UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended May 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 ☒ 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 ☒ 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 ☒

As of June 29, 2007, there were 1,052,546,403 shares of the Registrant's Common Stock, par value $.01 per share, outstanding.

MORGAN STANLEY

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Quarter Ended May 31, 2007

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.

Item 1.

MORGAN STANLEY

CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION
(dollars in millions, except share data)

	May 31, 2007	November 30, 2006
	(unaudited)	
Assets		
Cash and cash equivalents	$ 31,786	$ 20,606
Cash and securities deposited with clearing organizations or segregated under federal and other regulations or requirements (including securities at fair value of $19,996 at May 31, 2007 and $8,648 at November 30, 2006)	47,114	29,565
Financial instruments owned (approximately $157 billion and $125 billion were pledged to various parties at May 31, 2007 and November 30, 2006, respectively):		
U.S. government and agency securities	35,198	39,352
Other sovereign government obligations	28,764	27,305
Corporate and other debt	167,751	158,864
Corporate equities	99,728	86,058
Derivative contracts	56,461	55,443
Investments	10,050	4,725
Physical commodities	3,165	3,031
Total financial instruments owned	401,117	374,778
Securities received as collateral	112,236	64,588
Collateralized agreements:		
Securities purchased under agreements to resell	144,051	175,787
Securities borrowed	252,213	299,631
Receivables:		
Consumer loans (net of allowances of $784 at May 31, 2007 and $831 at November 30, 2006)	21,917	22,915
Customers	113,866	82,923
Brokers, dealers and clearing organizations	17,009	7,633
Other loans	14,334	11,908
Fees, interest and other	11,991	8,937
Other investments	13,302	3,232
Office facilities and other equipment, at cost (net of accumulated depreciation of $3,927 at May 31, 2007 and $3,645 at November 30, 2006)	4,501	4,086
Goodwill	2,977	2,792
Intangible assets (net of accumulated amortization of $151 million at May 31, 2007 and $109 million at November 30, 2006)	1,155	651
Other assets	10,424	11,160
Total assets	$1,199,993	$1,121,192

MORGAN STANLEY

CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION—(Continued)
(dollars in millions, except share data)

	May 31, 2007	November 30, 2006
	(unaudited)	
Liabilities and Shareholders' Equity		
Commercial paper and other short-term borrowings	$ 33,747	$ 29,092
Deposits	43,577	28,343
Financial instruments sold, not yet purchased:		
U.S. government and agency securities	18,085	26,168
Other sovereign government obligations	23,586	28,961
Corporate and other debt	6,321	10,336
Corporate equities	58,491	59,399
Derivative contracts	58,919	57,491
Physical commodities	1,147	764
Total financial instruments sold, not yet purchased	166,549	183,119
Obligation to return securities received as collateral	112,236	64,588
Collateralized financings:		
Securities sold under agreements to repurchase	252,710	267,566
Securities loaned	147,216	150,257
Other secured financings	43,456	45,556
Payables:		
Customers	142,080	134,907
Brokers, dealers and clearing organizations	13,656	7,635
Interest and dividends	6,541	4,746
Other liabilities and accrued expenses	26,782	24,975
Long-term borrowings	171,932	144,978
	1,160,482	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 May 31, 2007 and November 30, 2006; Shares issued: 1,211,701,552 at May 31, 2007 and November 30, 2006; Shares outstanding: 1,051,690,047 at May 31, 2007 and 1,048,877,006 at November 30, 2006	12	12
Paid-in capital	2,165	2,213
Retained earnings	46,256	41,422
Employee stock trust	5,808	4,315
Accumulated other comprehensive loss	(119)	(35)
Common stock held in treasury, at cost, $0.01 par value; 160,011,505 shares at May 31, 2007 and 162,824,546 shares at November 30, 2006	(9,903)	(9,348)
Common stock issued to employee trust	(5,808)	(4,315)
Total shareholders' equity	39,511	35,364
Total liabilities and shareholders' equity	$1,199,993	$1,121,192

See Notes to Condensed Consolidated Financial Statements.

MORGAN STANLEY

CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(dollars in millions, except share and per share data)

	Three Months Ended May 31, 2007	Three Months Ended May 31, 2006	Six Months Ended May 31, 2007	Six Months Ended May 31, 2006
	(unaudited)		(unaudited)	
Revenues:				
Investment banking	$ 1,913	$ 1,132	$ 3,140	$ 2,114
Principal transactions:				
Trading	4,838	3,559	8,996	6,645
Investments	1,004	629	1,884	929
Commissions	1,123	994	2,128	1,914
Fees:				
Asset management, distribution and administration	1,596	1,321	3,075	2,589
Merchant, cardmember and other fees, net	261	277	558	566
Servicing and securitization income	643	651	1,199	1,247
Interest and dividends	16,066	10,111	30,880	20,655
Other	290	125	535	259
Total revenues	27,734	18,799	52,395	36,918
Interest expense	16,007	9,965	29,492	19,426
Provision for consumer loan losses	204	130	399	285
Net revenues	11,523	8,704	22,504	17,207
Non-interest expenses:				
Compensation and benefits	5,218	3,802	10,210	8,044
Occupancy and equipment	301	236	581	466
Brokerage, clearing and exchange fees	366	340	727	632
Information processing and communications	381	364	750	710
Marketing and business development	340	297	634	535
Professional services	626	537	1,125	970
Other	417	265	756	576
Total non-interest expenses	7,649	5,841	14,783	11,933
Income from continuing operations before losses from unconsolidated investees and income taxes	3,874	2,863	7,721	5,274
(Losses)/gains from unconsolidated investees	(21)	23	(48)	3
Provision for income taxes	1,271	1,058	2,532	1,847
Income from continuing operations	2,582	1,828	5,141	3,430
Discontinued operations:				
Gain/(loss) from discontinued operations	—	21	174	(26)
Income tax (provision)/benefit	—	(8)	(61)	11
Gain/(loss) on discontinued operations	—	13	113	(15)
Net income	$ 2,582	$ 1,841	$ 5,254	$ 3,415
Preferred stock dividend requirements	$ 17	$ —	$ 34	$ —
Earnings applicable to common shareholders	$ 2,565	$ 1,841	$ 5,220	$ 3,415
Earnings per basic common share:				
Income from continuing operations	$ 2.57	$ 1.81	$ 5.09	$ 3.37
Gain/(loss) on discontinued operations	—	0.01	0.12	(0.01)
Earnings per basic common share	$ 2.57	$ 1.82	$ 5.21	$ 3.36
Earnings per diluted common share:				
Income from continuing operations	$ 2.45	$ 1.74	$ 4.86	$ 3.25
Gain/(loss) on discontinued operations	—	0.01	0.10	(0.02)
Earnings per diluted common share	$ 2.45	$ 1.75	$ 4.96	$ 3.23
Average common shares outstanding:				
Basic	996,544,761	1,013,241,715	1,002,894,369	1,016,756,096
Diluted	1,045,643,087	1,054,733,745	1,051,684,753	1,056,493,761

See Notes to Condensed Consolidated Financial Statements.

MORGAN STANLEY

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(dollars in millions)

	Three Months Ended May 31,		Six Months Ended May 31,	
	2007	2006	2007	2006
	(unaudited)		(unaudited)	
Net income	$2,582	$1,841	$5,254	$3,415
Other comprehensive income (loss), net of tax:				
Foreign currency translation adjustments	5	97	(97)	130
Net change in cash flow hedges	3	53	11	80
Minimum pension liability adjustment	—	—	2	—
Comprehensive income	$2,590	$1,991	$5,170	$3,625

See Notes to Condensed Consolidated Financial Statements.

MORGAN STANLEY

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(dollars in millions)

	Six Months Ended May 31,	
	2007	2006
	(unaudited)	
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 5,254	$ 3,415
Adjustments to reconcile net income to net cash used for operating activities:		
Losses (gains) from unconsolidated investees	48	(3)
Compensation payable in common stock and options	1,266	1,215
Depreciation and amortization	254	365
Provision for consumer loan losses	399	285
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	(17,546)	(6,482)
Financial instruments owned, net of financial instruments sold, not yet purchased	(35,435)	(36,391)
Securities borrowed	47,418	(30,340)
Securities loaned	(3,041)	21,000
Receivables and other assets	(45,982)	(23,672)
Payables and other liabilities	16,383	24,557
Securities purchased under agreements to resell	31,736	(15,959)
Securities sold under agreements to repurchase	(15,491)	19,976
Net cash used for operating activities	(14,905)	(41,909)
CASH FLOWS FROM INVESTING ACTIVITIES		
Net (payments for) proceeds from:		
Office facilities and aircraft under operating leases	(607)	1,990
Business acquisitions, net of cash acquired	(1,167)	(1,676)
Sale of Quilter Holdings Ltd.	476	—
Net principal disbursed on consumer loans	(4,697)	(4,625)
Sales of consumer loans	5,301	6,613
Purchases of securities available for sale	(7,975)	—
Net cash (used for) provided by investing activities	(8,669)	2,302
CASH FLOWS FROM FINANCING ACTIVITIES		
Net proceeds from (payments for):		
Short-term borrowings	4,441	2,908
Derivatives financing activities	(89)	(156)
Other secured financings	(8,547)	5,264
Deposits	15,214	3,897
Tax benefits associated with stock-based awards	181	39
Net proceeds from:		
Issuance of common stock	602	229
Issuance of long-term borrowings	40,395	25,693
Payments for:		
Repayments of long-term borrowings	(14,160)	(10,995)
Redemption of Capital Units	(66)	—
Repurchases of common stock	(2,609)	(1,312)
Cash dividends	(608)	(581)
Net cash provided by financing activities	34,754	24,986
Net increase (decrease) in cash and cash equivalents	11,180	(14,621)
Cash and cash equivalents, at beginning of period	20,606	29,414
Cash and cash equivalents, at end of period	$ 31,786	$ 14,793

See Notes to Condensed Consolidated Financial Statements.

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, Asset Management and Discover.

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 funds and real estate, 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.

Discover offers Discover®-branded credit cards and related consumer products and services and operates the Discover Network, a merchant and cash access network for Discover Network-branded cards, and PULSE® EFT Association LP ("PULSE"), an automated teller machine/debit and electronic funds transfer network. Discover also offers consumer finance products and services in the U.K., including Morgan Stanley-branded, Goldfish-branded and various other credit cards issued on the MasterCard and Visa networks.

On June 30, 2007, the Company completed the spin-off of Discover Financial Services (the "Discover Spin-off"). Beginning in the third quarter of fiscal 2007, Discover's results will be included within discontinued operations for all periods presented.

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, consumer loan loss levels, 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, 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 in the quarter ended February 28, 2007, 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 $245 million in the quarter ended February 28, 2007 and $93 million and $187 million for the quarter and six month period ended May 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 Gains (losses) 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 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 $101 million and $255 million for the quarter and six months ended May 31, 2007, and $52 million and $57 million for the quarter and six months ended May 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 entity.

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. As discussed in Note 18, the Company has elected to fair value certain investments that had previously been accounted for under the equity method.

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"), Morgan Stanley Investment Advisors Inc. and Discover Financial Services (formerly NOVUS Credit Services 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 and provision for loan losses, as one integrated activity for each of the Company's separate businesses.

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.

Discontinued Operations.

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 Company’s aircraft leasing business was classified as “held for sale” prior to its sale on March 24, 2006, and associated revenues and expenses have been 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.

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 quarterly based on measuring account/fund performance to date versus the performance benchmark stated in the investment management agreement.

Merchant, Cardmember and Other Fees, Net. Merchant, cardmember and other fees, net, include revenues from fees charged to merchants on credit card sales (net of interchange fees paid to banks that issue cards on the Company’s merchant and cash access network), transaction processing fees on debit card transactions as well as charges to cardmembers for late payment fees, overlimit fees, balance transfer fees, credit protection fees and cash advance fees, net of cardmember rewards. Merchant, cardmember and other fees are recognized as earned. Cardmember rewards include various reward programs, including the Cashback Bonus® reward program, pursuant to which the Company pays certain cardmembers a percentage of their purchase amounts based upon a cardmember’s level and type of purchases. The liability for cardmember rewards, included in Other liabilities and accrued expenses, is computed on an individual cardmember basis and is accumulated as qualified cardmembers make progress toward earning a reward through their ongoing purchase activity. In determining the liability for cardmember rewards, the Company considers estimated forfeitures based on historical account closure, charge-off and transaction activity. The Company records the cost of its cardmember reward programs as a reduction of Merchant, cardmember and other fees, net.

Consumer Loans. Consumer loans, which consist primarily of general purpose credit card and consumer installment loans, are generally reported at their principal amounts outstanding less applicable allowances.

Interest on consumer loans is recorded to income as earned. Interest is generally accrued on credit card loans until the date of charge-off, which generally occurs at the end of the month during which an account becomes 180 contractually days past due, except in the case of cardmember bankruptcies, probate accounts, and fraudulent transactions. Cardmember bankruptcies and probate accounts are charged off at the end of the month 60 days following the receipt of notification of the bankruptcy or death but not later than the 180-day contractual time frame. Fraudulent transactions are reported in consumer loans at their net realizable value upon receipt of notification of the fraud through a charge to operating expenses and are subsequently written off at the end of the month 90 days following notification but not later than the contractual 180-day time frame. The interest portion of charged-off credit card loans is written off against interest revenue. Origination costs related to the issuance of credit cards are charged to earnings over periods not exceeding 12 months.

The Company classifies a portion of its consumer loans as held for sale. Loans held for sale include the lesser of loans eligible for securitization or sale, or loans that management intends to securitize within three months, net of amortizing securitizations. These loans are carried at the lower of aggregate cost or fair value.

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.

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 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 involve some 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 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 certain 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.

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 based upon changes in 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 and amounts excluded from the assessment of hedge effectiveness on the condensed consolidated statements of income was not material for all periods presented. 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 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, credit card loans and other types of financial assets (see Notes 3 and 4). The Company may retain interests in the securitized financial assets as one or more tranches of the securitization, undivided seller's interests, accrued interest receivable subordinate to investors' interests (see Note 4), cash collateral accounts, rights to any excess cash flows remaining after payments to investors in the securitization trusts of their contractual rate of return and reimbursement of credit losses, and other retained interests. The exposure to credit losses from securitized loans is limited to the Company's retained contingent risk, which represents the Company's retained interest in securitized loans, including any credit enhancement provided. 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, and each subsequent transfer in revolving structures, 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 are generally not available for 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. The present value of future net excess cash flows that the Company estimates it will receive over the term of the securitized loans is recognized in income as the loans are securitized. An asset also is recorded and charged to income over the term of the securitized loans, with actual net excess cash flows continuing to be recognized in income as they are earned.

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 on securities available for sale are reported in earnings (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 was 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 $395 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), Asset Management ($28 million) and Discover ($17 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 $7,679 million and $30 million in the six months ended May 31, 2007 and May 31, 2006, respectively.

2. Goodwill and Net Intangible Assets.

During the first quarter of fiscal 2007, the Company completed the annual goodwill impairment test (as of December 1 in each fiscal year). The Company's testing did not indicate any goodwill impairment.

Changes in the carrying amount of the Company's goodwill and intangible assets for the six month period ended May 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	—	7	—	2	9
Goodwill acquired during the period and other(1)	348	3	88	—	439
Goodwill disposed during the period(2)	(8)	(255)	—	—	(263)
Balance as of May 31, 2007	$1,041	$ 344	$1,056	$536	$2,977

	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)	356	—	224	5	585
Intangible assets disposed during the period	(39)	—	—	—	(39)
Amortization expense	(30)	—	(6)	(6)	(42)
Balance as of May 31, 2007	$734	$—	$221	$200	$1,155

(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 and Brookville Capital Management (see Note 16).

(2) Activity primarily represents goodwill disposed in connection with the Company's sale of Quilter (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.

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 May 31, 2007	At November 30, 2006
	(dollars in millions)	
Financial instruments owned:		
U.S. government and agency securities	$ 9,863	$12,111
Other sovereign government obligations	1,126	893
Corporate and other debt	61,399	44,237
Corporate equities	1,928	6,662
Total	$74,316	$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 May 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 $1,022 billion and $942 billion, respectively, and the fair value of the portion that has been sold or repledged was $837 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 the collateral in the condensed consolidated statement of financial condition. At May 31, 2007 and November 30, 2006, $112,236 million and $64,588 million, 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 $82 billion and $45 billion at May 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 $5.0 billion at May 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 not material in the six month period ended May 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 six month period ended May 31, 2007 were not materially different from the assumptions included in the table below.

The following table presents information on the Company's residential mortgage loan, U.S. agency collateralized mortgage obligation and commercial mortgage loan 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 May 31, 2007 were as follows (dollars in millions):

	Residential Mortgage Loans	U.S. Agency Collateralized Mortgage Obligations	Commercial Mortgage Loans
Retained interests (carrying amount/fair value)	$ 3,247	$ 863	$ 727
Weighted average life (in months)	41	74	83
Credit losses (rate per annum)	0.00-5.75%	—	0.00-11.20%
Impact on fair value of 10% adverse change	$ (217)	$ —	$ (5)
Impact on fair value of 20% adverse change	$ (409)	$ —	$ (10)
Weighted average discount rate (rate per annum)	10.44%	5.69%	7.22%
Impact on fair value of 10% adverse change	$ (72)	$ (22)	$ (21)
Impact on fair value of 20% adverse change	$ (139)	$ (43)	$ (43)
Prepayment speed assumption(1)(2)	162-7500PSA	138-385PSA	—
Impact on fair value of 10% adverse change	$ (188)	$ (3)	$ —
Impact on fair value of 20% adverse change	$ (273)	$ (6)	$ —

(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 six month periods ended May 31, 2007 and 2006, the Company received proceeds from new securitization transactions of $33.7 billion and $31.0 billion, respectively, and cash flows from retained interests in securitization transactions of $3.2 billion and $2.8 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 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 May 31, 2007	Six Months Ended May 31, 2007
	(dollars in millions)	
Fair value as of the beginning of the period	$ 287	$ 93
Additions:		
Purchases of servicing assets(1)	81	268
Servicing assets that result from transfers of financial assets	87	137
Total Additions	168	405
Subtractions:		
Sales/Disposals	(91)	(109)
Changes in fair value(2)	(26)	(51)
Fair value as of the end of the period	$ 338	$ 338
Amount of contractually specified(2):		
Servicing fees	$ 38	$ 76
Late fees	6	12
Ancillary fees	—	1
	$ 44	$ 89

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

Assumptions Used in Measuring Fair Value:

Weighted average discount rate	16.97%
Weighted average prepayment speed assumption	714 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 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 were as follows:

	At May 31, 2007	At November 30, 2006(1)
	(dollars in millions)	
General purpose credit card and consumer installment	$22,701	$23,746
Less:		
Allowance for consumer loan losses	784	831
Consumer loans, net	$21,917	$22,915

Activity in the allowance for consumer loan losses was as follows:

	Three Months Ended May 31,		Six Months Ended May 31,	
	2007	2006	2007	2006
	(dollars in millions)			
Balance at beginning of period	$ 790	$ 785	$ 831	$ 838
Additions:				
Provision for consumer loan losses	204	130	399	285
Purchase of consumer loans(2)	—	9	—	53
Deductions:				
Charge-offs	(256)	(192)	(539)	(492)
Recoveries	47	42	94	89
Net charge-offs	(209)	(150)	(445)	(403)
Translation adjustments and other	(1)	2	(1)	3
Balance at end of period	$ 784	$ 776	$ 784	$ 776

(1) Certain reclassifications have been made to prior-period amounts to conform to the current period's presentation.
(2) Amount relates to the Company's acquisition of Goldfish and other acquisitions.

Information on net charge-offs of interest and cardmember fees was as follows:

	Three Months Ended May 31,		Six Months Ended May 31,	
	2007	2006	2007	2006
	(dollars in millions)			
Interest accrued on general purpose credit card loans subsequently charged off, net of recoveries (recorded as a reduction of Interest revenue)	$50	$44	$104	$82
Cardmember fees accrued on general purpose credit card loans subsequently charged off, net of recoveries (recorded as a reduction to Merchant, cardmember and other fee revenue)	$21	$23	$ 44	$45

At May 31, 2007, the Company had commitments to extend credit for consumer loans of approximately $269 billion. Such commitments arise primarily from agreements with customers for unused lines of credit on certain credit cards, provided there is no violation of conditions established in the related agreement. These commitments, substantially all of which the Company can terminate at any time and which do not necessarily represent future cash requirements, are periodically reviewed based on account usage and customer creditworthiness. As a result of the completion of the Discover Spin-off, the Company will no longer have these commitments.

At May 31, 2007 and November 30, 2006, $504 million and $1,056 million, respectively, of the Company's consumer loans were classified as held for sale.

The Company received net proceeds from consumer loan sales of $3,722 million and $5,301 million in the quarter and six month period ended May 31, 2007 and $6,613 million in the six month period ended May 31, 2006.

Credit Card Securitization Activities. The Company's retained interests in credit card asset securitizations include undivided seller's interests, accrued interest receivable on securitized credit card receivables, cash collateral accounts, rights to any excess cash flows ("Residual Interests") remaining after payments to investors in the securitization trusts of their contractual rate of return and reimbursement of credit losses, and other retained interests. The undivided seller's interests less an applicable allowance for loan losses is recorded in Consumer loans. The Company's undivided seller's interests rank *pari passu* with investors' interests in the securitization trusts, and the remaining retained interests are subordinate to investors' interests. Accrued interest receivable and certain other subordinated retained interests are recorded in Other assets at amounts that approximate fair value. The Company receives annual servicing fees based on a percentage of the investor principal balance outstanding. The Company does not recognize servicing assets or servicing liabilities for servicing rights as the servicing contracts provide just adequate compensation, as defined in SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities" ("SFAS No. 140"), to the Company for performing the servicing. Residual Interests and cash collateral accounts are recorded in Other assets and reflected at fair value with changes in fair value recorded currently in earnings. At May 31, 2007, the Company had $14,855 million of retained interests, including $11,165 million of undivided seller's interests (included within Consumer loans), in credit card asset securitizations. The retained interests are subject to credit, payment and interest rate risks on the transferred credit card assets. The investors and the securitization trusts have no recourse to the Company's other assets for failure of cardmembers to pay when due.

During the six month periods ended May 31, 2007 and 2006, the Company completed credit card asset securitizations of $5.3 billion and $6.6 billion, respectively, and recognized net securitization gains of $32 million and $156 million, respectively, as servicing and securitization income in the condensed consolidated statements of income. The amount for the six month period ended May 31, 2006 includes an increase in the fair value of the Company's retained interests in securitized receivables primarily resulting from a favorable impact on charge-offs following the enactment of federal bankruptcy legislation that became effective in October 2005. Securitized general purpose credit card loans were $28.7 billion and $26.7 billion at May 31, 2007 and November 30, 2006, respectively.

Key economic assumptions used in measuring the Residual Interests at the date of securitization resulting from credit card asset securitizations completed during the six month periods ended May 31, 2007 and 2006 were as follows:

	Six Months Ended May 31,	
	2007	2006
Weighted average life (in months)	4.7 – 5.0	3.7 – 4.7
Payment rate (rate per month)	20.06 – 20.92%	19.69 – 21.34%
Credit losses (rate per annum)	4.23 –4.38%	4.72 – 5.23%
Discount rate (rate per annum)	11.00%	11.00%

Key economic assumptions and the sensitivity of the current fair value of the Residual Interests to immediate 10% and 20% adverse changes in those assumptions were as follows (dollars in millions):

	At May 31, 2007
Residual Interests (carrying amount/fair value)	$ 373
Weighted average life (in months)	4.6
Weighted average payment rate (rate per month)	20.06%
Impact on fair value of 10% adverse change	$ (29)
Impact on fair value of 20% adverse change	$ (53)
Weighted average credit losses (rate per annum)	4.23%
Impact on fair value of 10% adverse change	$ (40)
Impact on fair value of 20% adverse change	$ (80)
Weighted average discount rate (rate per annum)	11.00%
Impact on fair value of 10% adverse change	$ (2)
Impact on fair value of 20% adverse change	$ (3)

The sensitivity analysis in the table above 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 Residual Interests is calculated independent of changes in any other assumption; in practice, changes in one factor may result in changes in another (for example, increases in market interest rates may result in lower payments and increased credit losses), 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.

The table below summarizes certain cash flows received from the securitization master trusts (dollars in billions):

	Six Months Ended May 31,	
	2007	2006
Proceeds from new credit card asset securitizations	$ 5.3	$ 6.6
Proceeds from collections reinvested in previous credit card asset securitizations	$31.5	$29.6
Contractual servicing fees received	$ 0.3	$ 0.3
Cash flows received from retained interests	$ 1.1	$ 1.1

The table below presents quantitative information about delinquencies, net principal credit losses and components of managed general purpose credit card loans, including securitized loans (dollars in millions):

	At May 31, 2007		Six Months Ended May 31, 2007	
	Loans Outstanding	Loans Delinquent	Average Loans	Net Principal Credit Losses
Managed general purpose credit card loans	$51,265	$1,602	$51,000	$1,057
Less: Securitized general purpose credit card loans	28,717			
Owned general purpose credit card loans	$22,548			

5. Long-Term Borrowings and Capital Units.

Long-term Borrowings. Long-term borrowings at May 31, 2007 scheduled to mature within one year aggregated $24,193 million.

During the six month period ended May 31, 2007, the Company issued senior notes with a carrying value at quarter end aggregating $41,123 million, including non-U.S. dollar currency notes aggregating $18,630 million. Maturities in the aggregate of these notes by fiscal year are as follows: 2007, $256 million; 2008, $3,311 million; 2009, $4,275 million; 2010, $6,247 million; 2011, $1,249 million; and thereafter, $25,785 million. In the six month period ended May 31, 2007, $14,160 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 May 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 $5,120 million at May 31, 2007, which exceeded the amount required by $3,300 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 5% 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 May 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 countries in which they operate. These subsidiaries have consistently operated in excess of their local capital adequacy requirements. Morgan Stanley Derivative Products Inc., the Company's triple-A rated derivative products subsidiary, maintains 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 May 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 May 31, 2007, MS&Co. had tentative net capital in excess of the minimum and the notification requirements.

Treasury Shares. During the six month period ended May 31, 2007, the Company purchased approximately $2.6 billion of its common stock through open market purchases at an average cost of $79.57 per share. During the six month period ended May 31, 2006, the Company purchased approximately $1.3 billion of its common stock through open market purchases at an average cost of $59.47 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 May 31,		Six Months Ended May 31,	
	2007	2006	2007	2006
Basic EPS:				
Income from continuing operations	$2,582	$1,828	$5,141	$3,430
Gain/(loss) on discontinued operations	—	13	113	(15)
Preferred stock dividend requirements	(17)	—	(34)	—
Net income applicable to common shareholders	$2,565	$1,841	$5,220	$3,415
Weighted average common shares outstanding	997	1,013	1,003	1,017
Earnings per basic common share:				
Income from continuing operations	$ 2.57	$ 1.81	$ 5.09	$ 3.37
Gain/(loss) on discontinued operations	—	0.01	0.12	(0.01)
Earnings per basic common share	$ 2.57	$ 1.82	$ 5.21	$ 3.36
Diluted EPS:				
Net income applicable to common shareholders	$2,565	$1,841	$5,220	$3,415
Weighted average common shares outstanding	997	1,013	1,003	1,017
Effect of dilutive securities:				
Stock options and restricted stock units	49	42	49	39
Weighted average common shares outstanding and common stock equivalents	1,046	1,055	1,052	1,056
Earnings per diluted common share:				
Income from continuing operations	$ 2.45	$ 1.74	$ 4.86	$ 3.25
Gain/(loss) on discontinued operations	—	0.01	0.10	(0.02)
Earnings per diluted common share	$ 2.45	$ 1.75	$ 4.96	$ 3.23

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

	Three Months Ended May 31,		Six Months Ended May 31,	
	2007	2006	2007	2006
	(shares in millions)			
Number of antidilutive securities (including stock options and restricted stock units) outstanding at end of period	17	40	18	42

Cash dividends declared per common share were $0.27 and $0.54 for the quarter and six month periods ended May 31, 2007 and 2006, respectively.

8. Commitments and Contingencies.

Letters of Credit and Other Financial Guarantees. At May 31, 2007 and November 30, 2006, the Company had approximately $11.9 billion and $5.8 billion, respectively, of letters of credit and other financial guarantees outstanding to satisfy various collateral requirements.

Securities Activities. In connection with certain of its Institutional Securities business activities, the Company provides loans or lending commitments (including bridge financing) to selected clients. The borrowers may be rated investment grade or non-investment grade. These loans and commitments have varying terms, may be senior or subordinated and/or secured or non-secured, are generally contingent upon representations, warranties and contractual conditions applicable to the borrower, and may be syndicated, hedged or traded by the Company.

The aggregate amount of the investment grade and non-investment grade lending commitments are shown below:

	At May 31, 2007	At November 30, 2006
	(dollars in millions)	
Investment grade corporate lending commitments	$45,328	$37,030
Non-investment grade corporate lending commitments	34,760	19,351
Total	$80,088	$56,381

Financial instruments sold, not yet purchased include obligations of the Company to deliver specified financial instruments at contracted prices, thereby creating commitments to purchase the financial instruments in the market at prevailing prices. Consequently, the Company's ultimate obligation to satisfy the sale of financial instruments sold, not yet purchased may exceed the amounts recognized in the condensed consolidated statements of financial condition.

The Company has commitments to fund other less liquid investments, including, at May 31, 2007, $916 million in connection with investment activities, $1,062 million related to forward purchase contracts involving mortgage loans, $628 million related to mortgage loan originations and $1,162 million related to commercial loan commitments to small businesses and commitments related to securities-based lending activities. As of May 31, 2007, the Company also had commitments of $16,992 million related to secured lending transactions. Additionally, the Company has provided and will continue to provide financing, including margin lending and other extensions of credit, to clients that may subject the Company to increased credit and liquidity risks.

At May 31, 2007, the Company had commitments to enter into reverse repurchase and repurchase agreements of approximately $118 billion and $77 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 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 includes prejudgment interest and excludes 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. Included in cash and securities deposited with clearing organizations or segregated under federal and other regulations or requirements in the condensed consolidated statement of financial condition at May 31, 2007 is $1,845 million of money market deposits that have been pledged to obtain the supersedeas bond. The Company filed its initial brief in support of its appeal on December 7, 2005, and, on June 28, 2006, the Court of Appeal heard oral argument. The Company's appeal sought to reverse the judgment of the trial court on several grounds and asked that the case be remanded for entry of a judgment in favor of the Company or, in the alternative, for a new trial.

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. 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. 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 $1.4 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 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 May 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 May 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	$21,565	$13,564	$19,444	$15,688
Foreign exchange forward contracts and options	5,974	7,420	7,325	7,725
Equity securities contracts (including equity swaps, warrants and options)	17,134	26,772	16,705	23,155
Commodity forwards, options and swaps	11,788	11,163	11,969	10,923
Total	$56,461	$58,919	$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, Asset Management and Discover. 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.

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

Three Months Ended May 31, 2007	Institutional Securities	Global Wealth Management Group	Asset Management	Discover	Intersegment Eliminations	Total
			(dollars in millions)			
Net revenues excluding net interest	$7,865	$1,483	$1,517	$ 667	$ (68)	$11,464
Net interest	(472)	159	(8)	368	12	59
Net revenues	$7,393	$1,642	$1,509	$1,035	$ (56)	$11,523
Income from continuing operations before losses from unconsolidated investees and income taxes	$2,965	$ 269	$ 306	$ 333	$ 1	$ 3,874
Losses from unconsolidated investees	(20)	—	—	(1)	—	(21)
Provision for income taxes	937	104	107	123	—	1,271
Income from continuing operations(2)	$2,008	$ 165	$ 199	$ 209	$ 1	$ 2,582

Three Months Ended May 31, 2006	Institutional Securities(1)	Global Wealth Management Group(1)	Asset Management(1)	Discover	Intersegment Eliminations(1)	Total
			(dollars in millions)			
Net revenues excluding net interest	$5,674	$1,271	$ 896	$ 803	$ (86)	$ 8,558
Net interest	(369)	129	2	388	(4)	146
Net revenues	$5,305	$1,400	$ 898	$1,191	$ (90)	$ 8,704
Income from continuing operations before gains (losses) from unconsolidated investees and income taxes	$1,910	$ 161	$ 264	$ 541	$ (13)	$ 2,863
Gains from unconsolidated investees	23	—	—	—	—	23
Provision for income taxes	703	54	103	203	(5)	1,058
Income from continuing operations(2)	$1,230	$ 107	$ 161	$ 338	$ (8)	$ 1,828

Six Months Ended May 31, 2007	Institutional Securities(1)	Global Wealth Management Group(1)	Asset Management(1)	Discover	Intersegment Eliminations(1)	Total
			(dollars in millions)			
Net revenues excluding net interest	$14,195	$2,858	$2,888	$1,299	$(124)	$21,116
Net interest	322	295	(11)	761	21	1,388
Net revenues	$14,517	$3,153	$2,877	$2,060	$(103)	$22,504
Income from continuing operations before losses from unconsolidated investees and income taxes	$ 5,825	$ 498	$ 687	$ 705	$ 6	$ 7,721
Losses from unconsolidated investees	(46)	—	—	(2)	—	(48)
Provision for income taxes	1,821	192	256	261	2	2,532
Income from continuing operations(2)	$ 3,958	$ 306	$ 431	$ 442	$ 4	$ 5,141

Six Months Ended May 31, 2006	Institutional Securities(1)	Global Wealth Management Group(1)	Asset Management(1)	Discover	Intersegment Eliminations(1)	Total
			(dollars in millions)			
Net revenues excluding net interest	$10,485	$2,472	$1,632	$1,537	$(148)	$15,978
Net interest	257	217	3	743	9	1,229
Net revenues	$10,742	$2,689	$1,635	$2,280	$(139)	$17,207
Income from continuing operations before gains (losses) from unconsolidated investees and income taxes	$ 3,631	$ 185	$ 432	$1,020	$ 6	$ 5,274
Gains (losses) from unconsolidated investees	4	—	—	(1)	—	3
Provision for income taxes	1,231	63	170	381	2	1,847
Income from continuing operations(2)	$ 2,404	$ 122	$ 262	$ 638	$ 4	$ 3,430

Net Interest	Institutional Securities	Global Wealth Management Group	Asset Management	Discover	Intersegment Eliminations	Total
			(dollars in millions)			
Three Months Ended May 31, 2007						
Interest and dividends	$15,132	$298	$ 29	$ 704	$ (97)	$16,066
Interest expense	15,604	139	37	336	(109)	16,007
Net interest	$ (472)	$159	$ (8)	$ 368	$ 12	$ 59
Three Months Ended May 31, 2006						
Interest and dividends	$ 9,318	$243	$ 10	$ 608	$ (68)	$10,111
Interest expense	9,687	114	8	220	(64)	9,965
Net interest	$ (369)	$129	$ 2	$ 388	$ (4)	$ 146
Six Months Ended May 31, 2007						
Interest and dividends	$29,092	$572	$ 43	$1,384	$(211)	$30,880
Interest expense	28,770	277	54	623	(232)	29,492
Net interest	$ 322	$295	$(11)	$ 761	$ 21	$ 1,388
Six Months Ended May 31, 2006						
Interest and dividends	$19,106	$446	$ 16	$1,194	$(107)	$20,655
Interest expense	18,849	229	13	451	(116)	19,426
Net interest	$ 257	$217	$ 3	$ 743	$ 9	$ 1,229

Total Assets(1)(3)	Institutional Securities	Global Wealth Management Group	Asset Management	Discover	Total
			(dollars in millions)		
At May 31, 2007	$1,131,931	$21,683	$10,712	$35,667	$1,199,993
At November 30, 2006	$1,064,155	$21,232	$ 6,908	$28,897	$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.

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), which includes the credit card asset securitization master trusts (see Note 4), 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.

At May 31, 2007, in connection with its Institutional Securities business, the aggregate size of VIEs, including financial asset-backed securitization, mortgage-backed securitization, collateralized debt obligation, credit-linked note, structured note, municipal bond trust, loan issuing, commodities monetization, equity-linked note, equity fund and exchangeable trust entities, for which the Company was the primary beneficiary of the entities was approximately $51.4 billion, which is the carrying amount of the consolidated assets recorded as Financial instruments owned 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. The structured note, equity-linked note, equity fund, certain credit-linked note, certain collateralized debt obligation, certain mortgage-backed securitization, certain financial asset-backed securitization and municipal bond transactions also were executed 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 entered into a derivative instrument with the VIE, which 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.

At May 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 $39.6 billion. The Company's variable interests associated with these entities, primarily credit-linked note, structured note, loan and bond issuing, collateralized debt, loan and bond obligation, financial asset-backed securitization, mortgage-backed securitization and tax credit limited liability entities, including investments in affordable housing tax credit funds and underlying synthetic fuel production plants, were approximately $21.7 billion consisting primarily of senior beneficial interests, which represent the Company's maximum exposure to loss at May 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.

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.

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 Guarantees. 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 May 31, 2007:

	Maximum Potential Payout/Notional						
	Years to Maturity						
Type of Guarantee	**Less than 1**	**1-3**	**3-5**	**Over 5**	**Total**	**Carrying Amount**	**Collateral/ Recourse**
	(dollars in millions)						
Notional amount of derivative contracts	$1,296,379	$707,774	$1,469,581	$1,655,880	$5,129,614	$27,591	$121
Standby letters of credit and other financial guarantees	1,466	585	552	3,993	6,596	34	1,883
Market value guarantees	17	192	—	621	830	43	124
Liquidity facilities	1,368	275	—	98	1,741	—	—

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 May 31, 2007 and November 30, 2006 was $419 million and $320 million, respectively. As of May 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 $18 million and $25 million, respectively.

Securitized Asset Guarantees. As part of the Company's Institutional Securities and Discover 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 May 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 $112 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.

Merchant Chargeback Guarantees. In connection with its Discover business segment, the Company issues credit cards in the U.S. and U.K. and owns and operates the Discover Network in the U.S. The Company is contingently liable for certain transactions processed on the Discover Network in the event of a dispute between the cardmember and a merchant. The contingent liability arises if the disputed transaction involves a merchant or merchant acquirer with whom the Discover Network has a direct relationship. If a dispute is resolved in the cardmember's favor, the Discover Network will credit or refund the disputed amount to the Discover Network card issuer, who in turn credits its cardmember's account. Discover Network will then charge back the transaction to the merchant or merchant acquirer. If the Discover Network is unable to collect the amount from the merchant or merchant acquirer, it will bear the loss for the amount credited or refunded to the cardmember. In most instances, a payment requirement by the Discover Network is unlikely to arise because most products or services are delivered when purchased, and credits are issued by merchants on returned items in a timely fashion. However, where the product or service is not provided until some later date following the purchase, the likelihood of payment by the Discover Network increases. Similarly, the Company is also contingently liable for the resolution of cardmember disputes associated with its general purpose credit cards issued by its U.K. chartered bank on the MasterCard and Visa networks. The maximum potential amount of future payments related to these contingent liabilities is estimated to be the portion of the total Discover Network sales transaction volume processed to date as well as the total U.K. cardmember sales transaction volume occurring within the past six years for which timely and valid disputes may be raised under applicable law, and relevant issuer and cardmember agreements. The Company believes, however, that this amount is not representative of the Company's actual potential loss exposure based on the Company's historical experience. The actual amount of the potential exposure cannot be quantified as the Company cannot determine whether the current or cumulative transaction volumes may include or result in disputed transactions.

The table below summarizes certain information regarding merchant chargeback guarantees during the quarters and six month periods ended May 31, 2007 and 2006:

	Three Months Ended May 31,		Six Months Ended May 31,	
	2007	**2006**	**2007**	**2006**
Losses related to merchant chargebacks (dollars in millions)	$ 2.0	$ 1.4	$ 3.9	$ 1.9
Aggregate credit card sales volume (dollars in billions)	26.1	24.8	52.2	48.0

The amount of the liability related to the Company's credit cardmember merchant guarantee was not material at May 31, 2007. The Company mitigates this risk by withholding settlement from merchants or obtaining escrow deposits from certain merchants that are considered higher risk due to various factors such as time delays in the delivery of products or services. The table below provides information regarding the settlement withholdings and escrow deposits:

	At May 31, 2007	At November 30, 2006
	(dollars in millions)	
Settlement withholdings and escrow deposits	$60.7	$54.7

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 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) gains from these investments were $(21) million and $(48) million for the quarter and six month period ended May 31, 2007, respectively, compared with $23 million and $3 million for the quarter and six month period ended May 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 May 31,		Six Months Ended May 31,	
	2007	2006	2007	2006
	(dollars in millions)			
Losses from unconsolidated investees	$58	$103	$102	$172
Tax credits	66	—	123	74
Tax benefits on losses	23	40	39	67

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 May 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 from unconsolidated investees and the Provision for income taxes for the quarter and six months ended May 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 $37 million and $54 million for the quarter and six month period ended May 31, 2007, respectively, compared with $126 million and $175 million for the quarter and six month period ended May 31, 2006, respectively.

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 May 31,		Six Months Ended May 31,	
	2007	2006	2007	2006
	(dollars in millions)			
Service cost, benefits earned during the period	$ 34	$ 35	$ 68	$ 70
Interest cost on projected benefit obligation	38	37	76	74
Expected return on plan assets	(35)	(34)	(71)	(68)
Net amortization and other	7	12	16	24
Net periodic benefit expense	$ 44	$ 50	$ 89	$100

15. Discontinued Operations.

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. 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.

Summarized financial information for the Company's discontinued operations:

The table below provides information regarding amounts included within discontinued operations (dollars in millions):

	Three Months Ended May 31,		Six Months Ended May 31,	
	2007	**2006**	**2007**	**2006**
Pre-tax gain/(loss) on discontinued operations				
Quilter	$—	$ 7	$174	$ 16
Aircraft leasing	—	14	—	(42)
	$—	$21	$174	$(26)

16. Business and Other Acquisitions.

JM Financial. On February 22, 2007, the Company announced that it would dissolve its India joint venture with JM Financial. The Company has reached an agreement in principle to purchase the joint venture's institutional equities sales, trading and research platform by acquiring JM Financial's 49% interest and selling 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, the allocations of the purchase prices are preliminary and subject to further adjustment as the valuations of certain intangible assets are still in process.

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 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.

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.
- 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 commercial mortgage whole loans and complex derivatives, including 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.

The following tables present information about the Company's assets and liabilities measured at fair value on a recurring basis as of May 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 May 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 May 31, 2007
			(dollars in millions)		
Assets					
Cash and securities deposited with clearing organizations or segregated under federal and other regulations or requirements	$ 19,996	$ —	$ —	$ —	$ 19,996
Financial instruments owned:					
U.S. government and agency securities	14,507	20,628	63	—	35,198
Other sovereign government obligations	22,510	6,230	24	—	28,764
Corporate and other debt	674	131,813	35,264	—	167,751
Corporate equities	96,544	1,680	1,504	—	99,728
Derivative contracts	5,297	382,745	17,364	(348,945)	56,461
Investments	347	619	9,084	—	10,050
Physical commodities	—	3,165	—	—	3,165
Total financial instruments owned	139,879	546,880	63,303	(348,945)	401,117
Other investments(1)	—	7,975	—	—	7,975
Net intangible assets(2)	—	338	—	—	338
Other assets	—	—	2,446	—	2,446
Liabilities					
Commercial paper and other short-term borrowings	$ —	$ 2,684	$ —	$ —	$ 2,684
Deposits	—	5,304	—	—	5,304
Financial instruments sold, not yet purchased:					
U.S. government and agency securities	17,296	789	—	—	18,085
Other sovereign government obligations	17,079	6,507	—	—	23,586
Corporate and other debt	58	6,174	89	—	6,321
Corporate equities	58,406	22	63	—	58,491
Derivative contracts	8,272	379,064	15,446	(343,863)	58,919
Physical commodities	—	1,147	—	—	1,147
Total financial instruments sold, not yet purchased	101,111	393,703	15,598	(343,863)	166,549
Other secured financings	—	35,108	8,348	—	43,456
Long-term borrowings	—	20,097	446	—	20,543

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

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 Six Months ended May 31, 2007

	Beginning Balance	Total Realized and Unrealized Gains or (Losses) included in Income: Principal Transactions: Trading	Principal Transactions: Investments	Other Revenues	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	$ (10)	$ —	$—	$ (10)	$ 79	$ (8)	$ 63
Other sovereign government obligations	162	10	—	—	10	654	(802)	24
Corporate and other debt(1)	33,941	(1,217)	—	—	(1,217)	2,546	(6)	35,264
Corporate equities	1,040	125	—	—	125	358	(19)	1,504
Net derivative contracts(1)(2)	30	1,808	—	—	1,808	(219)	299	1,918
Investments(3)	4,429	—	1,179	11	1,190	3,585	(120)	9,084
Other assets	2,154	—	—	32	32	260	—	2,446
Liabilities								
Financial instruments sold, not yet purchased:								
Corporate and other debt	185	(103)	—	—	(103)	(386)	187	89
Corporate equities	9	(10)	—	—	(10)	39	5	63
Other secured financings	4,724	—	—	—	—	3,624	—	8,348
Long-term borrowings	464	(104)	—	—	(104)	(122)	—	446

(1) The net gains from Net derivative contracts and net losses from Corporate and other debt resulted from market movements primarily associated with credit products and various credit linked instruments, respectively. Such results are only a component of the overall trading strategies of the credit products business, 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.

(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.

The following table presents total realized and unrealized gains (losses) included in income for the quarter ended May 31, 2007 for Level 3 assets and liabilities measured at fair value on a recurring basis:

	Total Realized and Unrealized Gains or (Losses) included in Income		
	Principal Transactions: Trading	Principal Transactions: Investments	Other Revenues
	(dollars in millions)		
Assets			
Financial instruments owned:			
U.S. government and agency securities	$ (4)	$—	$—
Other sovereign government obligations	(25)	—	—
Corporate and other debt	(1,212)	—	—
Corporate equities	88	—	—
Net derivative contracts(1)	1,261	—	—
Investments	—	608	2
Other assets	—	—	36
Liabilities			
Financial instruments sold, not yet purchased:			
Corporate and other debt	(95)	—	—
Corporate equities	(10)	—	—
Long-term borrowings	(51)	—	—

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

The following table presents the amounts of unrealized gains or (losses) for the three and six months ended May 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 May 31, 2007:

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

	Three Months Ended May 31, 2007			Six Months Ended May 31, 2007		
	Principal Transactions: Trading	Principal Transactions: Investments	Other Revenues	Principal Transactions: Trading	Principal Transactions: Investments	Other Revenues
	(dollars in millions)					
Assets						
Financial instruments owned:						
U.S. government and agency securities	$ —	$—	$—	$ (6)	$ —	$—
Other sovereign government obligations	(19)	—	—	7	—	—
Corporate and other debt	(152)	—	—	(216)	—	—
Corporate equities	181	—	—	333	—	—
Investments	—	563	2	—	1,117	11
Net derivative contracts	1,513	—	—	2,568	—	—
Other assets	—	—	36	—	—	32
Liabilities						
Financial instruments sold, not yet purchased:						
Corporate and other debt	$ (3)	$—	$—	$ —	$ —	$—
Other sovereign government obligations	—	—	—	20	—	—
Corporate equities	(15)	—	—	(6)	—	—
Long-term borrowings	(50)	—	—	(98)	—	—

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 table above 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 above 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.

At May 31, 2007, the Company also had assets and liabilities measured at fair value on a non-recurring basis. During the quarter and six months ended May 31, 2007, the only fair value measurements for assets and liabilities measured at fair value on a non-recurring basis were associated with certain assets and liabilities of acquired businesses, including goodwill and intangible assets. Such measurements were determined utilizing Level 3 inputs. See Notes 2 and 16 for further information.

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 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 instruments within Consumer loans that are managed by the Discover business segment.

(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 are managed by the Discover business segment.

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 six months ended May 31, 2007:

Three months ended May 31, 2007	Financial instruments owned	Commercial paper and other short-term borrowings	Deposits	Long-term borrowings
	(dollars in millions)			
Principal transactions—trading	$ 79	$ (95)	$ (3)	$(160)
Principal transactions—investments	45	—	—	—
Net interest revenue	32	(5)	—	(129)
Gain (losses) included in the three months ended May 31, 2007(1)	$156	$(100)	$ (3)	$(289)

Six months ended May 31, 2007	Financial instruments owned	Commercial paper and other short-term borrowings	Deposits	Long-term borrowings
	(dollars in millions)			
Principal transactions—trading	$ 94	$(100)	$ 1	$ (24)
Principal transactions—investments	173	—	—	—
Net interest revenue	51	(5)	—	(178)
Gain (losses) included in the six months ended May 31, 2007(1)	$318	$(105)	$ 1	$(202)

(1) In addition to these amounts, as discussed in Note 2, the majority 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 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 change in 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 May 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 $20,968 million. The aggregate fair value of loans that were 90 or more days past due as of May 31, 2007 was $3,227 million. The aggregate contractual principal amount of such loans exceeded their fair value by approximately $20,699 million.

For the quarter and six months ended May 31, 2007, the estimated changes in the fair value of liabilities for which the fair value option was elected that were attributable to changes in instrument-specific credit spreads were not material. As of May 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 $981 million.

For the quarter and six months ended May 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 estimated to be an immaterial unrealized loss.

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 May 31, 2007	At November 30, 2006
	(dollars in millions)	
Securities available for sale	$ 7,975	$ —
Other	5,327	3,232
Total	$13,302	$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 May 31, 2007			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(dollars in millions)			
Securities available for sale:				
Corporate and other debt	$ 75	$—	$—	$ 75
Mortgage-backed securities	7,900	1	(1)	7,900
Total	$7,975	$ 1	$ (1)	$7,975

Corporate and other debt securities have contractual maturities of greater than 10 years. The average yield on the corporate and other debt securities and mortgage-backed securities is 5.52% and 5.47%, respectively.

At May 31, 2007, mortgage-backed securities with a fair value of $2,519 million have been in an unrealized loss position for less than 12 months.

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 an entity's defined benefit and postretirement plans as an asset or liability in the financial statements and requires the measurement of defined benefit and postretirement plan assets and obligations as of the end of the employer's 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 is currently assessing the impact that SFAS No. 158 will have on its condensed consolidated financial statements.

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.

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 May 31, 2007, and the related condensed consolidated statements of income and comprehensive income for the three-month and six-month periods ended May 31, 2007 and 2006, and condensed consolidated statements of cash flows for the six-month periods ended May 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
July 9, 2007

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, Asset Management and Discover. 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 funds and real estate, 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.

Discover offers Discover®-branded credit cards and related consumer products and services and operates the Discover Network, a merchant and cash access network for Discover Network-branded cards, and PULSE® EFT Association LP ("PULSE"), an automated teller machine/debit and electronic funds transfer network. Discover also offers consumer finance products and services in the U.K., including Morgan Stanley-branded, Goldfish-branded and various other credit cards issued on the MasterCard and Visa networks.

On June 30, 2007, the Company had completed the spin-off (the "Discover Spin-off") of Discover Financial Services ("DFS") (see "Other Items—Discover Spin-off" herein). Beginning in the third quarter of fiscal 2007, Discover's results will be included within discontinued operations for all periods presented.

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, "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.

The Company's results of operations for the three and six month periods ended May 31, 2007 and 2006 are discussed below. 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).

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 Institutional Securities. 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 restated to conform to the current year's presentation.

Results of Operations.

Executive Summary.

Financial Information.

	Three Months Ended May 31, 2007	Three Months Ended May 31, 2006(1)	Six Months Ended May 31, 2007	Six Months Ended May 31, 2006(1)
Net revenues (dollars in millions):				
Institutional Securities	$ 7,393	$5,305	$14,517	$10,742
Global Wealth Management Group	1,642	1,400	3,153	2,689
Asset Management	1,509	898	2,877	1,635
Discover	1,035	1,191	2,060	2,280
Intersegment Eliminations	(56)	(90)	(103)	(139)
Consolidated net revenues	$11,523	$8,704	$22,504	$17,207
Income before taxes (dollars in millions)(2):				
Institutional Securities	$ 2,965	$1,910	$ 5,825	$ 3,631
Global Wealth Management Group	269	161	498	185
Asset Management	306	264	687	432
Discover	333	541	705	1,020
Intersegment Eliminations	1	(13)	6	6
Consolidated income before taxes	$ 3,874	$2,863	$ 7,721	$ 5,274
Consolidated net income (dollars in millions)	$ 2,582	$1,841	$ 5,254	$ 3,415
Earnings applicable to common shareholders (dollars in millions)(3)	$ 2,565	$1,841	$ 5,220	$ 3,415
Earnings per basic common share:				
Income from continuing operations	$ 2.57	$ 1.81	$ 5.09	$ 3.37
Gain/(loss) on discontinued operations	—	0.01	0.12	(0.01)
Earnings per basic common share	$ 2.57	$ 1.82	$ 5.21	$ 3.36
Earnings per diluted common share:				
Income from continuing operations	$ 2.45	$ 1.74	$ 4.86	$ 3.25
Gain/(loss) on discontinued operations	—	0.01	0.10	(0.02)
Earnings per diluted common share	$ 2.45	$ 1.75	$ 4.96	$ 3.23
Statistical Data.				
Book value per common share(4)	$ 36.52	$29.97	$ 36.52	$ 29.97
Average common equity (dollars in billions)(5):				
Institutional Securities	$ 22.8	$ 17.9	$ 21.4	$ 16.9
Global Wealth Management Group	1.6	3.1	1.7	3.2
Asset Management	3.4	2.3	3.2	2.2
Total from securities businesses	27.8	23.3	26.3	22.3
Discover	5.3	5.0	5.4	4.8
Total from operating segments	33.1	28.3	31.7	27.1
Discontinued operations	0.1	0.2	0.1	0.2
Unallocated capital	4.2	2.6	4.6	3.0
Consolidated	$ 37.4	$ 31.1	$ 36.4	$ 30.3

Statistical Data—(Continued).

	Three Months Ended May 31, 2007	Three Months Ended May 31, 2006(1)	Six Months Ended May 31, 2007	Six Months Ended May 31, 2006(1)
Return on average common equity(5):				
Consolidated	27%	24%	29%	23%
Institutional Securities	35%	28%	37%	28%
Global Wealth Management Group	41%	14%	37%	8%
Asset Management	23%	28%	27%	23%
Discover	16%	27%	16%	27%
Effective income tax rate	33.0%	36.7%	33.0%	35.0%
Worldwide employees	58,333	53,163	58,333	53,163
Consolidated assets under management or supervision by asset class (dollars in billions)(6):				
Equity	$ 344	$ 288	$ 344	$ 288
Fixed income	116	106	116	106
Money market	94	79	94	79
Alternatives(7)	87	49	87	49
Subtotal	641	522	641	522
Unit trusts	16	13	16	13
Other(8)	55	46	55	46
Total assets under management or supervision(9)	$ 712	$ 581	$ 712	$ 581
Share of minority interest assets(10)	5	—	5	—
Total	$ 717	$ 581	$ 717	$ 581
Institutional Securities:				
Mergers and acquisitions completed transactions (dollars in billions)(11):				
Global market volume	$ 338.9	$ 182.3	$ 488.8	$ 290.1
Market share	42.7%	29.5%	38.5%	28.1%
Rank	1	2	1	2
Mergers and acquisitions announced transactions (dollars in billions)(11):				
Global market volume	$ 484.7	$ 178.8	$ 698.1	$ 314.5
Market share	31.3%	20.6%	32.7%	25.0%
Rank	4	3	2	3
Global equity and equity-related issues (dollars in billions)(11):				
Global market volume	$ 20.0	$ 19.2	$ 26.0	$ 24.0
Market share	8.6%	9.3%	7.7%	8.4%
Rank	3	2	5	3
Global debt issues (dollars in billions)(11):				
Global market volume	$ 133.4	$ 102.3	$ 203.1	$ 178.3
Market share	6.6%	5.9%	6.2%	6.2%
Rank	3	5	5	5
Global initial public offerings (dollars in billions)(11):				
Global market volume	$ 6.3	$ 7.6	$ 8.0	$ 9.0
Market share	8.0%	11.0%	7.7%	9.8%
Rank	4	3	3	2
Pre-tax profit margin(12)	40%	36%	40%	34%

Statistical Data—(Continued).

	Three Months Ended May 31,		Six Months Ended May 31,	
	2007	2006(1)	2007	2006(1)
Global Wealth Management Group:				
Global representatives	8,137	8,091	8,137	8,091
Annualized net revenue per global representative (dollars in thousands)(13)	$ 814	$ 659	$ 786	$ 611
Client assets by segment (dollars in billions)(13):				
$10 million or more	$ 223	$ 170	$ 223	$ 170
$1 million – $10 million	268	220	268	220
Subtotal $1 million or more	491	390	491	390
$100,000 – $1 million	180	180	180	180
Less than $100,000	24	29	24	29
Client assets excluding corporate and other accounts	695	599	695	599
Corporate and other accounts	33	30	33	30
Total client assets	$ 728	$ 629	$ 728	$ 629
Fee-based assets as a percentage of total client assets(14)	29%	29%	29%	29%
Client assets per global representative (dollars in millions)(15)	89	78	89	78
Bank deposit program (dollars in millions)(16)	$18,226	$ 9,114	$18,226	$ 9,114
Pre-tax profit margin(12)	16%	12%	16%	7%
Asset Management:				
Assets under management or supervision (dollars in billions)(17)	$ 560	$ 454	$ 560	$ 454
Percent of fund assets in top half of Lipper rankings(18)	52%	48%	52%	48%
Pre-tax profit margin(12)	20%	29%	24%	26%
Discover (dollars in millions, unless otherwise noted)(19):				
Period-end credit card loans—Owned	$22,548	$21,764	$22,548	$21,764
Period-end credit card loans—Managed	$51,265	$48,539	$51,265	$48,539
Average credit card loans—Owned	$21,286	$19,664	$22,960	$20,808
Average credit card loans—Managed	$50,618	$47,307	$51,000	$47,439
Net principal charge-off rate—Owned	3.93%	3.02%	3.85%	3.82%
Net principal charge-off rate—Managed	4.24%	3.30%	4.14%	4.18%
Return on average receivables—Owned	3.86%	6.83%	3.85%	6.15%
Return on average receivables—Managed	1.62%	2.84%	1.73%	2.70%
Transaction volume (dollars in billions):				
Net sales	$ 25.2	$ 24.0	$ 50.3	$ 46.5
Other transaction volume	4.7	4.5	9.9	8.9
Total	$ 29.9	$ 28.5	$ 60.2	$ 55.4
Payment services transaction volume (millions of transactions):				
Discover network	362	340	723	679
PULSE network	559	471	1,080	896
Total network transaction volume	921	811	1,803	1,575
Pre-tax profit margin(12)	32%	45%	34%	45%

(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) Book value per common share equals common shareholders' equity of $38,411 million at May 31, 2007 and $32,255 million at May 31, 2006, divided by common shares outstanding of 1,052 million at May 31, 2007 and 1,072 million at May 31, 2006.
(5) 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.
(6) Amounts reported for the 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.
(7) 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.
(8) Amounts include assets under management or supervision associated with the Global Wealth Management Group business segment.
(9) Revenues and expenses associated with these assets are included in the Company's Asset Management, Global Wealth Management Group and Institutional Securities business segments.
(10) Amount represents Asset Management's proportional share of assets managed by entities in which it owns a minority interest.
(11) Source: Thomson Financial, data as of June 7, 2007—The data for the three months ended May 31, 2007 and 2006 are for the periods from March 1 to May 31, 2007 and March 1 to May 31, 2006, respectively. The data for the six months ended May 31 are for the periods from January 1 to May 31, 2007 and January 1 to May 31, 2006, respectively, as Thomson Financial presents these data on a calendar-year basis.
(12) Percentages represent income from continuing operations before gains (losses) from unconsolidated investees and income taxes as a percentage of net revenues.
(13) 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.
(14) Pursuant to a recent court decision vacating an SEC rule that permitted fee-based brokerage, it is anticipated that fee-based brokerage at the Company will be discontinued in the U.S. on or about October 1, 2007, and either clients will elect to move these assets into a permitted fee-based advisory account program or the assets will be in a commission-based brokerage account. Accordingly, as a result of these changes, fee-based assets as a percentage of total client assets could decline in the next few quarters.
(15) Client assets per global representative equal total period-end client assets divided by period-end global representative headcount.
(16) 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.
(17) Amount includes Asset Management's proportional share of assets managed by entities in which it owns a minority interest.
(18) Source: Lipper, one-year performance excluding money market funds as of May 31, 2007 and 2006, respectively.
(19) The Company analyzes its financial performance on both a managed loan basis and as reported under U.S. Generally Accepted Accounting Principles. Managed data include owned and securitized credit card loans. For an explanation of managed data and a reconciliation of credit card loan and asset quality data, see "Discover—Managed General Purpose Credit Card Loan Data" herein.

Second Quarter 2007 Performance.

Company Results. The Company recorded net income of $2,582 million and diluted earnings per share of $2.45 for the quarter ended May 31, 2007, both increases of 40% from the comparable fiscal 2006 period. Net revenues (total revenues less interest expense and the provision for loan losses) increased 32% to a record $11,523 million and the annualized return on average common equity was 27.5% compared with 23.7% in the second quarter of last year. Non-interest expenses of $7,649 million increased 31% from the prior-year period, primarily due to higher compensation costs.

For the six month period ended May 31, 2007, net income was $5,254 million, a 54% increase from $3,415 million a year ago. Net revenues rose 31% to $22,504 million and non-interest expenses increased 24% to $14,783 million. Diluted earnings per share were $4.96 compared with $3.23 a year ago. The annualized return on average common equity for the six month period was 28.7% compared with 22.5% in the prior-year period.

The Company's effective income tax rate was 33.0% for both the quarter and six month period ended May 31, 2007 compared with 36.7% and 35.0% for the quarter and six month period ended May 31, 2006. The decrease in both periods primarily reflected higher estimated domestic tax credits partially offset by higher earnings that reduced the impact of permanent differences. Domestic tax credits were lower in the quarter and six month period of fiscal 2006 due to the idling of production by three of the Company's synthetic fuel investees during the second quarter of fiscal 2006.

The results for the six month period ended May 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 achieved record income from continuing operations before gains (losses) from unconsolidated investees and income taxes of $2,965 million, a 55% increase from last year's second quarter. Net revenues rose 39% to a record $7,393 million driven by strong fixed income and record equity sales and trading revenues, along with record investment banking revenues. Non-interest expenses increased 30% to $4,428 million, reflecting higher compensation accruals resulting from higher net revenues, as well as higher compensation costs associated with certain employee deferred compensation plans (see "Other Items—Deferred Compensation Plans" herein). Non-compensation expenses increased as a result of higher levels of business activity.

Investment banking revenues increased 65% from last year's second quarter to a record $1,704 million. Advisory fees from merger, acquisition and restructuring transactions were $725 million, an increase of 99% from last year's second quarter. Underwriting revenues rose 46% from last year's second quarter to $979 million.

Fixed income sales and trading revenues were $2,859 million, up 34% from the second quarter of fiscal 2006. The increase was driven by strong results in interest rate and currency products and credit products, partially offset by lower results in commodities. Interest rate and currency product revenues increased primarily due to record revenues in emerging markets and higher results in interest rate trading. Credit product revenues increased primarily due to higher revenues from corporate credit and structured products resulting from strong customer flows and improved corporate credit trading results. Lower securitized product revenues, primarily in residential mortgage securities, negatively impacted credit product revenues. Commodity revenues decreased from last year's second quarter, reflecting lower trading results in electricity and natural gas products. Equity sales and trading revenues increased 33% to a record $2,216 million. The increase was driven by higher revenues from equity cash products, derivatives products, prime brokerage and financing products.

Global Wealth Management Group. The Global Wealth Management Group recorded income from continuing operations before income taxes of $269 million, a 67% increase from last year's second quarter. Net revenues increased 17% from last year's second quarter to $1,642 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 11% from a year ago to $1,373 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 decreased, primarily due to lower costs associated with legal and regulatory matters. Total client assets increased to $728 billion, up 16% from last year's second quarter. In addition, client assets in fee-based accounts rose 17% to $210 billion at May 31, 2007 and represented 29% of total client assets. At quarter-end, the number of global representatives was 8,137, an increase of 46 from a year ago.

Asset Management. Asset Management recorded income before income taxes of $306 million, a 16% increase from last year's second quarter. Net revenues increased 68% from last year's second quarter to $1,509 million driven by higher investment revenues, primarily in the real estate, private equity and alternatives 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 90% to $1,203 million, largely due to higher incentive-based compensation accruals associated with increased net revenues and investment in the business. Assets under management or supervision within Asset Management of $560 billion were up $106 billion, or 23%, from the second quarter of last year, primarily due to market appreciation.

Discover. Discover recorded income before losses from unconsolidated investees and income taxes of $333 million, a decrease of 38% compared with $541 million in the second quarter of fiscal 2006. Net revenues decreased 13% from last year's second quarter, primarily due to an increase in the provision for loan losses. The second quarter of fiscal 2006 included a favorable impact following changes in federal bankruptcy legislation in 2005. Non-interest expenses increased 8% to $702 million, primarily due to higher legal fees associated with the VISA/MasterCard litigation and costs associated with the Discover Spin-off. The managed credit card net principal charge-off rate increased 94 basis points to 4.24% from the same quarter a year ago. The managed over-30-day delinquency rate decreased 16 basis points to 3.13%, and the managed over-90-day delinquency rate decreased 1 basis point to 1.52% from the same period a year ago. Managed credit card loans were $51,265 million at quarter-end, a 6% increase from a year ago.

Global Market and Economic Conditions in the Quarter and Six Month Period Ended May 31, 2007.

In the U.S., the moderate pace of economic growth that occurred during the second half of fiscal 2006 slowed during the first half of fiscal 2007, reflecting, among other things, the continued slowdown in the residential real estate market, lower business investment and a growing trade deficit, partially offset by higher consumer spending. The U.S. unemployment rate at the end of the quarter was unchanged at 4.5% from the end of fiscal 2006. Conditions in the U.S. equity markets were generally favorable, and major equity market indices rose during most of the quarter and were supported by strong corporate earnings. The Federal Reserve Board (the "Fed") left interest rates unchanged during the quarter and has not raised interest rates since June 2006. Inflationary pressures appeared to moderate but continued to be a primary concern of the Fed.

In Europe, economic growth during the first half of fiscal 2007 continued to be strong, reflecting momentum in domestic demand and exports. Major equity market indices in Europe increased during much of the quarter, reflecting strong corporate earnings as well as merger and acquisition activity and generally favorable economic conditions. The European Central Bank (the "ECB") raised the benchmark interest rate by 0.25% during the quarter and 0.50% in the six month period. In June 2007, the ECB raised the benchmark interest rate by an additional 0.25%. The Bank of England (the "BOE") raised the benchmark interest rate by 0.25% during the quarter and by 0.50% in the six month period. In July 2007, the BOE raised the benchmark interest rate by an additional 0.25%.

In Japan, moderate economic growth continued to be driven by exports and domestic demand. The level of unemployment also remained relatively low, and Japanese equity market indices increased during the quarter. The Bank of Japan left rates unchanged during the second quarter of fiscal 2007 and raised the benchmark interest rate from 0.25% to 0.50% during the six 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 second quarter after a sharp decline at the end of the first quarter of fiscal 2007. In the quarter and six month period of fiscal 2007, the People's Bank of China raised the benchmark interest 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 $1 million and $(13) million in the quarters ended May 31, 2007 and 2006, respectively, and $6 million in both the six month periods ended May 31, 2007 and 2006. The results for the fiscal 2006 periods also 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 Quilter within discontinued operations for all periods presented, the transfer of the real estate investing business from the Institutional Securities segment to the Asset Management segment, and the transfer of certain shareholder recordkeeping services from the Asset Management segment to the Global Wealth Management Group segment.

INSTITUTIONAL SECURITIES
INCOME STATEMENT INFORMATION

	Three Months Ended May 31,		Six Months Ended May 31,	
	2007	2006	2007	2006
	(dollars in millions)			
Revenues:				
Investment banking	$ 1,704	$ 1,035	$ 2,736	$ 1,927
Principal transactions:				
Trading	4,705	3,442	8,734	6,405
Investments	396	389	746	632
Commissions	766	693	1,457	1,303
Asset management, distribution and administration fees	25	29	50	37
Servicing and securitization income	42	—	77	—
Interest and dividends	15,132	9,318	29,092	19,106
Other	227	86	395	181
Total revenues	22,997	14,992	43,287	29,591
Interest expense	15,604	9,687	28,770	18,849
Net revenues	7,393	5,305	14,517	10,742
Total non-interest expenses	4,428	3,395	8,692	7,111
Income from continuing operations before (losses)/gains from unconsolidated investees and income taxes	2,965	1,910	5,825	3,631
(Losses)/gains from unconsolidated investees	(20)	23	(46)	4
Provision for income taxes	937	703	1,821	1,231
Income from continuing operations	$ 2,008	$ 1,230	$ 3,958	$ 2,404

Investment Banking. Investment banking revenues for the quarter ended May 31, 2007 increased 65% 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, reflecting robust market conditions and higher industry-wide transaction activity. Advisory fees from merger, acquisition and restructuring transactions were a record $725 million, an increase of 99% from the comparable period of fiscal 2006. Underwriting revenues were a record $979 million, an increase of 46% from the comparable period of fiscal 2006. Equity underwriting revenues increased 33% to $493 million. Fixed income underwriting revenues increased 63% to a record $486 million.

At May 31, 2007, the backlog of merger, acquisition and restructuring transactions and equity and fixed income underwriting transactions was higher as compared with the second 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 unforeseen economic and 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 six month period ended May 31, 2007 increased 42% 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.

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 increased 33% in the quarter ended May 31, 2007 from the comparable period of fiscal 2006, reflecting higher fixed income and equity sales and trading revenues.

Sales and trading revenues include the following:

	Three Months Ended May 31,		Six Months Ended May 31,	
	2007(1)	2006(1)	2007(1)	2006(1)
	(dollars in millions)			
Equity	$2,216	$1,669	$ 4,425	$3,325
Fixed income	2,859	2,131	6,252	4,782
Other	(76)	(34)	(164)	(142)
Total sales and trading revenues	$4,999	$3,766	$10,513	$7,965

(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 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 33% to a record $2,216 million in the second quarter of fiscal 2007. The increase was driven by higher revenues from equity cash products, derivatives products, prime brokerage and financing products. Revenues from equity cash, derivatives and financing products all benefited from favorable global market conditions and increased customer flows. Prime brokerage generated record revenues reflecting continued growth in global client asset balances. Although commission revenues increased modestly, revenues continued to be affected by intense competition, particularly in the U.S., and a continued shift toward electronic trading.

Fixed income sales and trading revenues increased 34% to $2,859 million driven by strong results in interest rate and currency products and credit products, partially offset by lower results in commodities. Interest rate and currency product revenues increased 51%, primarily due to record revenues in emerging markets and higher results in interest rate trading. Credit product revenues increased 28%, primarily due to higher revenues from corporate credit and structured products resulting from strong customer flows and improved corporate credit trading results. The increase was partially offset by lower securitized product revenues, primarily in residential mortgage securities. Commodity revenues decreased 10% from last year's second quarter, reflecting lower trading results in electricity and natural gas products.

Total sales and trading revenues increased 32% in the six month period ended May 31, 2007 from the comparable period of fiscal 2006, reflecting higher fixed income and equity sales and trading revenues. Equity sales and trading revenues increased 33% primarily due to higher revenues from derivatives products, equity cash products, financing products and prime brokerage. Fixed income sales and trading revenues increased 31% primarily due to higher revenues from credit products and interest rate and currency products, partially offset by lower revenues from commodities products.

Principal Transactions-Investments. Principal transaction net investment revenues aggregating $396 million and $746 million were recognized in the quarter and six month period ended May 31, 2007, as compared with net gains of $389 million and $632 million in the quarter and six month period ended May 31, 2006. The increase in both periods primarily related to realized and unrealized net gains associated with certain of the Company's investments, including 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).

Servicing and Securitization Income. Servicing and securitization income of $42 million and $77 million recognized in the quarter and six month period ended May 31, 2007 was primarily attributable to Saxon Capital, Inc. ("Saxon"), which the Company acquired on December 4, 2006.

Other. Other revenues increased 164% and 118% in the quarter and six month period ended May 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 TransMontaigne Inc. ("TransMontaigne"), which the Company acquired 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 30% and 22% in the quarter and the six month period ended May 31, 2007, respectively. Compensation and benefits expense increased 34% and 22% in the quarter and six month period, respectively, primarily reflecting higher incentive-based compensation costs resulting from higher net revenues as well as higher costs associated with certain employee deferred compensation plans (see "Other Items—Deferred Compensation Plans" herein). The increase in the six month period was 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 22% and 24% in the quarter and six month period. Occupancy and equipment expense increased 42% and 39% in the quarter and six month period, primarily due to higher rent and occupancy costs in Europe, Asia and the U.S. In the U.S., a portion of the increased costs was associated with TransMontaigne, the Heidmar Group of companies ("Heidmar"), and a new office building in New York City. The Company acquired TransMontaigne and Heidmar in September 2006 and the office building in June 2006. Brokerage, clearing and exchange fees increased 5% and 16% in the quarter and six month period, primarily reflecting increased equity and fixed income trading activity. Marketing and business development expense increased 31% in both the quarter and six month period, primarily due to a higher level of business activity. Professional services expense increased 11% in the six month period, primarily due to higher legal and consulting costs related to increased business activity. Other expenses increased 112% and 70% in the quarter and six month period, respectively, reflecting costs associated with TransMontaigne and Heidmar.

GLOBAL WEALTH MANAGEMENT GROUP

INCOME STATEMENT INFORMATION

	Three Months Ended May 31,		Six Months Ended May 31,	
	2007	2006	2007	2006
	(dollars in millions)			
Revenues:				
Investment banking	$ 164	$ 95	$ 330	$ 162
Principal transactions:				
Trading	133	120	262	245
Investments	20	27	18	28
Commissions	357	302	672	612
Asset management, distribution and administration fees	769	691	1,498	1,358
Interest and dividends	298	243	572	446
Other	40	36	78	67
Total revenues	1,781	1,514	3,430	2,918
Interest expense	139	114	277	229
Net revenues	1,642	1,400	3,153	2,689
Total non-interest expenses	1,373	1,239	2,655	2,504
Income from continuing operations before income taxes	269	161	498	185
Provision for income taxes	104	54	192	63
Income from continuing operations	$ 165	$ 107	$ 306	$ 122

Investment Banking. Investment banking revenues increased 73% and 104% in the quarter and six month period ended May 31, 2007, driven by robust equity underwriting results primarily related to closed end fund offerings. The increase in the six month period also reflected strong results from fixed income underwriting and unit trusts.

Principal Transactions—Trading. Principal transaction trading revenues increased 11% and 7% in the quarter and six month period ended May 31, 2007, primarily 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 $20 million and $18 million in the quarter and six month period ended May 31, 2007 compared with net revenues of $27 million and $28 million in the quarter and six month period ended May 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 18% and 10% in the quarter and six month period ended May 31, 2007 due to higher levels of client activity and favorable market conditions.

Asset Management, Distribution and Administration Fees. Asset management, distribution and administration fees increased 11% and 10% in the quarter and six month period ended May 31, 2007, primarily reflecting higher client assets in fee-based accounts.

Client assets in fee-based accounts rose 17% to $210 billion at May 31, 2007, including $35 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, it is anticipated that fee-based brokerage at the Company will be discontinued in the U.S. on or about October 1, 2007, and either clients will elect to move these assets into a permitted fee-based advisory account program or the assets will be in a commission-based brokerage account. Accordingly, as a result of these changes, fee-based assets as a percentage of total client assets could decline in the next few quarters. Client asset balances increased to $728 billion at May 31, 2007 from $629 billion at May 31, 2006, primarily due to market appreciation. Client asset balances in accounts greater than $1 million increased to $491 billion at May 31, 2007 from $390 billion at May 31, 2006.

Net Interest. Net interest revenues increased 23% and 36% in the quarter and six month period ended May 31, 2007, primarily due to increased account balances in the bank deposit program. Balances in the bank deposit program rose to $18,226 million at May 31, 2007 as compared with $9,114 million at May 31, 2006.

Non-Interest Expenses. Non-interest expenses increased 11% and 6% in the quarter and six month period ended May 31, 2007, primarily reflecting an increase in compensation and benefits expense. Compensation and benefits expense increased 19% and 13% in the quarter and six month period ended May 31, 2007, primarily reflecting higher incentive-based compensation accruals due to higher net revenues and investments in the business. The increase in the six 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 decreased 5% and 8% in the quarter and six month period. Occupancy and equipment expense increased 8% in both the quarter and six month period primarily due to higher rental costs. Information processing and communications expense decreased 18% and 11% in the quarter and six month period, primarily due to lower telecommunications costs. Marketing and business development expense increased 25% and 26% in the quarter and six month period primarily due to costs associated with an advertising campaign. Other expenses decreased 16% and 28% in the quarter and six month period, primarily resulting from lower costs associated with legal and regulatory matters.

ASSET MANAGEMENT

INCOME STATEMENT INFORMATION

	Three Months Ended May 31,		Six Months Ended May 31,	
	2007	2006	2007	2006
	(dollars in millions)			
Revenues:				
Investment banking	$ 61	$ 35	$ 92	$ 58
Principal transactions:				
Investments	588	213	1,120	269
Commissions	6	7	12	14
Asset management, distribution and administration fees	844	636	1,612	1,280
Interest and dividends	29	10	43	16
Other	18	5	52	11
Total revenues	1,546	906	2,931	1,648
Interest expense	37	8	54	13
Net revenues	1,509	898	2,877	1,635
Total non-interest expenses	1,203	634	2,190	1,203
Income before income taxes	306	264	687	432
Provision for income taxes	107	103	256	170
Net income	$ 199	$161	$ 431	$ 262

Investment Banking. Investment banking revenues increased 74% and 59% in the quarter and six month period ended May 31, 2007, primarily reflecting higher revenues from real estate products.

Principal Transactions-Investments. Principal transaction net investment gains aggregating $588 million and $1,120 million were recognized in the quarter and six month period ended May 31, 2007 as compared with net gains of $213 million and $269 million in the quarter and six month period ended May 31, 2006. The increase in both periods was primarily related to higher net gains on certain investments, including investments associated with the Company's real estate products, private equity portfolio and 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 33% and 26%, primarily due to higher fund management and administration fees associated with a 17% and 15% increase in average assets under management in the quarter and six month period, respectively, and higher performance fees from the alternatives business, including those associated with FrontPoint Partners ("FrontPoint"), which was acquired in December 2006 (see "Other Items—Business and Other Acquisitions" herein).

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

	At May 31, 2007	At May 31, 2006(1)	Average For the Three Months Ended May 31, 2007(1)	Average For the Three Months Ended May 31, 2006(1)	Average For the Six Months Ended May 31, 2007(1)	Average For the Six Months Ended May 31, 2006(1)
	(dollars in billions)					
Assets under management or supervision by distribution channel:						
Americas Retail Morgan Stanley brand	$ 67	$ 63	$ 64	$ 64	$ 64	$ 66
Americas Retail Van Kampen brand	102	89	99	90	97	90
Americas Intermediary(2)	67	51	63	50	62	48
U.S. Institutional	119	96	114	98	110	98
Non-U.S.	111	80	106	80	102	77
Total long-term assets under management or supervision	466	379	446	382	435	379
Institutional money markets/liquidity	57	37	54	37	52	36
Retail money markets	32	38	33	40	34	41
Total money markets	89	75	87	77	86	77
Total assets under management or supervision	555	454	533	459	521	456
Share of minority interest assets(4)	5	—	5	—	5	—
Total	$560	$454	$538	$459	$526	$456

	At May 31, 2007	At May 31, 2006(1)	Average For the Three Months Ended May 31, 2007(1)	Average For the Three Months Ended May 31, 2006(1)	Average For the Six Months Ended May 31, 2007(1)	Average For the Six Months Ended May 31, 2006(1)
	(dollars in billions)					
Assets under management or supervision by asset class:						
Equity	$265	$226	$253	$232	$250	$229
Fixed income	98	91	96	90	94	91
Money market	89	75	87	77	86	77
Alternatives(3)	87	49	82	47	76	46
Subtotal	539	441	518	446	506	443
Unit trusts	16	13	15	13	15	13
Total assets under management or supervision	555	454	533	459	521	456
Share of minority interest assets(4)	5	—	5	—	5	—
Total	$560	$454	$538	$459	$526	$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 Institutional Securities. 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) 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 May 31,		Six Months Ended May 31,	
	2007(1)	2006(1)	2007(1)	2006(1)
	(dollars in billions)			
Balance at beginning of period	$521	$455	$496	$443
Net flows by distribution channel:				
Americas Retail Morgan Stanley brand	—	(2)	(2)	(5)
Americas Retail Van Kampen brand	—	(1)	—	(1)
Americas Intermediary(2)	2	4	3	6
U.S. Institutional	1	(5)	1	(10)
Non-U.S.	4	3	9	4
Net inflows/(outflows) excluding money markets	7	(1)	11	(6)
Money market net flows:				
Institutional	4	(1)	6	3
Retail	(2)	(3)	(3)	(9)
Total money market net flows	2	(4)	3	(6)
Net market appreciation	28	4	42	23
Total net increase	37	(1)	56	11
Acquisitions	1	—	7	—
Net increase in share of minority interest assets(3)	1	—	1	—
Balance at end of period	$560	$454	$560	$454

(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 Institutional Securities. 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 six month period ended May 31, 2007 were primarily associated with positive flows from non-U.S. clients. Inflows in the six month period were partially offset by outflows in the Americas Retail Morgan Stanley branded channel. For the quarter and six month period ended May 31, 2007, positive flows into institutional liquidity assets 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 $18 million and $52 million in quarter and six month periods ended May 31, 2007 as compared with $5 million and $11 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 were acquired in the fourth quarter of fiscal 2006.

Non-Interest Expenses. Non-interest expenses increased 90% and 82% in the quarter and six month period ended May 31, 2007. The increase in both periods primarily reflected an increase in compensation and benefits expense and higher non-compensation expenses. Compensation and benefits expense increased 124% and 131% in the quarter and six month period, primarily reflecting higher incentive-based compensation accruals due to higher net revenues, expenses associated with certain employee deferred compensation plans, as well as investments in the business. The increase in the six month period was 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 45% and 27% in the quarter and six month period. Occupancy and equipment expense increased 25% in both the quarter and six month period, primarily due to higher rental costs associated with acquisition of FrontPoint and new business initiatives. Brokerage, clearing and exchange fees increased 7% in the quarter and decreased 3% in the six month period. The increase in the quarter was primarily due to higher costs associated with the launch of new products. The decrease in the six month period was primarily due to a lower amortization expense associated with a lower level of deferred costs in recent periods due to a decrease in sales of certain open-ended funds, partially offset by higher costs associated with new products. Information processing and communications expense increased 29% and 33% in the quarter and six month period primarily due to higher costs associated with FrontPoint and new business initiatives. Professional services expense increased 100% in the quarter and 51% in the six month period, primarily due to higher sub-advisory and legal fees. Other expenses increased $43 million in the quarter and $61 million in the six month period ended May 31, 2007. The increase in both periods was primarily due to an insurance reimbursement received in the second quarter of fiscal 2006 related to certain legal matters and the amortization of intangible assets associated with acquisitions and minority stakes.

DISCOVER

INCOME STATEMENT INFORMATION

	Three Months Ended May 31,		Six Months Ended May 31,	
	2007	2006	2007	2006
	(dollars in millions)			
Merchant, cardmember and other fees, net	$ 261	$ 277	$ 558	$ 566
Servicing and securitization income	601	651	1,122	1,247
Other revenue	9	5	18	9
Total non-interest revenues	871	933	1,698	1,822
Interest revenue	704	608	1,384	1,194
Interest expense	336	220	623	451
Net interest income	368	388	761	743
Provision for consumer loan losses	204	130	399	285
Net credit income	164	258	362	458
Net revenues	1,035	1,191	2,060	2,280
Total non-interest expenses	702	650	1,355	1,260
Income before losses from unconsolidated investees and income taxes	333	541	705	1,020
Losses from unconsolidated investees	(1)	—	(2)	(1)
Provision for income taxes	123	203	261	381
Net income	$ 209	$ 338	$ 442	$ 638

On June 30, 2007, the Company completed the Discover Spin-off (see "Other Items—Discover Spin-off" herein).

Merchant, Cardmember and Other Fees, Net. Merchant, cardmember and other fees, net, decreased 6% and 1% in the quarter and six month period ended May 31, 2007, respectively. The decrease in the quarter was primarily due to lower net merchant discount revenue and lower cardmember and other fees. The decrease in net merchant discount revenue was due to higher allocations of interchange revenue to securitization transactions, partially offset by higher sales volume. The allocation of interchange revenue has the effect of decreasing Merchant, cardmember and other fees, net, and increasing Servicing and securitization income. During the quarter and six month period ended May 31, 2007, the Company had a higher level of outstanding securitization transactions receiving interchange allocations than in the comparable prior-year periods. The decrease in cardmember and other fees was due to a decrease in late payment and overlimit fees, partially offset by higher balance transfer fees, higher transaction processing revenue and higher credit protection revenues. The decrease in merchant, cardmember and other fees, net, in the six month period was primarily due to higher cardmember rewards and a decrease in late payment and overlimit fees, partially offset by higher balance transfer fees and higher credit protection revenues.

Servicing and Securitization Income. The table below presents the components of servicing and securitization income:

	Three Months Ended May 31,		Six Months Ended May 31,	
	2007	2006	2007	2006
	(dollars in millions)			
Merchant, cardmember and other fees, net	$ 290	$ 264	$ 545	$ 494
Other revenue	36	17	32	156
Total non-interest revenues	326	281	577	650
Interest revenue	1,013	968	1,932	1,857
Interest expense	411	356	773	666
Net interest income	602	612	1,159	1,191
Provision for consumer loan losses	327	242	614	594
Net credit income	275	370	545	597
Servicing and securitization income	$ 601	$ 651	$1,122	$1,247

Servicing and securitization income decreased 8% and 10% in the quarter and six month period ended May 31, 2007, primarily due to lower net interest income and a higher provision for consumer loan losses, partially offset by higher Merchant, cardmember and other fees, net. The decrease in the six month period also reflected lower Other revenue. The decrease in net interest income in both periods was attributable to a lower net interest spread, partially offset by a higher level of average securitized general purpose credit card loans. The higher provision for consumer loan losses in both periods reflected a higher level of average securitized general purpose credit card loans. The higher provision for consumer loan losses in the quarter was also attributable to a higher rate of net principal charge-offs on the securitized general purpose credit card portfolio. The increase in both periods in Merchant, cardmember and other fees, net, primarily reflected a higher level of outstanding securitization transactions that received interchange allocations. Other revenue for the six month period ended May 31, 2006 benefited from an increase in the fair value of the Company's retained interests in securitized receivables, primarily resulting from a favorable impact on charge-offs following the enactment of bankruptcy legislation effective in October 2005.

The net proceeds received from general purpose credit card asset securitizations in the six month periods ended May 31, 2007 and 2006 were $5,301 million and $6,613 million, respectively. The credit card asset securitization transactions completed in the six month period ended May 31, 2007 have expected maturities ranging from approximately three to seven years from the date of issuance.

Net Interest Income. Net interest income decreased 5% in the quarter and increased 2% in the six month period ended May 31, 2007. The decrease in the quarter was due to an increase in interest expense, partially offset by an increase in interest revenue. The increase in the six month period was due to an increase in interest income, partially offset by an increase in interest expense. The increase in interest expense in both periods was primarily due to a higher level of average interest bearing liabilities and an increase in the Company's average cost of borrowings. The increase in interest revenue in both periods was primarily due to an increase in federal funds sold and average owned general purpose credit card loans.

The following tables present analyses of Discover's average balance sheets and interest rates for the quarters and six months ended May 31, 2007 and 2006 and changes in net interest income during those periods:

Average Balance Sheet Analysis.

	Three Months Ended May 31,					
	2007			2006		
	Average Balance	Rate	Interest	Average Balance	Rate	Interest
	(dollars in millions)					
ASSETS						
Interest earning assets:						
General purpose credit card loans	$21,286	10.56%	$ 567	$19,664	11.01%	$ 546
Other consumer loans	92	4.95	1	214	7.43	4
Investment securities	87	3.09	1	59	3.97	1
Other	9,846	5.44	135	4,265	5.32	57
Total interest earning assets	31,311	8.92	704	24,202	9.95	608
Allowance for loan losses	(789)			(785)		
Non-interest earning assets	2,776			2,682		
Total assets	$33,298			$26,099		
LIABILITIES AND SHAREHOLDER'S EQUITY						
Interest bearing liabilities:						
Interest bearing deposits						
Savings	$ 4,186	5.32%	$ 56	$ 1,579	4.54%	$ 18
Brokered	14,686	5.17	191	10,931	4.55	125
Other time	1,632	4.98	21	1,759	4.49	20
Total interest bearing deposits	20,504	5.18	268	14,269	4.54	163
Other borrowings	4,882	5.55	68	4,689	4.80	57
Total interest bearing liabilities	25,386	5.25	336	18,958	4.60	220
Shareholder's equity/other liabilities	7,912			7,141		
Total liabilities and shareholder's equity	$33,298			$26,099		
Net interest income			$ 368			$ 388
Net interest margin(1)			4.66%			6.35%
Interest rate spread(2)		3.67%			5.35%	

(1) Net interest margin represents net interest income as a percentage of total interest earning assets.
(2) Interest rate spread represents the difference between the rate on total interest earning assets and the rate on total interest bearing liabilities.

Average Balance Sheet Analysis.

	Six Months Ended May 31,					
	2007			2006		
	Average Balance	Rate	Interest	Average Balance	Rate	Interest
	(dollars in millions)					
ASSETS						
Interest earning assets:						
General purpose credit card loans	$22,960	10.50%	$1,202	$20,808	10.41%	$1,080
Other consumer loans	94	5.76	3	260	7.48	10
Investment securities	83	4.06	2	49	3.86	1
Other	6,452	5.51	177	4,149	5.00	103
Total interest earning assets	29,589	9.38	1,384	25,266	9.48	1,194
Allowance for loan losses	(810)			(811)		
Non-interest earning assets	2,942			2,423		
Total assets	$31,721			$26,878		
LIABILITIES AND SHAREHOLDER'S EQUITY						
Interest bearing liabilities:						
Interest bearing deposits						
Savings	$ 3,824	5.30%	$ 101	$ 1,203	4.31%	$ 26
Brokered	12,329	5.12	315	11,655	4.50	262
Other time	1,601	4.91	39	1,771	4.45	39
Total interest bearing deposits	17,754	5.14	455	14,629	4.48	327
Other borrowings	6,050	5.56	168	5,338	4.67	124
Total interest bearing liabilities	23,804	5.25	623	19,967	4.53	451
Shareholder's equity/other liabilities	7,917			6,911		
Total liabilities and shareholder's equity	$31,721			$26,878		
Net interest income			$ 761			$ 743
Net interest margin(1)			5.15%			5.90%
Interest rate spread(2)		4.13%			4.95%	

(1) Net interest margin represents net interest income as a percentage of total interest earning assets.

(2) Interest rate spread represents the difference between the rate on total interest earning assets and the rate on total interest bearing liabilities.

Rate/Volume Analysis.

Increase/(Decrease) due to Changes in:	Three Months Ended May 31, 2007 vs. 2006 Volume	Rate	Total	Six Months Ended May 31, 2007 vs. 2006 Volume	Rate	Total
			(dollars in millions)			
Interest Revenue						
General purpose credit card loans	$ 45	$ (24)	$ 21	$112	$ 10	$122
Other consumer loans	(2)	(1)	(3)	(6)	(1)	(7)
Investment securities	—	—	—	1	—	1
Other	75	3	78	57	17	74
Total interest revenue	178	(82)	96	205	(15)	190
Interest Expense						
Interest bearing deposits:						
Savings	30	8	38	56	19	75
Brokered	43	23	66	15	38	53
Other time	(1)	2	1	(4)	4	—
Total interest bearing deposits	72	33	105	69	59	128
Other borrowings	2	9	11	17	27	44
Total interest expense	74	42	116	87	85	172
Net interest income	$104	$(124)	$ (20)	$118	$(100)	$ 18

Provision for Consumer Loan Losses. The provision for consumer loan losses increased 57% and 40% in the quarter and six month period ended May 31, 2007. The increase in both periods reflected a lower net reduction of reserves as compared with the prior-year periods in addition to an increased net charge-off rate. The net reduction in reserves was $6 million and $45 million in the quarter and six month period ended May 31, 2007, respectively, compared with $21 million and $118 million in the comparable prior-year periods, reflecting a continued trend toward more normalized bankruptcy charge-offs in the U.S. portfolio. In addition, the current quarter included a $16 million increase in reserves related to implementation of higher minimum payment requirements on certain accounts in the U.K.

Delinquencies and Charge-offs. Delinquency rates in the over 30-day category decreased in both the owned and managed portfolio. The 30-day delinquency rate declined from the prior year reflecting lower U.S. delinquencies, partially offset by higher delinquencies in the U.K. Net principal charge-off rates in the quarter were higher in both the owned and managed portfolios. The net charge-off rate increased from the prior year reflecting a trend towards more normalized levels of bankruptcy chargeoffs as compared with record lows a year ago, as well as a more difficult credit environment in the U.K. While the Company expects credit costs to continue to rise, the Company expects charge-off rates to remain relatively low and reach between 4.0% and 4.5% by the end of fiscal 2007.

In response to industry-wide regulatory guidance, the Company has increased minimum payment requirements on certain general purpose credit card loans. Bank regulators have discretion to interpret the guidance or its application, and changes in such guidance or its application by the regulators could impact minimum payment requirements. Increases in minimum payment requirements could negatively impact future levels of general purpose credit card loans and related interest and fee revenue and charge-offs.

The Company's future charge-off rates and credit quality are subject to uncertainties that could cause actual results to differ materially from what has been discussed above. Factors that influence the provision for consumer loan losses include the level and direction of general purpose credit card loan delinquencies and charge-offs, changes in consumer spending and payment behaviors, bankruptcy trends, regulatory changes or new guidance, the seasoning of the Company's general purpose credit card loan portfolio, interest rate movements and their impact on consumer behavior and changes in the Company's general purpose credit card loan portfolio, including the overall mix of accounts, products and loan balances within the portfolio.

Non-Interest Expenses. Non-interest expenses increased 8% in both the quarter and six month period ended May 31, 2007. Compensation and benefits expense increased 5% in the quarter and was unchanged in the six month period as compared with the prior year period. The quarter and six month period ended May 31, 2007 reflected higher salaries and wages while the six month period ended May 31, 2006 included Discover's share ($17 million) of the incremental compensation expense related to equity awards to retirement-eligible employees (see "Other Items—Stock Based-Compensation" herein). Excluding compensation and benefits expense, non-interest expenses increased 9% and 12% in the quarter and six month period. Professional services expenses increased 23% and 24% in the quarter and six month period, primarily due to higher legal fees associated with the VISA/MasterCard litigation and costs related to the Discover Spin-off. Other expenses increased 21% in both the quarter and six month period, primarily due to an increase in certain operating expenses, including costs related to the Discover Spin-off and losses associated with cardmember fraud.

Managed General Purpose Credit Card Loan Data. The Company analyzes its financial performance on both a "managed" loan basis and as reported under U.S. Generally Accepted Accounting Principles ("U.S. GAAP") ("owned" loan basis). Managed loan data assume that the Company's securitized loan receivables have not been sold and present the results of the securitized loan receivables in the same manner as the Company's owned loans. Discover operates its business and analyzes its financial performance on a managed basis. Accordingly, underwriting and servicing standards are comparable for both owned and securitized loans. The Company believes that managed loan information is useful to investors because it provides information regarding the quality of loan origination and credit performance of the entire managed portfolio and allows investors to understand the related credit risks inherent in owned loans and retained interests in securitizations. In addition, investors often request information on a managed basis, which provides a more meaningful comparison with industry competitors.

The following table provides a reconciliation of owned and managed average loan balances, returns on receivables, interest yields and interest rate spreads for the periods indicated:

Reconciliation of General Purpose Credit Card Loan Data (dollars in millions)

	Three Months Ended May 31,							
	2007				2006			
	Average Balance	Return on Receivables(1)	Interest Yield	Interest Rate Spread	Average Balance	Return on Receivables(1)	Interest Yield	Interest Rate Spread
General Purpose Credit Card Loans:								
Owned	$21,286	3.86%	10.56%	5.31%	$19,664	6.83%	11.01%	6.41%
Securitized	29,332	2.80%	13.69%	8.14%	27,643	4.86%	13.89%	8.76%
Managed	$50,618	1.62%	12.38%	6.96%	$47,307	2.84%	12.69%	7.78%

(1) Return on receivables is equal to Discover annualized income divided by average owned, securitized or managed credit card receivables, as applicable.

	Six Months Ended May 31,							
	2007				2006			
	Average Balance	Return on Receivables(1)	Interest Yield	Interest Rate Spread	Average Balance	Return on Receivables(1)	Interest Yield	Interest Rate Spread
General Purpose Credit Card Loans:								
Owned	$22,960	3.85%	10.50%	5.25%	$20,808	6.15%	10.41%	5.89%
Securitized	28,040	3.15%	13.82%	8.26%	26,631	4.80%	13.98%	8.97%
Managed	$51,000	1.73%	12.32%	6.91%	$47,439	2.70%	12.42%	7.61%

(1) Return on receivables is equal to Discover annualized income divided by average owned, securitized or managed credit card receivables, as applicable.

The following tables present a reconciliation of owned and managed general purpose credit card loans and delinquency and net charge-off rates:

Reconciliation of General Purpose Credit Card Loan Asset Quality Data (dollars in millions)

	At May 31,					
	2007			2006		
		Delinquency Rates			Delinquency Rates	
	Period End Loans	Over 30 Days	Over 90 Days	Period End Loans	Over 30 Days	Over 90 Days
General Purpose Credit Card Loans:						
Owned	$22,548	2.95%	1.43%	$21,764	2.97%	1.38%
Securitized	28,717	3.26%	1.58%	26,775	3.56%	1.65%
Managed	$51,265	3.13%	1.52%	$48,539	3.29%	1.53%

	Three Months Ended May 31,		Six Months Ended May 31,	
	2007	2006	2007	2006
Net Principal Charge-offs				
Owned	3.93%	3.02%	3.85%	3.82%
Securitized	4.46%	3.50%	4.38%	4.46%
Managed	4.24%	3.30%	4.14%	4.18%
Net Total Charge-offs (inclusive of interest and fees)				
Owned	5.27%	4.38%	5.14%	5.05%
Securitized	6.25%	5.02%	6.20%	6.38%
Managed	5.84%	4.75%	5.72%	5.80%

Other Items.

Deferred Compensation Plans.

The Company maintains various deferred compensation plans for the benefit of certain employees. Beginning in the quarter ended February 28, 2007, 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 $245 million in the quarter ended February 28, 2007 and $93 million and $187 million for the quarter and six month period ended May 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 was 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 $395 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), Asset Management ($28 million) and Discover ($17 million) business segments.

Discontinued Operations.

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 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 (see Note 15 to the condensed consolidated financial statements).

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.

Discover Spin-off.

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 has 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 will allow 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.

Beginning in the third quarter of fiscal 2007, the results of Discover will be included within discontinued operations for all periods presented.

Business and Other Acquisitions.

JM Financial. On February 22, 2007, the Company announced that it would dissolve its India joint venture with JM Financial. The Company has reached an agreement in principle to purchase the joint venture's institutional equities sales, trading and research platform by acquiring JM Financial's 49% interest and selling 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 Report on Form 10-Q for the quarter ended February 28, 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 ("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.

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 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 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 an entity's defined benefit and postretirement plans as an asset or liability in the financial statements and requires the measurement of defined benefit and postretirement plan assets and obligations as of the end of the employer's 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 is currently assessing the impact that SFAS No. 158 will have on its condensed consolidated financial statements.

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.

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.

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.

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 involve some 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 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.

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 May 31, 2007		At November 30, 2006	
	Assets	Liabilities	Assets	Liabilities
Exchange traded	$12,545	$16,550	$12,554	$17,094
OTC	43,916	42,369	42,889	40,397
Total	$56,461	$58,919	$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 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 certain 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 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 based upon changes in 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 and Market 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.

Allowance for Consumer Loan Losses.

The allowance for consumer loan losses in the Company's Discover business is established through a charge to the provision for consumer loan losses. Provisions are made to reserve for estimated losses in outstanding loan balances. The allowance for consumer loan losses is a significant estimate that represents management's estimate of probable losses inherent in the consumer loan portfolio. The allowance for consumer loan losses is primarily applicable to the owned homogeneous consumer credit card loan portfolio and is evaluated quarterly for adequacy.

In estimating the allowance for consumer loan losses, the Company uses a systematic and consistently applied approach. This process starts with a migration analysis (a technique used to estimate the likelihood that a consumer loan will progress through the various stages of delinquency and ultimately charge-off) of delinquent and current consumer credit card accounts in order to determine the appropriate level of the allowance for consumer loan losses. The migration analysis considers uncollectible principal, interest and fees reflected in consumer loans. In evaluating the adequacy of the allowance for consumer loan losses, management also considers factors that may impact credit losses, including current economic conditions, recent trends in delinquencies and bankruptcy filings, account collection management, policy and regulatory changes, account seasoning, loan volume and amounts, payment rates and forecasting uncertainties. A provision for consumer loan losses is charged against earnings to maintain the allowance for consumer loan losses at an appropriate level. The use of different estimates or assumptions could produce different provisions for consumer loan losses (see "Discover—Provision for Consumer Loan Losses" herein).

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.

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 framework are the cash capital policy, the liquidity reserve and stress testing through the contingency funding plan. 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 $1,199,993 million at May 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 and other debt and corporate equities) and securities received as collateral, partially offset by a decrease in securities borrowed and securities purchased under agreements to resell.

Within the sales and trading related assets and liabilities are transactions attributable to securities financing activities. Securities financing assets and liabilities as of May 31, 2007 were $669 billion and $654 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.

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.

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

	Balance at		Average Month-End Balance(1)	
	May 31, 2007	November 30, 2006	For the Quarter Ended May 31, 2007	For the Six Month Period Ended May 31, 2007
	(dollars in millions, except ratio data)			
Total assets	$1,199,993	$1,121,192	$1,230,345	$1,201,003
Less: Securities purchased under agreements to resell	(144,051)	(175,787)	(173,354)	(179,419)
Securities borrowed	(252,213)	(299,631)	(292,666)	(296,144)
Add: Financial instruments sold, not yet purchased	166,549	183,119	172,203	170,251
Less: Derivative contracts sold, not yet purchased	(58,919)	(57,491)	(53,499)	(53,216)
Subtotal	911,359	771,402	883,029	842,475
Less: Cash and securities deposited with clearing organizations or segregated under federal and other regulations or requirements(2)	(47,114)	(29,565)	(41,776)	(36,879)
Assets recorded under certain provisions of SFAS No. 140 and FIN 46R	(155,692)	(100,236)	(139,826)	(126,821)
Goodwill and net intangible assets(3)	(4,132)	(3,443)	(4,167)	(4,083)
Adjusted assets	$ 704,421	$ 638,158	$ 697,260	$ 674,692
Common equity	$ 38,411	$ 34,264	$ 37,381	$ 36,391
Preferred equity	1,100	1,100	1,100	1,100
Shareholders' equity	39,511	35,364	38,481	37,491
Junior subordinated debt issued to capital trusts	4,874	4,884	4,877	4,880
Subtotal	44,385	40,248	43,358	42,371
Less: Goodwill and net intangible assets(3)	(4,132)	(3,443)	(4,167)	(4,083)
Tangible shareholders' equity	$ 40,253	$ 36,805	$ 39,191	$ 38,288
Leverage ratio(4)	29.8x	30.5x	31.4x	31.4x
Adjusted leverage ratio(5)	17.5x	17.3x	17.8x	17.6x

(1) Average balances for the second quarter of fiscal 2007 were calculated based upon month-end balances from February 2007 through May 2007. Average balances for the six month period ended May 31, 2007 were calculated based upon month-end balances from November 2006 through May 2007.

(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 Six Month Period Ended May 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 May 31, 2007, total capital was $187,250 million, an increase of $25,116 million from November 30, 2006. The Company redeemed all $66 million of its outstanding Capital Units on February 28, 2007.

During the six month period ended May 31, 2007, the Company issued senior notes with a carrying value at quarter-end aggregating $41.1 billion, including non-U.S. dollar currency notes aggregating $18.6 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 May 31, 2007, the aggregate outstanding principal amount of the Company's Senior Indebtedness (as defined in the Company's senior debt indentures) was approximately $193 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 May 31, 2007.

During the six month period ended May 31, 2007, the Company purchased approximately $2.6 billion of its common stock (approximately 33 million shares) through open market purchases at an average cost of $79.57 (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. The Company expects to exercise the authorization over 12-18 months at prices the Company deems appropriate, subject to its unallocated capital position, market conditions and regulatory considerations. As of May 31, 2007, the Company had $3.4 billion remaining under its current share repurchase authorization.

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 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 six month period ended May 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 six month period ended May 31, 2007 and average common equity for the quarters and six month periods ended May 31, 2007 and 2006:

	Three Months Ended May 31,			Six Months Ended May 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	$23.7	$22.8	$17.9	$22.4	$21.4	$16.9
Global Wealth Management Group	1.5	1.6	3.1	1.5	1.7	3.2
Asset Management	2.7	3.4	2.3	2.5	3.2	2.2
Securities business	27.9	27.8	23.3	26.4	26.3	22.3
Discover	4.5	5.3	5.0	4.6	5.4	4.8
Unallocated capital	4.2	4.2	2.6	4.6	4.6	3.0
Total—continuing operations	36.6	37.3	30.9	35.6	36.3	30.1
Discontinued operations	—	0.1	0.2	—	0.1	0.2
Consolidated	$36.6	$37.4	$31.1	$35.6	$36.4	$30.3

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 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 Global Wealth Management Group. The incremental equity capital allocated to Asset Management and Discover represents primarily capital required for acquisitions and seed investments and increased managed receivables, respectively. The $1.6 billion of incremental unallocated capital under the Tier 1 equity methodology is primarily due to the inclusion of eligible hybrid capital instruments, which is partially offset by the inclusion of certain deferred tax assets.

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).

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 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. Contingency Funding Plans are produced on a parent, bank subsidiary and non-bank subsidiary level. The adequacy of the liquidity reserves are continually assessed and determined based on regular updates to the contingency funding plans.

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 May 31, 2007**	**For the Quarter Ended May 31, 2007**	**For the Six Month Period Ended May 31, 2007**
		(dollars in billions)	
Parent	$42	$38	$42
Bank subsidiaries	18	17	12
Discover Bank	7	6	3
Non-bank subsidiaries	14	13	12
Total	$81	$74	$69

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.

Committed Credit Facilities.

The maintenance of committed credit facilities serves to further diversify the Company's funding sources. The Company values committed credit as a secondary component of its liquidity management framework. The committed credit facilities include a diversification of lenders to the Company covering geographic regions, including North America, Europe and Asia.

During the quarter ended May 31, 2007, the Company restructured the Morgan Stanley and Morgan Stanley Japan Securities Co., Ltd. ("MSJS") Committed Revolving Credit Facility. The Company now maintains a senior revolving credit agreement with a group of banks to support general liquidity needs, including the issuance of commercial paper, which consists of three separate tranches: a U.S. dollar tranche; a Japanese yen tranche; and a multicurrency tranche available in both euro and sterling, all of which exist with the Company as the sole borrower (MSJS was removed as an eligible borrower). Under this combined facility (the "Credit Facility"), the banks are committed to provide up to $7.6 billion under the U.S. dollar tranche, 80 billion Japanese yen under the Japanese yen tranche and $3.25 billion under the multicurrency tranche. At May 31, 2007, the Company had a $16.5 billion consolidated stockholders' equity surplus as compared with the Credit Facility's covenant requirement.

The Company anticipates that it may utilize the Credit Facility for short-term funding from time to time. The Company does not believe that any of the covenant requirements in its Credit Facility will impair its ability to obtain funding under the Credit Facility, pay its current level of dividends or obtain loan arrangements, letters of credit and other financial guarantees or other financial accommodations. At May 31, 2007, no borrowings were outstanding under the Credit Facility.

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 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 May 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 $727 million. Of this amount, $622 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 June 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	A+

(1) On December 19, 2006, Fitch Ratings changed the outlook on the Company's senior debt ratings from Stable to Negative.
(2) On October 27, 2006, Standard & Poor's changed the outlook on the Company's senior debt ratings from Stable to Positive.

Commitments.

The Company's commitments associated with outstanding letters of credit, other financial guarantees, investment activities, and corporate lending and financing commitments as of May 31, 2007 are summarized below by period of expiration. Since commitments associated with letters of credit, other financial guarantees, and corporate lending and financing arrangements 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)	$11,876	$ —	$ —	$ —	$ 11,876
Investment activities	237	73	3	603	916
Investment grade corporate lending commitments(2)	10,733	7,661	21,856	5,078	45,328
Non-investment grade corporate lending commitments(2)	6,722	1,333	7,139	19,566	34,760
Commitments for secured lending transactions(3)	8,246	5,337	800	2,609	16,992
Commitments to purchase mortgage loans(4)	1,062	—	—	—	1,062
Commitments to originate mortgage loans(5)	628	—	—	—	628
Other commitments(6)	842	297	23	—	1,162
Total(7)	$40,346	$14,701	$29,821	$27,856	$112,724

(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) 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. Credit ratings of BB+ or lower are considered non-investment grade.
(3) 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.
(4) This amount represents the Company's forward purchase contracts involving mortgage loans.
(5) This amount represents residential mortgage loan commitments to individuals.
(6) This amount includes commercial loan commitments to small businesses and commitments related to securities-based lending activities.
(7) See Note 8 to the condensed consolidated financial statements.

The table above does not include commitments to extend credit for consumer loans of approximately $269 billion. Such commitments arise primarily from agreements with customers for unused lines of credit on certain credit cards, provided there is no violation of conditions established in the related agreement. These commitments, substantially all of which the Company can terminate at any time and which do not necessarily represent future cash requirements, are periodically reviewed based on account usage and customer creditworthiness. As a result of the completion of the Discover Spin-off, the Company will no longer have these commitments. In addition, 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 May 31, 2007, the Company had commitments to enter into reverse repurchase and repurchase agreements of approximately $118 billion and $77 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 May 31, 2007, the Company was in compliance with the CSE capital requirements.

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. 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 May 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 11.0 years.

The table below presents 95%/one-day VaR for each of the Company's primary risk exposures and on an aggregate basis at May 31, 2007, February 28, 2007 and November 30, 2006.

Table 1: 95% Total VaR	Aggregate (Trading and Non-trading)			Trading			Non-trading		
	95%/One-Day VaR at			95%/One-Day VaR at			95%/One-Day VaR at		
Primary Market Risk Category	May 31, 2007	February 28, 2007	November 30, 2006	May 31, 2007	February 28, 2007	November 30, 2006	May 31, 2007	February 28, 2007	November 30, 2006
	(dollars in millions)								
Interest rate and credit spread	$ 47	$ 37	$ 41	$ 42	$ 38	$ 38	$15	$11	$13
Equity price	53	42	58	50	39	55	8	6	5
Foreign exchange rate	18	13	9	18	13	9	1	—	—
Commodity price	33	36	31	33	36	31	—	—	—
Subtotal	151	128	139	143	126	133	24	17	18
Less diversification benefit(1)	58	50	50	57	50	48	5	4	3
Total VaR	$ 93	$ 78	$ 89	$ 86	$ 76	$ 85	$19	$13	$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 May 31, 2007 were $93 million and $86 million, respectively, compared with $78 million and $76 million, respectively, at February 28, 2007. The increase in Aggregate VaR and Trading VaR was primarily driven by increases in interest rate and credit spread and equity exposures toward the end of the quarter.

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 May 31, 2007, February 28, 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 May 31, 2007 decreased to $81 million from $90 million for the quarter ended February 28, 2007, primarily driven by a decrease in commodity price VaR. The decrease in commodity price VaR was predominately driven by decreased exposure to petroleum products.

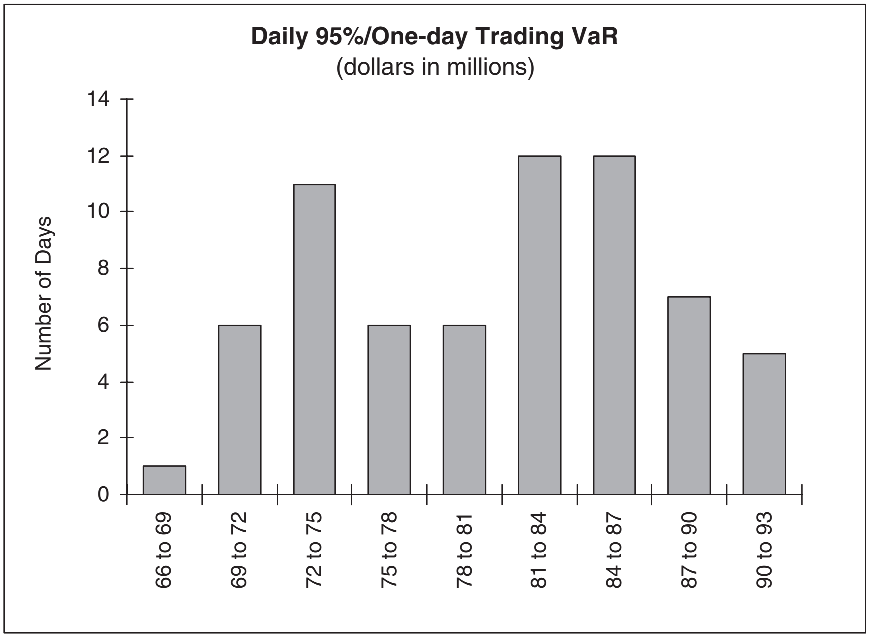
Table 2: 95% High/Low/Average Trading VaR	Daily 95%/One-Day VaR for the Quarter Ended May 31, 2007			Daily 95%/One-Day VaR for the Quarter Ended February 28, 2007			Daily 95%/One-Day VaR for the Quarter Ended November 30, 2006		
Primary Market Risk Category	**High**	**Low**	**Average**	**High**	**Low**	**Average**	**High**	**Low**	**Average**
				(dollars in millions)					
Interest rate and credit spread	$50	$34	$40	$46	$36	$39	$40	$29	$34
Equity price	53	35	44	53	37	45	55	24	32
Foreign exchange rate	21	11	16	19	10	15	23	8	12
Commodity price	40	31	34	48	28	40	35	26	30
Trading VaR	$92	$69	$81	$99	$76	$90	$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:

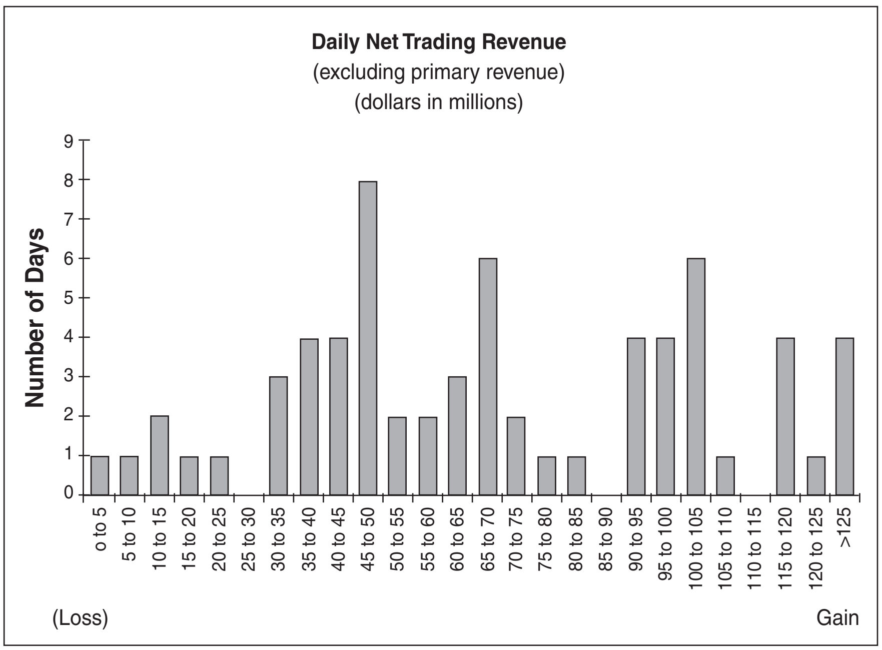
Table 3: Average 95% and 99% Trading VaR with Four-Year/One-Year Historical Time Series	Average 95%/One-Day VaR for the Quarter Ended May 31, 2007		Average 99%/One-Day VaR for the Quarter Ended May 31, 2007	
Primary Market Risk Category	**Four-Year Factor History**	**One-Year Factor History**	**Four-Year Factor History**	**One-Year Factor History**
	(dollars in millions)			
Interest rate and credit spread	$ 40	$ 35	$ 62	$ 55
Equity price	44	51	64	76
Foreign exchange rate	16	17	22	25
Commodity price	34	35	55	50
Trading VaR	$ 81	$ 83	$116	$119

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 May 31, 2007 would have been $255 million and $367 million, respectively.

Distribution of VaR Statistics and Net Revenues for the quarter ended May 31, 2007. As shown in Table 2 above, the Company's average 95%/one-day Trading VaR for the quarter ended May 31, 2007 was $81 million. The histogram below presents the distribution of the Company's daily 95%/one-day Trading VaR for the quarter ended May 31, 2007. The most frequently occurring value was between $81 million and $87 million, while for approximately 90% of trading days during the quarter, VaR ranged between $69 million and $90 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 histogram below shows the distribution of daily net trading revenue during the quarter ended May 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). There were no days during the quarter ended May 31, 2007 in which the Company incurred daily trading losses in excess of the 95%/one-day Trading VaR. Additionally, there were no days during the quarter where the largest one-day loss exceeded the lowest 95% One-day Aggregate Trading VaR reported in Table 2 above.



As of May 31, 2007, interest rate risk exposure associated with the Company's consumer lending activities, included within Discover, as measured by the reduction in pre-tax income resulting from a hypothetical, immediate 100 basis point increase in interest rates, had not changed significantly from November 30, 2006.

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 to support client acquisitions, recapitalizations and broader relationships. 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. The borrowers may be rated investment grade or non-investment grade. At May 31, 2007 and November 30, 2006, the aggregate amount of investment grade loans was $13.7 billion and $9.1 billion, respectively, and the aggregate amount of non-investment grade loans was $4.9 billion for both periods. At May 31, 2007 and November 30, 2006, the aggregate amount of lending commitments outstanding was $74.5 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 $34.2 billion and $26.5 billion at May 31, 2007 and November 30, 2006, respectively, including both internal and external hedges utilized by the lending business. The table below shows the Company's credit exposure from its corporate lending positions and commitments as of May 31, 2007. Since commitments associated with these business activities may expire unused, they do not necessarily reflect the actual future cash funding requirements:

Corporate Lending Commitments and Funded Loans

Credit Rating(1)	Years to Maturity: Less than 1	1-3	3-5	Over 5	Total Corporate Lending Exposure(2)	Corporate Loans
	(dollars in millions)					
AAA	$ 398	$ 418	$ 1,322	$ —	$ 2,138	$ —
AA	3,105	2,304	3,257	630	9,296	1,166
A	3,971	3,738	7,817	1,129	16,655	2,082
BBB	10,554	4,251	11,163	1,730	27,698	10,451
Non-investment grade	7,320	2,121	7,309	20,554	37,304	4,910
Total	$25,348	$12,832	$30,868	$24,043	$93,091	$18,609
Notional amount of hedges owned					$34,172	

(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.

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 May 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	$ 1,017	$ 1,308	$ 840	$ 3,114	$ (1,594)	$ 4,685	$ 4,585
AA	7,407	6,552	4,890	15,615	(19,954)	14,510	12,449
A	3,880	3,035	2,262	5,931	(6,450)	8,658	7,832
BBB	3,153	2,025	2,875	1,728	(3,306)	6,475	4,448
Non-investment grade	3,912	2,338	3,172	2,647	(4,394)	7,675	3,796
Unrated(4)	1,191	811	165	487	(741)	1,913	349
Total	$20,560	$16,069	$14,204	$29,522	$(36,439)	$43,916	$33,459

(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.

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 May 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	$ 3,565	$ 6,510	$ 8,216	$27,323	$(24,151)	$21,463	$17,511
Foreign exchange forward contracts and options	7,085	764	103	17	(1,996)	5,973	4,910
Equity securities contracts (including equity swaps, warrants and options)	5,359	3,278	858	488	(4,435)	5,548	2,632
Commodity forwards, options and swaps	4,551	5,517	5,027	1,694	(5,857)	10,932	8,406
Total	$20,560	$16,069	$14,204	$29,522	$(36,439)	$43,916	$33,459

(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	$ 6,080	$ 5,924	$ 7,592	$16,436	$(22,494)	$13,538
Foreign exchange forward contracts and options	7,604	648	92	24	(949)	7,419
Equity securities contracts (including equity swaps, warrants and options)	5,309	4,538	2,610	917	(2,166)	11,208
Commodity forwards, options and swaps	6,694	5,576	1,620	2,077	(5,763)	10,204
Total	$25,687	$16,686	$11,914	$19,454	$(31,372)	$42,369

(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.

The Company's derivatives (both listed and OTC) at May 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 May 31, 2007		At November 30, 2006	
	Assets	Liabilities	Assets	Liabilities
	(dollars in millions)			
Interest rate and currency swaps, interest rate options, credit derivatives and other fixed income securities contracts	$21,565	$13,564	$19,444	$15,688
Foreign exchange forward contracts and options	5,974	7,420	7,325	7,725
Equity securities contracts (including equity swaps, warrants and options)	17,134	26,772	16,705	23,155
Commodity forwards, options and swaps	11,788	11,163	11,969	10,923
Total	$56,461	$58,919	$55,443	$57,491

Each category of OTC 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 May 31, 2007, approximately 8% 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 4% 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 May 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: utilities, consumer-related entities, banks and financial institutions, energy-related entities, transportation, healthcare and media.

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.

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 Report on Form 10-Q for the quarterly period ended February 28, 2007 (the "First 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 and the First Quarter Form 10-Q.

Coleman Litigation.

On June 4, 2007, the District Court of Appeal for the Fourth District of Florida (the "Court of Appeal") March 21, 2007 opinion became final when the Court of Appeal issued an order denying Coleman (Parent) Holdings Inc.'s ("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.

IPO Allocation Matters.

On April 6, 2007, in the numerous purported class actions, now captioned *In re Initial Public Offering Securities Litigation,* the U.S. Court of Appeals for the Second Circuit (the "Second Circuit") denied plaintiffs' petition for rehearing and, on May 18, 2007, the Second Circuit denied plaintiffs' petition for rehearing *en banc*.

On May 24, 2007, in *Breakaway Solutions, Inc. v. Morgan Stanley & Co. Incorporated, et al.*, plaintiff filed a Second Amended Complaint that removed any class allegations. The case is proceeding as an individual action.

On June 12, 2007, purported assignees of certain issuers and underwriter defendants filed a joint notice of voluntary dismissal with prejudice in the Second Circuit in the case in which the assignees had appealed the dismissal of their claims by the U.S. District Court for the Southern District of New York (the "SDNY") on February 24, 2006.

On June 18, 2007, in the numerous purported class actions, now captioned, *In re Initial Public Offering Antitrust Litigation*, the U.S. Supreme Court reversed the Second Circuit's decision, ruling that the breadth of federal securities regulation prevented the antitrust suit.

Global Wealth Management Group Employment Matters.

Wage and Hour Matters. On May 25, 2007, in *Bart et al. v. Morgan Stanley DW Inc.*, the Company filed a Notification of Potential Tagalong Action with the Judicial Panel on Multi-District Litigation ("JPML"). On June 7, 2007, the JPML issued a conditional transfer order, transferring *Bart* to the U.S. District Court for the Southern District of California.

Gender Matters. On April 24, 2007, in *Joanne Augst-Johnson et al. v. Morgan Stanley & Co. Inc*., the parties filed a motion for preliminary approval of the settlement which included, among other provisions, a payment to the settlement fund and certain programmatic relief.

On April 16, 2007, in *Daisy Jaffe v. Morgan Stanley DW Inc*., the court issued an order extending the stay until May 15, 2007. On June 25, 2007, the court extended the stay until August 6, 2007.

Indonesian Litigation.

In April and May 2007, the Company and other defendants filed memoranda in support of an application for Civil Review of the Indonesian Supreme Court's November 14, 2006 decision in favor of PT Indah Kiat Pulp & Paper Tbk.

In May 2007, the Company received notification that the Indonesian High Court had affirmed the Indonesian District Court's September 28, 2005 decision to reject PT Lontar Papyrus' claim against the Company.

AOL Time Warner Litigation.

In May 2007, the parties entered into a settlement agreement that resolved all claims in the consolidated actions in the SDNY, with the exception of plaintiffs' claims against Ernst & Young.

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 May 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 (D)	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs
Month #1				
(March 1, 2007 – March 31, 2007)				
Share Repurchase Program (A)	10,149,993	$75.71	10,149,993	$4,039
Employee Transactions (B)	513,354	$79.77	N/A	N/A
Odd Lot Tender Shares (C)	91,416	$77.75	91,416	N/A
Month #2				
(April 1, 2007 – April 30, 2007)				
Share Repurchase Program (A)	7,682,710	$80.00	7,682,710	$3,424
Employee Transactions (B)	164,945	$81.91	N/A	N/A
Odd Lot Tender Shares (C)	N/A	N/A	N/A	N/A
Month #3				
(May 1, 2007 – May 31, 2007)				
Share Repurchase Program (A)	114,800	$83.57	114,800	$3,415
Employee Transactions (B)	29,311	$85.95	N/A	N/A
Odd Lot Tender Shares (C)	N/A	N/A	N/A	N/A
Total				
Share Repurchase Program (A)	17,947,503	$77.59	17,947,503	$3,415
Employee Transactions (B)	707,610	$80.53	N/A	N/A
Odd Lot Tender Shares (C)	91,416	$77.75	91,416	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) Repurchases by the Company pursuant to an odd lot tender offer authorized by the Company's Board of Directors on September 19, 2006. Pursuant to the offer, which ended March 7, 2007, the Company offered to purchase all shares of common stock held by stockholders holding less than 100 shares of common stock.

(D) 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 4. Submission of Matters to a Vote of Security Holders

Information regarding the submission of matters to a vote of security holders under Item 8.01 of the Company's Current Report on Form 8-K filed on April 13, 2007 is incorporated by reference herein.

Item 6. Exhibits

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

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,
Chief Financial Officer

By: /s/ PAUL C. WIRTH

Paul C. Wirth,
Controller and Principal Accounting Officer

Date: July 10, 2007

EXHIBIT INDEX

MORGAN STANLEY

Quarter Ended May 31, 2007

Exhibit No.	Description
3	Amendment to Bylaws (Exhibit 3 to Company's Current Report on Form 8-K dated June 19, 2007).
10.1	Morgan Stanley 2007 Notional Leveraged Co-Investment Plan.
10.2	Directors' Equity Capital Accumulation Plan, as amended through March 19, 2007.
10.3	Governmental Service Amendment to Outstanding Stock Option and Stock Unit Awards.
10.4	Amendment to the 1993 Stock Plan for Non-employee Directors, dated as of March 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 July 9, 2007, concerning unaudited interim financial information.
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.
99.1	Unaudited pro forma condensed consolidated financial information. • Unaudited pro forma condensed consolidated statement of financial condition as of May 31, 2007. • Unaudited pro forma condensed consolidated statements of income for the fiscal years ended November 30, 2006, 2005 and 2004, the three months ended February 28, 2007 and the three and six months ended May 31, 2007.

Printed with soy ink on recycled paper.

EXHIBIT 10.1

MORGAN STANLEY
2007 NOTIONAL LEVERAGED CO-INVESTMENT PLAN

Section 1. *Purpose.* The Morgan Stanley 2007 Notional Leveraged Co-Investment Plan (as may be amended from time to time, the "**Plan**") has the purposes of: (i) providing the opportunity to a select group of management and highly compensated employees to enhance (A) the portion of any discretionary above base compensation that would otherwise be awarded to them in the form of Morgan Stanley equity compensation or other mandatory long-term incentive compensation or (B) any retention, new hire or similar awards that would be granted to such management and employees and (ii) facilitating the allocation of such compensation to the notional investment opportunities afforded by the Plan.

Section 2. *Definitions*. As used in the Plan, unless determined otherwise by the Firm and set forth in the applicable Award Certificate, the following terms shall have the indicated meanings:

"**Above Base Compensation**" means any compensation other than base salary that the Firm awards to an Eligible Person for a Fiscal Year, before reduction for any applicable taxes. Nothing in the Plan shall obligate the Firm to award or pay any Above Base Compensation to any person.

"**Account**" means the bookkeeping account that the Firm establishes and maintains for a Participant pursuant to Section 6. An Account is established only for purposes of tracking a Notional Plan Investment and not to segregate or identify assets that may be used to make distributions or other payments under the Plan.

"**Administration Fee**" shall have the meaning set forth in Section 8(a).

"**Administrator**" means one or more officers of the Firm to whom the Committee, in its sole discretion, delegates all or some of its authority and responsibilities to administer the Plan. Such officers are authorized to sub-delegate some or all of such authority and responsibilities to the Executive Compensation Department, another committee of the Firm and/or one or more officers of the Firm, and any person or persons to whom are sub-delegated all or some of such authority and responsibilities is also, to the extent of such sub-delegation, the "Administrator".

"**Allocation**" shall have the meaning set forth in Section 4(a).

"**Allocation Form**" shall have the meaning set forth in Section 4(a).

"**Allocation Preference**" shall have the meaning set forth in Section 4(a).

“**Applicable Reduction Amount**” shall have the meaning set forth in Section 10(a)(i).

“**Associated Employee Fund**” means, with respect to any reference investment underlying a Notional Plan Investment, a co-investment or feeder fund that is available primarily to employees of the Firm and is associated with such reference investment.

“**Award Certificate**”, with respect to any Participant, means a written document (including in electronic form) for each Total Notional Investment that sets forth the terms and conditions of such Participant’s participation in the Plan. A Participant’s participation in the Plan shall be governed by the Plan, such Participant’s Award Certificate or Certificates, as applicable, and, if and to the extent applicable pursuant to Section 16(e), the International Supplement.

“**Board**” means the Board of Directors of Morgan Stanley.

“**Cancellation Event**”, with respect to any Plan Interest of any Participant, shall have the meaning set forth in the applicable Award Certificate. Cancellation Events in respect of any Plan Interest related to a Fiscal Year Award shall be substantially similar to such events as set forth in the annual year-end equity compensation awards granted to such Participant.

“**Closed-End Investment**” means a Notional Plan Investment in a reference investment that generally does not permit redemptions by investors but makes distributions to investors from time to time following the sale, transfer or other disposition of its investments.

“**Closed-End Distribution Date**” means, with respect to any Plan Interest of any Participant, any date, specified in the applicable Award Certificate, as a Distribution Date for Proceeds with respect to Closed-End Investments.

“**Code**” means the United States Internal Revenue Code of 1986, as amended.

“**Committee**” means the Compensation, Management Development and Succession Committee of the Board, any successor committee thereto or any other committee of the Board appointed by the Board with the powers of the Committee under the Plan, or any subcommittee appointed by such Committee.

“**Descriptive Materials**” means all brochures, letters, memoranda or other documents from the Firm to a Participant regarding the Plan, including all electronic-based materials.

“**Distribution Date**” means,

(i) with respect to a Closed-End Investment, (A) the Earliest Distribution Date, if applicable, (B) any Subsequent Closed-End Distribution Dates (including the Final Distribution Date), if applicable, and (C) any other date specified as a Closed-End Distribution Date in the Participant's applicable Award Certificate; and

(ii) with respect to an Open-End Investment, the Earliest Distribution Date and any Subsequent Open-End Distribution Dates.

"**Earliest Distribution Date**" means, with respect to any Plan Interest, the date, specified in the applicable Award Certificate, on which Proceeds in respect of Notional Plan Investments shall commence being distributed to the applicable Participant.

"**Eligible Person**" means a professional employee of the Firm who is determined by the Committee to be eligible to participate in the Plan.

"**Executive Compensation Department**" means Morgan Stanley's Executive Compensation Department or any other department of Morgan Stanley that succeeds to the functions of the Executive Compensation Department.

"**Final Distribution Date**" means, with respect to any Plan Interest of any Participant, the date, specified in the applicable Award Certificate, on which the Firm shall make its final distribution with respect to such Plan Interest to such Participant in accordance with Section 10(a)(iii).

"**Firm**" means Morgan Stanley together with its subsidiaries and other affiliates.

"**Fiscal Year**" and "**Fiscal Quarter**" mean Morgan Stanley's Fiscal Year and Morgan Stanley's Fiscal Quarter, respectively.

"**Fiscal Year Award**" means an allocation to the Plan of a Participant's compensation that would otherwise be mandatorily granted in the form of Morgan Stanley equity compensation or other mandatory long-term incentive compensation in respect of a Fiscal Year.

"**International Supplement**" shall have the meaning set forth in Section 16(e).

"**Investment Committee**" means a committee of two or more officers of the Firm to whom the Administrator delegates the authority and responsibilities to select Notional Plan Investments.

"**Legal Requirement**" means any law, regulation, ruling, judicial decision, accounting standard, regulatory guidance or other legal requirement.

“**Morgan Stanley**” means Morgan Stanley, a Delaware corporation, or any successor thereto.

“**Morgan Stanley Applicable Rate**” means, for any period, the rate at which notional interest with respect to any Notional Advance (or any portion thereof) shall accrue from the date that the Notional Advance (or portion thereof) is deemed to be notionally invested until and to the extent such Notional Advance (or portion thereof) is reduced by any Proceeds. Pursuant and subject to Section 3(a)(v), the Firm reserves the right to revise the Morgan Stanley Applicable Rate at any time and from time to time.

“**Notional Advance**” means, with respect to any Participant Allocation, the notional amount, if any, that Morgan Stanley adds or will add to the Participant Allocation for notional investment in Notional Plan Investments in accordance with Section 5.

“**Notional Plan Investment**” means an investment designated by the Firm as a reference investment for the benefit of the Plan. Reference investments underlying Notional Plan Investments may include proprietary investment funds of the Firm or “funds of funds” of the Firm that include investment funds sponsored or offered by third parties. For the avoidance of doubt, a Participant’s interest in any Notional Plan Investment shall be notional.

“**Open-End Investment**” means a Notional Plan Investment in a reference investment that generally does not make distributions to its investors but permits investors to redeem their interest in the fund from time to time.

“**Participant**” means an Eligible Person who participates in the Plan.

A “**Participant Allocation**” means, with respect to any Participant, (i) a Fiscal Year Award, or (ii) a Special Award.

“**Participant Applicable Rate**” means, for any period, the rate at which notional interest may accrue with respect to:

(i) Each Participant Allocation (or portion thereof), from, (A) in the case of a Fiscal Year Award, the date on which the annual equity award for such Fiscal Year is granted (or such other date specified in the applicable Award Certificate) or (B) in the case of a Special Award, the grant date of such Special Award, in each case until the Firm notionally allocates such Participant Allocation (or portion thereof) to one or more Notional Plan Investments;

(ii) Each Participant Allocation, if the Firm determines that a Participant Allocation shall not be notionally invested in Notional Plan Investments, from the date on which the annual equity award for such Fiscal Year is granted (or, in the case of a Special Award, the grant date of such Special Award) until the applicable Earliest Distribution Date;

(iii) The Proceeds relating to a Realization (or partial Realization) with respect to a Closed-End Investment, from the date of such Realization until the applicable Distribution Date, as further set forth in Section 10(a) and (b), as applicable;

(iv) The Proceeds relating to a Realization (or partial Realization) with respect to an Open-End Investment, from the date of such Realization until the applicable Distribution Date, as further set forth in Section 10(c);

(v) The Proceeds relating to a Realization (or partial Realization) with respect to a Notional Plan Investment, from the date of the applicable Distribution Date to the actual date of distribution permitted by Section 11(a); and

(vi) Each Plan Termination Value, from the date of any termination of the Plan until the distribution of such Plan Termination Value on the applicable Distribution Date.

Pursuant and subject to Section 3(a)(v), the Firm reserves the right to revise the Participant Applicable Rate at any time and from time to time.

"**Plan**" shall have the meaning set forth in Section 1.

"**Plan Interest**" means, with respect to any Participant Allocation, a Participant's Total Notional Investment (including any notional interest accrued at the Participant Applicable Rate) *minus* the sum of such Participant's previously unreduced Notional Advances reflected in the Participant's Account with respect to such Participant Allocation (plus accrued and previously unreduced notional interest thereon) and such Participant's previously unreduced Administration Fee.

"**Plan Termination Value**" means, with respect to any Plan Interest in connection with the termination of this Plan, a Final Distribution Date, or a single Closed-End Distribution Date, the fair value (as determined by the Firm) of such vested Plan Interest (or portion thereof), if any (together with any notional interest accrued thereon), on the effective date of such termination, or as of such Final Distribution Date or single Closed-End Distribution Date, as applicable.

"**Proceeds**" means, with respect to any Notional Plan Investment, (i) notional gross cash proceeds, if any, that are Realized in respect of such Notional Plan Investment at any time, *plus* (ii) if there is an Associated Employee Fund, an additional amount equal to the difference between (A) the "carried interest" that would be paid by third-party investors with respect to the reference investment underlying such Notional Plan Investment, and (B) the "carried interest" that would be paid by employee investors in an Associated Employee Fund. For the avoidance of doubt, Proceeds shall be net of any fees or expenses charged to Morgan Stanley by any reference investment that relates to a Notional Investment.

“**Realization**” or “**Realize**” means (i) with respect to a Closed-End Investment, the receipt of a distribution by an investor, had such investor received such a distribution from such Closed-End Investment; and (ii) with respect to an Open-End Investment, the receipt of a distribution or redemption proceeds by an investor, had such investor received such a distribution or effected such a redemption from such Open-End Investment as of such Open-End Investment’s most recent valuation date. For the avoidance of doubt, the re-investment of proceeds by a Notional Plan Investment does not, itself, give rise to a Realization.

“**Section 409A**” means Section 409A of the Code, and the rules, regulations and guidance thereunder (or any successor provisions thereto).

“**Securities Act**” means the United States Securities Act of 1933, as amended.

“**Special Award**” means a retention, new hire or similar award that is granted in the form of a participation in the Plan.

“**Subsequent Closed-End Distribution Date**”, with respect to any Plan Interest, means each date after the Earliest Distribution Date selected as a Distribution Date for Proceeds relating to Closed-End Investments. Any such selection may be made from a menu of possible dates specified by the Firm, in accordance with any rules and procedures that the Firm establishes.

“**Subsequent Open-End Distribution Date**”, with respect to any Plan Interest, means each date after the Earliest Distribution Date selected as a Distribution Date for Proceeds relating to Open-End Investments. Any such selection may be made from a menu of possible dates specified by the Firm, in accordance with any rules and procedures that the Firm establishes.

“**Total Compensation**” means (i) base salary, commissions and annual bonus, inclusive of the value of long-term incentive compensation, or what the Firm designates as “total reward”; and (ii) for employees who are Investment Representatives or Financial Advisors of the Global Wealth Management Group, gross compensation, pre-deductions, inclusive of the value of long-term incentive compensation, or what the Firm designates as “total reward”.

“**Total Notional Investment**” means, with respect to any Participant Allocation at any time, the interest in the Plan that is attributable to such Participant Allocation at such time and any related Notional Advance.

Section 3. *Administration.*

(a) The Committee shall administer the Plan. In addition to other express powers and authorizations that the Plan confers on the Committee, the Committee shall have full power and authority, subject to the express provisions of the Plan, Legal Requirements and contractual provisions binding upon the Firm and any internal policies and procedures of the Firm:

(i) to determine the terms and conditions of each Award Certificate;

(ii) to determine the pool of Eligible Persons;

(iii) to construe and interpret the Plan, any Award Certificate, the International Supplement or any summary of the foregoing (including any Descriptive Materials);

(iv) to prescribe, amend, rescind or waive rules and procedures relating to the Plan with respect to any and all Participants;

(v) to revise the Morgan Stanley Applicable Rate and the Participant Applicable Rate;

(vi) to waive any provision of the Plan or one or more Award Certificates with respect to any and all Participants;

(vii) to vary the terms and conditions of participation in the Plan to take account of tax laws, securities laws and other regulatory requirements of foreign jurisdictions; and

(viii) to make all other determinations necessary or advisable for the administration of the Plan.

Except as expressly provided for in the Plan, the Committee's determinations under the Plan need not be uniform and may be made selectively among Eligible Persons and Participants, whether or not such persons are similarly situated. All determinations by the Committee or the Administrator pursuant to Section 3(b), in administering, construing or interpreting the Plan shall be final, binding and conclusive for all purposes and upon all persons.

(b) The Committee may, but need not, from time to time delegate such of its responsibilities under the Plan as it deems appropriate to the Administrator. In connection with the performance of their responsibilities under the Plan, the Committee, the Administrator and the Investment Committee may consult with any third party they deem necessary or advisable, including any outside consultant or advisor.

(c) Neither the Firm nor any member of the Board, the Committee, the Investment Committee, the Administrator and their respective affiliates and employees shall be liable in any manner whatsoever in connection with the administration, construction or interpretation of the Plan, any Award Certificate or the Descriptive Materials, except for any liability arising out of such person's willful misconduct. Under no circumstances shall any such person be liable for any act or omission of any other person. In the performance of its, his or her functions with respect to the Plan, each such person shall be entitled to rely upon information and advice furnished by the Firm's officers, the Firm's accountants, the Firm's counsel, the Firm's tax advisors and any other person the Committee deems necessary or advisable, and no such person shall be liable for any action taken or not taken in reliance upon any such advice.

(d) Any discretionary authority or obligation pursuant to the Plan shall not be applicable to the extent such discretionary authority or obligation is prohibited by Section 409A, or would result in a Participant being required to recognize income for United States federal income tax purposes prior to the relevant Distribution Date or would result in a Participant incurring interest or additional tax under Section 409A.

Section 4. *Participant Allocation.*

(a) In accordance with any rules and procedures that the Firm establishes, an Eligible Person may be permitted to express a preference to allocate a portion of the compensation other than base salary that would otherwise be granted in the form of Morgan Stanley equity compensation or other mandatory long-term incentive compensation in respect of such Fiscal Year to the Plan (an "**Allocation Preference**"). Such Allocation Preference, which such Eligible Person shall make by submitting a form, including in electronic form (an "**Allocation Form**"), on or prior to a date specified on such Allocation Form, shall be irrevocable by the Eligible Person on or after such date. The Firm, in its sole and absolute discretion, reserves the right not to give effect to all or any portion of such Allocation Preference during the time period designated by the Administrator after such Allocation Preference is irrevocable to the Eligible Person. The Firm shall give effect to such Eligible Person's Allocation Preference in its entirety, subject to (i) the eligibility criteria as determined by the Committee and (ii) any adjustment thereto effected by the Firm in accordance with the immediately preceding sentence, except to the extent not giving such effect is not prohibited by Section 409A and would not result in such Eligible Person being required to recognize income for United States federal income tax purposes prior to the relevant Distribution Date or in an Eligible Person incurring interest or additional tax under Section 409A. The Firm's final allocation ("**Allocation**") of the non-cash component of such Eligible Person's Above Base Compensation shall not constitute a guarantee of Plan participation.

(b) The Firm shall issue to each Participant an Award Certificate setting forth the terms and conditions of such Participant's participation in the Plan.

(c) Each Participant Allocation shall accrue notional interest, (A) in the case of a Fiscal Year Award, at the Participant Applicable Rate from the date that the annual equity award for such Fiscal Year is granted (or such other date specified in the applicable Award Certificate), in each case, unless the Firm determines otherwise in accordance with any rules and procedures that the Firm establishes or (B) in the case of a Special Award, the grant date of such Special Award, in each case: (i) until the Firm notionally allocates such Participant Allocation (or a portion thereof) to one or more Notional Plan Investments pursuant to Section 7, or (ii) if the Firm does not notionally invest such Participant Allocation (or a portion thereof) in one or more Notional Plan Investments, until the Earliest Distribution Date, on which date the Firm shall pay such Participant Allocation (or portion thereof) to such Participant.

(d) Participant Allocations are intended to be exempt from registration under the Securities Act. By participating in the Plan, each Participant shall be deemed to acknowledge, represent and warrant to and agree with Morgan Stanley, and the Firm may require the Participant to affirmatively acknowledge, represent and warrant to and agree with Morgan Stanley, as follows:

(i) The Participant received and carefully reviewed the Descriptive Materials, and the Participant understands the information contained therein, the risks associated with a Notional Plan Investment under the Plan and the conflicts that the Plan may present for the Firm and agrees to be bound by the terms of the Descriptive Materials;

(ii) The Participant had a reasonable opportunity to ask questions of and receive answers from a person or persons acting on behalf of Morgan Stanley concerning the Plan and all such questions were answered to the Participant's full satisfaction;

(iii) No oral or written representations were made to the Participant concerning the Plan other than as stated in any Award Certificate and/or the Descriptive Materials, and no oral or written information furnished to the Participant in connection with the Plan was inconsistent with the information stated in the Descriptive Materials;

(iv) The Participant has adequate means of providing for the Participant's current financial needs and contingencies, is able to bear the substantial economic risks of the Plan for an indefinite period of time, has no need for liquidity regarding the Participant's assets placed in the Plan and, at the present time, could afford a complete loss of such assets;

(v) The Participant has such knowledge and experience in financial, tax and business matters so as to enable the Participant to utilize the information made available to the Participant in connection with the Plan to evaluate the merits and risks of the Plan and to make an informed decision with respect thereto;

(vi) The Participant is not relying on Morgan Stanley or any person or persons acting on behalf of Morgan Stanley with respect to the tax and other economic considerations of the Plan;

(vii) The Participant satisfies the eligibility requirements as determined by the Committee;

(viii) The Participant shall provide such information and execute and deliver such documents as may reasonably be requested by the Firm in connection with the Plan, including such information and documents as may reasonably be necessary to comply with any and all laws to which the Firm is subject, and such additional information as the Firm may deem appropriate with regard to the Participant's eligibility (including documentation relating to the Participant's qualification as an Accredited Investor); and

(ix) The Participant shall keep confidential all matters relating to the Plan (including the terms of the Plan and any Award Certificate and the Descriptive Materials), except to the extent such matters are publicly available (through no fault of the Participant) or as otherwise required by Legal Requirements. The Firm's Code of Conduct regarding confidential and proprietary information shall cover such matters.

Section 5. *Notional Advance.*

(a) In connection with the notional investment of any Participant Allocation (or portion thereof) in a Notional Plan Investment, an amount equal to a multiple (which may include zero) of such Participant Allocation (or portion thereof), as determined in the discretion of the Firm, may be added to the Participant's Account for purposes of enhancing the leverage of the applicable Participant Allocation in its notional investment in Notional Plan Investments. In accordance with any rules and procedures that the Firm establishes, an Eligible Person may be permitted to express a preference to receive a Notional Advance of a specified amount with respect to any Participant Allocation.

(b) Each Notional Advance shall accrue notional interest at the Morgan Stanley Applicable Rate (unless the Firm determines otherwise in accordance with any rules and procedures that the Firm establishes) during the period that such Notional Advance (or portion thereof) is deemed to be outstanding (*i.e.*, from the date that the Notional Advance (or portion thereof) is deemed to be notionally invested until and to the extent such Notional Advance (or portion thereof) is reduced by any Proceeds).

(c) Any Notional Advance shall be satisfied only through reductions to: (i) any notional interest previously accrued at the Participant Applicable Rate, or (ii) Proceeds in accordance with Section 10. No Participant shall be required to make any direct or out-of-pocket payment to the Firm in connection with any Notional Advance.

Section 6. *Establishment of Accounts.* The Firm shall establish an Account for each Participant, to which it shall credit such Participant's Participant

Allocations, any related Notional Advances, any notional interest accrued at the Participant Applicable Rate and any notional interest accrued at the Morgan Stanley Applicable Rate. Each Participant's Account shall reflect such Participant's notional share of each Notional Plan Investment.

Section 7. *Notional Plan Investments.*

(a) The Firm shall designate Notional Plan Investments for the benefit of the Plan, and shall establish a purchase price, for purposes of the Plan, equal to the fair value (as the Firm shall determine) of such Notional Plan Investments at the time of their designation. These Notional Plan Investments may differ for Participant Allocations granted in different Fiscal Years and for Special Awards. Participants shall participate in each Notional Plan Investment *pro rata* based on their respective Total Notional Investments (unless the Firm determines otherwise, in accordance with any rules and procedures that the Firm establishes). Each Participant's notional share of any Notional Plan Investment shall be deemed to have been notionally funded, first, by such Participant's applicable Participant Allocation and, to the extent such Participant Allocation has been fully notionally invested, the remaining Notional Plan Investment amount shall be deemed to have been notionally funded by any Notional Advance amount reflected in the Participant's Account with respect to such Participant Allocation (therefore, no notional interest shall begin to accrue until such time as a Notional Plan Investment is deemed to be funded by such Notional Advance (or portion thereof)).

(b) Notional Plan Investments in respect of any given Fiscal Year or any Special Awards shall be indicated on the Executive Compensation Department website or through other means that the Firm shall determine and communicate to Participants from time to time. The Firm may provide a Participant with a description of the related reference investments and their historical returns; *however*, the Firm is not responsible for actions, statements or performance of the Notional Plan Investments.

(c) The Firm may choose Notional Plan Investments based on a variety of factors, which may include the Firm's own business interests and its relations with such reference investments or parties affiliated with such referenced funds. By participating in the Plan, each Participant shall be deemed to acknowledge the existence of actual and potential conflicts of interest with the Firm and waive any claim with respect to the existence of any conflict of interest and the Firm may require each Participant to affirmatively make such acknowledgment and waiver.

(d) The performance of each Notional Plan Investment shall reflect all of the fees and costs of the related reference investment, including placement agent and brokerage fees, which such reference investment may pay to the Firm if the Firm provides such services to it. The Firm may also act as the investment advisor or provide other services to such reference investment and receive fees for providing these services. Fees paid by any reference investment will reduce the performance of such reference investment (and, accordingly, the performance of the Notional Plan Investment) and, therefore, will reduce the amount of the Firm's distribution obligations to Participants under the Plan.

(e) Nothing in the Descriptive Materials shall be construed to confer on a Participant the right to continue to have any particular Notional Plan Investment available for purposes of measuring the value of the Participant's Total Notional Investment.

(f) The value of a Participant's Total Notional Investment is subject to risk at all times based upon the performance of the Notional Plan Investments. If the value of the Notional Plan Investments decreases in the future, then the value of a Participant's Total Notional Investment may be lower than a Participant's applicable Participant Allocation. Additionally, if the value of the Notional Plan Investments decreases in the future and proves to be less than the sum of the unreduced invested Notional Advance, accrued and unreduced notional interest, accrued and unreduced Administration Fee and any Notional Advance committed but not yet notionally invested, a Participant will not be entitled to receive any of his or her applicable Participant Allocation with respect to such Total Notional Investment. Although a Participant will not be an investor in any reference investments underlying the Notional Plan Investments, a Participant's Total Notional Investment will be determined by referencing the gains and losses attributable to the performance of such Notional Plan Investments. In effect, the Firm is merely targeting the return and liquidity on such Notional Plan Investments and to the extent that the Firm incurs any costs in connection therewith or in connection with the administration of the Plan, it has the right to adjust the return on a Participant's Notional Plan Investments to reflect these costs. Any distribution or other payment under the Plan is also subject to the risks associated with the Participant's status as an unsecured general creditor of Morgan Stanley as described in Section 16(c).

Section 8. *Fees.*

(a) Unless otherwise determined by the Administrator the Firm shall reduce each Participant's Account by a notional administration fee (the "**Administration Fee**") in an amount that it determines is fair and appropriate. Any Administration Fee shall apply to all Participants in the same manner and shall be communicated to Participants in advance of any decision by Eligible Persons to allocate their long-term incentive mix.

(b) The Administration Fee, which shall be applied against each Participant's Account balance, shall accrue periodically in arrears (but shall not accrue any notional interest) and shall reduce the Participant's share of Proceeds as described in the distribution formula set forth below in Section 10.

(c) The Administration Fee shall be satisfied only through reductions to: (i) a Participant's notional interest previously accrued at the Participant

Applicable Rate, or (ii) a Participant's share of any Proceeds in accordance with Section 10. No Participant shall be required to make any direct or out-of-pocket payment to the Firm in connection with a Total Notional Investment.

(d) The Administration Fees are separate from any fees applicable to the Notional Plan Investments and the related reference investments which, without limiting the generality of Section 7(d), are reflected in the net returns credited to a Participant's Account.

Section 9. *Vesting.*

(a) Terms and conditions relating to the vesting of a Participant's Plan Interest (including any consequences of a termination of such Participant's employment) shall be set forth in such Participant's Award Certificate. Such terms and conditions with respect to any Participant in respect of any Fiscal Year Award shall be substantially similar to analogous terms and conditions set forth in the annual year-end equity compensation awards granted to such Participant in respect of such Fiscal Year.

(b) The Firm may accelerate the vesting of a Participant's Plan Interest and may, in its sole discretion, determine other circumstances under which a Participant's Plan Interest shall vest. Nothing in the Plan or in any Award Certificate shall entitle a Participant to request or receive any distribution or other payment upon the vesting of all or any portion of such Participant's Plan Interest.

(c) Even if a Participant holds a Plan Interest, whether or not fully vested, it may be canceled without any consideration upon the occurrence of a Cancellation Event prior to the Earliest Distribution Date. Upon such occurrence, the Participant shall have no further interest in or entitlement under the Plan, including no right or entitlement to any Participant Allocation.

Section 10. *Distributions.*

(a) <u>Closed-End Investments – Multiple Distribution Dates</u>. If a Participant's Award Certificate specifies multiple Closed-End Distribution Dates, this Section 10(a) shall apply to such Participant's applicable Total Notional Investment:

(i) With respect to any Proceeds in respect of a Closed-End Investment on or prior to the Earliest Distribution Date of a vested Plan Interest, the share of such Proceeds attributable to the Total Notional Investment with respect to such Plan Interest shall immediately be reduced by the sum of (A) the applicable, previously unreduced invested Notional Advance (plus accrued and previously unreduced notional interest thereon), (B) any applicable, accrued and previously unreduced Administration Fee and (C) any committed but not yet notionally invested Notional Advance (such sum, the "**Applicable Reduction Amount**").

Any committed but not yet notionally invested Notional Advance will reduce the applicable Proceeds as determined in the discretion of the Firm prior to the date on which the Allocation Preferences become irrevocable and such Proceeds may be withheld in escrow, accruing notional interest at the Participant Applicable Rate. Any remaining Proceeds shall accrue notional interest at the Participant Applicable Rate from the date of the Realization of such Proceeds until such Earliest Distribution Date (unless the Firm determines otherwise in accordance with any rules and procedures that the Firm establishes). The Applicable Reduction Amount shall reduce the portion of subsequent Proceeds attributable to such remaining Total Notional Investment (including, if applicable, Proceeds in respect of a Closed-End Investment Realized after such Earliest Distribution Date and/or Proceeds in respect of an Open-End Investment). Such remaining Proceeds shall be aggregated and distributed to such Participant on the applicable Earliest Distribution Date.

(ii) With respect to any Proceeds in respect of a Closed-End Investment Realized after the Earliest Distribution Date of a vested Plan Interest, but on or prior to the Subsequent Closed-End Distribution Date of such Plan Interest, the share of such Proceeds attributable to the remaining Total Notional Investment with respect to such Plan Interest, to the extent of such Realizations, shall be reduced and aggregated and distributed on such Subsequent Closed-End Distribution Date in accordance with the method described in Section 10(a)(i). The share of Proceeds attributable to the remaining Total Notional Investment with respect to such Plan Interest in respect of a Closed-End Investment Realized after such Subsequent Closed-End Distribution Date and on or prior to the next Subsequent Closed-End Distribution Date shall be reduced and aggregated and distributed on such next Subsequent Closed-End Distribution Date.

(iii) If the last Subsequent Closed-End Distribution Date of a vested Plan Interest is such Plan Interest's Final Distribution Date, then the Firm shall distribute to each Participant an amount equal to the sum of (i) the share of any undistributed Proceeds attributable to any remaining Total Notional Investment with respect to such Plan Interest, subject to any reductions, and (ii) such Plan Termination Value with respect to such Plan Interest that relates to any then un-Realized Notional Plan Investments in accordance with the method described in Section 10(a)(i) on such Final Distribution Date.

(b) Closed-End Investments – Single Distribution Date. If a Participant's Award Certificate specifies a single Closed-End Distribution Date, this Section 10(b) shall apply to such Participant's applicable Total Notional Investment:

(i) Proceeds in respect of any Closed-End Investment, if any, will be distributed on or as soon as administratively practicable after the single Closed-End Distribution Date (reduced by the Applicable Reduction Amount in accordance with the method described in Section 10(a)(i)). In addition, Morgan Stanley will distribute on such Closed-End Distribution Date, or as soon as administratively practicable thereafter, any remaining Plan Termination Value with respect to any then un-Realized Closed-End Investments (these amounts shall be reduced by the Applicable Reduction Amount in accordance with the method described in Section 10(a)(i)).

(ii) With respect to Realizations which occur prior to the single Closed-End Distribution Date, the Proceeds, if any, from such Realizations may be allocated to a set of alternative notional investments within a Participant's Account until the Closed-End Distribution Date. Such an alternative notional investment menu will be provided by the Firm and communicated to the Participant prior to the Earliest Distribution Date.

(c) Open-End Investments.

(i) With respect to any Proceeds in respect of an Open-End Investment, a Plan Interest's previously designated percentage share thereof shall accrue notional interest at the Participant Applicable Rate from the date of the Realization of such Proceeds until the Earliest Distribution Date relating to such Plan Interest. On such Earliest Distribution Date, (A) the previously designated percentage share of such Proceeds relating to such Plan Interest (and any accrued notional interest thereon) shall be reduced by the Applicable Reduction Amount in accordance with the method described in Section 10(a)(i), and (B) after such reduction, the previously designated percentage share of such Proceeds relating to such Plan Interest, if any, shall be distributed to the applicable Participant.

(ii) With respect to any Proceeds in respect of an Open-End Investment Realized after the Earliest Distribution Date relating to a Plan Interest, but on or prior to the next Subsequent Open-End Distribution Date relating to such Plan Interest, the previously designated percentage share thereof with respect to such Plan Interest shall accrue notional interest at the Participant Applicable Rate from the date of the Realization relating to such Proceeds until such next Subsequent Open-End Distribution Date. On such Subsequent Open-End Distribution Date, (A) the previously designated percentage share of such Proceeds (and any accrued notional interest thereon) relating to such Plan Interest will be reduced by the Applicable Reduction Amount, in accordance with the method described in Section 10(a)(i), and (B) after such reduction, such previously designated percentage share of such Proceeds relating to such Plan Interest, if any, will be distributed to the applicable Participant.

(iii) Until there are no more Subsequent Open-End Distribution Dates, with respect to any Proceeds in respect of an Open-End Investment Realized after the most recent Subsequent Open-End Distribution Date relating to a Plan Interest, but on or prior to the next Subsequent Open-End Distribution Date relating to such Plan Interest, the previously designated percentage share thereof relating to such Plan Interest will accrue notional interest at the Participant Applicable Rate from the date of the Realization relating to such Proceeds until such next Subsequent Open-End Distribution Date. On such Subsequent Open-End Distribution Date, (A) the previously designated percentage share of such Proceeds (and any accrued notional interest thereon) relating to such Plan Interest will be reduced by the Applicable Reduction Amount, in accordance with the method described in Section 10(a)(i), and (B) after such reduction, the previously designated percentage share of such Proceeds relating to such Plan Interest, if any, will be distributed to the applicable Participant.

(d) Distributions in Connection with a Termination of Employment. Terms and conditions relating to any distribution of a Participant's vested Plan Interest in connection with a termination of such Participant's employment shall be set forth in such Participant's applicable Award Certificate. Such terms and conditions with respect to any Fiscal Year Award shall be consistent with analogous terms and conditions set forth in the annual year-end equity compensation awards granted to such Participant in respect of such Fiscal Year.

(e) Distributions in Connection with a Plan Termination. Upon a termination of the Plan, subject to any Cancellation Event, the Firm shall distribute to each Participant an amount equal to the sum of such Participant's Plan Termination Values (with notional interest accruing thereon at the Participant Applicable Rate from the date of such termination until the date of distribution) in accordance with the method described in Section 10(a)(i) on the applicable Distribution Date.

Section 11. *Distributions and Other Payments Generally.*

(a) References in the Plan to distributions or other payments on a given date (including any Distribution Date) shall mean on such date or as soon thereafter as administratively practicable; *provided* that such distributions or other payments shall be made prior to December 31 of the calendar year in which the applicable Distribution Date or other payment date occurs or, if later, no more than 21/2 months after such Distribution Date or other payment date. The Proceeds relating to a Realization (or partial Realization) with respect to a Notional Plan Investment (after the reduction of such Proceeds pursuant to Section 10, as applicable) shall accrue interest at the Participant Applicable Rate from the date of the applicable Distribution Date to the actual date of distribution permitted by this Section 11(a).

(b) The Firm shall not accelerate distributions or other payments under the Plan, except to the extent accelerating distributions or other payments under the Plan is not prohibited by Section 409A and would not result in such Eligible Person being required to recognize income for United States federal income tax purposes prior to the relevant Distribution Date or in an Eligible Person incurring interest or additional tax under Section 409A.

(c) Notwithstanding any provision of the Plan or in the Award Certificate to the contrary, if the Firm considers a Participant to be one of its "specified employees" under Section 409A at the time of termination of such Participant's employment, any distribution or other payment of any deferred amounts shall commence on the date that is six months after such termination of employment.

(d) Notwithstanding the other provisions of the Plan or in any Award Certificate, distributions or other payments under the Plan shall be deferred with respect to a Participant if, at the time scheduled for such distribution or payment (whether on a Distribution Date or at some other time), Morgan Stanley considers such Participant to be one of its executive officers and such Participant's compensation may not be fully deductible by virtue of Section 162(m) of the Code. This deferral shall continue until the termination of such Participant's employment with the Firm, and the Firm shall make any distribution or other payment in respect of such Participant's vested Plan Interest as soon thereafter as administratively practicable; *provided* that if Morgan Stanley considers such Participant to be one of its "specified employees" under Section 409A at the time of termination of such Participant's employment with the Firm, such deferral shall continue until the date that is six months after such termination of employment, and the Firm shall make any distribution or other payment in respect of such Participant's vested Plan Interest as soon thereafter as administratively practicable; and *provided, further,* that in the event of such Participant's death or a corporate event relating to the ownership of Morgan Stanley, such distribution or payment shall be made in accordance with such Participant's Award Certificate.

(e) Unless otherwise set forth in the International Supplement, all distributions or other payments under the Plan shall be made in United States dollars or the Participant's local currency.

(f) The Firm may, in its sole discretion and to the maximum extent permissible under applicable Legal Requirements, withhold from or offset against any distribution or other payment to which a Participant may be entitled under the Plan an amount sufficient to satisfy any obligation owed by such Participant to the Firm.

Section 12. *Transferability.*

(a) No Participant may transfer (other than by will or by the laws of descent and distribution), pledge, hypothecate or otherwise dispose of or encumber such Participant's Total Notional Investment.

(b) During a Participant's lifetime, the Firm shall make any distribution or other payment in respect of such Participant's Plan Interest only to such Participant. A Participant may designate in writing on a beneficiary designation form, in accordance with procedures established by the Executive Compensation Department, a beneficiary or beneficiaries (including the Participant's estate) to receive all or part of the amounts that the Firm may be obligated to pay or distribute in respect of such Participant's Plan Interest in the event of such Participant's death. A Participant may replace or revoke a designation of a beneficiary at any time by filing a new beneficiary designation form.

Section 13. *Withholding or Other Deductions.* The Firm may withhold or otherwise deduct from any amounts distributable or otherwise payable under the Plan any such taxes or other amounts as may be required to be withheld or otherwise deducted pursuant to applicable Legal Requirements.

Section 14. *Special Awards.* In the sole discretion of the Firm, an Eligible Employee may be eligible to receive a Special Award. Upon the grant of such Special Award, such Eligible Employee shall be treated as a Participant for all purposes of the Plan. Notwithstanding anything to the contrary in the Plan, terms and conditions relating to such Participant's participation in the Plan may differ from the analogous terms and conditions set forth in the Plan, in which case such terms and conditions shall be set forth in such Participant's Award Certificate.

Section 15. *Termination and Amendment.*

(a) The Firm may terminate the Plan at any time in its sole discretion, subject to Section 10(e).

(b) The Firm may also alter, amend or modify the Plan, any Award Certificate or the International Supplement at any time in its sole discretion. These amendments may include changes that the Firm considers necessary or advisable as a result of changes in any, or the adoption or interpretation of any new, Legal Requirement. The Firm may not amend or modify the Plan, any Award Certificate or the International Supplement in a manner that would materially impair a Participant's participation in the Plan without the Participant's consent; *provided*, *however*, that the Firm may, without a Participant's consent alter, amend or modify the Plan, any Award Certificate or the International Supplement in any manner that the Firm considers necessary or advisable to comply with any Legal Requirement (including Section 409A) and to ensure that no Participant would be required to recognize income for United States federal income tax purposes prior to the relevant Distribution Date or would result in a Participant incurring interest or additional tax under Section 409A. No such action shall give rise to a claim of constructive termination on the part of such Participant. Any amendment or waiver of a provision of the Plan, any Award Certificate or the International Supplement (other than any amendment or waiver applicable to all Participants, or similarly situated Participants, generally), which amendment or waiver operates in a Participant's favor or confers a benefit on the Participant, must be in writing and signed by the Global Director of Human Resources or the Chief Administrative Officer (or if such positions no longer exist, by the holder of an equivalent position) to be effective. The Firm shall notify Participants of any amendment to the Plan, any Award Certificate or the International Supplement that is material, and shall notify affected Participants of any amendment that affects such Participants' rights.

Section 16. *Miscellaneous.*

(a) The headings of sections herein are included solely for the convenience of reference and shall not affect the meaning of any of the provisions of the Plan.

(b) THE PLAN AND ALL RIGHTS UNDER THE PLAN (INCLUDING UNDER ANY AWARD CERTIFICATE OR THE INTERNATIONAL SUPPLEMENT) SHALL BE CONSTRUED IN ACCORDANCE WITH AND GOVERNED BY THE LAWS OF THE STATE OF NEW YORK, WITHOUT REGARD TO ANY CONFLICTS IN CHOICE OF LAW, RULE OR PRINCIPLE THAT MIGHT OTHERWISE REFER THE INTERPRETATION OF THE PLAN ON ANY SUCH RIGHT TO THE SUBSTANTIVE LAW OF ANOTHER JURISDICTION. THE COURTS OF NEW YORK SHALL HAVE EXCLUSIVE JURISDICTION OVER THE PLAN AND ANY DISPUTE ARISING IN CONNECTION WITH THE PLAN, A PARTICIPANT'S PARTICIPATION IN THE PLAN OR RIGHTS UNDER THE PLAN.

(c) Except as set forth in the International Supplement, neither the Plan, any Award Certificate, the International Supplement nor the Descriptive Materials shall create or be construed to create a trust with respect to the Plan nor create or be construed to create a separate fund of any kind or a fiduciary relationship between the Firm, a Participant or any other person nor create or be construed to create a segregation by the Firm of assets to fund the Plan. To the extent any Participant has a right to receive distributions or other payments from the Firm pursuant to the Plan, such right shall be no greater than the right of any unsecured general creditor of the Firm.

(d) The Firm has no obligation to invest amounts corresponding to a Participant's Participant Allocation or Notional Advance and/or any Proceeds with respect to Notional Plan Investments. If the Firm invests amounts corresponding to a Participant's Participant Allocation or Notional Advance in any Notional Plan Investment, such investment shall not confer on such Participant any right or interest in any such Notional Plan Investment. The Participant shall have no ownership or other interest in any financial or other instrument or arrangement that the Firm may acquire or enter into to hedge its obligations under the Plan.

(e) A Participant's participation in the Plan shall be conditioned on the Firm making any filings and the Firm's receipt of any consents or authorizations required to comply with, or required to be obtained under, applicable Legal Requirements. To the extent necessary to comply with the local Legal Requirements of any jurisdiction in which the Firm implements the Plan, the Firm may supplement the Plan and/or the Award Certificate with a supplement (the "**International Supplement**"), which shall set forth certain terms and conditions applicable to such implementation in such jurisdiction. If there is a conflict between the provisions of the Plan and the provisions contained in the International Supplement on an issue pertinent to such jurisdiction, then the provisions of such International Supplement shall govern.

(f) Neither the Plan, any Award Certificate, the International Supplement, the Descriptive Materials nor any interpretation, determination or other action taken or omitted to be taken pursuant to the Plan shall be construed as guaranteeing a Participant's employment, a discretionary bonus or any particular level of bonus, compensation or benefits, as giving a Participant any right to continued employment, during any period, nor shall they be construed as giving a Participant any right to be reemployed by the Firm following any termination of employment. The Firm reserves the right not to make available any plan similar to the Plan (in whole or in part), nor to permit any future participation after Allocations are made with respect to Above Base Compensation in respect of any given Fiscal Year or after a Special Award is granted.

(g) If any provision of the Plan or any Award Certificate is or becomes or is deemed to be invalid, illegal, or unenforceable in any jurisdiction or as to any Participant, or would disqualify the Plan or such Award Certificate under any Legal Requirement, such provision shall be construed or deemed amended to conform to any such Legal Requirement, or if it cannot be construed or deemed amended without materially altering the intent of the Plan or such Award Certificate, then such provision shall be stricken as to such jurisdiction or as to such Participant, and the remainder of the Plan or such Award Certificate shall remain in full force and effect.

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EXHIBIT 10.2

MORGAN STANLEY
DIRECTORS' EQUITY CAPITAL ACCUMULATION PLAN
(as amended through March 19, 2007)

Section 1. Purpose

Morgan Stanley, a Delaware corporation (the "*Company*"), hereby adopts the Morgan Stanley Directors' Equity Capital Accumulation Plan (the "*Plan*"). The purpose of the Plan is to promote the long-term growth and financial success of the Company by attracting, motivating and retaining non-employee directors of outstanding ability and assisting the Company in promoting a greater identity of interest between the Company's non-employee directors and its stockholders.

Capitalized terms used herein without definition have the meanings ascribed thereto in Section 22.

Section 2. Eligibility

Only directors of the Company who are not employees of the Company or any affiliate of the Company (the "*Eligible Directors*") shall participate in the Plan.

Section 3. Plan Operation

(a) Administration. Other than as provided in Section 5(c)(v), the Plan requires no discretionary action by any administrative body with regard to any transaction under the Plan. To the extent, if any, that questions of administration arise, these shall be resolved by the Board. The Board may, in its discretion, delegate to the Chief Financial Officer, the Chief Legal Officer, the Secretary of the Company or to one or more officers of the Company any or all authority and responsibility to act pursuant to the Plan. All references to the "Plan Administrators" in the Plan shall refer to the Board, or the Chief Financial Officer, the Chief Legal Officer, the Secretary or to one or more officers of the Company if the Board has delegated its authority pursuant to this Section 3(a). The determination of the Plan Administrators on all matters within their authority relating to the Plan shall be conclusive.

(b) No Liability. The Plan Administrators shall not be liable for any action or determination made in good faith with respect to the Plan or any award hereunder, and the Company shall indemnify and hold harmless the Plan Administrators from all losses and expenses (including reasonable attorneys' fees) arising from the assertion or judicial determination of any such liability.

Section 4. Shares of Stock Subject to the Plan

(a) Stock. Awards under the Plan shall relate to shares of Stock.

(b) Shares Available for Awards. Subject to Section 4(c) (relating to adjustments upon changes in capitalization), as of any date, the total number of shares of Stock with respect to which awards may be granted under the Plan shall be equal to the excess (if any) of (i)

1,700,000 shares over (ii) the sum of (a) the number of shares subject to outstanding awards granted under the Plan and (b) the number of shares previously issued pursuant to the Plan. In accordance with (and without limitation upon) the preceding sentence, shares of Stock covered by awards granted under the Plan that are canceled or expire unexercised shall again become available for awards under the Plan. Shares of Stock that shall be issuable pursuant to the awards granted under the Plan shall be authorized and unissued shares, treasury shares or shares of Stock purchased by, or on behalf of, the Company in open-market transactions.

(c) Adjustments. In the event of any merger, reorganization, recapitalization, consolidation, sale or other distribution of substantially all of the assets of the Company, any stock dividend, split, spin-off, split-up, split-off, distribution of cash, securities or other property by the Company, or other change in the Company's corporate structure affecting the Stock, then the following shall be automatically adjusted in order to prevent dilution or enlargement of the benefits or potential benefits intended to be awarded under the Plan:

(i) the aggregate number of shares of Stock reserved for issuance under the Plan,

(ii) the number of shares of Stock subject to outstanding awards,

(iii) the number of Stock Units credited pursuant to Sections 6(a) and 7(a) of the Plan,

(iv) the per share purchase price of Stock subject to any stock options granted pursuant to the Plan, and

(v) the number of shares to be granted as Director Stock pursuant to Section 6(a) or to be granted pursuant to any other automatic awards that may be provided for under the Plan in the future.

(d) Types of Award. The Company's stockholders originally approved the Plan on April 19, 1996, and approved amendments to the Plan on March 19, 2002. The types of award authorized by the stockholders under the Plan are Director Stock, Stock Units, shares of Stock awarded at an Eligible Director's election pursuant to Section 8 and stock options.

Section 5. Stock Options

(a) Effective as of February 8, 2005 (the "*Transition Date*"), no additional stock options will be awarded under the Plan.

(b) Section 5(a) shall not impair the rights of any person in any stock option that was awarded under the Plan prior to the Transition Date. All such stock options shall remain subject to the terms and conditions applicable thereto.

(c) The following terms and conditions apply to stock options issued under the Plan, including without limitation all stock options issued prior to the Transition Date:

(i) Nontransferability. No stock option granted pursuant to the Plan shall be sold, assigned or otherwise transferred by an Eligible Director other than by will or the laws of descent or distribution and any such stock option may be exercised during the Eligible Director's lifetime only by such Eligible Director.

(ii) Limitation on Exercise. No stock option granted pursuant to this Plan may be exercised for a period of six (6) months from the date such stock option was granted.

(iii) Effect of Termination.

(A) If an Eligible Director's service as a director of the Company terminates for a reason other than for Cause, then any stock option granted to such Eligible Director shall remain exercisable following the date of such Eligible Director's termination of service in accordance with the following provisions:

(a) Disability, Normal Retirement or Death. If service terminates by reason of Disability, Normal Retirement or death, until the expiration date of the stock option.

(b) Other. If service terminates for any other reason (except for Cause), until the earlier of 90 days after the termination date and the expiration date of the stock option.

(B) If an Eligible Director is terminated for Cause, all stock options granted under the Plan to such Eligible Director shall be canceled and shall no longer be exercisable, effective on the date of such Eligible Director's termination for Cause.

(iv) Expiration Date of Stock Options. All stock options granted under the Plan shall expire on the tenth anniversary of the date on which they are granted.

(v) Extension of Exercisability. Notwithstanding any other provision hereof, the Board shall have the authority, in its discretion, to amend any outstanding stock option granted pursuant to the Plan to extend the exercisability thereof; ***provided, however***, that no such amendment shall cause such stock option to remain exercisable beyond its original expiration date.

(d) Notwithstanding Section 5(a), stock options remain one of the types of award that the stockholders of the Company have authorized for the Plan, and Section 5(a) shall not impair the authority of the Board under Section 13 to amend the Plan in the future to provide for awards of stock options without obtaining additional stockholder approval.

Section 6. Initial and Annual Awards of Director Stock and Stock Units

(a) Awards Granted.

(i) Initial Awards. On the first day of the calendar month following the month in which any person (other than a person who is already an Eligible Director) becomes an Eligible Director, otherwise than by reason of being elected to the Board at an Annual Meeting, (A) such Eligible Director shall be entitled to receive a number of shares of Director Stock equal to the number obtained by dividing $125,000 by the Fair Market Value of a share of Stock on such day and (B) the Company shall credit an equal number of Initial Stock Units, representing the other half of the initial equity award, to such Eligible Director's Mandatory Stock Unit Account; ***provided, however,*** that if such a person is elected, appointed or otherwise becomes an Eligible Director less than 60 days prior to the Annual Meeting in any year, then such Eligible Director shall receive no shares of Director Stock and no Initial Stock Units shall be credited to such Eligible Director's Mandatory Stock Unit Account pursuant to this Section 6(a)(i).

(ii) Subsequent Awards. As of the date of each Annual Meeting, (A) each Eligible Director, including, without limitation, any Eligible Director who becomes a member of the Board by reason of being elected to the Board at such Annual Meeting, shall be entitled to receive a number of shares of Director Stock equal to the number obtained by dividing $125,000 by the Fair Market Value of a share of Stock on such day and (B) the Company shall credit an equal number of Annual Stock Units, representing the other half of the annual equity award, to the Mandatory Stock Unit Account of each Eligible Director; ***provided, however,*** that such Eligible Director shall continue to serve as a director of the Company after such Annual Meeting.

(b) Limitation on Transfer. Director Stock may not be sold, transferred, pledged, assigned or otherwise conveyed by an Eligible Director for a period of six (6) months from the date such Stock is awarded. Neither Annual Stock Units nor Initial Stock Units may be sold, transferred, pledged, assigned or otherwise conveyed by an Eligible Director until distributed in accordance with Section 7 or Section 9.

(c) Deferral of Awards. Annual Stock Units and Initial Stock Units credited to the Mandatory Stock Unit Account of each Eligible Director shall be deferred in accordance with Section 7(b). An Eligible Director may elect to defer the receipt of all or a portion of the Director Stock by making an election pursuant to Section 7(a), in which case there shall be credited to the Eligible Director's Elective Stock Unit Account a number of Elective Stock Units equal to the number of shares of Director Stock being deferred.

Section 7. Deferral Elections and Distributions

(a) Elective Stock Unit Account and Cash Account Deferral Elections. Each Eligible Director may make a Deferral Election to defer receipt of (i) all or part of any or all of such Eligible Director's Retainers or (ii) any or all shares of Director Stock. An Eligible Director may make a Deferral Election with respect to all or part of any or all Retainers or shares of Director Stock by submitting a Deferral Election Form to the Secretary, indicating: (i) the Deferred Amount or a percentage of such Retainer or shares of Director Stock to be deferred; (ii) the Distribution Commencement Date, in accordance with Section 7(c); (iii) whether distributions are to be made in a lump sum, installments or a combination thereof, in accordance with Section 7(e); (iv) the percentage or amount of (x) Retainers to be deferred and credited to a Cash Account or (y) Retainers and/or Director Stock to be deferred and credited to the Elective Stock Unit Account; and (v) from which Account each distribution is to be made on each Distribution Commencement Date. Deferral Election Forms must be submitted before the start of the fiscal year during which the Eligible Director will earn such Retainer or shares of Director Stock to be deferred; ***provided, however***, that in the case of an Eligible Director who is newly elected or appointed to the Board, such Eligible Director's Deferral Election Form relating to the Retainer or shares of Director Stock earned during the fiscal year of such election or appointment may be submitted within 30 days after the date of such election or appointment. In all cases, a Deferral Election Form shall be effective only with respect to such Retainers or shares of Director Stock that are earned after the Deferral Election is made. All Deferral Elections (including indications on the Deferral Election Form as to Distribution Commencement Date and form of distributions), once made, shall be irrevocable. Notwithstanding the foregoing, a Deferral Election may be superseded with respect to future deferrals of an Eligible Director's Retainers and grants of Director Stock by submitting a new Deferral Election Form to the Secretary, in which case such new Deferral Election shall be effective starting with the Retainer or shares of Director Stock earned in the fiscal year following the year in which such new Deferral Election Form is submitted. An Eligible Director may designate, in any Deferral Election Form, one or more beneficiaries to receive any distributions under the Plan upon the Eligible Director's death, and may change such designation at any time by submitting a new Deferral Election Form to the Secretary.

(i) Stock Unit Deferral. An Eligible Director may elect to have all or part of the Deferred Amount credited to an Elective Stock Unit Account in the form of Elective Stock Units. Credits to an Eligible Director's Elective Stock Unit Account will be made as follows:

(A) Deferral of Retainers. As of each Retainer Payment Date, the Company shall credit to the Elective Stock Unit Account an amount equal to any Deferred Amount resulting from an Eligible Director's deferral of all or part of such Eligible Director's Retainers. The number of Elective Stock Units credited to the Elective Stock Unit Account shall be the amount obtained by dividing (X) the Deferred Amount by (Y) the Fair Market Value of a share of Stock on such Retainer Payment Date.

(B) Deferral of Director Stock. An Eligible Director who defers the receipt of Director Stock shall have credited to the Elective Stock Unit Account a number of Elective Stock Units equal to the number of shares of Director Stock deferred. The credit will be made as of the date on which the Eligible Director becomes entitled to receive the Director Stock.

(ii) Cash Deferral. An Eligible Director may elect to have all or part of the Deferred Amount derived from his or her Retainers credited to a Cash Account.

The Deferred Amount allocated to the Cash Account shall be credited thereto on the date on which the Eligible Director becomes entitled to payment of such Deferred Amount. As of the last day of each fiscal quarter and the Eligible Director's Service Termination Date, the Eligible Director's Cash Account will be credited with an Interest Equivalent equal to (i) the Rate of Interest, multiplied by (ii) the Average Daily Cash Balance, multiplied by (iii) the number of days during the fiscal quarter or other period during which such Cash Account had a positive balance, divided by (iv) 365.

(b) Mandatory Stock Unit Account Deferral Elections. An Eligible Director may elect to defer receipt of Annual Stock Units and Initial Stock Units by submitting a Deferral Election Form to the Secretary indicating: (i) the Distribution Commencement Date for such Mandatory Stock Unit Account, in accordance with Section 7(d) and (ii) whether distributions are to be made in a lump sum, installments or a combination thereof, in accordance with Section 7(e). Deferral Election Forms must be submitted prior to the first day of the fiscal year during which the Eligible Director will earn the Annual Stock Units and Initial Stock Units to be deferred; ***provided, however***, that in the case of an Eligible Director who is newly elected or appointed to the Board, such Eligible Director's Deferral Election Form relating to the Annual Stock Units and/or Initial Stock Units earned during the fiscal year of such election or appointment may be submitted within 30 days after the date of such election or appointment. In all cases, a Deferral Election Form shall be effective only with respect to the Annual Stock Units and Initial Stock Units that are earned after the Deferral Election is made. All Deferral Elections with respect to any Annual Stock Units and Initial Stock Units, once made, shall be irrevocable. Notwithstanding the foregoing, a Deferral Election relating to Annual Stock Units may be superseded with respect to future deferrals of an Eligible Director's Annual Stock Units by submitting a new Deferral Election Form to the Secretary, in which case such new Deferral Election shall be effective starting with the Annual Stock Units earned in the fiscal year following the year in which such new Deferral Election Form is submitted. An Eligible Director may designate, in any Deferral Election Form, one or more beneficiaries to receive any distributions under the Plan upon the Eligible Director's death, and may change such designation at any time by submitting a new Deferral Election Form to the Secretary.

(c) Distribution Commencement Date for Elective Stock Unit Account and Cash Account. Each Eligible Director shall designate on the Deferral Election Form one of the following dates as a Distribution Commencement Date with respect to amounts credited to the Elective Stock Unit Account or Cash Account thereafter: (A) the date of such Eligible Director's death; (B) such Eligible Director's Service Termination Date; (C) the first day of a calendar month specified by such Eligible Director; or (D) the earliest to occur of (A), (B) or (C). If an Eligible Director fails to designate one of the foregoing alternatives as the Distribution Commencement Date for the Elective Stock Unit Account and Cash Account, the Eligible Director shall be deemed to have designated alternative (D). Unless a Deferral Election Form designates a different Distribution Commencement Date for the Eligible Director's Elective Stock Unit Account than for such Eligible Director's Cash Account, the Eligible Director shall be deemed to have selected the same Distribution Commencement Date for both Accounts. Notwithstanding any election made by an Eligible Director on any Deferral Election Form or any other provision of the Plan, in the event of such Eligible Director's death, all amounts credited to such Eligible Director's Elective Stock Unit Account and Cash Account will be paid in a lump sum to such Eligible Director's beneficiary (or if no beneficiary has been designated, to such Eligible Director's estate) as soon as administratively practicable following the date of such Eligible Director's death.

(d) Distribution Commencement Date for Mandatory Stock Unit Account. Notwithstanding any provision to the contrary in this Plan or any Deferral Election Form, no amounts credited to an Eligible Director's Mandatory Stock Unit Account shall be distributed prior to such Eligible Director's Service Termination Date. Each Eligible Director may designate on the Deferral Election Form for such Eligible Director's Mandatory Stock Unit Account one of the following dates as a Distribution Commencement Date with respect to amounts credited to the Mandatory Stock Unit Account: (A) the date of such Eligible Director's death; (B) such Eligible Director's Service Termination Date; or (C) the later to occur of (B) or first day of a calendar month specified by such Eligible Director. If an Eligible Director fails to designate one of the foregoing alternatives as the Distribution Commencement Date for the Mandatory Stock Unit Account, such Eligible Director shall be deemed to have designated alternative (B). Notwithstanding any election made by an Eligible Director on any Deferral Election Form or any other provision of the Plan, in the event of such Eligible Director's death, all amounts credited to such Eligible Director's Mandatory Stock Unit Account will be paid in a lump sum to such Eligible Director's beneficiary (or if no beneficiary has been designated, to such Eligible Director's estate) as soon as administratively practicable following the date of such Eligible Director's death.

(e) Distribution Method. An Eligible Director shall state on each Deferral Election Form whether distributions that are subject to such Deferral Election Form shall be made in (A) a lump sum, (B) no more than 120 monthly, 40 quarterly or 10 annual installments or (C) in part as provided in clause (A) and in part as provided in clause (B); ***provided, however,*** that any distributions following an Eligible Director's death shall be paid in a lump sum to such Eligible Director's beneficiary (or if no beneficiary has been designated, to such Eligible Director's estate) as soon as administratively practicable following the date of such Eligible Director's death. The amount to be distributed in any installment pursuant to a specific Deferral Election Form shall be determined by dividing the balance in the Cash Account or the number of Stock Units in the Mandatory Stock Unit Account or Elective Stock Unit Account, as the case may be, that are subject to such Deferral Election Form by the number of remaining installments. If an Eligible Director receives a distribution on an installment basis, undistributed Deferred Amounts shall remain subject to the provisions of this Section 7.

(f) Form of Distributions. All distributions from the Cash Account shall be paid in cash. Distributions made from the Elective Stock Unit Account and the Mandatory Stock Unit Account shall be for a number of whole shares of Stock equal to the number of whole Stock Units to be distributed and cash in lieu of any fractional share (determined by using the Fair Market Value of a share of Stock on the date on which such distributions are distributed).

(g) Dividend Equivalents. If there are Stock Units in an Eligible Director's Elective Stock Unit Account or Mandatory Stock Unit Account on a dividend record date with respect to the Company's Stock, the Elective Stock Unit Account and/or Mandatory Stock Unit Account, as applicable, shall be credited, on the dividend payment date for such dividend record date, with an additional number of Stock Units equal to (i) the cash dividend paid on one share of Stock, multiplied by (ii) the number of Stock Units in such Account on such dividend record date, divided by (iii) the Fair Market Value of a share of Stock on the dividend payment date.

(h) Deferral of Meeting Fees. As of the Transition Date, the Company does not pay Meeting Fees. In the event that the Company determines in the future to pay Meeting Fees to Eligible Directors, and in the case of Meeting Fees deferred prior to the Transition Date, the provision of this Section 7 relating to elective deferrals of Retainers and Director Stock, and the provisions of Section 8 relating to Stock Elections, shall apply to such Meeting Fees mutatis mutandis; ***provided*, *however***, that any Deferred Amount resulting from deferral of all or part of an Eligible Director's Meeting Fees (other than Meeting Fees for meetings of the Board or any committee thereof held on the date of an Annual Meeting) will initially be credited to the Cash Account as of the date on which the Eligible Director becomes entitled to payment of the Meeting Fees, shall thereafter be credited with Interest Equivalents as calculated under Section 7(a)(ii) (such Deferred Amount as increased by such Interest Equivalents being the "*Adjusted Deferred Amount*") and will thereafter be debited from the Cash Account and credited to the Eligible Director's Elective Stock Unit Account as of the date of the next Annual Meeting following the date of such meeting (or, if the Eligible Director's service on the Board terminates prior to the next Annual Meeting following the date of such meeting, as of the first business day following his or her Service Termination Date), with the number of Stock Units credited to the Elective Stock Unit Account being the amount obtained by dividing (i) the relevant Adjusted Deferred Amount by (ii) the Fair Market Value of a share of Stock on the date of such Annual Meeting or the Service Termination Date, as applicable.

Section 8. Election to Receive Stock

(a) Election. An Eligible Director may make a Stock Election to receive all or part of any or all of such Eligible Director's Retainers in shares of Stock by submitting a Stock Election Form to the Secretary indicating the Stock Amount. A Stock Election Form shall be effective only with respect to Retainers payable after the date on which the Secretary receives the Stock Election Form. Each Stock Election, once made, shall be irrevocable. Notwithstanding the foregoing, a Stock Election may be superseded with respect to future payments of an Eligible Director's Retainers by submitting a new Stock Election Form to the Secretary.

(b) Payment in Stock. As of each Retainer Payment Date, an Eligible Director who has made a Stock Election will receive, in lieu of the Retainer elected to be received in Stock, a whole number of shares of Stock (but not fractional shares) determined by dividing:

(i) the amount of the Retainer that is payable to the Eligible Director on the applicable Retainer Payment Date and is subject to a Stock Election; by

(ii) the Fair Market Value of a share of Stock on such Retainer Payment Date.

In no circumstances shall an Eligible Director be entitled to receive, or shall the Company have any obligation to issue to the Eligible Director, any fractional share of Stock. In lieu of any fractional share of Stock, the Eligible Director shall be entitled to receive, and the Company shall be obligated to pay to such Eligible Director, cash equal to the value of any fractional share of Stock (determined by using the Fair Market Value of a share of Stock on such Retainer Payment Date).

Section 9. Governmental Service

(a) Governmental Service Resignation. Notwithstanding any election made by an Eligible Director on any Deferral Form, if an Eligible Director resigns as a director of the Company as a result of accepting employment at a governmental department or agency, self-regulatory agency or other public service employer (a "Governmental Employer") (such resignation is referred to herein as a "Governmental Service Resignation"), then (i) provided that the Eligible Director provides the Company with satisfactory evidence demonstrating that as a result of such employment the divestiture of his or her continued interest in Company equity awards or continued ownership of Stock is reasonably necessary to avoid the violation of U.S. federal, state or local or non-U.S. ethics law or conflicts of interest law applicable to the Eligible Director at such Governmental Employer, all amounts credited to the Eligible Director's Elective Stock Unit Account and Mandatory Stock Unit Account will be distributed in a lump sum in accordance with Section 7(f), and all transfer restrictions will lift on shares of Director Stock held by the Eligible Director, on or as soon as administratively practicable after the date of such Governmental Service Resignation, and (ii) provided that the Eligible Director provides the Company with satisfactory evidence demonstrating that as a result of such employment the divestiture of the Eligible Director's continued interest in his or her Cash Account is reasonably necessary to avoid the violation of U.S. federal, state or local or non-U.S. ethics law or conflicts of interest law applicable to the Eligible Director at such Governmental Employer, all amounts credited to the Eligible Director's Cash Account will be distributed in a lump sum on or as soon as administratively practicable after the date of such Governmental Service Resignation.

(b) Governmental Service following Termination of Service. Notwithstanding any election made by an Eligible Director on any Deferral Form, if, following the termination of an Eligible Director's service as a director of the Company, the Eligible Director accepts employment with a Governmental Employer, then (i) provided that the Eligible Director provides the Company with satisfactory evidence demonstrating that as a result of such employment the divestiture of the Eligible Director's continued interest in Company equity awards or continued ownership of Stock is reasonably necessary to avoid the violation of U.S. federal, state or local or non-U.S. ethics law or conflicts of interest law applicable to the Eligible Director at such Governmental Employer, all amounts credited to the Eligible Director's Elective Stock Unit Account and Mandatory Stock Unit Account will be distributed in a lump sum in accordance with Section 7(f) on or as soon as administratively practicable after, and all transfer restrictions will lift on shares of Director Stock held by the Director on, the date on which the Eligible Director provides the Company with such satisfactory evidence, and (ii) provided that the Eligible Director provides the Company with satisfactory evidence demonstrating that as a result of such employment the divestiture of the Eligible Director's continued interest in his or her Cash Account is reasonably necessary to avoid the violation of U.S. federal, state or local or non-U.S. ethics law or conflicts of interest law applicable to the Eligible Director at such Governmental Employer, all amounts credited to the Eligible Director's Cash Account will be distributed in a lump sum on or as soon as administratively practicable after the date on which the Eligible Director provides the Company with such satisfactory evidence.

Section 10. Fair Market Value

"*Fair Market Value*" shall mean, with respect to each share of Stock for any day:

(a) if the Stock is listed for trading on the New York Stock Exchange, (i) the volume weighted average price of the Stock, reflecting composite trading between 9:30 a.m. and 4:00 p.m. (Eastern time) on such date, as reported by the Bloomberg Professional Service on the MS Equity Volume at Price page under the "VWAP" field, at 4:00 p.m. on such date, rounded up to the nearest whole cent, or, if not so reported, as reported by another third party source to which the Company has access on such date, or if no such reported sale of the Stock shall have occurred on such date, on the most recent date on which such a reported sale occurred; or (ii) if the volume weighted average price is not available from a third party source to which the Company has access on such date or on the most recent date on which a reported sale occurred, "Fair Market Value" will be the average of the high and low prices of the Stock as reported on the Consolidated Transaction Reporting System on such date, rounded up to the nearest whole cent, or if no such reported sale of the Stock shall have occurred on such date, on the most recent date on which such a reported sale occurred; or

(b) if the Stock is not so listed, but is listed on another national securities exchange, the closing price, regular way, of the Stock on such exchange, rounded up to the nearest whole cent, on which the largest number of shares of Stock have been traded in the aggregate on the preceding twenty trading days, or, if no such reported sale of the Stock shall have occurred on such date on such exchange, on the most recent date on which such a reported sale occurred on such exchange, or

(c) if the Stock is not listed for trading on a national securities exchange, the average of the closing bid and asked prices as reported by the National Association of Securities Dealers, rounded up to the nearest whole cent, or, if no such prices shall have been so reported for such date, on the most recent date for which such prices were so reported.

Section 11. Issuance of Stock

(a) Restrictions on Transferability. All shares of Stock delivered under the Plan shall be subject to such stop-transfer orders and other restrictions as the Company may deem advisable or legally necessary under any laws, statutes, rules, regulations and other legal requirements, including, without limitation, those of any stock exchange upon which the Stock is then listed and any applicable federal, state or foreign securities law.

(b) Compliance with Laws. Anything to the contrary herein notwithstanding, the Company shall not be required to issue any shares of Stock under the Plan if, in the opinion of legal counsel to the Company, the issuance and delivery of such shares would constitute a violation by the Eligible Director or the Company of any applicable law or regulation of any governmental authority, including, without limitation, federal and state securities laws, or the regulations of any stock exchanges on which the Company's securities may then be listed.

Section 12. Withholding Taxes

The Company may require as a condition of delivery of any shares of Stock that the Eligible Director remit (i) in cash, (ii) by tendering (or attesting to the ownership of) shares of Stock that the Company determines will not result in unfavorable accounting treatment or (iii) by the Company withholding shares of Stock, an amount sufficient to satisfy all foreign, federal, state, local and other governmental withholding tax requirements relating thereto (if any) and any or all indebtedness or other obligation of the Eligible Director to the Company or any of its subsidiaries. Any shares tendered or withheld pursuant to this Section 12 will be valued at Fair Market Value on the relevant payment or exercise date, as applicable.

Section 13. Plan Amendments and Termination

The Board may suspend or terminate the Plan at any time, in whole or in part. Termination of the Plan shall not adversely affect the rights of Eligible Directors in Mandatory Stock Unit Accounts, Cash Accounts and Elective Stock Unit Accounts outstanding at the time of termination. Notwithstanding any termination of the Plan, distributions to Eligible Directors in respect of their Mandatory Stock Unit Accounts, Cash Accounts and Elective Stock Unit Accounts shall be made at the times and in the manner provided herein.

The Board may also alter, amend or modify the Plan at any time. These amendments may include (but are not limited to) changes that the Board considers necessary or advisable as a result of changes in, or the adoption or interpretation of, any law, regulation, ruling, judicial decision or accounting standards (collectively, "*Legal Requirements*"). The Board may not amend or modify the Plan in a manner that would materially impair an Eligible Director's rights in any Mandatory Stock Unit Account, Cash Account or Elective Stock Unit Account without the Eligible Director's consent; ***provided, however***, that the Board may, without an Eligible Director's consent, amend or modify the Plan in any manner that it considers necessary or advisable to comply with any Legal Requirement or to ensure that amounts credited to an Eligible Director's Mandatory Stock Unit Account, Cash Account or Elective Stock Unit Account are not subject to federal, state or local income tax prior to payment.

Notwithstanding the foregoing, if any provision of this Plan would, in the reasonable, good faith judgment of the Company, result in or likely result in the imposition on any Eligible Director or any other person of any tax, interest or penalty under Section 409A of the Internal Revenue Code of 1986, as amended, the Company may reform this Plan or any provision hereof, without the consent of any Eligible Director, in the manner that the Company reasonably and in good faith determines to be necessary or advisable to avoid the imposition of such tax, interest or penalty; ***provided, however,*** that any such reformation shall, to the maximum extent the Company reasonably and in good faith determines to be possible, retain the economic and tax benefits to the Eligible Directors hereunder while not materially increasing the cost to the Company of providing such benefits to the Eligible Directors.

Section 14. Listing, Registration and Legal Compliance

If the Plan Administrators shall at any time determine that any Consent (as hereinafter defined) is necessary or desirable as a condition of, or in connection with, the granting of any award under the Plan, the issuance or purchase of shares or other rights hereunder or the taking of any other action hereunder (each such action being hereinafter referred to as a "*Plan Action*"), then such Plan Action shall not be taken, in whole or in part, unless and until such Consent shall have been effected or obtained. The term "*Consent*" as used herein with respect to any Plan Action means (i) the listing, registrations or qualifications in respect thereof upon any securities exchange or under any foreign, federal, state or local law, rule or regulation, (ii) any and all consents, clearances and approvals in respect of a Plan Action by any governmental or other regulatory bodies, or (iii) any and all written agreements and representations by an Eligible Director with respect to the disposition of Stock or with respect to any other matter, which the Plan Administrators shall deem necessary or desirable in order to comply with the terms of any such listing, registration or qualification or to obtain an exemption from the requirement that any such listing, qualification or registration be made.

Section 15. Right Reserved

Nothing in the Plan shall confer upon any Eligible Director the right to continue as a director of the Company or affect any right that the Company or any Eligible Director may have to terminate the service of such Eligible Director.

Section 16. Rights as a Stockholder

Except as otherwise provided by the terms of any applicable Benefit Plan Trust, an Eligible Director shall not, by reason of any stock option, Director Stock, Stock Unit or Stock Amount, have any rights as a stockholder of the Company until Stock has been issued to such Eligible Director.

Section 17. Unfunded Plan

The Plan shall be unfunded and shall not create (or be construed to create) a trust or a separate fund or funds. The Plan shall not establish any fiduciary relationship between the Company and any Eligible Director or other person. To the extent any person holds any rights by virtue of a pending grant or deferral under the Plan, such rights shall be no greater than the rights of an unsecured general creditor of the Company. Notwithstanding the foregoing, the Company may (but shall not be obligated to) contribute shares of Stock corresponding to Stock Units to a Benefit Plan Trust, provided that the principal and income of any such Benefit Plan Trust shall be subject to the claims of general creditors of the Company. The Company may amend the terms of any Benefit Plan Trust as applicable to any one or more Eligible Directors in order to procure favorable tax treatment for such Eligible Director(s) or to comply with the laws applicable in any non-U.S. jurisdiction.

Section 18. Governing Law

The Plan is deemed adopted, made and delivered in New York and shall be governed by the laws of the State of New York applicable to agreements made and to be performed entirely within such state.

Section 19. Severability

If any part of the Plan is declared by any court or governmental authority to be unlawful or invalid, such unlawfulness or invalidity shall not invalidate any portion of the Plan not declared to be unlawful or invalid. Any Section or part of a Section so declared to be unlawful or invalid shall, if possible, be construed in a manner that will give effect to the terms of such Section or part of a Section to the fullest extent possible while remaining lawful and valid.

Section 20. Notices

All notices and other communications hereunder shall be given in writing and shall be deemed given when personally delivered against receipt or five days after having been mailed by registered or certified mail, postage prepaid, return receipt requested, addressed as follows: (a) if to the Company: Morgan Stanley, 1585 Broadway, New York, New York 10036, Attention: Corporate Secretary; and (b) if to an Eligible Director, at the Eligible Director's principal residential address last furnished to the Company. Either party may, by notice, change the address to which notice to such party is to be given.

Section 21. Section Headings

The Section headings contained herein are for the purposes of convenience only and are not intended to define or limit the contents of said Sections.

Section 22. Definitions

As used in the Plan, the following terms shall have the meanings indicated below:

"Account" means Cash Account, Elective Stock Unit Account or Mandatory Stock Unit Account, as applicable.

"*Adjusted Deferred Amount*" has the meaning set forth in Section 7(h).

"*Annual Meeting*" means an annual meeting of the Company's stockholders.

"*Annual Retainer*" means a cash retainer for services as a member of the Board.

"*Annual Stock Units*" means the Stock Units credited to any Eligible Director's Mandatory Stock Unit Account pursuant to Section 6(a)(ii)(B).

"*Average Daily Cash Balance*" means the sum of the daily balances for a Cash Account for any quarter or shorter period for which the calculation is made, divided by the number of days on which a positive balance existed in such Cash Account.

"*Benefit Plan Trust*" means any trust established by the Company under which Eligible Directors, or Eligible Directors and participants in designated employee benefit plans of the Company, constitute the principal beneficiaries.

"*Board*" means the board of directors of the Company.

"*Cash Account*" means a bookkeeping account to which Deferred Amounts are credited pursuant to Section 7(a)(ii).

"*Cause*" means, with respect to any Eligible Director, termination of service on the Board on account of any act of (A) fraud or intentional misrepresentation, or (B) embezzlement, misappropriation or conversion of assets or opportunities of the Company or any affiliate.

"*Committee Retainer*" means a cash retainer for services as a member of any committee of the Board.

"*Company*" has the meaning set forth in Section 1.

"Consent" has the meaning set forth in Section 14.

"*Deferred Amount*" means any amount, in dollars, of Retainers and/or Director Stock that an Eligible Director elects to defer, as indicated on the relevant Deferral Election Form.

"*Deferral Election*" means a deferral election by an Eligible Director made with respect to any Retainers, Director Stock, Initial Stock Units and/or Annual Stock Units.

"*Deferral Election Form*" means an election form submitted by an Eligible Director to the Secretary with respect to any Retainers, Director Stock, or Stock Units.

"*Director Stock*" means shares of Stock awarded to an Eligible Director for service on the Board as provided in Section 6 (a).

"*Disability*" means a "permanent and total disability" as defined in Section 22(e)(3) of the Internal Revenue Code of 1986, as amended.

"*Distribution Commencement Date*" means the date that an Eligible Director elects as the date on which distribution of Deferred Amounts should begin, as indicated on the relevant Deferral Election Form.

"*Elective Stock Unit Account*" means a bookkeeping account to which Deferred Amounts are credited pursuant to Section 7(a).

"*Elective Stock Units*" means Stock Units that are elected pursuant to Section 7(a) to be received in lieu of Retainers and/or Director Stock.

"*Eligible Directors*" has the meaning set forth in Section 2.

"*Fair Market Value*" has the meaning set forth in Section 10.

"*Initial Stock Units*" means the Stock Units credited to any Eligible Director's Mandatory Stock Unit Account pursuant to Section 6(a)(i)(B).

"*Interest Equivalent*" means an additional amount to be credited to a Cash Account calculated in accordance with Section 7 (a)(ii).

"*Lead Director Retainer*" means a cash retainer for services as the lead director of the Board.

"*Mandatory Stock Unit Account*" means a bookkeeping account to which Initial Stock Units and Annual Stock Units are credited pursuant to Sections 6(a)(i)(B) and 6(a)(ii)(B).

"*Meeting Fees*" means fees (if any) payable to an Eligible Director for participation in meetings of the Board or any committee thereof.

"*Normal Retirement*" means the termination of service on the Board for retirement at or after attaining age 65, other than for Cause, Disability or death.

"*Plan*" has the meaning set forth in Section 1.

"*Rate of Interest*" means the time weighted average interest rate paid by the Company for a quarter, or such shorter period from the end of the preceding quarter to an Eligible Director's Service Termination Date, to institutions from which it borrows funds.

"Retainer" means the Annual Retainer, the Committee Retainer and/or the Lead Director Retainer, as applicable.

"*Retainer Payment Date*" means, with respect to any Retainer, the date as of which an Eligible Director becomes entitled to payment of Retainer; ***provided, however***, that in the event such date is a date other than the date of the Annual Meeting, the Retainer Payment Date shall be the first day of the calendar month following the month in which such Eligible Director becomes entitled to the payment of such Retainer.

"*Service Termination Date*" means the date of an Eligible Director's termination of service on the Board.

"*Stock*" means the Company's common stock, par value $0.01 per share, and any other shares into which such stock shall thereafter be changed by reason of any merger, reorganization, recapitalization, consolidation, split-up, combination of shares or similar event as set forth in and in accordance with Section 4.

"*Stock Amount*" means the percentage of the Retainers that an Eligible Director elects to have paid in Stock, as indicated on the relevant Stock Election Form.

"*Stock Election*" means an election by an Eligible Director to receive all or a portion of the Eligible Director's Retainers in shares of Stock.

"*Stock Election Form*" means the election form submitted by an Eligible Director to the Secretary as provided in Section 8 (a).

"*Stock Units*" means Initial Stock Units, Annual Stock Units and/or Elective Stock Units, as applicable.

"*Transition Date*" has the meaning set forth in Section 5(a).

EXHIBIT 10.3

Governmental Service Amendment
to Outstanding Stock Option and Stock Unit Awards

Pursuant to its authority under the applicable Award Certificate and Morgan Stanley equity compensation plan to modify or amend the terms of stock options and stock units, Morgan Stanley hereby amends, effective as of March 18, 2007, the terms and conditions of each of your outstanding stock option and/or stock unit awards (each, a "***Covered Award***") as set forth in the Award Certificate for each such Covered Award to provide as follows:

(a) ***General treatment of stock units and stock options upon Governmental Service Termination.*** If your employment with the Firm (or your Employment, if applicable to the award) terminates in a Governmental Service Termination and not involving a cancellation event as set forth in the applicable Award Certificate then, provided that you sign an agreement satisfactory to the Firm relating to your obligations pursuant to paragraph (c) below, (i) all of your unvested stock units will vest on, and your vested stock units will convert to shares of Morgan Stanley common stock on or as soon as administratively practicable after, the date of your Governmental Service Termination; (ii) all of your unvested stock options will vest on the date of your Governmental Service Termination, and your vested stock options will expire on the date provided for in the applicable Award Certificate; and (iii) the transfer restrictions set forth in the applicable Award Certificate will no longer apply to your Option Shares (or Net Option Shares, as applicable).

(b) ***General treatment of vested stock units and Option Shares upon acceptance of employment at a Governmental Employer following termination of Employment.*** If, following your termination of employment with the Firm (or Employment, if applicable), you accept employment with a Governmental Employer, then, provided that you sign an agreement satisfactory to the Firm relating to your obligations pursuant to paragraph (c) below and provide Morgan Stanley with satisfactory evidence demonstrating that as a result of such employment the divestiture of your continued interest in Morgan Stanley equity awards or continued ownership in Morgan Stanley common stock is reasonably necessary to avoid the violation of U.S. federal, state or local or non-U.S. ethics law or conflicts of interest law applicable to you at such Governmental Employer, (i) all of your outstanding vested stock units will convert to shares on or as soon as administratively practicable after the date on which you provide Morgan Stanley with such satisfactory evidence; and (ii) the transfer restrictions set forth in the applicable Award Certificate will no longer apply to your Option Shares (or Net Option Shares, as applicable) on the date on which you provide Morgan Stanley with such satisfactory evidence.

(c) ***Repayment obligation.*** If you engage in any activity constituting a cancellation event set forth in the applicable Award Certificate within the applicable period of time that would have resulted in cancellation of all or a portion of your stock units (had they not converted to shares pursuant to paragraph (a) or (b) above), stock options or Option Shares (or Net Option Shares, as applicable), then you will be required to pay to Morgan Stanley an amount equal to (i) the number of stock units that would have been canceled upon the occurrence of such cancellation event, multiplied by the fair market value, determined using a valuation methodology established by Morgan Stanley, of Morgan Stanley common stock on the date your stock units converted to shares of Morgan Stanley common stock; and (ii) the amount you were required to recognize as income for federal income tax purposes in connection with your exercise of any such stock options that would have been canceled; and, in each case, (iii) interest on such amount at the average rate of interest Morgan Stanley paid to borrow money from financial institutions during the period from the date of such conversion or exercise, as applicable, through the date preceding the payment date.

"***Governmental Employer***" means a governmental department or agency, self-regulatory agency or other public service employer.

"***Governmental Service Termination***" means the termination of your employment with the Firm (or your termination of Employment, if applicable to the award) as a result of accepting employment at a Governmental Employer and you provide Morgan Stanley with satisfactory evidence demonstrating that as a result of such new employment, the divestiture of your continued interest in Morgan Stanley equity awards or continued ownership in Morgan Stanley common stock is reasonably necessary to avoid the violation of U.S. federal, state or local or non-U.S. ethics law or conflicts of interest law applicable to you at such Governmental Employer.

Capitalized terms used in this Amendment without definition have the meanings set forth in the applicable Award Certificate(s).

If your Covered Award does not include stock options, the terms of this Amendment relating to stock options will not apply to such award. If your Covered Award does not include stock units, the terms of this Amendment relating to stock units will not apply to such Award.

Except as expressly modified by this Amendment, your Covered Awards shall continue to be governed in accordance with their terms.

IN WITNESS WHEREOF, Morgan Stanley has duly executed and delivered this Amendment to your Award Certificate(s) as of March 18, 2007.

MORGAN STANLEY

/s/ Thomas R. Nides

Thomas R. Nides
Chief Administrative Officer

EXHIBIT 10.4

MARCH 19, 2007 AMENDMENT TO
THE 1993 STOCK PLAN FOR NON-EMPLOYEE DIRECTORS

The 1993 Stock Plan for Non-Employee Directors, as amended, is amended to include the following new Section 6.4.4:

6.4.4 Governmental Service.

(a) If an Eligible Director resigns as a director of the Company as a result of accepting employment at a governmental department or agency, self-regulatory agency or other public service employer (a "Governmental Employer"), then, provided that the Eligible Director provides the Company with satisfactory evidence demonstrating that as a result of such new employment the divestiture of the Eligible Director's continued interest in Company equity awards or continued ownership of Stock is reasonably necessary to avoid the violation of U.S. federal, state or local or non-U.S. ethics law or conflicts of interest law applicable to the Eligible Director at such Governmental Employer, all Stock Units credited to the Eligible Director's Stock Unit Account shall be distributed in accordance with Section 6.4.3 on or as soon as administratively practicable after the date of such Eligible Director's resignation.

(b) If, following the termination of an Eligible Director's service as a director of the Company, the Eligible Director accepts employment with a Governmental Employer then, provided that the Eligible Director provides the Company with satisfactory evidence demonstrating that as a result of such employment the divestiture of the Eligible Director's continued interest in Company equity awards or continued ownership of Stock is reasonably necessary to avoid the violation of U.S. federal, state or local or non-U.S. ethics law or conflicts of interest law applicable to the Eligible Director at such Governmental Employer, all Stock Units credited to the Eligible Director's Stock Unit Account shall be distributed in accordance with Section 6.4.3 on or as soon as administratively practicable after the date on which the Eligible Director provides the Company with such satisfactory evidence.

Morgan Stanley
Ratio of Earnings to Fixed Charges
and Ratio of Earnings to Fixed Charges and Preferred Stock Dividends
(dollars in millions)

	Three Months Ended		Six Months Ended		Fiscal Year				
	May 31, 2007	May 31, 2006(1)	May 31, 2007	May 31, 2006(1)	2006	2005	2004	2003	2002
Ratio of Earnings to Fixed Charges									
Earnings:									
Income before income taxes (2)	$ 3,874	$ 2,863	$ 7,721	$ 5,274	$10,803	$ 7,342	$ 6,810	$ 6,155	$ 4,862
Add: Fixed charges, net	16,062	10,006	29,595	19,510	42,115	24,637	14,870	12,856	12,686
Income before income taxes and fixed charges, net	$19,936	$12,869	$37,316	$24,784	$52,918	$31,979	$21,680	$19,011	$17,548
Fixed Charges:									
Total interest expense	$16,007	$ 9,965	$29,492	$19,426	$41,937	$24,425	$14,706	$12,693	$12,513
Interest factor in rents	55	41	103	84	178	212	164	163	173
Dividends on preferred securities subject to mandatory redemption	—	—	—	—	—	—	45	154	87
Total fixed charges	$16,062	$10,006	$29,595	$19,510	$42,115	$24,637	$14,915	$13,010	$12,773
Ratio of earnings to fixed charges	1.2	1.3	1.3	1.3	1.3	1.3	1.5	1.5	1.4
Ratio of Earnings to Fixed Charges and Preferred Stock Dividends									
Earnings:									
Income before income taxes (2)	$ 3,874	$ 2,863	$ 7,721	$ 5,274	$10,803	$ 7,342	$ 6,810	$ 6,155	$ 4,862
Add: Fixed charges, net	16,062	10,006	29,595	19,510	42,115	24,637	14,870	12,856	12,686
Income before income taxes and fixed charges, net	$19,936	$12,869	$37,316	$24,784	$52,918	$31,979	$21,680	$19,011	$17,548
Fixed Charges:									
Total interest expense	$16,007	$ 9,965	$29,492	$19,426	$41,937	$24,425	$14,706	$12,693	$12,513
Interest factor in rents	55	41	103	84	178	212	164	163	173
Dividends on preferred securities subject to mandatory redemption	—	—	—	—	—	—	45	154	87
Preferred stock dividends	17	—	34	—	19	—	—	—	—
Total fixed charges and preferred stock dividends	$16,079	$10,006	$29,629	$19,510	$42,134	$24,637	$14,915	$13,010	$12,773
Ratio of earnings to fixed charges and preferred stock dividends	1.2	1.3	1.3	1.3	1.3	1.3	1.5	1.5	1.4

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

(2) Income before income taxes does not include losses from unconsolidated investees, dividends on preferred securities subject to mandatory redemption, gain/(loss) on discontinued operations, cumulative effect of accounting change (net) and income (loss) from investments accounted for under the equity method of accounting.

"Fixed charges" consist of interest cost, including interest on deposit, dividends on preferred securities subject to mandatory redemption, and that portion of rent expense estimated to be representative of the interest factor.

The preferred stock dividend amounts represent pre-tax earnings required to cover dividends on preferred stock.

EXHIBIT 15

To the Board of Directors and Shareholders of Morgan Stanley:

We have reviewed, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the unaudited interim condensed consolidated financial information of Morgan Stanley and subsidiaries as of May 31, 2007 and for the three-month and six-month periods ended May 31, 2007 and 2006, and have issued our report dated July 9, 2007 (which report included an explanatory paragraph regarding Morgan Stanley's adoption of Statement of Financial Accounting Standards No. 157, "Fair Value Measurement" and Statement of Financial Accounting Standards No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities–Including an amendment of FASB Statement No. 115" and an explanatory paragraph regarding Morgan Stanley's spin-off of Discover Financial Services). As indicated in such report, because we did not perform an audit, we expressed no opinion on that information.

We are aware that our report referred to above, which is included in your Quarterly Report on Form 10-Q for the quarter ended May 31, 2007, is incorporated by reference in the following Registration Statements of Morgan Stanley:

Filed on Form S-3:

Registration Statement No. 33-57202
Registration Statement No. 33-60734
Registration Statement No. 33-89748
Registration Statement No. 33-92172
Registration Statement No. 333-07947
Registration Statement No. 333-27881
Registration Statement No. 333-27893
Registration Statement No. 333-27919
Registration Statement No. 333-46403
Registration Statement No. 333-46935
Registration Statement No. 333-76111
Registration Statement No. 333-75289
Registration Statement No. 333-34392
Registration Statement No. 333-47576
Registration Statement No. 333-83616
Registration Statement No. 333-106789
Registration Statement No. 333-117752
Registration Statement No. 333-129243
Registration Statement No. 333-131266

Filed on Form S-4:

Registration Statement No. 333-25003

Filed on Form S-8:

Registration Statement No. 33-63024
Registration Statement No. 33-63026
Registration Statement No. 33-78038
Registration Statement No. 33-79516
Registration Statement No. 33-82240
Registration Statement No. 33-82242
Registration Statement No. 33-82244
Registration Statement No. 333-04212
Registration Statement No. 333-28141
Registration Statement No. 333-28263
Registration Statement No. 333-62869
Registration Statement No. 333-78081
Registration Statement No. 333-95303
Registration Statement No. 333-85148

Registration Statement No. 333-85150
Registration Statement No. 333-108223
Registration Statement No. 333-142874

We also are aware that the aforementioned report, pursuant to Rule 436(c) under the Securities Act of 1933, is not considered a part of the Registration Statements prepared or certified by an accountant or a report prepared or certified by an accountant within the meaning of Sections 7 and 11 of that Act.

Deloitte & Touche LLP

New York, New York
July 9, 2007

EXHIBIT 31.1

Certification

I, John J. Mack, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Morgan Stanley (the "registrant");
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
   a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
   b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
   c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
   d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
   a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
   b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: July 10, 2007

/s/ JOHN J. MACK

John J. Mack
Chairman of the Board and Chief Executive Officer

EXHIBIT 31.2

Certification

I, David H. Sidwell, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Morgan Stanley (the “registrant”);

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant’s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   c) Evaluated the effectiveness of the registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   d) Disclosed in this report any change in the registrant’s internal control over financial reporting that occurred during the registrant’s most recent fiscal quarter (the registrant’s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant’s internal control over financial reporting; and

5. The registrant’s other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant’s auditors and the audit committee of the registrant’s board of directors (or persons performing the equivalent functions):

   a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant’s ability to record, process, summarize and report financial information; and

   b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant’s internal control over financial reporting.

Date: July 10, 2007

/s/ DAVID H. SIDWELL

David H. Sidwell
Executive Vice President and Chief Financial Officer

EXHIBIT 32.1

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Morgan Stanley (the "Company") on Form 10-Q for the quarterly period ended May 31, 2007, as filed with the Securities and Exchange Commission (the "Report"), I, John J. Mack, Chairman of the Board and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ JOHN J. MACK

John J. Mack
Chairman of the Board and
Chief Executive Officer

Dated: July 10, 2007

EXHIBIT 32.2

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Morgan Stanley (the “Company”) on Form 10-Q for the quarterly period ended May 31, 2007, as filed with the Securities and Exchange Commission (the “Report”), I, David H. Sidwell, Executive Vice President and Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ DAVID H. SIDWELL

David H. Sidwell
Executive Vice President and
Chief Financial Officer

Dated: July 10, 2007

Exhibit 99.1

Morgan Stanley
Unaudited Pro Forma Condensed Consolidated Financial Information

The accompanying unaudited pro forma condensed consolidated financial information has been prepared to reflect the June 30, 2007 (the "Distribution Date") distribution by Morgan Stanley (the "Company") of all the shares of Discover Financial Services ("Discover") to the Company's stockholders (the "Discover spin-off"). On the Distribution Date, the Company distributed one share of common stock of Discover, par value $0.01 per share, for every two shares of the Company's common stock held by stockholders of record as of June 18, 2007. Stockholders will receive cash in lieu of fractional shares for amounts less than one full Discover share. The Company has received a ruling from the Internal Revenue Service that, based on customary representations and qualifications, the distribution will be tax-free to Morgan Stanley stockholders for U.S. federal income tax purposes. Discover common stock is listed on the New York Stock Exchange under the ticker symbol "DFS".

The unaudited pro forma condensed consolidated statements of income for the fiscal years ended November 30, 2006, 2005 and 2004, the three months ended February 28, 2007 and for the three and six months ended May 31, 2007 gives effect to the Discover spin-off as if the distribution and related transactions occurred on December 1, 2003. The unaudited pro forma condensed consolidated statement of financial condition as of May 31, 2007 gives effect to the Discover spin-off as if the distribution and related transactions occurred on May 31, 2007. The unaudited pro forma condensed consolidated financial statements are subject to the assumptions and adjustments set forth in the accompanying notes. Management believes that the assumptions used and adjustments made are reasonable under the circumstances and given the information available.

The unaudited pro forma condensed consolidated financial information is for illustrative and informational purposes only and is not intended to represent, or be indicative of, what the Company's results of operations or financial position would have been had the Discover spin-off occurred on the dates indicated. The unaudited pro forma condensed consolidated financial information also should not be considered representative of the Company's future financial position or results of operations.

The unaudited pro forma condensed consolidated financial information should be read in conjunction with the:

- Accompanying notes to the unaudited pro forma condensed consolidated financial information;
- The Company's Annual Report on Form 10-K for the fiscal year ended November 30, 2006;
- The Company's Current Report on Form 8-K dated April 10, 2007;
- The Company's Quarterly Report on Form 10-Q for the three months ended February 28, 2007;
- The Company's Quarterly Report on Form 10-Q for the three and six months ended May 31, 2007;
- Discover's Registration Statement on Form 10 initially filed with the Securities Exchange Commission on March 23, 2007, as amended by Amendment No. 1 filed on May 1, 2007, Amendment No. 2 filed on May 9, 2007, Amendment No. 3 filed on May 18, 2007 and Amendment No. 4 filed on June 1, 2007.

MORGAN STANLEY

UNAUDITED PRO FORMA CONDENSED CONSOLIDATED STATEMENT OF FINANCIAL CONDITION
(dollars in millions)

	May 31, 2007			
	Morgan Stanley Historical(a)	Discover Distribution(b)	Pro forma Adjustments	Morgan Stanley Pro forma
	(unaudited)			
Assets				
Cash and cash equivalents	$ 31,786	$ (7,892)	$4,139(c) 350(d)	$ 28,383
Cash and securities deposited with clearing organizations or segregated under federal and other regulations or requirements	47,114	(1)	—	47,113
Financial instruments owned:				
U.S. government and agency securities	35,198	(73)	—	35,125
Other sovereign government obligations	28,764	—	—	28,764
Corporate and other debt	167,751	—	—	167,751
Corporate equities	99,728	—	—	99,728
Derivative contracts	56,461	(28)	—	56,433
Investments	10,050	—	—	10,050
Physical commodities	3,165	—	—	3,165
Total financial instruments owned	401,117	(101)	—	401,016
Securities received as collateral	112,236	—	—	112,236
Collateralized agreements:				
Securities purchased under agreements to resell	144,051	—	—	144,051
Securities borrowed	252,213	—	—	252,213
Receivables:				
Consumer loans, net	21,917	(21,854)	—	63
Customers	113,866	—	—	113,866
Brokers, dealers and clearing organizations	17,009	—	—	17,009
Other loans	14,334	—	—	14,334
Fees, interest and other	11,991	(312)	—	11,679
Other investments	13,302	—	—	13,302
Office facilities and other equipment, at cost, net	4,501	(658)	—	3,843
Goodwill	2,977	(536)	—	2,441
Intangible assets, net	1,155	(200)	—	955
Other assets	10,424	(4,119)	—	6,305
Total assets	$1,199,993	$(35,673)	$4,489	$1,168,809

MORGAN STANLEY

UNAUDITED PRO FORMA CONDENSED CONSOLIDATED STATEMENT OF FINANCIAL CONDITION—(Continued)
(dollars in millions)

	May 31, 2007			
	Morgan Stanley Historical(a)	Discover Distribution(b)	Pro forma Adjustments	Morgan Stanley Pro forma
		(unaudited)		
Liabilities and Shareholders' Equity				
Commercial paper and other short-term borrowings	$ 33,747	$ (530)	$ —	$ 33,217
Deposits	43,577	(23,080)	—	20,497
Financial instruments sold, not yet purchased:				
U.S. government and agency securities	18,085	—	—	18,085
Other sovereign government obligations	23,586	—	—	23,586
Corporate and other debt	6,321	—	—	6,321
Corporate equities	58,491	—	—	58,491
Derivative contracts	58,919	(40)	—	58,879
Physical commodities	1,147	—	—	1,147
Total financial instruments sold, not yet purchased	166,549	(40)	—	166,509
Obligation to return securities received as collateral	112,236	—	—	112,236
Collateralized financings:				
Securities sold under agreements to repurchase	252,710	—	—	252,710
Securities loaned	147,216	—	—	147,216
Other secured financings	43,456	—	—	43,456
Payables:				
Customers	142,080	—	—	142,080
Brokers, dealers and clearing organizations	13,656	—	—	13,656
Interest and dividends	6,541	(228)	—	6,313
Intercompany notes payable	—	(4,274)	4,274(c)	—
Other liabilities and accrued expenses	26,782	(1,491)	—	25,291
Long-term borrowings	171,932	(250)	—	171,682
Total liabilities	1,160,482	(29,893)	4,274	1,134,863
Total shareholders' equity	39,511	(5,780)	215(c)(d)	33,946
Total liabilities and shareholders' equity	$1,199,993	$(35,673)	$4,489	$1,168,809

See Notes to Unaudited Pro Forma Condensed Consolidated Statement of Financial Condition.

MORGAN STANLEY

NOTES TO UNAUDITED PRO FORMA CONDENSED CONSOLIDATED STATEMENT OF FINANCIAL CONDITION

(a) Reflects the Company's historical condensed consolidated statement of financial condition.

(b) Reflects the Company's distribution of Discover's assets and liabilities to the Company's stockholders.

(c) Reflects the net receipt of cash from Discover in connection with the settlement of intercompany funding prior to the Discover spin-off. Such intercompany balances were previously eliminated in the Company's historical consolidated financial statements.

(d) Reflects the receipt of a $350 million cash dividend from Discover prior to the Discover spin-off.

MORGAN STANLEY

UNAUDITED PRO FORMA CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(in millions, except per share data)

	Fiscal Year Ended November 30, 2006			
	Morgan Stanley Historical(a)	Discover Distribution(b)	Pro forma Adjustments	Morgan Stanley Pro forma
		(unaudited)		
Revenues:				
Investment banking	$ 4,755	$ —	$ —	$ 4,755
Principal transactions:				
Trading	11,738	—	—	11,738
Investments	1,669	—	—	1,669
Commissions	3,770	—	—	3,770
Fees:				
Asset management, distribution and administration	5,238	—	—	5,238
Merchant, cardmember and other fees, net	1,167	(1,167)	—	—
Servicing and securitization income	2,338	(2,338)	—	—
Interest and dividends	45,199	(2,458)	—	42,741
Other	571	(35)	—	536
Total revenues	76,445	(5,998)	—	70,447
Interest expense	41,937	(952)	245(c)	41,230
Provision for consumer loan losses	756	(756)	—	—
Net revenues	33,752	(4,290)	(245)	29,217
Non-interest expenses:				
Compensation and benefits	14,328	(922)	52(d)	13,458
Occupancy and equipment	993	(91)	10(d)	912
Brokerage, clearing and exchange fees	1,305	—	—	1,305
Information processing and communications	1,463	(387)	4(d)	1,080
Marketing and business development	1,244	(604)	3(d)	643
Professional services	2,242	(368)	13(d)	1,887
Other	1,204	(332)	5(d)	877
Total non-interest expenses	22,779	(2,704)	87	20,162
Income from continuing operations before losses from unconsolidated investees and income taxes	10,973	(1,586)	(332)	9,055
Losses from unconsolidated investees	228	(3)	—	225
Provision for income taxes	3,265	(506)	(101)	2,658
Income from continuing operations	$ 7,480	$(1,077)	$(231)	$ 6,172
Earnings per basic common share:				
Income from continuing operations	$ 7.39			$ 6.06
Earnings per diluted common share:				
Income from continuing operations	$ 7.08			$ 5.77
Average common shares outstanding:				
Basic	1,010		5(e)	1,015
Diluted	1,055		12(e)	1,067

See Notes to Unaudited Pro Forma Condensed Consolidated Statements of Income.

MORGAN STANLEY

UNAUDITED PRO FORMA CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(in millions, except per share data)

	Fiscal Year Ended November 30, 2005			
	Morgan Stanley Historical(a)	Discover Distribution(b)	Pro forma Adjustments	Morgan Stanley Pro forma
		(unaudited)		
Revenues:				
Investment banking	$ 3,843	$ —	$ —	$ 3,843
Principal transactions:				
Trading	7,365	—	—	7,365
Investments	981	—	—	981
Commissions	3,331	—	—	3,331
Fees:				
Asset management, distribution and administration	4,915	—	—	4,915
Merchant, cardmember and other fees, net	1,323	(1,323)	—	—
Servicing and securitization income	1,609	(1,609)	—	—
Interest and dividends	28,160	(2,174)	—	25,986
Other	464	(5)	—	459
Total revenues	51,991	(5,111)	—	46,880
Interest expense	24,425	(781)	143(c)	23,787
Provision for consumer loan losses	878	(878)	—	—
Net revenues	26,688	(3,452)	(143)	23,093
Non-interest expenses:				
Compensation and benefits	11,267	(865)	58(d)	10,460
Occupancy and equipment	1,038	(92)	11(d)	957
Brokerage, clearing and exchange fees	1,069	—	—	1,069
Information processing and communications	1,400	(353)	5(d)	1,052
Marketing and business development	1,160	(587)	3(d)	576
Professional services	1,898	(294)	14(d)	1,618
Other	1,765	(343)	6(d)	1,428
September 11th related insurance recoveries, net	(251)	—	—	(251)
Total non-interest expenses	19,346	(2,534)	97	16,909
Income from continuing operations before losses from unconsolidated investees, income taxes and cumulative effect of accounting change, net	7,342	(918)	(240)	6,184
Losses from unconsolidated investees	311	—	—	311
Provision for income taxes	1,852	(340)	(64)	1,448
Income from continuing operations before cumulative effect of accounting change, net	$ 5,179	$ (578)	$(176)	$ 4,425
Earnings per basic common share:				
Income from continuing operations	$ 4.93			$ 4.20
Earnings per diluted common share:				
Income from continuing operations	$ 4.80			$ 4.07
Average common shares outstanding:				
Basic	1,050		4(e)	1,054
Diluted	1,080		8(e)	1,088

See Notes to Unaudited Pro Forma Condensed Consolidated Statements of Income.

MORGAN STANLEY

UNAUDITED PRO FORMA CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(in millions, except per share data)

	Fiscal Year Ended November 30, 2004			
	Morgan Stanley Historical(a)	Discover Distribution(b)	Pro forma Adjustments	Morgan Stanley Pro forma
		(unaudited)		
Revenues:				
Investment banking	$ 3,341	$ —	$ —	$ 3,341
Principal transactions:				
Trading	5,510	—	—	5,510
Investments	607	—	—	607
Commissions	3,235	—	—	3,235
Fees:				
Asset management, distribution and administration	4,436	—	—	4,436
Merchant, cardmember and other fees, net	1,317	(1,317)	—	—
Servicing and securitization income	1,921	(1,921)	—	—
Interest and dividends	18,575	(1,859)	—	16,716
Other	323	(10)	—	313
Total revenues	39,265	(5,107)	—	34,158
Interest expense	14,706	(648)	112(c)	14,170
Provision for consumer loan losses	926	(926)	—	—
Net revenues	23,633	(3,533)	(112)	19,988
Non-interest expenses:				
Compensation and benefits	9,812	(752)	41(d)	9,101
Occupancy and equipment	839	(84)	8(d)	763
Brokerage, clearing and exchange fees	931	—	—	931
Information processing and communications	1,304	(344)	5(d)	965
Marketing and business development	1,121	(575)	2(d)	548
Professional services	1,538	(263)	8(d)	1,283
Other	1,278	(296)	2(d)	984
Total non-interest expenses	16,823	(2,314)	66	14,575
Income from continuing operations before losses from unconsolidated investees, dividends on preferred securities subject to mandatory redemption and income taxes	6,810	(1,219)	(178)	5,413
Losses from unconsolidated investees	328	—	—	328
Provision for income taxes	1,854	(443)	(51)	1,360
Dividends on preferred securities subject to mandatory redemption	45	—	—	45
Income from continuing operations	$ 4,583	$ (776)	$(127)	$ 3,680
Earnings per basic common share:				
Income from continuing operations	$ 4.24			$ 3.39
Earnings per diluted common share:				
Income from continuing operations	$ 4.15			$ 3.30
Average common shares outstanding:				
Basic	1,080		6(e)	1,086
Diluted	1,105		10(e)	1,115

See Notes to Unaudited Pro Forma Condensed Consolidated Statements of Income.

MORGAN STANLEY

UNAUDITED PRO FORMA CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(in millions, except per share data)

	Six months Ended May 31, 2007			
	Morgan Stanley Historical(a)	Discover Distribution(b)	Pro forma Adjustments	Morgan Stanley Pro forma
		(unaudited)		
Revenues:				
Investment banking	$ 3,140	$ —	$ —	$ 3,140
Principal transactions:				
Trading	8,996	—	—	8,996
Investments	1,884	—	—	1,884
Commissions	2,128	—	—	2,128
Fees:				
Asset management, distribution and administration	3,075	—	—	3,075
Merchant, cardmember and other fees, net	558	(558)	—	—
Servicing and securitization income	1,199	(1,122)	—	77
Interest and dividends	30,880	(1,384)	—	29,496
Other	535	(18)	—	517
Total revenues	52,395	(3,082)	—	49,313
Interest expense	29,492	(623)	142 (c)	29,011
Provision for consumer loan losses	399	(399)	—	—
Net revenues	22,504	(2,060)	(142)	20,302
Non-interest expenses:				
Compensation and benefits	10,210	(466)	26 (d)	9,770
Occupancy and equipment	581	(46)	5 (d)	540
Brokerage, clearing and exchange fees	727	—	—	727
Information processing and communications	750	(191)	2 (d)	561
Marketing and business development	634	(283)	1 (d)	352
Professional services	1,125	(194)	(1)(d)	930
Other	756	(175)	1 (d)	582
Total non-interest expenses	14,783	(1,355)	34	13,462
Income from continuing operations before losses from unconsolidated investees and income taxes	7,721	(705)	(176)	6,840
Losses from unconsolidated investees	(48)	(2)	—	(46)
Provision for income taxes	2,532	(261)	(58)	2,213
Income from continuing operations	$ 5,141	$ (442)	$(118)	$ 4,581
Earnings per basic common share:				
Income from continuing operations	$ 5.09			$ 4.50
Earnings per diluted common share:				
Income from continuing operations	$ 4.86			$ 4.27
Average common shares outstanding:				
Basic	1,003		7 (e)	1,010
Diluted	1,052		14 (e)	1,066

See Notes to Unaudited Pro Forma Condensed Consolidated Statements of Income.

MORGAN STANLEY
UNAUDITED PRO FORMA CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(in millions, except per share data)

	Three months Ended May 31, 2007			
	Morgan Stanley Historical(a)	Discover Distribution(b)	Pro forma Adjustments	Morgan Stanley Pro forma
		(unaudited)		
Revenues:				
Investment banking	$ 1,913	$ —	$—	$ 1,913
Principal transactions:				
Trading	4,838	—	—	4,838
Investments	1,004	—	—	1,004
Commissions	1,123	—	—	1,123
Fees:				
Asset management, distribution and administration	1,596	—	—	1,596
Merchant, cardmember and other fees, net	261	(261)	—	—
Servicing and securitization income	643	(601)	—	42
Interest and dividends	16,066	(704)	—	15,362
Other	290	(9)	—	281
Total revenues	27,734	(1,575)	—	26,159
Interest expense	16,007	(336)	55 (c)	15,726
Provision for consumer loan losses	204	(204)	—	—
Net revenues	11,523	(1,035)	(55)	10,433
Non-interest expenses:				
Compensation and benefits	5,218	(236)	13 (d)	4,995
Occupancy and equipment	301	(24)	2 (d)	279
Brokerage, clearing and exchange fees	366	—	—	366
Information processing and communications	381	(97)	1 (d)	285
Marketing and business development	340	(141)	1 (d)	200
Professional services	626	(113)	(2)(d)	511
Other	417	(91)	1 (d)	327
Total non-interest expenses	7,649	(702)	16	6,963
Income from continuing operations before losses from unconsolidated investees and income taxes	3,874	(333)	(71)	3,470
Losses from unconsolidated investees	(21)	(1)	—	(20)
Provision for income taxes	1,271	(123)	(24)	1,124
Income from continuing operations	$ 2,582	$ (209)	$ (47)	$ 2,326
Earnings per basic common share:				
Income from continuing operations	$ 2.57			$ 2.30
Earnings per diluted common share:				
Income from continuing operations	$ 2.45			$ 2.18
Average common shares outstanding:				
Basic	997		7 (e)	1,004
Diluted	1,046		14 (e)	1,060

See Notes to Unaudited Pro Forma Condensed Consolidated Statements of Income.

MORGAN STANLEY

UNAUDITED PRO FORMA CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(in millions, except per share data)

	Three Months Ended February 28, 2007			
	Morgan Stanley Historical(a)	Discover Distribution(b)	Pro forma Adjustments	Morgan Stanley Pro forma
		(unaudited)		
Revenues:				
Investment banking	$ 1,227	$ —	$ —	$ 1,227
Principal transactions:				
Trading	4,158	—	—	4,158
Investments	880	—	—	880
Commissions	1,005	—	—	1,005
Fees:				
Asset management, distribution and administration	1,479	—	—	1,479
Merchant, cardmember and other fees, net	297	(297)	—	—
Servicing and securitization income	556	(521)	—	35
Interest and dividends	14,814	(680)	—	14,134
Other	245	(9)	—	236
Total revenues	24,661	(1,507)	—	23,154
Interest expense	13,485	(287)	87(c)	13,285
Provision for consumer loan losses	195	(195)	—	—
Net revenues	10,981	(1,025)	(87)	9,869
Non-interest expenses:				
Compensation and benefits	4,992	(230)	13(d)	4,775
Occupancy and equipment	280	(22)	2(d)	260
Brokerage, clearing and exchange fees	361	—	—	361
Information processing and communications	369	(94)	1(d)	276
Marketing and business development	294	(142)	1(d)	153
Professional services	499	(81)	1(d)	419
Other	339	(83)	1(d)	257
Total non-interest expenses	7,134	(652)	19	6,501
Income from continuing operations before losses from unconsolidated investees and income taxes	3,847	(373)	(106)	3,368
Losses from unconsolidated investees	(27)	(1)	—	(26)
Provision for income taxes	1,261	(138)	(35)	1,088
Income from continuing operations	$ 2,559	$ (234)	$ (71)	$ 2,254
Earnings per basic common share:				
Income from continuing operations	$ 2.52			$ 2.20
Earnings per diluted common share:				
Income from continuing operations	$ 2.40			$ 2.08
Average common shares outstanding:				
Basic	1,009		7(e)	1,016
Diluted	1,058		15(e)	1,073

See Notes to Unaudited Pro Forma Condensed Consolidated Statements of Income.

MORGAN STANLEY

NOTES TO UNAUDITED PRO FORMA CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(a) Reflects the Company's historical condensed consolidated statements of income.

(b) Reflects the elimination of the revenues and expenses of Discover's continuing operations from the Company's historical results.

(c) Reflects an adjustment for intercompany interest expense. This amount reflects an allocation of the Company's funding costs, which are managed on a consolidated basis, that had been charged by the Company to Discover. The intercompany funding was used to finance Discover's receivables and operations, and such intercompany amounts have been repaid. The intercompany amounts were eliminated in the Company's historical consolidated financial statements.

(d) Reflects adjustments associated with certain allocated costs related to Discover. Such allocated costs will be retained by the Company as they represent certain corporate functions that will not be transferred to Discover in conjunction with the Discover spin-off. Amounts for Professional services for the three months ended February 28, 2007, three months ended May 31, 2007 and six months ended May 31, 2007 include adjustments for approximately $2 million, $5 million and $7 million, respectively, of costs directly associated with the Discover spin-off.

(e) Represents the net dilutive impact of the issuance of additional stock-based compensation awards (including stock options and restricted stock units) to Morgan Stanley employees in order to maintain the pre-Discover spin-off intrinsic value of such awards, and the recission of stock-based compensation awards held by active employees of Discover.