives (see Note 18 to the condensed consolidated financial statements).

Other sales and trading net revenues in the third quarter of fiscal 2007 included losses of approximately $940 million due to the impact of mark-to-market valuations associated with loans and loan commitments associated with the Company s corporate lending activities. The losses included $726 million of markdowns of leveraged loan commitments associated with acquisition financing transactions that were accepted by the borrower but not yet closed. These losses were primarily related to the illiquid market conditions that existed during the period. The valuation of these commitments could change in future periods depending on, among other things, the extent that they are renegotiated or repriced or the associated acquisition transaction does not occur. In addition, the Company s leveraged finance business originates and distributes loans and commitments, and intends to distribute its current positions; however, this may take longer than in the past and is dependent on liquidity reentering the market. The fair value measurement of loan commitments takes into account certain fees that are attributable to the contingent commitment contract. For further information about the Company s corporate lending activities, see Item 3, Quantitative and Qualitative Disclosures about Market Risk Credit Risk .

Total sales and trading revenues increased 17% in the nine month period ended August 31, 2007 from the comparable period of fiscal 2006, reflecting higher fixed income and equity sales and trading revenues, partially offset by losses in other sales and trading revenues. Equity sales and trading revenues increased 28% primarily due to higher revenues from derivatives products, financing products, equity cash products and prime brokerage. Fixed income sales and trading revenues increased 21% primarily due to higher revenues from interest rate and currency products and credit products, partially offset by lower revenues from commodities products. The losses in other sales and trading revenues were driven by markdowns of loans and loan commitments associated with the Company s corporate lending activities.

Principal Transactions-Investments. Principal transaction net investment revenues aggregating $217 million and $963 million were recorded in the quarter and nine month period ended August 31, 2007, as compared with net revenues of $114 million and $746 million in the quarter and nine month period ended August 31, 2006. The increase in both periods primarily related to realized and unrealized net gains associated with certain of the Company s investments. The increase in the nine month period also reflected higher revenues from the

Table of Contents

Company s investments in passive limited partnership interests associated with the Company s real estate funds. Both periods also reflected higher revenues related to certain employee deferred compensation plans (see Other Items Deferred Compensation Plans herein).

Other. Other revenues increased 141% and 157% in the quarter and nine month period ended August 31, 2007. The increase was primarily attributable to revenues related to the operation of pipelines, terminals and barges and the distribution of refined petroleum products associated with the Company s acquisition of TransMontaigne Inc. (TransMontaigne) on September 1, 2006. Higher sales of benchmark indices and risk management analytic products also contributed to the increase.

Non-Interest Expenses. Non-interest expenses increased 17% and 21% in the quarter and the nine month period ended August 31, 2007. Compensation and benefits expense increased 11% and 19% in the quarter and nine month period primarily reflecting higher incentive-based compensation accruals resulting from higher net revenues. In addition, the prior year quarter included lower incentive-based compensation accruals to reflect the estimated full year 2006 compensation levels. The increase in the nine month period also reflected higher costs associated with certain employee deferred compensation plans (see Other Items Deferred Compensation Plans herein), partially offset by Institutional Securities share ($270 million) of the incremental compensation expense related to equity awards to retirement-eligible employees in the first quarter of fiscal 2006 (see Other Items Stock-Based Compensation herein). Excluding compensation and benefits expense, non-interest expenses increased 26% and 27% in the quarter and nine month period, reflecting increased levels of business activity and expenses associated with the acquired businesses discussed below. Occupancy and equipment expense increased 27% and 35% in the quarter and nine month period, primarily due to higher rent and occupancy costs in Europe, Asia and the U.S. Brokerage, clearing and exchange fees increased 41% and 25% in the quarter and nine month period, primarily reflecting substantially increased equity and fixed income trading activity. Marketing and business development expense increased 28% and 30% in the quarter and nine month period, primarily due to a higher level of business activity. Professional services expense increased 5% in the nine month period, primarily due to higher legal and consulting costs related to increased business activity. Other expenses increased 55% and 83% in the quarter and nine month period, respectively, reflecting costs associated with TransMontaigne, the Heidmar Group of companies (Heidmar) and Saxon Capital, Inc. (Saxon), partially offset by higher net litigation accruals in the fiscal 2006 periods. The Company acquired TransMontaigne and Heidmar in September 2006 and Saxon in December 2006. The quarter and nine month periods of fiscal 2006 included legal accruals related to the pending settlement of General American litigation, which was partially offset by a favorable outcome related to the LVMH litigation.

Table of Contents

GLOBAL WEALTH MANAGEMENT GROUP

INCOME STATEMENT INFORMATION

	Three Months Ended August 31, 2007	Three Months Ended August 31, 2006	Nine Months Ended August 31, 2007	Nine Months Ended August 31, 2006
	(dollars in millions)			
Revenues:				
Investment banking	$ 166	$ 120	$ 496	$ 282
Principal transactions:				
Trading	145	117	407	362
Investments	3	16	21	44
Commissions	353	252	1,025	864
Asset management, distribution and administration fees	788	704	2,286	2,062
Interest and dividends	321	265	893	711
Other	33	26	111	93
Total revenues	1,809	1,500	5,239	4,418
Interest expense	126	129	403	358
Net revenues	1,683	1,371	4,836	4,060
Total non-interest expenses	1,396	1,210	4,059	3,721
Income from continuing operations before income taxes	287	161	777	339
Provision for income taxes	119	54	308	114
Income from continuing operations	$ 168	$ 107	$ 469	$ 225

Investment Banking. Investment banking revenues increased 38% and 76% in the quarter and nine month period ended August 31, 2007, driven by strong underwriting activity across equity, fixed income and unit trust products.

Principal Transactions Trading. Principal transaction trading revenues increased 24% and 12% in the quarter and nine month period ended August 31, 2007. The increase in both periods was primarily due to higher revenues from derivative and foreign exchange products and municipal fixed income securities. The increase in the nine month period was also due to higher revenues from certain employee deferred compensation plans (see Other Items Deferred Compensation Plans herein).

Principal Transactions Investments. Principal transaction investment net revenues were $3 million and $21 million in the quarter and nine month period ended August 31, 2007 compared with net revenues of $16 million and $44 million in the quarter and nine month period ended August 31, 2006. The decline in both periods primarily reflected lower net gains from certain of the Company s investments in exchanges and memberships.

Commissions. Commission revenues increased 40% and 19% in the quarter and nine month period ended August 31, 2007 due to higher levels of client activity.

Asset Management, Distribution and Administration Fees. Asset management, distribution and administration fees increased 12% and 11% in the quarter and nine month period ended August 31, 2007, primarily reflecting higher client assets in fee-based accounts.

Client assets in fee-based accounts rose 15% to $211 billion at August 31, 2007, including $33 billion in fee-based (fee-in-lieu of commission) brokerage accounts. Pursuant to a recent court decision vacating an SEC rule that permitted fee-based brokerage, the Company s fee-based brokerage program was terminated in the U.S. on October 1, 2007. Assets that were in such program are now largely in commission-based brokerage accounts,

Table of Contents

although some clients elected to move assets to fee-based advisory programs. Accordingly, as a result of these changes, fee-based assets as a percentage of total client assets have recently declined. Client asset balances increased to $734 billion at August 31, 2007 from $642 billion at August 31, 2006, primarily due to market appreciation. Client asset balances in accounts greater than $1 million increased to $493 billion at August 31, 2007 from $405 billion at August 31, 2006.

Net Interest. Net interest revenues increased 43% and 39% in the quarter and nine month period ended August 31, 2007, primarily due to the bank deposit program. Balances in the bank deposit program rose to $19,409 million at August 31, 2007 as compared with $9,839 million at August 31, 2006.

Non-Interest Expenses. Non-interest expenses increased 15% and 9% in the quarter and nine month period ended August 31, 2007, primarily reflecting an increase in compensation and benefits expense. Compensation and benefits expense increased 23% and 16% in the quarter and nine month period ended August 31, 2007, primarily reflecting higher incentive-based compensation accruals due to higher net revenues and investments in the business. The increase in the nine month period was partially offset by Global Wealth Management Group s share ($80 million) of the incremental compensation expense related to equity awards to retirement-eligible employees in the first quarter of 2006 (see Other Items Stock-Based Compensation herein). Excluding compensation and benefits expense, non-interest expenses were flat in the quarter and decreased 5% in the nine month period. Occupancy and equipment expense increased 7% in the nine month period, primarily due to higher rental costs. Information processing and communications expense decreased 8% in the nine month period, primarily due to lower telecommunications costs. Marketing and business development expense increased 42% in the quarter and 32% in the nine month period, primarily due to costs associated with the Company s advertising campaign. Professional services expense increased 17% and 4% in the quarter and nine month period, primarily due to higher sub-advisory fees associated with growth in fee-based assets, partially offset by lower costs for legal counsel. The increase in the quarter was also due to higher consulting costs. Other expenses decreased 39% and 32% in the quarter and nine month period, primarily resulting from an insurance reimbursement related to a litigation matter.

Table of Contents

ASSET MANAGEMENT

INCOME STATEMENT INFORMATION

	Three Months Ended August 31,		Nine Months Ended August 31,	
	2007	2006	2007	2006
	(dollars in millions)			
Revenues:				
Investment banking	$ 92	$ 26	$ 184	$ 84
Principal transactions:				
Investments	338	170	1,458	439
Commissions	6	5	18	19
Asset management, distribution and administration fees	926	629	2,538	1,909
Interest and dividends	14	21	57	37
Other	10	5	62	16
Total revenues	1,386	856	4,317	2,504
Interest expense	22	11	76	24
Net revenues	1,364	845	4,241	2,480
Total non-interest expenses	873	690	3,068	1,897
Income before income taxes	491	155	1,173	583
Provision for income taxes	174	61	428	230
Net income	$ 317	$ 94	$ 745	$ 353

Investment Banking. Investment banking revenues increased $66 million and $100 million in the quarter and nine month period ended August 31, 2007, primarily reflecting higher revenues from real estate products.

Principal Transactions-Investments. Principal transaction net investment gains of $338 million and $1,458 million were recognized in the quarter and nine month period ended August 31, 2007 as compared with net gains of $170 million and $439 million in the quarter and nine month period ended August 31, 2006. The increase in both periods was primarily related to investments associated with the Company s real estate products and private equity portfolio. The increase in the nine month period was also due to higher net gains on investments associated with the Company s alternatives products and higher revenues associated with certain employee deferred compensation plans (see Other Items Deferred Compensation Plans herein).

Asset Management, Distribution and Administration Fees. Asset management, distribution and administration fees increased 47% and 33%, primarily due to higher fund management and administration fees associated with a 24% and 18% increase in average assets under management in the quarter and nine month period, respectively, a more favorable asset mix and higher performance fees from the alternatives business, including those associated with FrontPoint Partners (FrontPoint), which the Company acquired in December 2006 (see Other Items Acquisitions and Sale of Minority Interest herein).

Table of Contents

Asset Management s period-end and average customer assets under management or supervision were as follows:

	At August 31, 2007	At August 31, 2006(1)	Average For the Three Months Ended August 31, 2007(1)	Average For the Three Months Ended August 31, 2006(1)	Average For the Nine Months Ended August 31, 2007(1)	Average For the Nine Months Ended August 31, 2006(1)
			(dollars in billions)			
Assets under management or supervision by distribution channel:						
Americas Retail Morgan Stanley brand	$ 63	$ 61	$ 65	$ 62	$ 64	$ 64
Americas Retail Van Kampen brand	99	90	100	89	98	90
Americas Intermediary(2)	66	55	66	53	63	49
U.S. Institutional	122	95	119	95	113	97
Non-U.S.	118	84	114	81	106	79
Total long-term assets under management or supervision	468	385	464	380	444	379
Institutional money markets/liquidity	70	40	61	38	55	37
Retail money markets	33	38	33	38	34	40
Total money markets	103	78	94	76	89	77
Total assets under management or supervision	571	463	558	456	533	456
Share of minority interest assets(4)	6		6		5	
Total	$ 577	$ 463	$ 564	$ 456	$ 538	$ 456

	At August 31, 2007	At August 31, 2006(1)	Average For the Three Months Ended August 31, 2007(1)	Average For the Three Months Ended August 31, 2006(1)	Average For the Nine Months Ended August 31, 2007(1)	Average For the Nine Months Ended August 31, 2006(1)
			(dollars in billions)			
Assets under management or supervision by asset class:						
Equity	$ 254	$ 226	$ 259	$ 225	$ 252	$ 228
Fixed income	98	93	98	91	95	91
Money market	103	78	94	76	89	77
Alternatives(3)	101	53	92	51	82	48
Subtotal	556	450	543	443	518	444
Unit trusts	15	13	15	13	15	12
Total assets under management or supervision	571	463	558	456	533	456
Share of minority interest assets(4)	6		6		5	
Total	$ 577	$ 463	$ 564	$ 456	$ 538	$ 456

(1) Assets under management or supervision and net flows by distribution channel have been restated for all periods presented to include amounts related to real estate funds previously managed within the Institutional Securities business segment. Additionally, the amounts reported for these real estate funds have been redefined to reflect the Company s invested equity in those funds. Previously, these amounts were disclosed on a gross real estate asset basis, which included leverage.

Table of Contents

(2) Americas Intermediary channel primarily represents client flows through defined contribution, insurance and bank trust platforms.
(3) The alternatives asset class includes a range of investment products, such as real estate funds, hedge funds, private equity funds, funds of hedge funds and funds of private equity funds. Prior period amounts have been reclassified to conform to the current period s presentation.
(4) Amount represents Asset Management s proportional share of assets managed by entities in which it owns a minority interest.

Activity in Asset Management s customer assets under management or supervision were as follows:

	Three Months Ended August 31,		Nine Months Ended August 31,	
	2007(1)	2006(1)	2007(1)	2006(1)
	(dollars in billions)			
Balance at beginning of period	$ 560	$ 454	$ 496	$ 443
Net flows by distribution channel:				
Americas Retail Morgan Stanley brand	(1)	(2)	(3)	(7)
Americas Retail Van Kampen brand	1	(1)	1	(2)
Americas Intermediary(2)	1	2	4	7
U.S. Institutional	1	(3)	2	(12)
Non-U.S.	6		15	4
Net inflows/(outflows) excluding money markets	8	(4)	19	(10)
Money market net flows:				
Institutional	12	3	19	5
Retail	1	(1)	(3)	(9)
Total money market net flows	13	2	16	(4)
Market appreciation/(depreciation)	(5)	11	37	34
Total net increase	16	9	72	20
Acquisitions			7	
Net increase in share of minority interest assets(3)	1		2	
Balance at end of period	$ 577	$ 463	$ 577	$ 463

(1) Assets under management or supervision and net flows by distribution channel have been restated for all periods presented to include amounts related to real estate funds previously managed within the Institutional Securities business segment. Additionally, the amounts reported for these real estate funds have been redefined to reflect the Company s invested equity in those funds. Previously, these amounts were disclosed on a gross real estate asset basis, which included leverage.
(2) Americas Intermediary channel primarily represents client flows through defined contribution, insurance and bank trust platforms.
(3) Amount represents Asset Management s proportional share of assets managed by entities in which it owns a minority interest.

Net inflows (excluding money markets) in the quarter and nine month period ended August 31, 2007 were primarily associated with positive flows from non-U.S. clients. Money market net flows for the quarter and nine month period ended August 31, 2007 were primarily associated with positive flows into institutional liquidity assets. In the nine month period ended August 31, 2007, the inflows were partially offset by outflows from certain money market funds that were impacted by the growth of Global Wealth Management Group s bank deposit program.

Other. Other revenues were $10 million and $62 million in the quarter and nine month period ended August 31, 2007 as compared with $5 million and $16 million, respectively, in the prior-year periods. The increase in both periods was primarily due to revenue recognized from the Company s minority stakes in Avenue Capital Group and Lansdowne Partners, which the Company acquired in the fourth quarter of fiscal 2006.

Non-Interest Expenses. Non-interest expenses increased 27% and 62% in the quarter and nine month period ended August 31, 2007, reflecting an increase in compensation and benefits expense and non-compensation expenses. Compensation and benefits expense increased 28% and 91% in the quarter and nine month period, primarily reflecting higher incentive-based compensation accruals due to higher net revenues. The increase in the nine month period was also due to expenses associated with certain employee deferred compensation plans, as well as investments in the business, partially offset by Asset Management s share ($28 million) of the incremental compensation expense related to equity awards to retirement-eligible employees that was recorded in the first quarter of fiscal 2006 (see Other Items Stock Based-Compensation herein). Excluding compensation and benefits expense, non-interest expenses increased 24% and 26% in the quarter and nine month period. Occupancy and equipment expense increased 22% and 24% in the quarter and nine month period, primarily due to higher rental costs associated with the acquisition of FrontPoint and new business initiatives. Brokerage, clearing and exchange fees increased 19% and 4% in the quarter and nine month period, primarily due to higher costs associated with the launch of new products. Information processing and communications expense increased 25% in the nine month period primarily due to higher costs associated with FrontPoint and new business initiatives. Professional services expense increased 43% and 49% in the quarter and nine month period, primarily due to higher sub-advisory fees. Other expenses increased $63 million in the nine month period ended August 31, 2007, primarily due to an insurance reimbursement received in the second quarter of fiscal 2006 related to certain legal matters.

Table of Contents

Other Items.

Deferred Compensation Plans.

The Company maintains various deferred compensation plans for the benefit of certain employees. Beginning December 1, 2006, increases or decreases in assets or earnings associated with such plans are reflected in net revenues, and increases or decreases in liabilities associated with such plans are reflected in compensation expense. Previously, the increases or decreases in assets and liabilities associated with these plans were both recorded in net revenues. The amount of the reclassification that was recorded within net revenues was $172 million and $358 million for the quarter and nine month period ended August 31, 2006. Prior periods have been reclassified to conform to the current presentation.

Stock-Based Compensation.

For stock-based awards issued prior to the adoption of SFAS No. 123R, Share-Based Payment (SFAS No. 123R) as of December 1, 2004, the Company s accounting policy for awards granted to retirement-eligible employees is to recognize compensation cost over the service period specified in the award terms. The Company accelerates any unrecognized compensation cost for such awards if and when a retirement-eligible employee leaves the Company.

For fiscal 2005 year-end stock-based compensation awards that were granted to retirement-eligible employees in December 2005, the Company recognized the compensation cost for such awards on the date of grant instead of over the service period specified in the award terms. As a result, the Company recorded non-cash incremental compensation expenses of approximately $378 million in the first quarter of fiscal 2006 for stock-based awards granted to retirement-eligible employees as part of the fiscal 2005 year-end award process and for awards granted to retirement-eligible employees, including new hires, in the first quarter of fiscal 2006. These incremental expenses were included within Compensation and benefits expense and reduced income before taxes within the Institutional Securities ($270 million), Global Wealth Management Group ($80 million) and Asset Management ($28 million) business segments.

Discontinued Operations.

Discover. On June 30, 2007, the Company completed the Discover Spin-off. The Company distributed all of the outstanding shares of DFS common stock, par value $0.01 per share, to the Company s stockholders of record as of June 18, 2007. The Company s stockholders received one share of DFS common stock for every two shares of the Company s common stock. Stockholders received cash in lieu of fractional shares for amounts less than one full DFS share. The Company received a tax ruling from the Internal Revenue Service that, based on customary representations and qualifications, the distribution was tax-free to the Company s stockholders for U.S. federal income tax purposes. The Company distributed net assets of $5,558 million to shareholders on the date of the Discover Spin-off, which was recorded as a reduction of the Company s retained earnings.

The Discover Spin-off allows the Company to focus its efforts on more closely aligned firm-wide strategic priorities within its Institutional Securities, Global Wealth Management Group and Asset Management business segments.

The results of DFS prior to the Discover Spin-off are included within discontinued operations for all periods presented.

The results of discontinued operations include interest expense that was allocated based upon borrowings that were specifically attributable to DFS s operations through intercompany transactions existing prior to the Discover Spin-off. For the three months ended August 31, 2007 and 2006, the amount of interest expense reclassified to discontinued operations was approximately $14 million and $74 million, respectively. Interest expense reclassified to discontinued operations in the nine months ended August 31, 2007 and 2006 was approximately $159 million and $186 million, respectively.

Quilter. On February 28, 2007, the Company sold Quilter, which was formerly included within the Global Wealth Management Group business segment. The results of Quilter are included within discontinued operations

Table of Contents

for all periods presented through the date of sale. The results for discontinued operations in the quarter ended February 28, 2007 also included a gain of $168 million ($109 million after-tax) on disposition.

Aircraft Leasing. On March 24, 2006, the Company sold its aircraft leasing business to Terra Firma, a European private equity group. The results for discontinued operations in the quarter ended February 28, 2006 included a loss of $125 million ($75 million after-tax) related to the impact of the finalization of the sales proceeds and balance sheet adjustments related to the closing. The results for discontinued operations in the second quarter of 2006 included the results of operations of the aircraft leasing business through the date of sale.

See Note 15 to the condensed consolidated financial statements for further information on discontinued operations.

Acquisitions and Sale of Minority Interest.

MSCI. On July 31, 2007, the Company announced that it would sell a minority interest in its subsidiary, MSCI Inc. (MSCI) in an initial public offering. MSCI is a provider of investment decision support tools to equity, fixed income and multi-asset class investment institutions globally. MSCI is included within the Institutional Securities business segment.

JM Financial. In October 2007, the Company dissolved its India joint ventures with JM Financial. The Company purchased the joint venture s institutional equities sales, trading and research platform by acquiring JM Financial s 49% interest and sold the Company s 49% interest in the joint venture s investment banking, fixed income and retail operation to JM Financial.

CityMortgage Bank. On December 21, 2006, the Company acquired CityMortgage Bank (CityMortgage), a Moscow-based mortgage bank that specializes in originating, servicing and securitizing residential mortgage loans in the Russian Federation. Since the acquisition date, the results of CityMortgage have been included within the Institutional Securities business segment.

Olco Petroleum Group Inc. On December 15, 2006, the Company acquired a 60% equity stake in Olco Petroleum Group Inc. (Olco), a petroleum products marketer and distributor based in eastern Canada. Since the acquisition date, the results of Olco have been included within the Institutional Securities business segment.

Saxon Capital, Inc. On December 4, 2006, the Company acquired Saxon, a servicer and originator of residential mortgages. Since the acquisition date, the results of Saxon have been included within the Institutional Securities business segment.

FrontPoint Partners. On December 4, 2006, the Company acquired FrontPoint, a provider of absolute return investment strategies. Since the acquisition date, the results of FrontPoint have been included within the Asset Management business segment.

Coleman Litigation.

In the first quarter of fiscal 2005, the Company recorded a $360 million charge related to the Coleman litigation matter (see Note 8 to the condensed consolidated financial statements). For further information, refer to Legal Proceedings in Part II, Item 1 herein, Legal Proceedings in Part II, Item I of the Quarterly Reports on Form 10-Q for the quarters ended February 28, 2007 and May 31, 2007 and Legal Proceedings in Part I, Item 3 of the Form 10-K.

On March 21, 2007, the District Court of Appeal for the Fourth District of Florida (the Court of Appeal) issued an opinion reversing the trial court s award for compensatory and punitive damages and remanding the case to the trial court for entry of a judgment for the Company. On June 4, 2007, the Court of Appeal s March 21, 2007 opinion became final when the Court of Appeal issued an order denying Coleman (Parent) Holdings Inc. s

Table of Contents

(CPH) motions for rehearing, rehearing *en banc* and for certification of certain questions for review by the Florida Supreme Court. On June 11, 2007, the trial court issued an order cancelling the supersedeas bond that the Company had posted. On July 2, 2007 CPH filed a petition with the Florida Supreme Court asking that court to review the Court of Appeal s decision. On July 25, 2007, the Company filed a brief in opposition to the CPH petition.

Income Tax Examinations.

The Company is under continuous examination by the Internal Revenue Service (the IRS) and other tax authorities in certain countries, such as Japan and the U.K., and states in which the Company has significant business operations, such as New York. The tax years under examination vary by jurisdiction; for example, the current IRS examination covers 1999-2005. The Company regularly assesses the likelihood of additional assessments in each of the taxing jurisdictions resulting from these and subsequent years examinations. The Company has established tax reserves that the Company believes are adequate in relation to the potential for additional assessments. Once established, the Company adjusts tax reserves only when more information is available or when an event occurs necessitating a change to the reserves. The Company believes that the resolution of tax matters will not have a material effect on the condensed consolidated financial condition of the Company, although a resolution could have a material impact on the Company s condensed consolidated statement of income for a particular future period and on the Company s effective income tax rate for any period in which such resolution occurs.

Accounting Developments.

Limited Partnerships. In June 2005, the Financial Accounting Standards Board (FASB) ratified the consensus reached in Emerging Issues Task Force (EITF) Issue No. 04-5, Determining Whether a General Partner, or the General Partners as a Group, Controls a Limited Partnership or Similar Entity When the Limited Partners Have Certain Rights (EITF Issue No. 04-5). Under the provisions of EITF Issue No. 04-5, a general partner in a limited partnership is presumed to control that limited partnership and, therefore, should include the limited partnership in its consolidated financial statements, regardless of the amount or extent of the general partner s interest unless a simple majority of the limited partners can vote to dissolve or liquidate the partnership or otherwise remove the general partner without having to show cause or the limited partners have substantive participating rights that can overcome the presumption of control by the general partner. EITF Issue No. 04-5 was effective immediately for all newly formed limited partnerships and existing limited partnerships for which the partnership agreements have been modified. For all other existing limited partnerships for which the partnership agreements have not been modified, the Company adopted EITF Issue No. 04-5 on December 1, 2006. The adoption of EITF Issue No. 04-5 on December 1, 2006 did not have a material impact on the Company s condensed consolidated financial statements.

Accounting for Certain Hybrid Financial Instruments. In February 2006, the FASB issued SFAS No. 155, Accounting for Certain Hybrid Financial Instruments (SFAS No. 155), which amends SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, as amended (SFAS No. 133) and SFAS No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities (SFAS No. 140). SFAS No. 155 permits hybrid financial instruments that contain an embedded derivative that would otherwise require bifurcation to irrevocably be accounted for at fair value, with changes in fair value recognized in the statement of income. The fair value election may be applied on an instrument-by-instrument basis. SFAS No. 155 also eliminates a restriction on the passive derivative instruments that a qualifying special purpose entity may hold. The Company adopted SFAS No. 155 on December 1, 2006. Since SFAS No. 159 incorporates accounting and disclosure requirements that are similar to SFAS No. 155, the Company decided to apply SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities (SFAS No. 159), rather than SFAS No. 155, to its fair value elections for hybrid financial instruments. See Fair Value Option below.

Accounting for Servicing of Financial Assets. In March 2006, the FASB issued SFAS No. 156, Accounting for Servicing of Financial Assets, an amendment of FASB Statement No. 140 (SFAS No. 156). SFAS No. 156 requires all separately recognized servicing assets and servicing liabilities to be initially measured at fair value, if practicable. The standard permits an entity to subsequently measure each class of servicing assets or servicing liabilities at fair value and report changes in fair value in the statement of income in the period in which the changes occur. The Company adopted SFAS No. 156 on December 1, 2006 and has elected to fair value mortgage servicing rights held as of the date of adoption. This election did not have a material impact on the Company s opening balance of Retained earnings as of December 1, 2006. The Company also elected to fair value mortgage servicing rights acquired after December 1, 2006.

Accounting for Uncertainty in Income Taxes. In July 2006, the FASB issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109 (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in a company s financial statements and prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in an income tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective for the Company as of December 1, 2007. The Company is currently evaluating the potential impact of adopting FIN 48.

Fair Value Measurements. In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements (SFAS No. 157). SFAS No. 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. In addition, SFAS No. 157 disallows the use of block discounts for large holdings of unrestricted financial instruments where quoted prices are readily and regularly available in an active market, and nullifies select guidance provided by EITF Issue No. 02-3, Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities (EITF Issue No. 02-3), which prohibited the recognition of trading gains or losses at the inception of a derivative contract, unless the fair value of such derivative is obtained from a quoted market price, or other valuation technique that incorporates observable market data. SFAS No. 157 also requires the Company to consider its own credit spreads when measuring the fair value of liabilities, including derivatives. Effective December 1, 2006, the Company elected early adoption of SFAS No. 157. In accordance with the provisions of SFAS No. 157 related to block discounts and EITF Issue No. 02-3, the Company recorded a cumulative effect adjustment of approximately $80 million after-tax as an increase to the opening balance of Retained earnings as of December 1, 2006, which was primarily associated with EITF Issue No. 02-3. The impact of considering the Company s own credit spreads when measuring the fair value of liabilities, including derivatives, did not have a material impact on fair value measurements at the date of adoption. With the adoption of SFAS No. 157, the Company no longer applies the revenue recognition criteria of EITF Issue No. 02-3.

Employee Benefit Plans. In September 2006, the FASB issued SFAS No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132(R) (SFAS No. 158). Among other items, SFAS No. 158 requires recognition of the overfunded or underfunded status of the Company s defined benefit and postretirement plans as an asset or liability in the financial statements for the fiscal year ending November 30, 2007. SFAS No. 158 also requires the measurement of defined benefit and postretirement plan assets and obligations as of the end of the fiscal year. SFAS No. 158 s requirement to recognize the funded status in the financial statements is effective for fiscal years ending after December 15, 2006, and its requirement to use the fiscal year-end date as the measurement date is effective for fiscal years ending after December 15, 2008. The Company expects to adopt a fiscal year-end measurement date for its fiscal year ending November 30, 2008. Based on information currently available, the Company expects to record an after-tax charge of approximately $200 million to Shareholders equity as of November 30, 2007 upon the adoption of SFAS No. 158. The effect of the measurement date change is not expected to be material.

Fair Value Option. In February 2007, the FASB issued SFAS No. 159. SFAS No. 159 provides a fair value option election that allows companies to irrevocably elect fair value as the initial and subsequent measurement attribute for certain financial assets and liabilities, with changes in fair value recognized in earnings as they occur. SFAS No. 159 permits the fair value option election on an instrument by instrument basis at initial recognition of an asset or liability or upon an event that gives rise to a new basis of accounting for that instrument. Effective December 1, 2006, the Company elected early adoption of SFAS No. 159. As a result of the adoption of SFAS No. 159, the Company recorded a cumulative effect adjustment of approximately $102 million after-tax as an increase to the opening balance of Retained earnings as of December 1, 2006.

Offsetting of Amounts Related to Certain Contracts. In April 2007, the FASB issued FSP No. FIN 39-1, Amendment of FASB Interpretation No. 39 , (FSP FIN 39-1). FSP FIN 39-1 amends certain provisions of FIN 39, Offsetting of Amounts Related to Certain Contracts and permits companies to offset fair value amounts recognized for cash collateral receivables or payables against fair value amounts recognized for net derivative positions executed with the same counterparty under the same master netting arrangement. FSP FIN 39-1 is effective for fiscal years beginning after November 15, 2007, with early application permitted. The guidance in this FSP is consistent with the Company s current accounting practice.

Investment Company Accounting. In June 2007, the American Institute of Certified Public Accountants (AICPA) issued Statement of Position (SOP) 07 1, Clarification of the Scope of the Audit and Accounting Guide *Investment Companies* and Accounting by Parent Companies and Equity Method Investors for Investments in Investment Companies (SOP 07-1). SOP 07-1 provides guidance for determining whether an entity is within the scope of the AICPA Audit and Accounting Guide *Investment Companies* (the Guide). SOP 07-1 addresses whether the specialized industry accounting principles of the Guide should be retained by a parent company in consolidation. In addition, SOP 07-1 includes certain disclosure requirements for parent companies and equity method investors in investment companies that retain investment company accounting in the parent company s consolidated financial statements or the financial statements of an equity method investor. SOP 07-1 is effective for the Company as of December 1, 2008. In May 2007, the FASB issued FASB Staff Position (FSP) FIN 46R-7, Application of FIN 46R to Investment Companies, which amends FASB Interpretation No. 46 (revised), Consolidation of Variable Interest Entities (FIN 46R), to make permanent the temporary deferral of the application of FIN 46R to entities within the scope of the revised audit guide under SOP 07-1. FSP FIN No. 46R-7 is effective upon adoption of SOP 07-1. The Company is currently evaluating the potential impact of adopting SOP 07-1 and FSP FIN 46R-7.

Dividends on Share-Based Payment Awards. In June 2007, the EITF reached consensus on Issue No. 06-11, Accounting for Income Tax Benefits of Dividends on Share-Based Payment Awards. EITF Issue No. 06-11 requires that the tax benefit related to dividend equivalents paid on restricted stock units that are expected to vest be recorded as an increase to additional paid-in capital. The Company currently accounts for this tax benefit as a reduction to its income tax provision. EITF Issue No. 06-11 is to be applied prospectively for tax benefits on dividends declared in fiscal years beginning after December 15, 2007. The Company is currently evaluating the potential impact of adopting EITF Issue No. 06-11.

Subsequent Event.

In October 2007, the Company announced that it was restructuring its residential mortgage business to reflect current market conditions and to position the business for long-term growth. The plan reduces origination capacity to a level appropriate for the existing market. The restructuring will result in a net reduction-in-force of approximately 600 employees. The costs associated with the restructuring are not expected to be material.

Table of Contents

Critical Accounting Policies.

The Company s condensed consolidated financial statements are prepared in accordance with U.S. GAAP, which requires the Company to make estimates and assumptions (see Note 1 to the condensed consolidated financial statements). The Company believes that of its significant accounting policies (see Note 2 to the consolidated financial statements for the fiscal year ended November 30, 2006 included in the Current Report on Form 8-K dated April 10, 2007), the following may involve a higher degree of judgment and complexity.

Fair Value.

Overview. The Company s financial instruments owned and financial instruments sold, not yet purchased are recorded at fair value. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

In connection with the Company s adoption of SFAS No. 157 effective December 1, 2006, the Company categorizes its assets and liabilities that are accounted for at fair value in the condensed consolidated statements of financial condition into a fair value hierarchy as defined by SFAS No. 157. The fair value hierarchy is directly related to the amount of subjectivity associated with the inputs utilized to determine the fair value of these assets and liabilities. See Note 18 to the condensed consolidated financial statements for further information about the fair value hierarchy and the Company s assets and liabilities that are accounted for at fair value.

As a result of the Company s adoption of SFAS No. 159 on December 1, 2006, the Company elected the fair value option for certain instruments. Such instruments included loans and other financial instruments held by subsidiaries that are not registered broker-dealers as defined in the AICPA Audit and Accounting Guide, *Brokers and Dealers in Securities,* or that are not held by investment companies as defined in the AICPA Audit and Accounting Guide, *Investment Companies*. A substantial portion of these positions, as well as the financial instruments included within Other secured financings, had been accounted for by the Company at fair value prior to the adoption of SFAS No. 159. Changes in the fair value of these positions are included within Principal transactions trading revenues in the Company s condensed consolidated statements of income.

Financial Instruments Used for Trading. Financial instruments owned and Financial instruments sold, not yet purchased, which include cash and derivative products, are recorded at fair value in the condensed consolidated statements of financial condition, and gains and losses are reflected net in Principal transactions trading revenues in the condensed consolidated statements of income.

The fair value of the Company s financial instruments are generally based on or derived from bid prices or parameters for Financial instruments owned and ask prices or parameters for Financial instruments sold, not yet purchased.

A substantial percentage of the fair value of the Company s financial instruments used for trading is based on observable market prices, observable market parameters, or is derived from such prices or parameters. The availability of observable market prices and pricing parameters can vary from product to product. Where available, observable market prices and pricing parameters in a product (or a related product) may be used to derive a price without requiring significant judgment. In certain markets, such as for products that are less actively traded, observable market prices or market parameters are not available, and fair value is determined using techniques appropriate for each particular product. These techniques can, at times, involve a significant degree of judgment.

In the case of financial instruments transacted on recognized exchanges, the observable prices represent quotations for completed transactions from the exchange on which the financial instrument is principally traded. Also, as a result of the adoption of SFAS No. 157 on December 1, 2006, the Company no longer utilizes block discounts in cases where it has large holdings of unrestricted financial instruments with quoted prices that are readily and regularly available in an active market.

The price transparency of the particular product will determine the degree of judgment involved in determining the fair value of the Company s financial instruments. Price transparency is affected by a wide variety of factors, including, for example, the type of product, whether it is a new product and not yet established in the marketplace, and the characteristics particular to the transaction. Products for which actively quoted prices or pricing parameters are available or for which fair value is derived from actively quoted prices or pricing parameters will generally have a higher degree of price transparency. By contrast, products that are thinly traded or not quoted will generally have reduced to no price transparency. Even in normally active markets, the price

Table of Contents

transparency for actively quoted instruments may be reduced for periods of time during periods of market dislocation. Alternatively, in thinly quoted markets, the participation of market-makers willing to purchase and sell a product provides a source of transparency for products that otherwise are not actively quoted or during periods of market dislocation. For further information on the observability of the pricing inputs used to determine the fair value of the Company s financial instruments, see Note 18 to the condensed consolidated financial statements.

The Company s financial instruments used for trading include both cash and derivative products. Cash products include securities issued by the U.S. government and its agencies, other sovereign debt obligations, certain corporate and other debt securities, corporate equity securities, exchange traded funds and physical commodities. The fair value of these products is based principally on observable market prices or is derived using observable market parameters. These products generally do not entail a significant degree of judgment in determining fair value. Examples of products for which actively quoted prices or pricing parameters are available or for which fair value is derived from actively quoted prices or pricing parameters include securities issued by the U.S. government and its agencies, exchange traded corporate equity securities, most municipal debt securities, most corporate debt securities, most high-yield debt securities, physical commodities, certain tradable loan products and most mortgage-backed securities.

In certain circumstances, principally involving loan products and other financial instruments held for securitization transactions, the Company determines fair value from within the range of bid and ask prices such that fair value indicates the value likely to be realized in a current market transaction. Bid prices reflect the price that the Company and others pay, or stand ready to pay, to originators of such assets. Ask prices represent the prices that the Company and others require to sell such assets to the entities that acquire the financial instruments for purposes of completing the securitization transactions. Generally, the fair value of such acquired assets is based upon the bid price in the market for the instrument or similar instruments. In general, the loans and similar assets are valued at bid pricing levels until structuring of the related securitization is substantially complete and such that the value likely to be realized in a current transaction is consistent with the price that a securitization entity will pay to acquire the financial instruments. Factors affecting securitized value and investor demand relating specifically to loan products include, but are not limited to, loan type, underlying property type and geographic location, loan interest rate, loan to value ratios, debt service coverage ratio, investor demand and credit enhancement levels.

In addition, some cash products exhibit little or no price transparency, and the determination of fair value requires more judgment. Examples of cash products with little or no price transparency include certain high-yield debt, certain collateralized mortgage obligations, certain tradable loan products, distressed debt securities (i.e., securities of issuers encountering financial difficulties, including bankruptcy or insolvency) and equity securities that are not publicly traded. Generally, the fair value of these types of cash products is determined using one of several valuation techniques appropriate for the product, which can include cash flow analysis, revenue or net income analysis, default recovery analysis (i.e., analysis of the likelihood of default and the potential for recovery) and other analyses applied consistently.

The Company s derivative products include exchange traded and OTC derivatives. Exchange traded derivatives have valuation attributes similar to the cash products valued using observable market prices or market parameters described above. OTC derivatives, whose fair value is derived using pricing models, include a wide variety of instruments, such as interest rate swap and option contracts, foreign currency option contracts, credit and equity swap and option contracts, and commodity swap and option contracts.

Table of Contents

The following table presents the fair value of the Company s exchange traded and OTC derivatives included within Financial instruments owned and Financial instruments sold, not yet purchased (dollars in millions):

	At August 31, 2007		At November 30, 2006	
	Assets	Liabilities	Assets	Liabilities
Exchange traded	$ 14,277	$ 18,563	$ 12,554	$ 17,094
OTC	48,211	43,525	42,889	40,397
Total	$ 62,488	$ 62,088	$ 55,443	$ 57,491

The fair value of OTC derivative contracts is derived primarily using pricing models, which may require multiple market input parameters. Where appropriate, valuation adjustments are made to account for various factors, including credit quality and market liquidity. These adjustments are applied on a consistent basis and are based upon observable market data where available. The Company also uses pricing models to manage the risks introduced by OTC derivatives. 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 formulae, such as the Black-Scholes option pricing model, simulation models or a combination thereof, applied consistently. In the case of more established derivative products, the pricing models used by the Company are widely accepted by the financial services industry. Pricing models take into account the contract terms, including the maturity, as well as market parameters such as interest rates, volatility and the creditworthiness of the counterparty. As a result of the Company s adoption of SFAS No. 157 on December 1, 2006, the impact of the Company s own credit spreads are also considered when measuring the fair value of liabilities, including OTC derivative contracts.

Prior to the adoption of SFAS No. 157 on December 1, 2006, the Company followed the provisions of EITF Issue No. 02-3 (see Other Items Accounting Developments herein). Under EITF Issue No. 02-3, in the absence of observable market prices or parameters in an active market, observable prices or parameters of other comparable current market transactions, or other observable data supporting a fair value based on a pricing model at the inception of a contract, revenue recognition at the inception of an OTC derivative financial instrument was not permitted. Such revenue was recognized in income at the earlier of when there was market value observability or at the end of the contract period. In the absence of observable market prices or parameters in an active market, observable prices or parameters of other comparable current market transactions, or other observable data supporting a fair value based on a pricing model at the inception of a contract, fair value was based on the transaction price. With the adoption of SFAS No. 157, the Company is no longer applying the revenue recognition criteria of EITF Issue No. 02-3.

Many pricing models do not entail material subjectivity because the methodologies employed do not necessitate significant judgment, and the pricing inputs are observed from actively quoted markets, as is the case for generic interest rate swap and option contracts. A substantial majority of OTC derivative products valued by the Company using pricing models fall into this category. Other derivative products, typically the newest and most complex products, will require more judgment in the implementation of the modeling technique applied due to the complexity of the modeling assumptions and the reduced price transparency surrounding the model s market parameters. The Company manages its market exposure for OTC derivative products primarily by entering into offsetting derivative contracts or other related financial instruments. The Company s trading divisions, the Financial Control Department and the Market Risk Department continuously monitor the price changes of the OTC derivatives in relation to the offsetting positions. For a further discussion of the price transparency of the Company s OTC derivative products, see Quantitative and Qualitative Disclosures about Market Risk Risk Management Credit Risk in Part II, Item 7A of the Form 10-K.

Investment Activities. Substantially all equity and debt investments purchased in connection with private equity and other investment activities are recorded at fair value and are included within Financial instruments owned Investments in the condensed consolidated statements of financial condition, and gains and losses are primarily reflected in Principal transactions investment revenues. The carrying value of such investments reflects expected exit values based upon appropriate valuation techniques applied on a consistent basis. Such

Table of Contents

techniques employ various market, income and cost approaches to determine fair value at the measurement date. The Company s partnership interests are included within Financial instruments owned Investments in the condensed consolidated statements of financial condition and are recorded at fair value, which considers the fair value of the underlying partnership s net assets.

Fair Value Control Processes. The Company employs control processes to validate the fair value of its financial instruments, including those derived from pricing models. These control processes are designed to assure that the values used for financial reporting are based on observable market prices or market-based parameters wherever possible. In the event that market prices or parameters are not available, the control processes are designed to assure that the valuation approach utilized is appropriate and consistently applied and that the assumptions are reasonable. These control processes include reviews of the pricing model s theoretical soundness and appropriateness by Company personnel with relevant expertise who are independent from the trading desks. Additionally, groups independent from the trading divisions within the Financial Control, Market Risk and Credit Risk Departments participate in the review and validation of the fair values generated from pricing models, as appropriate. Where a pricing model is used to determine fair value, recently executed comparable transactions and other observable market data are considered for purposes of validating assumptions underlying the model. Consistent with market practice, the Company has individually negotiated agreements with certain counterparties to exchange collateral (margining) based on the level of fair values of the derivative contracts they have executed. Through this margining process, one party or both parties to a derivative contract provides the other party with information about the fair value of the derivative contract to calculate the amount of collateral required. This sharing of fair value information provides additional support of the Company s recorded fair value for the relevant OTC derivative products. For certain OTC derivative products, the Company, along with other market participants, contributes derivative pricing information to aggregation services that synthesize the data and make it accessible to subscribers. This information is then used to evaluate the fair value of these OTC derivative products. For more information regarding the Company s risk management practices, see Quantitative and Qualitative Disclosures about Market Risk Risk Management in Part II, Item 7A of the Form 10-K.

Table of Contents

Legal, Regulatory and Tax Contingencies.

In the normal course of business, the Company has been named, from time to time, as a defendant in various legal actions, including arbitrations, class actions and other litigation, arising in connection with its activities as a global diversified financial services institution. Certain of the actual or threatened legal actions include claims for substantial compensatory and/or punitive damages or claims for indeterminate amounts of damages. In some cases, the issuers that would otherwise be the primary defendants in such cases are bankrupt or in financial distress.

The Company is also involved, from time to time, in other reviews, investigations and proceedings (both formal and informal) by governmental and self-regulatory agencies regarding the Company s business, including, among other matters, accounting and operational matters, certain of which may result in adverse judgments, settlements, fines, penalties, injunctions or other relief. The number of these reviews, investigations and proceedings has increased in recent years with regard to many firms in the financial services industry, including the Company.

Reserves for litigation and regulatory proceedings are generally determined on a case-by-case basis and represent an estimate of probable losses after considering, among other factors, the progress of each case, prior experience and the experience of others in similar cases, and the opinions and views of internal and external legal counsel. Given the inherent difficulty of predicting the outcome of such matters, particularly in cases where claimants seek substantial or indeterminate damages or where investigations and proceedings are in the early stages, the Company cannot predict with certainty the loss or range of loss, if any, related to such matters, how such matters will be resolved, when they will ultimately be resolved or what the eventual settlement, fine, penalty or other relief, if any, might be.

The Company is subject to the income and indirect tax laws of the U.S., its states and municipalities and those of the foreign jurisdictions in which the Company has significant business operations. These tax laws are complex and subject to different interpretations by the taxpayer and the relevant governmental taxing authorities. The Company must make judgments and interpretations about the application of these inherently complex tax laws when determining the provision for income taxes and the expense for indirect taxes and must also make estimates about when in the future certain items affect taxable income in the various tax jurisdictions. Disputes over interpretations of the tax laws may be settled with the taxing authority upon examination or audit. The Company regularly assesses the likelihood of assessments in each of the taxing jurisdictions resulting from current and subsequent years examinations, and tax reserves are established as appropriate.

The Company establishes reserves for potential losses that may arise out of litigation, regulatory proceedings and tax audits to the extent that such losses are probable and can be estimated in accordance with SFAS No. 5, Accounting for Contingencies (SFAS No. 5). Once established, reserves are adjusted when there is more information available or when an event occurs requiring a change. Significant judgment is required in making these estimates, and the actual cost of a legal claim, tax assessment or regulatory fine/penalty may ultimately be materially different from the recorded reserves, if any.

See Notes 8 and 17 to the condensed consolidated financial statements for additional information on legal proceedings and income tax examinations.

Special Purpose Entities.

The Company enters into a variety of transactions with special purpose entities (SPE), primarily in connection with securitization activities. The Company engages in securitization activities related to commercial and residential mortgage loans, U.S. agency collateralized mortgage obligations, corporate bonds and loans, municipal bonds, credit card loans and other types of financial instruments. In most cases, these SPEs are deemed to be variable interest entities (VIE). Unless a VIE is determined to be a qualifying special purpose entity (QSPE), the Company is required under accounting guidance to perform an analysis of each VIE at the date upon which the Company becomes involved with it to determine whether the Company is the primary beneficiary of the VIE, in which case the Company must consolidate the VIE. QSPEs are not consolidated. The determination of whether an SPE meets the accounting requirements of a QSPE requires significant judgment, particularly in evaluating whether the permitted activities of the SPE are significantly limited and in determining whether derivatives held by the SPE are passive and nonexcessive. In addition, the analysis involved in determining whether an entity is a VIE, and in determining the primary beneficiary of a VIE, also requires significant judgment (see Note 11 to the condensed consolidated financial statements).

Table of Contents

Liquidity and Capital Resources.

The Company s senior management establishes the overall liquidity and capital policies of the Company. Through various risk and control committees, the Company s senior management reviews business performance relative to these policies, monitors the availability of alternative sources of financing, and oversees the liquidity and interest rate and currency sensitivity of the Company s asset and liability position. These committees, along with the Company s Treasury Department and other control groups, also assist in evaluating, monitoring and controlling the impact that the Company s business activities have on its condensed consolidated balance sheet, liquidity and capital structure, thereby helping to ensure that its business activities are integrated with the Company s liquidity and capital policies.

The Company s liquidity and funding risk management policies are designed to mitigate the potential risk that the Company may be unable to access adequate financing to service its financial obligations when they come due without material, adverse franchise or business impact. The key objectives of the liquidity and funding risk management framework are to support the successful execution of the Company s business strategies while ensuring ongoing and sufficient liquidity through the business cycle and during periods of financial distress. The principal elements of the Company s liquidity management framework are the Contingency Funding Plan, the Liquidity Reserve and the Cash Capital Policy. Comprehensive financing guidelines (collateralized funding, long-term funding strategy, surplus capacity, diversification, staggered maturities and committed credit facilities) support the Company s target liquidity profile.

For a more detailed summary of the Company s Liquidity and Capital Policies and funding sources, including committed credit facilities and off-balance sheet funding, refer to Management s Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources in Part II, Item 7 of the Form 10-K.

The Balance Sheet.

The Company monitors and evaluates the composition and size of its balance sheet. Given the nature of the Company s market-making and customer financing activities, the size of the balance sheet fluctuates from time to time. A substantial portion of the Company s total assets consists of highly liquid marketable securities and short-term receivables arising principally from its Institutional Securities sales and trading activities. The highly liquid nature of these assets provides the Company with flexibility in financing and managing its business.

The Company s total assets increased to $1,185,131 million at August 31, 2007 from $1,121,192 million at November 30, 2006. The increase was primarily due to increases in financial instruments owned (largely driven by increases in corporate equities, investments, other sovereign government obligations and derivative contracts) and securities received as collateral, partially offset by the completion of the Discover Spin-off (see Other Items Discontinued Operations Discover herein) and a decrease in securities borrowed.

Within the sales and trading related assets and liabilities are transactions attributable to securities financing activities. Securities financing assets and liabilities as of August 31, 2007 were $658 billion and $663 billion, respectively. Securities financing transactions include repurchase and resale agreements, securities borrowed and loaned transactions, securities received as collateral and obligation to return securities received, customer receivables/payables and related segregated customer cash.

Securities financing assets and liabilities include matched book transactions with minimal market, credit and/or liquidity risk. These matched book transactions are to accommodate customers, as well as to obtain securities for the settlement and finance of inventory positions. The customer receivable/payable portion of the securities financing transactions includes customer margin loans, collateralized by customer owned securities, and customer cash, which is segregated in order to satisfy regulatory requirements. The Company s exposure on these transactions is limited by collateral maintenance policies, which limits the Company s credit exposure to customers. Included within securities financing assets was $92 billion that in accordance with SFAS No. 140 represented equal and offsetting assets and liabilities for fully collateralized non-cash loan transactions.

Table of Contents

Balance sheet leverage ratios are one indicator of capital adequacy when viewed in the context of a company s overall liquidity and capital policies. The Company views the adjusted leverage ratio as a more relevant measure of financial risk when comparing financial services firms and evaluating leverage trends. The Company has adopted a definition of adjusted assets that excludes certain self-funded assets considered to have minimal market, credit and/or liquidity risk. These low-risk assets generally are attributable to the Company s matched book and securities lending businesses. Adjusted assets are calculated by reducing gross assets by aggregate resale agreements and securities borrowed less non-derivative short positions and assets recorded under certain provisions of SFAS No. 140 and FIN 46R. Gross assets are also reduced by the full amount of cash and securities deposited with clearing organizations or segregated under federal and other regulations or requirements. The adjusted leverage ratio reflects the deduction from shareholders equity of the amount of equity used to support goodwill and intangible assets (as the Company does not view this amount of equity as available to support its risk capital needs). In addition, the Company views junior subordinated debt issued to capital trusts as a component of its capital base given the inherent characteristics of the securities. These characteristics include the long-dated nature (e.g., some have final maturity at issuance of 30 years extendible at the Company s option by a further 19 years, others have a 60-year final maturity at issuance), the Company s ability to defer coupon interest for up to 20 consecutive quarters and the subordinated nature of the obligations in the capital structure. The Company also receives rating agency equity credit for these securities. Excluding the $92 billion of assets and liabilities recorded in accordance with SFAS No. 140 would reduce the leverage ratio from 32.3x to 29.8x.

The following table sets forth the Company s total assets, adjusted assets and leverage ratios as of August 31, 2007 and November 30, 2006 and for the average month-end balances during the quarter and nine month period ended August 31, 2007:

	Balance at		Average Month-End Balance(1)	
	August 31, 2007	November 30, 2006	For the Quarter Ended August 31, 2007	For the Nine Month Period Ended August 31, 2007
	(dollars in millions, except ratio data)			
Total assets	$ 1,185,131	$ 1,121,192	$ 1,211,866	$ 1,205,450
Less: Securities purchased under agreements to resell	(176,910)	(175,787)	(167,799)	(178,308)
Securities borrowed	(257,032)	(299,631)	(254,864)	(284,025)
Add: Financial instruments sold, not yet purchased	176,097	183,119	174,478	172,312
Less: Derivative contracts sold, not yet purchased	(62,088)	(57,491)	(60,530)	(55,571)
Subtotal	865,198	771,402	903,151	859,858
Less: Cash and securities deposited with clearing organizations or segregated under federal and other regulations or requirements(2)	(43,229)	(29,565)	(43,903)	(38,665)
Assets recorded under certain provisions of SFAS No. 140 and FIN 46R	(129,552)	(100,236)	(150,858)	(133,549)
Goodwill and net intangible assets(3)	(3,451)	(3,443)	(3,781)	(3,958)
Adjusted assets	$ 688,966	$ 638,158	$ 704,609	$ 683,686
Common equity	$ 34,150	$ 34,264	$ 35,780	$ 36,200
Preferred equity	1,100	1,100	1,100	1,100
Shareholders equity	35,250	35,364	36,880	37,300
Junior subordinated debt issued to capital trusts	4,875	4,884	4,874	4,877
Subtotal	40,125	40,248	41,754	42,177
Less: Goodwill and net intangible assets(3)	(3,451)	(3,443)	(3,497)	(3,844)
Tangible shareholders equity	$ 36,674	$ 36,805	$ 38,257	$ 38,333
Leverage ratio(4)	32.3x	30.5x	31.7x	31.4x
Adjusted leverage ratio(5)	18.8x	17.3x	18.4x	17.8x

(1)

Average balances for the third quarter of fiscal 2007 were calculated based upon month-end balances from May 2007 through August 2007. Average balances for the nine month period ended August 31, 2007 were calculated based upon month-end balances from November 2006 through August 2007. Average common equity was adjusted for the Discover Spin-off.

Table of Contents

(2) In the second quarter of fiscal 2007, the adjusted assets calculation was revised in order to reduce gross assets by the full amount of cash and securities deposited with clearing organizations or segregated under federal and other regulations or requirements. All prior periods have been restated to conform with the current presentation.
(3) Effective December 1, 2006, mortgage servicing rights have been included in net intangible assets. Amounts as of November 30, 2006 have been reclassified to conform with the current presentation.
(4) Leverage ratio equals total assets divided by tangible shareholders equity.
(5) Adjusted leverage ratio equals adjusted assets divided by tangible shareholders equity.

Activity in the Nine Month Period Ended August 31, 2007.

The Company s total capital consists of shareholders equity, long-term borrowings (debt obligations scheduled to mature in more than 12 months) and junior subordinated debt issued to capital trusts. At August 31, 2007, total capital was $187,480 million, an increase of $25,346 million from November 30, 2006. The Company redeemed all $66 million of its outstanding Capital Units on February 28, 2007.

During the nine month period ended August 31, 2007, the Company issued senior notes with a carrying value at quarter-end aggregating $55.6 billion, including non-U.S. dollar currency notes aggregating $23.7 billion. In connection with the note issuances, the Company has entered into certain transactions to obtain floating interest rates based primarily on short-term London Interbank Offered Rates (LIBOR) trading levels. At August 31, 2007, the aggregate outstanding principal amount of the Company s Senior Indebtedness (as defined in the Company s senior debt indentures) was approximately $197 billion (including guaranteed obligations of the indebtedness of subsidiaries). The weighted average maturity of the Company s long-term borrowings, based upon stated maturity dates, was approximately 5.6 years at August 31, 2007.

During the nine month period ended August 31, 2007, the Company purchased approximately $3.2 billion of its common stock (approximately 42 million shares) through publicly announced plans or programs at an average cost of $76.23 per share, which includes the actual price of shares purchased prior to the Discover Spin-off (see also Unregistered Sales of Equity Securities and Use of Proceeds in Part II, Item 2). In December 2006, the Company announced that its Board of Directors had authorized the repurchase of up to $6 billion of the Company s outstanding common stock. This share repurchase authorization considers, among other things, business segment capital needs, as well as equity-based compensation and benefit plan requirements. As of August 31, 2007, the Company had approximately $2.8 billion remaining under its current share repurchase authorization, which the Company expects to utilize over the next 3-9 months at prices the Company deems appropriate, subject to its unallocated capital position, market conditions and regulatory considerations.

Economic Capital.

The Company uses an economic capital model to determine the amount of equity capital needed to support the risk of its business activities and to ensure that the Company remains adequately capitalized. The Company calculates economic capital on a going-concern basis, which is defined as the amount of capital needed to run the business through the business cycle and satisfy the requirements of regulators, rating agencies and the market. Economic capital allocations are evaluated by benchmarking to similarly rated peer firms by business segment. The Company believes this methodology provides an indication of the appropriate level of capital for each business segment as if each were an independent operating entity.

Economic capital requirements are allocated to each business segment and are sub-allocated to product lines as appropriate. This process is intended to align equity capital with the risks in each business, provide business managers with tools for measuring and managing risk, and allow senior management to evaluate risk-adjusted returns (such as return on equity and shareholder value added) to facilitate resource allocation decisions.

The Company s methodology is based on a going-concern approach that assigns equity to each business based on regulatory capital usage plus additional capital for stress losses, including principal investment risk. Regulatory capital, including additional capital assigned for goodwill and intangible assets, is a minimum requirement to ensure the Company s access to funding and credibility in the market. The Company believes it must be able to sustain stress losses and maintain capital substantially above regulatory minimums while supporting ongoing

Table of Contents

business activities. The difference between the Company s consolidated book equity and aggregate equity requirements denotes the Company s unallocated capital position, which is not currently reflected in business segment performance metrics.

The Company assesses stress loss capital across various dimensions of market, credit, business and operational risks. Stress losses are defined at the 90% to 95% confidence interval in order to capture worst potential losses in 10 to 20 years. Stress loss calculations are tangible and transparent and avoid reliance on extreme loss statistical models.

Market risk scenarios capture systematic, idiosyncratic and random market risk through the use of internal market stress data. Credit risk is included in the form of idiosyncratic counterparty default events. Business risk incorporates earnings volatility due to variability in revenue flows, with estimates on the mix of fixed versus variable expenses at various points in the business cycle. Operational stress losses primarily reflect legal risk across the Company.

The Company may enhance the economic capital model and allocation methodology over time in response to changes in the business and regulatory environment to ensure that the model continues to reflect the risks inherent in the Company s business activities and to reflect changes in the drivers of the level and cost of required capital.

In the quarter and nine month period ended August 31, 2007, economic capital requirements have been met by regulatory Tier 1 equity (including common shareholders equity, certain preferred stock, eligible hybrid capital instruments and deductions of goodwill and certain intangible assets and deferred tax assets), subject to regulatory limits.

The following table presents the Company s allocated average Tier 1 equity (economic capital) for the quarter and nine month period ended August 31, 2007 and average common equity for the quarters and nine month periods ended August 31, 2007 and 2006:

	Three Months Ended August 31,			Nine Months Ended August 31,		
	2007		2006	2007		2006
	Average Tier 1 equity	Average common equity	Average common equity	Average Tier 1 equity	Average common equity	Average common equity
	(dollars in billions)					
Institutional Securities	$ 25.7	$ 25.1	$ 18.6	$ 23.5	$ 22.6	$ 17.5
Global Wealth Management Group	1.6	1.7	2.8	1.5	1.7	3.1
Asset Management	2.8	3.6	2.5	2.6	3.3	2.3
Unallocated capital	3.5	3.5	3.4	4.2	4.2	3.1
Total from continuing operations	33.6	33.9	27.3	31.8	31.8	26.0
Discontinued operations	1.6	1.9	5.3	3.6	4.4	5.1
Total	$ 35.2	$ 35.8	$ 32.6	$ 35.4	$ 36.2	$ 31.1

The increase in economic capital allocated to Institutional Securities from the prior year periods reflects the increased risk profile that has resulted from the Company s decisions to invest in key businesses. The Company expects this growth to continue, provided market opportunities continue to warrant such investments. The decrease in the economic capital allocated to the Global Wealth Management Group was due to the Company s reassessment of the amount of capital required to support the market risks and credit risks in the Global Wealth Management Group. The incremental equity capital allocated to Asset Management represents primarily capital required for acquisitions and investments in asset management products.

Table of Contents

The Company currently anticipates that unallocated capital will be used for organic growth, additional acquisitions and other capital needs, including repurchases of common stock.

During fiscal 2007, the Company s shareholders equity has been affected by the adoption of SFAS No. 157 and SFAS No. 159 (see Other Items Accounting Developments herein) and the Discover Spin-off (see Other Items Discontinued Operations Discover herein).

81

Liquidity Management Policies.

The primary goal of the Company s liquidity management and financing activities is to ensure adequate funding over a wide range of market environments. Given the highly liquid nature of the Company s balance sheet, funding requirements are largely fulfilled through the use of collateralized financing. The Company has centralized management of credit-sensitive unsecured funding sources in the Treasury Department. The Company maintains a liquidity management framework in order to meet target liquidity requirements and withstand a contraction in credit availability. The framework components include the Contingency Funding Plan, Liquidity Reserve and Cash Capital.

Contingency Funding Plan*.* The Company maintains a Contingency Funding Plan to manage a potential prolonged liquidity contraction over a one-year time period and to provide the ability to conduct business in an orderly manner. The Contingency Funding Plan is produced on a parent, bank subsidiary and non-bank subsidiary level. The Contingency Funding Plan sets forth a course of action to ensure effective management of a liquidity event. Liquidity risk exposures are regularly evaluated and reported to the Firm Risk Committee and appropriate business segment risk committees.

Liquidity Reserve*.* The Company seeks to maintain liquidity reserves to meet daily funding needs and strategic liquidity targets as outlined in the Contingency Funding Plan. The adequacy of the liquidity reserves are continually assessed and determined based on regular updates to the Contingency Funding Plan. During the quarter ended August 31, 2007, the Company proactively increased its liquidity reserves to address volatility in the credit markets, including the potential need to fund loan commitments and certain assets with reduced distribution channels.

These liquidity reserves are held in the form of cash deposits with banks and pools of unencumbered securities, which are managed on a global basis. The Company believes that diversifying the form in which its liquidity reserves (cash and securities) are maintained enhances its ability to quickly and efficiently source funding in a stressed environment. The table below summarizes the Company s liquidity reserves on a parent, bank subsidiary and non-bank subsidiary level. The liquidity held on the bank and non-bank subsidiary level is generally not available to the parent.

		Average Balance	
Liquidity Reserve	**At August 31, 2007**	**For the Quarter Ended August 31, 2007**	**For the Nine Month Period Ended August 31, 2007**
		(dollars in billions)	
Parent	$ 75	$ 49	$ 44
Bank subsidiaries	20	20	14
Non-bank subsidiaries	30	24	16
Total	$ 125	$ 93	$ 74

Cash Capital*.* The Company maintains a Cash Capital Policy to ensure the funding of its balance sheet while repaying financial obligations maturing within the next 12 months without issuing new unsecured debt. The Company attempts to achieve this by maintaining sufficient cash capital (long-term debt and equity capital) to finance illiquid assets and the portion of its securities inventory that is not expected to be financed on a secured basis in a credit-stressed environment.

Credit Ratings.

The Company s reliance on external sources to finance a significant portion of its day-to-day operations makes access to global sources of financing important. The cost and availability of unsecured financing generally are dependent on the Company s short-term and long-term credit ratings. Factors that are significant to the determination of the Company s credit ratings or that otherwise affect its ability to raise short-term and long-term financing include the Company s level and volatility of earnings, relative positions in the markets in which it operates, geographic and product diversification, retention of key personnel, risk profile, risk management policies, cash liquidity, capital structure, corporate lending credit risk, and legal and regulatory developments. A

Table of Contents

deterioration in any of the previously mentioned factors or combination of these factors may lead rating agencies to downgrade the credit ratings of the Company, thereby increasing the cost to the Company in obtaining unsecured funding. In addition, the Company s debt ratings can have a significant impact on certain trading revenues, particularly in those businesses where longer term counterparty performance is critical, such as OTC derivative transactions, including credit derivatives and interest rate swaps.

In connection with certain OTC trading agreements and certain other agreements associated with the Institutional Securities business, the Company would be required to provide additional collateral to certain counterparties in the event of a downgrade by either Moody s Investors Service or Standard & Poor s. At August 31, 2007, the amount of additional collateral that would be required in the event of a one-notch downgrade of the Company s senior debt credit rating was approximately $588 million. Of this amount, $587 million relates to bilateral arrangements between the Company and other parties where upon the downgrade of one party, the downgraded party must deliver incremental collateral to the other. These bilateral downgrade arrangements are a risk management tool used extensively by the Company as credit exposures are reduced if counterparties are downgraded.

As of September 30, 2007, the Company s credit ratings were as follows:

	Commercial Paper	Senior Debt
Dominion Bond Rating Service Limited	R-1 (middle)	AA (low)
Fitch Ratings(1)	F1+	AA-
Moody s Investors Service	P-1	Aa3
Rating and Investment Information, Inc.	a-1+	AA
Standard & Poor s(2)	A-1+	AA-

(1) On December 19, 2006, Fitch Ratings changed the outlook on the Company s senior debt ratings from Stable to Negative.
(2) On July 30, 2007, Standard & Poor s upgraded the Company s commercial paper rating from A-1 to A-1+ and upgraded the Company s senior debt rating from A+ to AA-.

Commitments.

The Company s commitments as of August 31, 2007 are summarized below by period of expiration. Since commitments may expire unused, the amounts shown do not necessarily reflect the actual future cash funding requirements:

	Years to Maturity				
	Less than 1	1-3	3-5	Over 5	Total
	(dollars in millions)				
Letters of credit and other financial guarantees(1)	$ 10,739	$ 1	$	$	$ 10,740
Investment activities(2)	402	185	3	854	1,444
Investment grade corporate lending commitments(3)	18,759	7,703	22,148	1,770	50,380
Non-investment grade corporate lending commitments(3)	3,812	823	4,425	26,615	35,675
Sales and trading-related commitments(4)	677	1,549	1,090	8,369	11,685
Commitments for secured lending transactions(5)	8,199	3,695	1,248	2,601	15,743
Commitments to purchase mortgage loans(6)	222				222
Commitments to originate mortgage loans(7)	869				869
Commitments to extend credit for mortgage lending(8)	3,985				3,985
Commitments to municipal bond trusts(9)	16,020				16,020
Other commitments(10)	1,221	42	4		1,267
Total(11)	$ 64,905	$ 13,998	$ 28,918	$ 40,209	$ 148,030

Table of Contents

(1) This amount represents the Company s outstanding letters of credit and other financial guarantees, which are primarily used to satisfy various collateral requirements.
(2) This amount represents commitments associated with the Company s real estate, private equity and principal investment activities.
(3) The Company s investment grade and non-investment grade lending commitments are made in connection with corporate lending and other business activities. Credit ratings for commitments are determined by the Company s Institutional Credit Department using methodologies generally consistent with those employed by external rating agencies. Obligor credit ratings of BB+ or lower are considered non-investment grade.
(4) This amount represents commitments associated with the Company s Institutional Securities sales and trading activities.
(5) This amount represents lending commitments extended by the Company to companies that are secured by assets of the borrower. Loans made under these arrangements typically are at variable rates and generally provide for over-collateralization based upon the creditworthiness of the borrower. This amount also includes commitments to asset-backed commercial paper conduits of $1,974 million, which primarily have maturities of less than 3 years.
(6) This amount represents the Company s forward purchase contracts involving mortgage loans.
(7) This amount represents residential mortgage loan commitments to individuals.
(8) This amount represents residential home equity lines of credit.
(9) This amount represents commitments to municipal bond trusts in connection with the Company s Institutional Securities business.
(10) This amount includes commercial loan commitments to small businesses and commitments related to securities-based lending activities in connection with the Company s Global Wealth Management Group business.
(11) See Note 8 to the condensed consolidated financial statements.

In the ordinary course of business, the Company guarantees the debt and/or certain trading obligations (including obligations associated with derivatives, foreign exchange contracts and the settlement of physical commodities) of certain subsidiaries. These guarantees generally are entity or product specific and are required by investors or trading counterparties. The activities of the subsidiaries covered by these guarantees (including any related debt or trading obligations) are included in the Company s condensed consolidated financial statements.

At August 31, 2007, the Company had commitments to enter into reverse repurchase and repurchase agreements of approximately $99 billion and $50 billion, respectively.

Regulatory Requirements.

The Company is a consolidated supervised entity (CSE) as defined by the SEC. As such, the Company is subject to group-wide supervision and examination by the SEC and to minimum capital requirements on a consolidated basis. As of August 31, 2007, the Company was in compliance with the CSE capital requirements.

Table of Contents

Item 3. Quantitative and Qualitative Disclosures about Market Risk.

Market Risk.

The Company uses Value-at-Risk (VaR) as one of a range of risk management tools. VaR values should be interpreted in light of the method s strengths and limitations, which include, but are not limited to: historical changes in market risk factors may not be accurate predictors of future market conditions; VaR estimates represent a one-day measurement and do not reflect the risk of positions that cannot be liquidated or hedged in one day; and VaR estimates may not fully incorporate the risk of more extreme market events that are outsized relative to observed historical market behavior or reflect the historical distribution of results beyond the 95% confidence interval. A small proportion of market risk generated by trading positions is not included in VaR, and the modeling of the risk characteristics of some positions relies upon approximations that, under certain circumstances, could produce significantly different VaR results from those produced using more precise measures. For a further discussion of the Company s VaR methodology and its limitations, and the Company s risk management policies and control structure, see Quantitative and Qualitative Disclosures about Market Risk Risk Management in Part II, Item 7A of the Form 10-K.

The tables below present the following: the Company s quarter-end Aggregate (Trading and Non-trading), Trading, and Non-trading VaR (see Table 1 below); the Company s quarterly average, high, and low Trading VaR (see Table 2 below); and the VaR statistics that would result if the Company were to adopt alternative parameters for its calculations, such as the reported confidence level (95% vs. 99%) for the VaR statistic or a shorter historical time series (four years vs. one year) of market data upon which it bases its simulations (see Table 3 below). Aggregate Trading and Non-trading VaR incorporates certain non-trading positions that are not included in Trading VaR; these include (a) the funding liabilities related to institutional trading positions and (b) public-company equity positions recorded as investments by the Company. Investments made by the Company that are not publicly traded are not reflected in the VaR results below. Aggregate Trading and Non-trading VaR also excludes certain funding liabilities primarily related to fixed and other non-trading assets. As of August 31, 2007, the notional amount of funding liabilities related to non-trading assets (including office facilities and other equipment, goodwill, deferred tax assets, and intangible assets) was approximately $7.8 billion, with a duration of approximately 10.6 years.

The table below presents 95%/one-day VaR for each of the Company s primary risk exposures and on an aggregate basis at August 31, 2007, May 31, 2007 and November 30, 2006.

Table 1: 95% Total VaR	Aggregate (Trading and Non-trading) 95%/One-Day VaR at			Trading 95%/One-Day VaR at			Non-trading 95%/One-Day VaR at		
	August 31,	May 31,	November 30,	August 31,	May 31,	November 30,	August 31,	May 31,	November 30,
Primary Market Risk Category	**2007**	**2007**	**2006**	**2007**	**2007**	**2006**	**2007**	**2007**	**2006**
				(dollars in millions)					
Interest rate and credit spread	$ 58	$ 47	$ 41	$ 55	$ 42	$ 38	$ 20	$ 15	$ 13
Equity price	36	53	58	34	50	55	5	8	5
Foreign exchange rate	16	18	9	16	18	9	2	1	
Commodity price	36	33	31	36	33	31			
Subtotal	146	151	139	141	143	133	27	24	18
Less diversification benefit(1)	62	58	50	60	57	48	6	5	3
Total VaR	$ 84	$ 93	$ 89	$ 81	$ 86	$ 85	$ 21	$ 19	$ 15

(1) Diversification benefit equals the difference between Total VaR and the sum of the VaRs for the four risk categories. This benefit arises because the simulated one-day losses for each of the four primary market risk categories occur on different days; similar diversification benefits also are taken into account within each category.

The Company s Aggregate VaR and Trading VaR at August 31, 2007 were $84 million and $81 million, respectively, compared with $93 million and $86 million, respectively, at May 31, 2007. The decrease in Aggregate VaR and Trading VaR was primarily driven by a decrease in equity exposures toward the end of the quarter.

Table of Contents

The Company views average Trading VaR over a period of time as more representative of trends in the business than VaR at any single point in time. Table 2 below, which presents the high, low and average 95%/one-day Trading VaR during the quarters ended August 31, 2007, May 31, 2007 and November 30, 2006, represents substantially all of the Company s trading activities. Certain market risks included in the year-end Aggregate VaR discussed above are excluded from these measures (e.g., equity price risk in public company equity positions recorded as investments by the Company and certain funding liabilities related to trading positions).

Average Trading VaR for the quarter ended August 31, 2007 increased to $87 million from $81 million for the quarter ended May 31, 2007, primarily driven by increases in interest rate and credit spread VaR and commodity price VaR. The increase in interest rate and credit spread VaR was predominately driven by increased volatility in securitized product and corporate credit markets, which resulted in a higher VaR despite a reduction in risk exposures during the third quarter. The increase in commodity price VaR was predominately driven by increased exposure to electricity and natural gas products.

Table 2: 95% High/Low/Average Trading VaR	Daily 95%/One-Day VaR for the Quarter Ended August 31, 2007			Daily 95%/One-Day VaR for the Quarter Ended May 31, 2007			Daily 95%/One-Day VaR for the Quarter Ended November 30, 2006		
Primary Market Risk Category	**High**	**Low**	**Average**	**High**	**Low**	**Average**	**High**	**Low**	**Average**
				(dollars in millions)					
Interest rate and credit spread	$ 88	$ 38	$ 52	$ 50	$ 34	$ 40	$ 40	$ 29	$ 34
Equity price	61	29	43	53	35	44	55	24	32
Foreign exchange rate	25	11	17	21	11	16	23	8	12
Commodity price	47	33	38	40	31	34	35	26	30
Trading VaR	$ 108	$ 72	$ 87	$ 92	$ 69	$ 81	$ 85	$ 49	$ 61

VaR Statistics Under Varying Assumptions. VaR statistics are not readily comparable across firms because of differences in the breadth of products included in each firm s VaR model, in the statistical assumptions made when simulating changes in market factors, and in the methods used to approximate portfolio revaluations under the simulated market conditions. These differences can result in materially different VaR estimates for similar portfolios. As a result, VaR statistics are more reliable and relevant when used as indicators of trends in risk taking within a firm rather than as a basis for inferring differences in risk taking across firms. Table 3 below presents the VaR statistics that would result if the Company were to adopt alternative parameters for its calculations, such as the reported confidence level (95% versus 99%) for the VaR statistic or a shorter historical time series (four years versus one year) for market data upon which it bases its simulations:

Table 3: Average 95% and 99% Trading VaR with Four-Year/One-Year Historical Time Series	Average 95%/One-Day VaR for the Quarter Ended August 31, 2007		Average 99%/One-Day VaR for the Quarter Ended August 31, 2007	
Primary Market Risk Category	**Four-Year Factor History**	**One-Year Factor History**	**Four-Year Factor History**	**One-Year Factor History**
		(dollars in millions)		
Interest rate and credit spread	$ 52	$ 48	$ 81	$ 71
Equity price	43	46	64	71
Foreign exchange rate	17	16	24	27
Commodity price	38	37	62	53
Trading VaR	$ 87	$ 87	$ 128	$ 126

In addition, if the Company were to report Trading VaR (using a four-year historical time series) with respect to a 10-day holding period, the Company s 95% and 99% Average Trading VaR for the quarter ended August 31, 2007 would have been $276 million and $403 million, respectively.

Table of Contents

Distribution of VaR Statistics and Net Revenues for the quarter ended August 31, 2007. As shown in Table 2 above, the Company s average 95%/one-day Trading VaR for the quarter ended August 31, 2007 was $87 million. The histogram below presents the distribution of the Company s daily 95%/one-day Trading VaR for the quarter ended August 31, 2007. The most frequently occurring value was between $84 million and $93 million, while for approximately 89% of trading days during the quarter, VaR ranged between $75 million and $102 million.

One method of evaluating the reasonableness of the Company s VaR model as a measure of the Company s potential volatility of net revenue is to compare the VaR with actual trading revenue. Assuming no intra-day trading, for a 95%/one-day VaR, the expected number of times that trading losses should exceed VaR during the fiscal year is 13, and, in general, if trading losses were to exceed VaR more than 21 times in a year, the accuracy of the VaR model could be questioned. Accordingly, the Company evaluates the reasonableness of its VaR model by comparing the potential declines in portfolio values generated by the model with actual trading results. The Company incurred daily trading losses in excess of the 95%/one-day Trading VaR on six days during the quarter and nine month period ended August 31, 2007. These losses were incurred during a period of exceptionally high volatility across equity, corporate credit and securitized product markets. Since the Company bases its VaR calculations on four years of equally weighted historical data, clustering of VaR exceptions should occur during periods of exceptionally high market turbulence. The occurrence of six outliers during the quarter is consistent with the fact that realized volatility exceeded the long term average during the quarter. Over the longer term, trading losses are expected to exceed VaR an average of three times per quarter at the 95% confidence level. The Company bases its VaR calculations on the long term (or unconditional) distribution, and therefore evaluates its risk from a longer term perspective, which avoids understating risk during periods of relatively lower volatility in the market.

The histogram below shows the distribution of daily net trading revenue during the quarter ended August 31, 2007 for the Company s trading businesses (including net interest and non-agency commissions but excluding certain non-trading revenues such as primary, fee-based and prime brokerage revenue credited to the trading businesses). During the quarter ended August 31, 2007, the Company experienced net trading revenue losses on 13 days. These loss days were driven predominately by increased market volatility realized during the second half of the quarter. The largest loss days resulted from losses associated with quantitative strategies in early August 2007, when these strategies were adversely affected by widespread portfolio reductions, with the largest single-day trading loss being $390 million.

Table of Contents

Credit Risk.

For a further discussion of the Company s credit risks, see Quantitative and Qualitative Disclosures about Market Risks Credit Risk in Part II, Item 7A of the Form 10-K.

***Credit Exposure-Corporate Lending*.** In connection with certain of its Institutional Securities business activities, the Company provides loans or lending commitments (including bridge financing) to selected clients. Such loans and commitments can generally be classified as either event-driven or relationship-driven .

Event-driven loans and commitments refer to activities associated with a particular event or transaction, such as to support client merger, acquisition or recapitalization transactions. The commitments associated with these event-driven activities may not be indicative of the Company s actual funding requirements, since funding is contingent upon a proposed transaction being completed. In addition, the borrower may not fully utilize the commitment, or the Company s portion of the commitment may be reduced through the syndication process. The borrower s ability to draw on the commitment is also subject to certain terms and conditions, among other factors. The borrowers of event-driven lending transactions may be investment grade or non-investment grade. The Company risk manages its exposures in connection with event-driven transactions through various means, including syndication, distribution and/or hedging.

Relationship-driven loans and commitments are generally made to expand business relationships with select clients. The commitments associated with relationship-driven activities may not be indicative of the Company s actual funding requirements, as the commitment may expire unused or the borrower may not fully utilize the commitment. The borrowers of relationship-driven lending transactions may be investment grade or non-investment grade. The Company may hedge its exposures in connection with relationship-driven transactions.

The following table presents information about the Company s corporate loans and commitments as of August 31, 2007. The total corporate lending exposure column includes both lending commitments and funded loans. Funded loans represent loans that have been drawn by the borrower and that were outstanding as of August 31, 2007. Lending commitments represent legally binding obligations to provide funding to clients as of August 31, 2007 for both relationship-driven and event-driven transactions. As discussed above, these loans and commitments have varying terms, may be senior or subordinated, may be secured or unsecured, are generally contingent upon representations, warranties and contractual conditions applicable to the borrower, and may be syndicated, traded or hedged by the Company.

At August 31, 2007 and November 30, 2006, the aggregate amount of investment grade loans was $11.1 billion and $6.4 billion, respectively, and the aggregate amount of non-investment grade loans was $7.5 billion and $3.4 billion, respectively. At August 31, 2007 and November 30, 2006, the aggregate net amount of lending commitments outstanding was $86.1 billion and $53.5 billion, respectively. In connection with these business activities (which include corporate funded loans and lending commitments), the Company had hedges with a notional amount of $37.5 billion and $26.5 billion at August 31, 2007 and November 30, 2006, respectively, including both internal and external hedges utilized by the lending business.

Corporate Lending Commitments and Funded Loans

	Years to Maturity					
Credit Rating(1)	**Less than 1**	**1-3**	**3-5**	**Over 5**	**Total Corporate Lending Exposure(2)(3)(4)**	**Corporate Loans**
	(dollars in millions)					
AAA	$ 742	$ 60	$ 1,312	$	$ 2,114	$
AA	4,442	1,267	3,694	290	9,693	1,299
A	5,437	3,381	7,840	828	17,486	2,369
BBB	13,834	4,660	12,838	909	32,241	7,487
Non-investment grade	5,032	2,025	5,094	31,005	43,156	7,480
Total	$ 29,487	$ 11,393	$ 30,778	$ 33,032	$ 104,690	$ 18,635
Notional amount of hedges owned					$ 37,474	

Table of Contents

(1) Obligor credit ratings are determined by Institutional Credit using methodologies generally consistent with those employed by external rating agencies.
(2) Total corporate lending exposure includes both lending commitments and funded loans.
(3) Includes event-driven funded loans of $8 billion and event-driven lending commitments of $43 billion.
(4) Included in the $43 billion of event-driven loan commitments were $31.3 billion of commitments to non-investment grade borrowers that were accepted by the borrower but not yet closed. Activity associated with these pipeline commitments during the third quarter was as follows: balance as of May 31, 2007, $26.6 billion; closed commitments, $(3.9) billion; withdrawn commitments, $(2.9) billion; other reductions, primarily through distribution, $(7.1) billion; additions during the quarter, $18.6 billion; balance as of August 31, 2007, $31.3 billion.

Credit Exposure-Derivatives. The table below presents a summary by counterparty credit rating and remaining contract maturity of the fair value of OTC derivatives in a gain position at August 31, 2007. Fair value represents the risk reduction arising from master netting agreements, where applicable, and, in the final column, net of collateral received (principally cash and U.S. government and agency securities):

OTC Derivative Products Financial Instruments Owned(1)

Credit Rating(2)	Years to Maturity: Less than 1	1-3	3-5	Over 5	Cross-Maturity and Cash Collateral Netting(3)	Net Exposure Post-Cash Collateral	Net Exposure Post-Collateral
	(dollars in millions)						
AAA	$ 1,028	$ 1,206	$ 1,066	$ 5,909	$ (2,153)	$ 7,056	$ 6,967
AA	8,213	7,401	5,530	17,918	(22,675)	16,387	14,652
A	3,378	2,609	2,706	6,748	(6,890)	8,551	8,134
BBB	2,789	2,261	2,640	1,858	(2,595)	6,953	5,305
Non-investment grade	4,362	2,709	1,988	2,792	(4,495)	7,356	4,199
Unrated(4)	1,102	600	181	695	(670)	1,908	667
Total	$ 20,872	$ 16,786	$ 14,111	$ 35,920	$ (39,478)	$ 48,211	$ 39,924

(1) Fair values shown present the Company s exposure to counterparties related to the Company s OTC derivative products. The table does not include the effect of any related hedges utilized by the Company. The table also excludes fair values corresponding to other credit exposures, such as those arising from the Company s lending activities.
(2) Obligor credit ratings are determined by Institutional Credit using methodologies generally consistent with those employed by external rating agencies.
(3) Amounts represent the netting of receivable balances with payable balances for the same counterparty across maturity categories. Receivable and payable balances with the same counterparty in the same maturity category are netted within such maturity category, where appropriate. Cash collateral received is netted on a counterparty basis, provided legal right of offset exists.
(4) In lieu of making an individual assessment of the creditworthiness of unrated companies, the Company makes a determination that the collateral held with respect to such obligations is sufficient to cover a substantial portion of its exposure. In making this determination, the Company takes into account various factors, including legal uncertainties and market volatility.

Table of Contents

The following tables summarize the fair values of the Company s OTC derivative products recorded in Financial instruments owned and Financial instruments sold, not yet purchased by product category and maturity at August 31, 2007, including on a net basis, where applicable, reflecting the fair value of related non-cash collateral for financial instruments owned:

OTC Derivative Products Financial Instruments Owned

Product Type	Years to Maturity: Less than 1	1-3	3-5	Over 5	Cross-Maturity and Cash Collateral Netting(1)	Net Exposure Post-Cash Collateral	Net Exposure Post-Collateral
	(dollars in millions)						
Interest rate and currency swaps, interest rate options, credit derivatives and other fixed income securities contracts	$ 3,915	$ 8,234	$ 9,534	$ 33,532	$ (29,254)	$ 25,961	$ 23,381
Foreign exchange forward contracts and options	6,818	656	108	39	(1,671)	5,950	4,816
Equity securities contracts (including equity swaps, warrants and options)	4,998	3,146	895	675	(4,650)	5,064	2,553
Commodity forwards, options and swaps	5,141	4,750	3,574	1,674	(3,903)	11,236	9,174
Total	$ 20,872	$ 16,786	$ 14,111	$ 35,920	$ (39,478)	$ 48,211	$ 39,924

(1) Amounts represent the netting of receivable balances with payable balances for the same counterparty across maturity and product categories. Receivable and payable balances with the same counterparty in the same maturity category are netted within the maturity category, where appropriate. Cash collateral received is netted on a counterparty basis, provided legal right of offset exists.

OTC Derivative Products Financial Instruments Sold, Not Yet Purchased(1)

Product Type	Years to Maturity: Less than 1	1-3	3-5	Over 5	Cross-Maturity and Cash Collateral Netting(2)	Total
	(dollars in millions)					
Interest rate and currency swaps, interest rate options, credit derivatives and other fixed income securities contracts	$ 7,123	$ 6,306	$ 8,147	$ 19,216	$ (24,159)	$ 16,633
Foreign exchange forward contracts and options	6,795	660	109	40	(833)	6,771
Equity securities contracts (including equity swaps, warrants and options)	5,284	3,655	1,924	1,108	(2,012)	9,959
Commodity forwards, options and swaps	6,710	4,393	1,723	1,295	(3,959)	10,162
Total	$ 25,912	$ 15,014	$ 11,903	$ 21,659	$ (30,963)	$ 43,525

(1) Since these amounts are liabilities of the Company, they do not result in credit exposures.
(2) Amounts represent the netting of receivable balances with payable balances for the same counterparty across maturity and product categories. Receivable and payable balances with the same counterparty in the same maturity category are netted within the maturity category, where appropriate. Cash collateral paid is

netted on a counterparty basis, provided legal right of offset exists.

Table of Contents

The Company s derivatives (both listed and OTC) at August 31, 2007 and November 30, 2006 are summarized in the table below, showing the fair value of the related assets and liabilities by product:

Product Type	At August 31, 2007 Assets	At August 31, 2007 Liabilities	At November 30, 2006 Assets	At November 30, 2006 Liabilities
	(dollars in millions)			
Interest rate and currency swaps, interest rate options, credit derivatives and other fixed income securities contracts	$ 26,437	$ 17,122	$ 19,444	$ 15,688
Foreign exchange forward contracts and options	5,952	6,775	7,325	7,725
Equity securities contracts (including equity swaps, warrants and options)	18,570	27,604	16,705	23,155
Commodity forwards, options and swaps	11,529	10,587	11,969	10,923
Total	$ 62,488	$ 62,088	$ 55,443	$ 57,491

Each category of derivative products in the above tables includes a variety of instruments, which can differ substantially in their characteristics. Instruments in each category can be denominated in U.S. dollars or in one or more non-U.S. currencies.

The Company determines the fair values recorded in the above tables using various pricing models. For a discussion of fair value as it affects the condensed consolidated financial statements, see Management s Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies in Part I, Item 2 and Note 1 to the condensed consolidated financial statements. As discussed under Critical Accounting Policies, the structure of the transaction, including its maturity, is one of several important factors that may impact the price transparency. The impact of maturity on price transparency can differ significantly among product categories. For example, single currency and multi-currency interest rate derivative products involving highly standardized terms and the major currencies (e.g., the U.S. dollar or the euro) will generally have greater price transparency from published external sources even in maturity ranges beyond 20 years. Credit derivatives with highly standardized terms and liquid underlying reference instruments can have price transparency from published external sources in a maturity ranging up to 10 years, while equity and foreign exchange derivative products with standardized terms in major currencies can have price transparency from published external sources within a two-year maturity range. Commodity derivatives with standardized terms and delivery locations can have price transparency from published external sources within various maturity ranges up to 10 years, depending on the commodity. In most instances of limited price transparency based on published external sources, dealers in these markets, in their capacities as market-makers and liquidity providers, provide price transparency beyond the above maturity ranges.

Country Exposure. The Company monitors its credit exposure and risk to individual countries. Credit exposure to a country arises from the Company s lending activities and derivatives activities in a country. At August 31, 2007, based on the domicile of the counterparty, approximately 7% of the Company s credit exposure (for credit exposure arising from corporate loans and lending commitments as discussed above and current exposure arising from the Company s OTC derivatives contracts) was to emerging markets, and no one emerging market country accounted for more than 3% of the Company s credit exposure. The Company defines emerging markets to include generally all countries that are not members of the Organization for Economic Co-operation and Development and includes as well the Czech Republic, Hungary, Korea, Mexico, Poland, the Slovak Republic and Turkey, but excludes countries rated AA/Aa2 or above by Standard & Poor s and Moody s Investors Service.

Industry Exposure. The Company also monitors its credit exposure and risk to individual industries. At August 31, 2007, the Company s material credit exposure (for credit exposure arising from corporate loans and lending commitments as discussed above and current exposure arising from the Company s OTC derivatives contracts) was to entities engaged in the following industries: consumer-related entities, utilities, telecommunications, financial institutions and banks, energy-related entities and healthcare.

Table of Contents

Item 4. Controls and Procedures

Under the supervision and with the participation of the Company s management, including our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of the effectiveness of the Company s disclosure controls and procedures (as defined in Rule 13a-15(e) of the Securities Exchange Act of 1934, as amended (the Exchange Act)). Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this report.

No change in the Company s internal control over financial reporting (as defined in Rule 13a-15(f) of the Exchange Act) occurred during the period covered by this report that materially affected, or is reasonably likely to materially affect, the Company s internal control over financial reporting.

Table of Contents

Part II OTHER INFORMATION

Item 1. Legal Proceedings

In addition to the matters described in the Company s Annual Report on Form 10-K for the fiscal year ended November 30, 2006 (the Form 10-K), the Company s Quarterly Reports on Form 10-Q for the quarterly periods ended February 28, 2007 (the First Quarter Form 10-Q) and May 31, 2007 (the Second Quarter Form 10-Q) and those described below, in the normal course of business, the Company has been named, from time to time, as a defendant in various legal actions, including arbitrations, class actions, and other litigation, arising in connection with its activities as a global diversified financial services institution. Certain of the actual or threatened legal actions include claims for substantial compensatory and/or punitive damages or claims for indeterminate amounts of damages. In some cases, the issuers that would otherwise be the primary defendants in such cases are bankrupt or in financial distress.

The Company is also involved, from time to time, in other reviews, investigations and proceedings (both formal and informal) by governmental and self-regulatory agencies regarding the Company s business, including, among other matters, accounting and operational matters, certain of which may result in adverse judgments, settlements, fines, penalties, injunctions or other relief. The number of these reviews, investigations and proceedings has increased in recent years with regard to many firms in the financial services industry, including the Company.

The Company contests liability and/or the amount of damages in each pending matter. In view of the inherent difficulty of predicting the outcome of such matters, particularly in cases where claimants seek substantial or indeterminate damages or where investigations and proceedings are in the early stages, the Company cannot predict with certainty the loss or range of loss, if any, related to such matters, how or if such matters will be resolved, when they will ultimately be resolved, or what the eventual settlement, fine, penalty or other relief, if any, might be. Subject to the foregoing, and except for the *Coleman Litigation* (see also Note 8 in Notes to Condensed Consolidated Financial Statements in Part I, Item 1), the Company believes, based on current knowledge and after consultation with counsel, that the outcome of the pending matters will not have a material adverse effect on the consolidated financial condition of the Company, although the outcome of such matters could be material to the Company s operating results for a particular future period, depending on, among other things, the level of the Company s revenues or income for such period.

The following developments have occurred with respect to certain matters previously reported in the Form 10-K, the First Quarter Form 10-Q and the Second Quarter Form 10-Q.

Coleman Litigation.

On July 25, 2007, the Company filed a brief with the Florida Supreme Court (the Supreme Court) in opposition to Coleman (Parent) Holdings Inc. s request that the Supreme Court review the March 21, 2007 decision of the District Court of Appeal for the Fourth District of Florida.

IPO Fee Litigation.

On September 11, 2007, in *In re Issuer Plaintiff Initial Public Offering Fee Antitrust Litigation*, the U.S. Court of Appeals for the Second Circuit reversed the U.S. District Court for the Southern District of New York s denial of class certification and remanded the case back to the district court for further consideration of class certification issues.

IPO Allocation Matters.

On August 14, 2007, in the numerous purported class actions, now captioned *In re Initial Public Offering Securities Litigation*, plaintiffs filed second consolidated amended class action complaints, which purport to amend the allegations in light of the court of appeals reversal of the lower court s decision approving the cases to proceed as class actions. Plaintiffs again seek certification of classes.

Table of Contents

Global Wealth Management Group Employment Matters.

Gender Matters. On July 17, 2007, in *Joanne Augst-Johnson et al. v. Morgan Stanley & Co. Inc.*, the court preliminarily approved the class action settlement which included, among other provisions, a payment to the settlement fund and certain programmatic relief. A final approval hearing is scheduled for October 11, 2007.

Global Wealth Management Group NASD Email Matter.

On September 27, 2007, the Financial Industry Regulatory Authority (FINRA) announced that the Company entered into a Letter of Acceptance, Waiver and Consent (the AWC) to resolve charges filed by FINRA on December 19, 2006. In the AWC, FINRA found that, among other things, the Company provided inaccurate information regarding the existence of pre-September 11, 2001 emails and failed to provide such emails to arbitration claimants and regulators in response to discovery obligations and regulatory inquiries, failed adequately to preserve books and records, and failed to establish and maintain systems and written procedures reasonably designed to preserve required records and to ensure that it conducted adequate searches in response to regulatory inquiries and discovery requests. The AWC also included findings that the Company failed to provide arbitration claimants with updates to a supervisory manual when called for in discovery. FINRA found that the Company violated Section 17(a) of the Securities Exchange Act of 1934, Rule 17a-4 thereunder, NASD Conduct Rules 2110, 3010 (a) and (b) and 3110, NASD Procedural Rule 8210 and Interpretative Material 10100 under the NASD Code of Arbitration Procedure. In the settlement, the Company neither admitted nor denied these findings. The settlement established a $9.5 million fund for the benefit of potentially affected arbitration claimants to be administered by a third party at the expense of the Company. In addition, the Company was censured and agreed to pay a $3 million regulatory fine and to retain an independent consultant to review its procedures for complying with discovery requirements in arbitration proceedings relating to the Company s retail brokerage operations.

Item 1A. Risk Factors

For a discussion of the risk factors affecting the Company, see Risk Factors in Part I, Item 1A of the Form 10-K.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

The table below sets forth the information with respect to purchases made by or on behalf of the Company of its common stock during the quarterly period ended August 31, 2007.

Issuer Purchases of Equity Securities

(dollars in millions, except per share amounts)

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased As Part of Publicly Announced Plans or Programs (C)	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs
Month #1				
(June 1, 2007 June 30, 2007)				
Share Repurchase Program (A)		N/A		$ 3,415
Employee Transactions (B)	162,671	$ 88.52	N/A	N/A
Month #2				
(July 1, 2007 July 31, 2007)				
Share Repurchase Program (A)	2,862,519	$ 68.17	2,862,519	$ 3,220
Employee Transactions (B)	558,283	$ 71.07	N/A	N/A

Month #3						
(August 1, 2007 August 31, 2007)						
Share Repurchase Program (A)	6,801,296	$	63.55	6,801,296	$	2,787
Employee Transactions (B)	62,109	$	61.95	N/A		N/A
Total						
Share Repurchase Program (A)	9,663,815	$	64.92	9,663,815	$	2,787
Employee Transactions (B)	783,063	$	73.98	N/A		N/A

(A) On December 19, 2006, the Company announced that its Board of Directors authorized the repurchase of up to $6 billion of the Company s outstanding stock under a new share repurchase program (the Share Repurchase Program). The Share Repurchase Program is a program for capital management purposes that considers, among other things, business segment capital needs, as well as equity-based compensation and benefit plan requirements. The Company expects to exercise the authorization over 12-18 months from initial authorization at prices the Company deems appropriate, subject to its unallocated capital position, market conditions and regulatory considerations.

(B) Includes: (1) shares delivered or attested to in satisfaction of the exercise price and/or tax withholding obligations by holders of employee stock options (granted under employee stock compensation plans) who exercised options; (2) restricted shares withheld (under the terms of grants under employee stock compensation plans) to offset tax withholding obligations that occur upon vesting and release of restricted shares; and (3) shares withheld (under the terms of grants under employee stock compensation plans) to offset tax withholding obligations that occur upon the delivery of outstanding shares underlying restricted stock units. The Company s employee stock compensation plans provide that the value of the shares delivered or attested, or withheld, shall be valued using the fair market value of the Company common stock on the date the relevant transaction occurs, using a valuation methodology established by the Company.

(C) Share purchases under publicly announced programs are made pursuant to open-market purchases, Rule 10b5-1 plans or privately negotiated transactions (including with employee benefit plans) as market conditions warrant and at prices the Company deems appropriate.

Item 6. Exhibits

An exhibit index has been filed as part of this Report on Page E-1.

Table of Contents

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

MORGAN STANLEY

(Registrant)

By: /s/ DAVID H. SIDWELL
David H. Sidwell,

Principal Financial Officer

By: /s/ PAUL C. WIRTH
Paul C. Wirth,

Controller and Principal Accounting Officer

Date: October 10, 2007

Table of Contents

EXHIBIT INDEX

MORGAN STANLEY

Quarter Ended August 31, 2007

Exhibit No.	Description
10.1	Amendment No. 5 dated as of June 25, 2007 to the Amended and Restated Trust Agreement between Morgan Stanley and State Street Bank and Trust Company.
10.2	Amendment to Morgan Stanley 401(k) Plan.
10.3	Employee Stock Purchase Plan, amended as of June 19, 2007.
11	Statement Re: Computation of Earnings Per Common Share (The calculation of per share earnings is in Part I, Item 1, Note 7 to the Condensed Consolidated Financial Statements (Earnings per Share) and is omitted in accordance with Section (b)(11) of Item 601 of Regulation S-K).
12	Statement Re: Computation of Ratio of Earnings to Fixed Charges and Computation of Earnings to Fixed Charges and Preferred Stock Dividends.
15	Letter of awareness from Deloitte & Touche LLP, dated October 9, 2007, concerning unaudited interim financial information.
18	Letter Re: Change in Accounting Principles.
31.1	Rule 13a-14(a) Certification of Chief Executive Officer.
31.2	Rule 13a-14(a) Certification of Chief Financial Officer.
32.1	Section 1350 Certification of Chief Executive Officer.
32.2	Section 1350 Certification of Chief Financial Officer.

Table of Contents