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 August 31, 2003

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 **(State of Incorporation)**	**36-3145972** **(I.R.S. Employer Identification No.)**
1585 Broadway **New York, NY** **(Address of Principal Executive Offices)**	**10036** **(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 an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes ☒ No ☐

As of September 30, 2003, there were 1,083,043,299 shares of the Registrant's Common Stock, par value $.01 per share, outstanding.

MORGAN STANLEY

INDEX TO QUARTERLY REPORT ON FORM 10-Q
Quarter Ended August 31, 2003

		Page
Part I—Financial Information		
Item 1.	Financial Statements	
	Condensed Consolidated Statements of Financial Condition—August 31, 2003 (unaudited) and November 30, 2002	1
	Condensed Consolidated Statements of Income (unaudited)—Three and Nine Months Ended August 31, 2003 and 2002	2
	Condensed Consolidated Statements of Comprehensive Income (unaudited)—Three and Nine Months Ended August 31, 2003 and 2002	3
	Condensed Consolidated Statements of Cash Flows (unaudited)—Nine Months Ended August 31, 2003 and 2002	4
	Notes to Condensed Consolidated Financial Statements (unaudited)	5
	Independent Accountants' Report	31
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	32
Item 3.	Quantitative and Qualitative Disclosures About Market Risk	65
Item 4.	Controls and Procedures	70
Part II—Other Information		
Item 1.	Legal Proceedings	71
Item 6.	Exhibits and Reports on Form 8-K	72

AVAILABLE INFORMATION

The Company 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 at the SEC's public reference room at Room 1024, 450 Fifth Street, NW, Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information on the public reference room. The SEC maintains a website that contains annual, quarterly and current reports, proxy statements and other information that issuers (including the Company) file electronically with the SEC. The SEC's website is *www.sec.gov.* The Company's website is *www.morganstanley.com.* The Company makes available free of charge through its internet site, via a link to the SEC's website at *www.sec.gov*, its annual reports on Form 10-K; quarterly reports on Form 10-Q; current reports on Form 8-K; Forms 3, 4 and 5 filed on behalf of directors and executive officers; and any amendments to those reports filed or furnished pursuant to the Securities Exchange Act of 1934 (the "Exchange Act") as soon as reasonably practicable after such material is electronically filed with, or furnished to, the SEC. The Company makes available on *www.morganstanley.com* its most recent annual report on Form 10-K, its quarterly reports on Form 10-Q for the current fiscal year, its most recent proxy statement and its most recent summary annual report to shareholders, although in some cases these documents are not available on our site as soon as they are available on the SEC's site. In addition, the Company posts on *www.morganstanley.com* its Certificate of Incorporation, Bylaws, charters for its Audit Committee, Compensation Committee and Nominating and Governance Committee as well as its Corporate Governance Policies and its Code of Ethics and Business Conduct for the Company's employees, officers and directors. You will need to have on your computer the Adobe Acrobat Reader software to view these documents, which are in PDF format. If you do not have Adobe Acrobat, a link to Adobe's Internet site, from which you can download the software, is provided. The information on the Company's website is not incorporated by reference into this report.

Item 1.

MORGAN STANLEY

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

	August 31, 2003	November 30, 2002
	(unaudited)	
ASSETS		
Cash and cash equivalents	$ 24,272	$ 29,212
Cash and securities deposited with clearing organizations or segregated under federal and other regulations (including securities at fair value of $23,906 at August 31, 2003 and $27,721 at November 30, 2002)	33,115	38,411
Financial instruments owned (approximately $66 billion at August 31, 2003 and $71 billion at November 30, 2002 were pledged to various parties):		
U.S. government and agency securities	27,222	32,474
Other sovereign government obligations	18,493	27,694
Corporate and other debt	71,654	55,254
Corporate equities	22,792	21,996
Derivative contracts	43,506	35,615
Physical commodities	656	355
Securities purchased under agreements to resell	74,271	76,910
Securities received as collateral	22,320	12,200
Securities borrowed	162,366	130,404
Receivables:		
Consumer loans (net of allowances of $988 at August 31, 2003 and $928 at November 30, 2002)	18,449	23,014
Customers, net	34,391	22,262
Brokers, dealers and clearing organizations	5,625	2,250
Fees, interest and other	4,638	4,892
Office facilities, at cost (less accumulated depreciation and amortization of $2,475 at August 31, 2003 and $2,206 at November 30, 2002)	2,354	2,270
Aircraft under operating leases (less accumulated depreciation of $968 at August 31, 2003 and $769 at November 30, 2002)	4,472	4,849
Goodwill	1,466	1,449
Other assets	8,570	7,988
Total assets	$580,632	$529,499
LIABILITIES AND SHAREHOLDERS' EQUITY		
Commercial paper and other short-term borrowings	$ 28,782	$ 50,789
Deposits	13,312	13,757
Financial instruments sold, not yet purchased:		
U.S. government and agency securities	16,883	13,235
Other sovereign government obligations	24,567	11,679
Corporate and other debt	11,116	12,240
Corporate equities	20,257	18,320
Derivative contracts	36,008	28,985
Physical commodities	3,223	1,833
Securities sold under agreements to repurchase	139,890	136,463
Obligation to return securities received as collateral	22,320	12,200
Securities loaned	57,490	43,229
Payables:		
Customers	95,896	88,229
Brokers, dealers and clearing organizations	4,857	4,610
Interest and dividends	2,512	3,363
Other liabilities and accrued expenses	13,641	12,245
Long-term borrowings	63,295	55,161
	554,049	506,338
Capital Units	66	66
Preferred Securities Subject to Mandatory Redemption	2,810	1,210
Commitments and contingencies		
Shareholders' equity:		
Common stock ($0.01 par value, 3,500,000,000 shares authorized, 1,211,699,552 and 1,211,685,904 shares issued, 1,088,107,975 and 1,081,417,377 shares outstanding at August 31, 2003 and November 30, 2002, respectively)	12	12
Paid-in capital	3,288	3,678
Retained earnings	27,270	25,250
Employee stock trust	2,778	3,003
Accumulated other comprehensive income (loss)	(239)	(251)
Subtotal	33,109	31,692
Note receivable related to ESOP	(8)	(13)
Common stock held in treasury, at cost ($0.01 par value, 123,591,577 and 130,268,527 shares at August 31, 2003 and November 30, 2002, respectively)	(6,616)	(7,176)
Common stock issued to employee trust	(2,778)	(2,618)
Total shareholders' equity	23,707	21,885
Total liabilities and shareholders' equity	$580,632	$529,499

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 August 31,		Nine Months Ended August 31,	
	2003	2002	2003	2002
	(unaudited)		(unaudited)	
Revenues:				
Investment banking	$ 608	$ 470	$ 1,733	$ 1,807
Principal transactions:				
Trading	2,105	469	5,244	2,297
Investments	38	(64)	75	(47)
Commissions	775	854	2,157	2,531
Fees:				
Asset management, distribution and administration	956	969	2,733	3,030
Merchant and cardmember	340	359	1,042	1,048
Servicing	462	510	1,532	1,556
Interest and dividends	3,534	4,376	11,015	12,089
Other	111	216	310	543
Total revenues	8,929	8,159	25,841	24,854
Interest expense	3,368	3,188	9,116	8,968
Provision for consumer loan losses	310	332	955	1,017
Net revenues	5,251	4,639	15,770	14,869
Non-interest expenses:				
Compensation and benefits	1,938	2,064	6,763	6,794
Occupancy and equipment	191	198	582	604
Brokerage, clearing and exchange fees	212	207	605	566
Information processing and communications	313	341	945	1,000
Marketing and business development	199	285	711	781
Professional services	283	273	767	748
Other	238	302	1,179	813
Total non-interest expenses	3,374	3,670	11,552	11,306
Income before income taxes and dividends on preferred securities subject to mandatory redemption	1,877	969	4,218	3,563
Provision for income taxes	561	337	1,336	1,242
Dividends on preferred securities subject to mandatory redemption	47	21	109	65
Net income	$ 1,269	$ 611	$ 2,773	$ 2,256
Earnings per common share:				
Basic	$ 1.18	$ 0.57	$ 2.57	$ 2.08
Diluted	$ 1.15	$ 0.55	$ 2.52	$ 2.03
Average common shares outstanding:				
Basic	1,077,680,996	1,081,708,833	1,077,140,296	1,084,059,497
Diluted	1,100,593,303	1,105,494,894	1,098,234,894	1,111,980,428

See Notes to Condensed Consolidated Financial Statements.

MORGAN STANLEY

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(dollars in millions)

	Three Months Ended August 31,		Nine Months Ended August 31,	
	2003	2002	2003	2002
	(unaudited)		(unaudited)	
Net income	$1,269	$611	$2,773	$2,256
Other comprehensive income (loss), net of tax:				
Foreign currency translation adjustment	(14)	17	25	34
Net change in cash flow hedges	46	(30)	(13)	3
Comprehensive income	$1,301	$598	$2,785	$2,293

See Notes to Condensed Consolidated Financial Statements.

MORGAN STANLEY

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(dollars in millions)

	Nine Months Ended August 31, 2003	Nine Months Ended August 31, 2002
	(unaudited)	
Cash flows from operating activities:		
Net income	$ 2,773	$ 2,256
Adjustments to reconcile net income to net cash (used for) provided by operating activities:		
Non-cash charges (credits) included in net income:		
Gain on sale of building and sale of self-directed online brokerage accounts	—	(125)
Aircraft impairment charge	287	74
Aircraft asset charge	36	—
Other non-cash charges included in net income	1,464	1,695
Changes in assets and liabilities:		
Cash and securities deposited with clearing organizations or segregated under federal and other regulations	5,296	6,024
Financial instruments owned, net of financial instruments sold, not yet purchased	11,995	(11,048)
Securities borrowed, net of securities loaned	(17,701)	(1,947)
Receivables and other assets	(14,689)	5,718
Payables and other liabilities	8,469	249
Net cash (used for) provided by operating activities	(2,070)	2,896
Cash flows from investing activities:		
Net (payments for) proceeds from:		
Office facilities and aircraft under operating leases	(523)	(857)
Net principal disbursed on consumer loans	(6,361)	(8,362)
Sales of consumer loans	9,972	5,514
Sale of self-directed online brokerage accounts	—	98
Net cash provided by (used for) investing activities	3,088	(3,607)
Cash flows from financing activities:		
Net (payments for) proceeds from:		
Short-term borrowings	(22,007)	5,931
Securities sold under agreements to repurchase, net of securities purchased under agreements to resell, and certain derivatives financing activities	8,203	(8,073)
Deposits	(445)	1,435
Net proceeds from:		
Issuance of common stock	172	145
Issuance of put options	—	6
Issuance of long-term borrowings	18,182	10,338
Issuance of Preferred Securities Subject to Mandatory Redemption	2,000	—
Payments for:		
Repurchases of common stock	(350)	(671)
Repayments of long-term borrowings	(10,566)	(5,934)
Redemption of Preferred Securities Subject to Mandatory Redemption	(400)	—
Redemption of Cumulative Preferred Stock	—	(345)
Cash dividends	(747)	(752)
Net cash (used for) provided by financing activities	(5,958)	2,080
Net (decrease) increase in cash and cash equivalents	(4,940)	1,369
Cash and cash equivalents, at beginning of period	29,212	26,596
Cash and cash equivalents, at end of period	$ 24,272	$ 27,965

See Notes to Condensed Consolidated Financial Statements.

MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Introduction and Basis of Presentation

The Company. Morgan Stanley (the "Company") is a global financial services firm that maintains leading market positions in each of its business segments—Institutional Securities, Individual Investor Group, Investment Management and Credit Services. The Company's Institutional Securities business includes securities underwriting and distribution; financial advisory services, including advice on mergers and acquisitions, restructurings, real estate and project finance; 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; principal investing and aircraft financing activities. The Company's Individual Investor Group business provides comprehensive financial planning and investment advisory services designed to accommodate individual investment goals and risk profiles. The Company's Investment Management business provides global asset management products and services for individual and institutional investors through three principal distribution channels: a proprietary channel consisting of the Company's financial advisors and investment representatives; a non-proprietary channel consisting of third-party broker-dealers, banks, financial planners and other intermediaries; and the Company's institutional channel. The Company's private equity activities also are included within the Investment Management business segment. The Company's Credit Services business offers Discover®-branded cards and other consumer finance products and services and includes the operation of Discover Business Services, a network of merchant and cash access locations primarily in the U.S.

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 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.

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. The Company's policy is to consolidate all entities in which it owns more than 50% of the outstanding voting stock unless it does not control the entity. In accordance with Financial Accounting Standards Board ("FASB") Interpretation No. 46, "Consolidation of Variable Interest Entities" ("FIN 46"), for variable interests obtained after January 31, 2003, the Company also consolidates any variable interest entities for which it is the primary beneficiary (see Note 13). For investments in companies in which the Company has significant influence over operating and financial decisions (generally defined as owning a voting or economic interest of 20% to 50%), the Company applies the equity method of accounting. In those cases where the Company's investment is less than 20% and significant influence does not exist, such investments are carried at cost.

The Company's U.S. and international subsidiaries include Morgan Stanley & Co. Incorporated ("MS&Co."), Morgan Stanley & Co. International Limited ("MSIL"), Morgan Stanley Japan Limited ("MSJL"), Morgan Stanley DW Inc. ("MSDWI"), Morgan Stanley Investment Advisors Inc. and NOVUS Credit Services Inc.

Certain reclassifications have been made to prior year amounts to conform to the current presentation. 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 Company's Annual Report on Form 10-K for the fiscal year ended November 30, 2002 (the "Form 10-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.

Financial Instruments Used for Trading and Investment. 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 in principal trading revenues in the condensed consolidated statements of income. Loans and lending commitments associated with the Company's lending activities also are recorded at fair value. Fair value is the amount at which financial instruments could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

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 or not quoted will generally have reduced to no price transparency.

A substantial percentage of the fair value of the Company's financial instruments owned and financial instruments sold, not yet purchased, 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, observable market prices or market parameters are not available for all products, and fair value is determined using techniques appropriate for each particular product. These analyses may involve a degree of judgment.

The fair value of over-the-counter ("OTC") derivative contracts is derived from pricing models, which may require multiple market input parameters. The Company relies on pricing models as a valuation methodology to determine fair value for OTC derivative products because market convention is to quote input parameters to models rather than prices, not because of a lack of an active trading market. The term "model" in this context typically refers to a mathematical calculation methodology based on accepted financial theories. 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 quoted market parameters such as interest rates, volatility and the creditworthiness of the counterparty.

Interest and dividend revenue and interest expense arising from financial instruments used in trading activities are reflected in the condensed consolidated statements of income as interest and dividend revenue or interest expense. Purchases and sales of financial instruments as well as commission revenues and related expenses are recorded in the accounts on trade date. Unrealized gains and losses arising from the Company's dealings in 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.

Equity securities purchased in connection with private equity and other principal investment activities initially are carried in the condensed consolidated financial statements at their original costs, which approximate fair value. The carrying value of such equity securities is adjusted when changes in the underlying fair values are readily ascertainable, generally as evidenced by observable market prices or transactions that directly affect the

value of such equity securities. Downward adjustments relating to such equity securities are made in the event that the Company determines that the fair value is less than the carrying value. The Company's partnership interests, including general partnership and limited partnership interests in real estate funds, are included within Other assets in the Company's condensed consolidated statements of financial condition and are recorded at fair value based upon changes in the fair value of the underlying partnership's net assets.

Financial Instruments Used for Asset and Liability Management. The Company enters into various derivative financial instruments for non-trading purposes. 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 and include interest rate swaps, foreign currency swaps, equity swaps and foreign exchange forwards. The Company uses interest rate and currency swaps and equity derivatives to manage interest rate, currency and equity price risk arising from certain borrowings. The Company also utilizes interest rate swaps to match the repricing characteristics of consumer loans with those of the borrowings that fund these loans. Certain of these derivative financial instruments are designated and qualify as fair value hedges and cash flow hedges in accordance with Statement of Financial Accounting Standards ("SFAS") No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended.

The Company's designated fair value hedges consist primarily of hedges of fixed rate borrowings, including fixed rate borrowings that fund consumer loans. The Company's designated cash flow hedges consist primarily of hedges of floating rate borrowings in connection with its aircraft financing business. In general, interest rate exposure in this business arises to the extent that the interest obligations associated with debt used to finance the Company's aircraft portfolio do not correlate with the aircraft rental payments received by the Company. The Company's objective is to manage the exposure created by its floating interest rate obligations given that future lease rates on new leases may not be repriced at levels that fully reflect changes in market interest rates. The Company utilizes interest rate swaps to minimize the risk created by its longer-term floating rate interest obligations and measures that risk by reference to the duration of those obligations and the expected sensitivity of future lease rates to future market interest rates.

For qualifying fair value hedges, the changes in the fair value of the derivative and the gain or loss on the hedged asset or liability relating to the risk being hedged are recorded currently in earnings. These amounts are recorded in interest expense and provide offset of one another. For qualifying cash flow hedges, the changes in the fair value of the derivative are recorded in Accumulated other comprehensive income in shareholders' equity, net of tax effects, and amounts in Accumulated other comprehensive income are reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. Ineffectiveness relating to fair value and cash flow hedges, if any, is recorded within interest expense. The impact of hedge ineffectiveness on the Company's condensed consolidated statements of income was not material for all periods presented.

The Company also utilizes foreign exchange forward contracts to manage the currency exposure relating to its net monetary investments in non-U.S. dollar functional currency operations. The gain or loss from revaluing these contracts is deferred and reported within Accumulated other comprehensive income in shareholders' equity, net of tax effects, with the related unrealized amounts due from or to counterparties included in Receivables from or Payables to brokers, dealers and clearing organizations. The interest elements (forward points) on these foreign exchange forward contracts are recorded in earnings.

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, municipal bonds, 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, servicing rights, and 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. 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 obtain 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 servicing revenues that the Company estimates it will receive over the term of the securitized loans is recognized in income as the loans are securitized. A corresponding asset also is recorded and then amortized as a charge to income over the term of the securitized loans, with actual net servicing revenues continuing to be recognized in income as they are earned.

Condensed 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.

During the third quarter of fiscal 2003, in accordance with SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities," the Company modified its classification within the condensed consolidated statement of cash flows of the activity associated with certain derivative financial instruments. The activity related to derivative financial instruments entered into or modified after June 30, 2003, and that have been determined to contain a financing element at inception where the Company is deemed the borrower, are now included within "Cash flows from financing activities." Prior to July 1, 2003, the activity associated with such derivative financial instruments is included within "Cash flows from operating activities."

2. Goodwill.

In accordance with SFAS No. 142, "Goodwill and Other Intangible Assets," the amortization of goodwill and indefinite-lived intangible assets is not permitted. Instead, these assets must be reviewed annually (or more frequently under certain conditions) for impairment. Intangible assets that do not have indefinite lives are to be amortized over their useful lives and reviewed for impairment under certain conditions. During the first quarter of fiscal 2003, the Company completed the annual goodwill impairment test, which did not indicate any goodwill impairment and therefore did not have an effect on the Company's condensed consolidated financial condition or results of operations.

Changes in the carrying amount of the Company's goodwill for the nine month period ended August 31, 2003, were as follows:

	Institutional Securities	Individual Investor Group	Investment Management	Total
		(dollars in millions)		
Balance as of November 30, 2002	$ 4	$478	$967	$1,449
Translation adjustments	—	13	—	13
Other	4	—	—	4
Balance as of August 31, 2003	$ 8	$491	$967	$1,466

3. Securities Financing 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 treated as financing transactions and 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 also are treated as financing transactions and are carried at the amounts of cash collateral advanced and received in connection with the transactions.

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) on the condensed consolidated statements of financial condition. The carrying value and classification of securities owned by the Company that have been loaned or pledged to counterparties where those counterparties do not have the right to sell or repledge the collateral were as follows:

	At August 31, 2003	At November 30, 2002
	(dollars in millions)	
Financial instruments owned:		
U.S. government and agency securities	$ 8,762	$ 9,144
Other sovereign government obligations	147	83
Corporate and other debt	10,019	9,026
Corporate equities	5,693	1,849
Total	$24,621	$20,102

The Company enters into reverse repurchase agreements, repurchase agreements, securities borrowed and securities loaned transactions to, among other things, finance the Company's inventory positions, acquire securities to cover short positions and settle other securities obligations and to accommodate customers' needs. 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 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 transactions or for delivery to counterparties to cover short positions. At August 31, 2003 and November 30, 2002, the fair value of securities received as collateral where the Company is permitted to sell or repledge the securities was $471 billion and $376 billion, respectively, and the fair value of the portion that has been sold or repledged was $431 billion and $344 billion, 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, the Company's collateral policies significantly limit 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 commercial and residential mortgage loans, U.S. agency collateralized mortgage obligations, corporate bonds and loans, municipal bonds 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 Company's Institutional Securities business were approximately $1.8 billion at August 31, 2003, the majority of which were related to U.S. agency collateralized mortgage obligation, residential mortgage loan and commercial mortgage loan securitization transactions. Gains or losses at the time of securitization, if any, were not material to the Company's results of operations, and 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 nine months ended August 31, 2003 were not materially different from the assumptions included in the table below. Additionally, as indicated in the table below, the Company's exposure to credit losses related to these retained interests was not material to the Company's results of operations.

The following table presents information on the Company's U.S. agency collateralized mortgage obligation, residential mortgage loan 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 August 31, 2003 were as follows (dollars in millions):

	U.S. Agency Collateralized Mortgage Obligations	Residential Mortgage Loans	Commercial Mortgage Loans
Retained interests (carrying amount/fair value)	$1,123	$ 370	$ 166
Weighted average life (in months)	88	20	72
Credit losses (rate per annum)	—	0.20-22.62%	0.42-11.35%
Impact on fair value of 10% adverse change	—	$ (31)	$ (1)
Impact on fair value of 20% adverse change	—	$ (57)	$ (2)
Weighted average discount rate (rate per annum)	7.45%	17.76%	5.50%
Impact on fair value of 10% adverse change	$ (37)	$ (9)	$ (3)
Impact on fair value of 20% adverse change	$ (70)	$ (18)	$ (5)
Prepayment speed assumption	170-681PSA	366-1136PSA	—
Impact on fair value of 10% adverse change	$ (9)	$ (28)	—
Impact on fair value of 20% adverse change	$ (16)	$ (34)	—

The table above does not include the offsetting benefit of any financial instruments that the Company may utilize to hedge risks inherent in its retained interests. In addition, the sensitivity analysis is hypothetical and should be used with caution. Changes in fair value based on a 10% or 20% variation in an assumption generally cannot be extrapolated because the relationship of the change in the assumption to the change in fair value may not be linear. Also, the effect of a variation in a particular assumption on the fair value of the retained interests is

calculated independent of changes in any other assumption; in practice, changes in one factor may result in changes in another, which might magnify or counteract the sensitivities. In addition, the sensitivity analysis does not consider any corrective action that the Company may take to mitigate the impact of any adverse changes in the key assumptions.

In connection with its Institutional Securities business, during the nine month period ended August 31, 2003, the Company received $54.7 billion of proceeds from new securitization transactions and $3.6 billion of cash flows from retained interests in securitization transactions.

4. Consumer Loans.

Consumer loans were as follows:

	At August 31, 2003	At November 30, 2002
	(dollars in millions)	
General purpose credit card, mortgage and consumer installment	$19,437	$23,942
Less:		
Allowance for consumer loan losses	988	928
Consumer loans, net	$18,449	$23,014

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

	Three Months Ended August 31,		Nine Months Ended August 31,	
	2003	2002	2003	2002
	(dollars in millions)			
Balance beginning of period	$975	$899	$928	$ 847
Additions:				
Provision for consumer loan losses	310	332	955	1,017
Deductions:				
Charge-offs	328	333	976	1,012
Recoveries	(31)	(29)	(81)	(75)
Net charge-offs	297	304	895	937
Balance end of period	$988	$927	$988	$ 927

Interest accrued on general purpose credit card loans subsequently charged off, recorded as a reduction of interest revenue, was $67 million and $202 million in the quarter and nine month period ended August 31, 2003 and $53 million and $163 million in the quarter and nine month period ended August 31, 2002. Cardmember fees accrued on general purpose credit loans subsequently charged-off, recorded as a reduction to merchant and cardmember fee revenue, was $43 million and $133 million in the quarter and nine month period ended August 31, 2003 and $38 million and $120 million in the quarter and nine month period ended August 31, 2002.

At August 31, 2003, the Company had commitments to extend credit for consumer loans of approximately $262 billion. Commitments to extend credit arise 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 do not necessarily represent future cash requirements, are periodically reviewed based on account usage and customer creditworthiness.

The Company received net proceeds from consumer loan sales of $1,241 million and $9,972 million in the quarter and nine month period ended August 31, 2003 and $1,057 million and $5,514 million in the quarter and nine month period ended August 31, 2002.

The Company's retained interests in credit card asset securitizations include undivided seller's interests, cash collateral accounts, servicing rights and 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. 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. The cash collateral accounts are recorded in Other assets with the carrying value of the cash collateral accounts approximating fair value. The Company receives annual servicing fees of 2% of the investor principal balance outstanding. The Company does not recognize servicing assets or servicing liabilities for servicing rights since the servicing contracts provide only adequate compensation (as defined in SFAS No. 140) to the Company for performing the servicing.

Residual Interests are recorded in Other assets and classified as trading and reflected at fair value with changes in fair value recorded currently in earnings. On December 4, 2002, the Federal Deposit Insurance Corporation ("FDIC"), in conjunction with other bank regulatory agencies, issued guidance, *Interagency Advisory on the Accounting Treatment of Accrued Interest Receivable Related to Credit Card Securitizations*, for the purpose of clarifying the treatment of accrued interest and fees ("accrued interest receivable") on securitized credit card receivables as a subordinated retained interest for accounting purposes. At August 31, 2003, the accrued interest receivable was $0.6 billion and is recorded in Other assets. Including this accrued interest receivable amount, at August 31, 2003 the Company had $8.7 billion of retained interests, including $5.5 billion of undivided seller's interests, 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 nine months ended August 31, 2003, the Company completed credit card asset securitizations of $5.7 billion and recognized net securitization gains of $37 million as servicing fees in the Company's condensed consolidated statements of income. The uncollected balances of general purpose credit card loans sold through asset securitizations were $31.9 billion at August 31, 2003 and $29.0 billion at November 30, 2002.

Key economic assumptions used in measuring the Residual Interests at the date of securitization resulting from credit card asset securitizations completed during the nine months ended August 31, 2003 were as follows:

Weighted average life (in months)	5.6-7.1
Payment rate (rate per month)	14.89-18.00%
Credit losses (rate per annum)	3.86-6.90%
Discount rate (rate per annum)	14.00%

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 August 31, 2003
Residual Interests (carrying amount/fair value)	$ 264
Weighted average life (in months)	5.6
Weighted average payment rate (rate per month)	17.97%
Impact on fair value of 10% adverse change	$ (18)
Impact on fair value of 20% adverse change	$ (34)
Weighted average credit losses (rate per annum)	6.87%
Impact on fair value of 10% adverse change	$ (79)
Impact on fair value of 20% adverse change	$ (158)
Weighted average discount rate (rate per annum)	14.00%
Impact on fair value of 10% adverse change	$ (3)
Impact on fair value of 20% adverse change	$ (6)

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):

	Nine Months Ended August 31, 2003
Proceeds from new credit card asset securitizations	$ 5.7
Proceeds from collections reinvested in previous credit card asset securitizations	$45.8
Contractual servicing fees received	$ 0.5
Cash flows received from retained interests	$ 1.3

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

	At August 31, 2003		Nine Months Ended August 31, 2003	
	Loans Outstanding	Loans Delinquent	Average Loans	Net Credit Losses
Managed general purpose credit card loans	$50.0	$3.0	$51.5	$2.5
Less: Securitized general purpose credit card loans	31.9			
Owned general purpose credit card loans	$18.1			

5. Long-Term Borrowings.

Long-term borrowings at August 31, 2003 scheduled to mature within one year aggregated $11,637 million.

During the nine month period ended August 31, 2003, the Company issued senior notes aggregating $18,759 million, including non-U.S. dollar currency notes aggregating $4,927 million. The Company has entered into certain transactions to obtain floating interest rates based primarily on short-term LIBOR trading levels. Maturities in the aggregate of these notes by fiscal year are as follows: 2003, $12 million; 2004, $732 million; 2005, $2,176 million; 2006, $1,951 million; 2007, $350 million; and thereafter, $13,538 million. In the nine month period ended August 31, 2003, $10,566 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 years at August 31, 2003.

6. Capital Units and Preferred Securities Subject to Mandatory Redemption.

The Company has Capital Units outstanding that were issued by the Company and Morgan Stanley Finance plc ("MSF"), a U.K. subsidiary. A Capital Unit consists of (a) a Subordinated Debenture of MSF guaranteed by the Company and maturing in 2017 and (b) a related Purchase Contract issued by the Company, which may be accelerated by the Company, requiring the holder to purchase one Depositary Share representing shares of the Company's Cumulative Preferred Stock. The aggregate amount of Capital Units outstanding was $66 million at both August 31, 2003 and November 30, 2002.

Preferred Securities Subject to Mandatory Redemption (also referred to as "Capital Securities" herein) represent preferred minority interests in certain of the Company's subsidiaries. Accordingly, dividends paid on Preferred Securities Subject to Mandatory Redemption are presented as a deduction to after-tax income (similar to minority interests in the income of subsidiaries) in the Company's condensed consolidated statements of income.

Morgan Stanley Capital Trust II ("Capital Trust II"), Morgan Stanley Capital Trust III ("Capital Trust III"), Morgan Stanley Capital Trust IV ("Capital Trust IV") and Morgan Stanley Capital Trust V ("Capital Trust V") are consolidated Delaware statutory trusts (all of the common securities of which are owned by the Company) and have Capital Securities outstanding. The trusts invested the proceeds of the Capital Securities offerings and the proceeds from the sale of common securities to the Company in junior subordinated deferrable interest debentures issued by the Company, the terms of which parallel the terms of the Capital Securities. The Capital Securities are fully and unconditionally guaranteed by the Company, based on the Company's combined obligations under a guarantee, a trust agreement and a junior subordinated debt indenture.

During the nine month period ended August 31, 2003, Capital Trust III issued $880 million of 6.25% Capital Securities (the "Capital Securities III"), Capital Trust IV issued $620 million of 6.25% Capital Securities (the "Capital Securities IV") and Capital Trust V issued $500 million of 5.75% Capital Securities (the "Capital Securities V").

During the quarter ended August 31, 2003, the Company redeemed all $400 million of its 7.10% Junior Subordinated Deferrable Interest Debentures held by MSDW Capital Trust I. The Company also simultaneously redeemed all of the outstanding 7.10% Capital Securities of MSDW Capital Trust I at a redemption price of $25 per share.

The significant terms of the Preferred Securities Subject to Mandatory Redemption issued by Capital Trust II, Capital Trust III, Capital Trust IV and Capital Trust V and the corresponding junior subordinated deferrable interest debentures issued by the Company, are presented below:

Preferred Securities Subject to Mandatory Redemption	Capital Trust II	Capital Trust III	Capital Trust IV	Capital Trust V
Issuance Date	July 19, 2001	February 27, 2003	April 21, 2003	July 16, 2003
Preferred securities issued	32,400,000	35,200,000	24,800,000	20,000,000
Liquidation preference per security	$25	$25	$25	$25
Liquidation value (in millions)	$810	$880	$620	$500
Coupon rate	7.25%	6.25%	6.25%	5.75%
Distribution payable	Quarterly	Quarterly	Quarterly	Quarterly
Distributions guaranteed by	Morgan Stanley	Morgan Stanley	Morgan Stanley	Morgan Stanley
Mandatory redemption date	July 31, 2031(1)	March 1, 2033(2)	April 1, 2033(3)	July 15, 2033(4)
Redeemable by issuer on or after(6)	July 31, 2006	March 1, 2008	April 21, 2008	July 16, 2008
Junior Subordinated Deferrable Interest Debentures				
Principal amount outstanding (in millions)(5)	$835	$907	$639	$515
Coupon rate	7.25%	6.25%	6.25%	5.75%
Interest payable	Quarterly	Quarterly	Quarterly	Quarterly
Maturity date	July 31, 2031(1)	March 1, 2033(2)	April 1, 2033(3)	July 15, 2033(4)
Redeemable by issuer on or after(6)	July 31, 2006	March 1, 2008	April 21, 2008	July 16, 2008

(1) May be extended to a date not later than July 31, 2050.
(2) May be extended to a date not later than March 1, 2052.
(3) May be extended to a date not later than April 1, 2052.
(4) May be extended to a date not later than July 16, 2052.
(5) Purchased by the trusts with the proceeds of the Capital Securities offerings and the proceeds from the sale of common securities to the Company.
(6) Redeemable prior to this date in whole (but not in part) upon the occurrence of certain events.

As of September 1, 2003, in connection with the Company's adoption of SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity," Preferred Securities Subject to Mandatory Redemption of $2,810 million will be reclassified and reported within Long-term borrowings, and the associated financing costs will be recorded within interest expense.

In addition, based on the most recent interpretation of FIN 46, the Company may deconsolidate all of its statutory trusts (Capital Trust II, III, IV and V) in the first quarter of fiscal 2004. As a result, the junior subordinated deferrable interest debentures issued by the Company to the statutory trusts would be included within the Long-term borrowings of the Company, and the common securities issued by the trusts and owned by the Company would be recorded by the Company as an asset. In addition, the Capital Securities issued by the statutory trusts would no longer be included in the Company's consolidated statement of financial condition. The impact of the deconsolidation of the statutory trusts will not have a material effect on the Company's consolidated financial position or results of operations.

7. Common Stock and Shareholders' Equity.

MS&Co. and MSDWI are registered broker-dealers and registered futures commission merchants and, accordingly, are subject to the minimum net capital requirements of the Securities and Exchange Commission, the New York Stock Exchange and the Commodity Futures Trading Commission. MS&Co. and MSDWI have

consistently operated in excess of these requirements. MS&Co.'s net capital totaled $4,165 million at August 31, 2003, which exceeded the amount required by $3,476 million. MSDWI's net capital totaled $1,065 million at August 31, 2003, which exceeded the amount required by $970 million. MSIL, a London-based broker-dealer subsidiary, is subject to the capital requirements of the Financial Services Authority, and MSJL, a Tokyo-based broker-dealer, is subject to the capital requirements of the Financial Services Agency. MSIL and MSJL have consistently operated in excess of their respective regulatory capital requirements.

Under regulatory capital requirements adopted by 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 August 31, 2003, 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.

In fiscal 2002, the FDIC, in conjunction with other bank regulatory agencies, issued guidance requiring FDIC-insured financial institutions to treat accrued interest receivable related to credit card securitizations as a subordinated retained interest, which requires holding higher regulatory capital beginning December 31, 2002. After implementing this revised guidance, the Company's FDIC-insured financial institutions have maintained capital ratios in excess of the 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.

During the nine month periods ended August 31, 2003 and 2002, the Company purchased approximately $350 million and $671 million of its common stock, respectively, through open market purchases at an average cost of $39.12 and $49.34 per share, respectively.

8. Earnings per Share.

Basic EPS reflects no dilution from common stock equivalents. Diluted EPS reflects dilution from common stock equivalents and other dilutive securities based on the average price per share of the Company's common stock during the period. The following table presents the calculation of basic and diluted EPS (in millions, except for per share data):

	Three Months Ended August 31,		Nine Months Ended August 31,	
	2003	2002	2003	2002
Basic EPS:				
Net income available to common shareholders	$1,269	$ 611	$2,773	$2,256
Weighted-average common shares outstanding	1,078	1,082	1,077	1,084
Basic EPS	$ 1.18	$ 0.57	$ 2.57	$ 2.08

	Three Months Ended August 31,		Nine Months Ended August 31,	
	2003	2002	2003	2002
Diluted EPS:				
Net income available to common shareholders	$1,269	$ 611	$2,773	$2,256
Weighted-average common shares outstanding	1,078	1,082	1,077	1,084
Effect of dilutive securities:				
Stock options	22	23	20	27
Convertible debt	1	1	1	1
Weighted-average common shares outstanding and common stock equivalents	1,101	1,106	1,098	1,112
Diluted EPS	$ 1.15	$ 0.55	$ 2.52	$ 2.03

At August 31, 2003, approximately 63 million stock options were outstanding that were excluded from the computation of diluted EPS, as the exercise price of such options exceeded the average price per share of the Company's common stock for the three and nine month periods ended August 31, 2003.

9. Commitments and Contingencies.

At August 31, 2003 and November 30, 2002, the Company had approximately $5.6 billion and $3.6 billion, respectively, of letters of credit outstanding to satisfy various collateral requirements.

At August 31, 2003, the Company had $471 million of commitments in connection with its private equity and other principal investment activities. 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.

In connection with certain of its business activities, the Company provides to corporate clients, on a selective basis, through subsidiaries (including Morgan Stanley Bank), loans or lending commitments, including bridge financing. The borrowers may be rated investment grade or non-investment grade. These loans and commitments have varying terms, may be senior or subordinated, are generally contingent upon representations, warranties and contractual conditions applicable to the borrower, and may be syndicated or traded by the Company. At August 31, 2003 and November 30, 2002, the aggregate value of investment grade loans and positions was $1.2 billion and $1.3 billion, respectively, and the aggregate value of non-investment grade loans and positions was $1.0 billion and $1.2 billion, respectively. At both August 31, 2003 and November 30, 2002, the Company's aggregate investment grade lending commitments were $13.8 billion and its aggregate non-investment grade lending commitments were $1.1 billion and $1.3 billion, respectively. In connection with these business activities (which include the loans and positions and lending commitments), the Company had hedges with a notional amount of $4.0 billion at August 31, 2003 and $4.4 billion at November 30, 2002.

Financial instruments sold, not yet purchased, represent 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.

At August 31, 2003, the Company had commitments to enter into reverse repurchase and repurchase agreements of approximately $35 billion and $34 billion, respectively.

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 which legal actions include claims for substantial compensatory and/or punitive damages or claims for indeterminate amounts of damages. The Company also is involved, from time to time, in investigations and proceedings by governmental and self-regulatory agencies, certain of which may result in adverse judgments, fines or penalties. The number of these investigations and proceedings has increased in recent years with regard to many firms, including the Company. In some cases, the issuers that would otherwise be the primary defendants in such cases are bankrupt or otherwise in financial distress.

In view of the inherent difficulty of predicting the outcome of such matters, particularly in cases in which claimants seek substantial or indeterminate damages, the Company cannot predict with certainty the eventual loss or range of loss related to such matters. The Company is contesting liability and/or the amount of damages in each pending matter and believes, based on current knowledge and after consultation with counsel, that the outcome of each matter will not have a material adverse effect on the condensed consolidated financial condition of the Company, although the outcome 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 income for such period.

10. 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 swap agreements and other derivatives in managing its interest rate exposure. The Company also uses forward and option contracts, futures and swaps in its trading activities; these derivative instruments also are used to hedge the U.S. dollar cost of certain foreign currency exposures. In addition, financial futures and forward contracts are actively traded by the Company and are used to hedge proprietary inventory. The Company also enters into delayed delivery, when-issued, and warrant and option contracts involving securities. These instruments generally represent future commitments to swap interest payment streams, exchange currencies or purchase or sell 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 and options and warrants on equities typically have longer maturities. For further discussion of these matters, refer to "Management's Discussion and Analysis of Financial Condition and Results of Operations—Derivative Financial Instruments" and Note 11 to the consolidated financial statements for the fiscal year ended November 30, 2002, included in the Form 10-K.

These derivative instruments involve varying degrees of market risk. 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 less than or exceeding fair value amounts recognized in the condensed consolidated statements of financial condition, which, as described in Note 1, are recorded at fair value.

The fair value (carrying amount) of derivative instruments represents the amount at which the derivative could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale, and is further described in Note 1. 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 unrealized gains and losses on exchange traded and OTC options and other contracts (including interest rate, foreign exchange, and other forward contracts and swaps) for derivatives used by the Company 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 collateral, which the Company obtains with respect to certain of these transactions to reduce its exposure to credit losses (see "Quantitative and Qualitative Disclosures about Market Risk—Credit Risk" in Part I, Item 3).

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 believes the ultimate settlement of the transactions outstanding at August 31, 2003 will not have a material effect on the Company's financial condition.

The Company's derivatives (both listed and OTC) at August 31, 2003 and November 30, 2002 are summarized in the table below, showing the fair value of the related assets and liabilities by product:

	At August 31, 2003		At November 30, 2002	
	Assets	Liabilities	Assets	Liabilities
	(dollars in millions)			
Interest rate and currency swaps and options, credit derivatives and other fixed income securities contracts	$26,827	$19,435	$25,456	$18,225
Foreign exchange forward contracts and options	4,033	3,792	2,308	2,508
Equity securities contracts (including equity swaps, warrants and options)	6,310	7,594	3,933	4,472
Commodity forwards, options and swaps	6,336	5,187	3,918	3,780
Total	$43,506	$36,008	$35,615	$28,985

A substantial portion of the Company's securities and commodities transactions are collateralized and are executed with and on behalf of commercial banks and other institutional investors, including other brokers and dealers.

Positions taken and commitments made by the Company, including positions taken and underwriting and financing commitments made in connection with its private equity and other principal investment activities, often involve substantial amounts and significant exposure to individual issuers and businesses, including non-investment grade issuers. The Company seeks to limit concentration risk created in its businesses through a variety of separate but complementary financial, position and credit exposure reporting systems, including the use of trading limits based in part upon the Company's review of the financial condition and credit ratings of its counterparties.

See also "Risk Management" in the Form 10-K for discussions of the Company's risk management policies and procedures for its securities businesses.

11. 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, Individual Investor Group, Investment Management and Credit Services. Certain reclassifications have been made to prior-period amounts to conform to the current year's presentation.

The Company's Institutional Securities business includes securities underwriting and distribution; financial advisory services, including advice on mergers and acquisitions, restructurings, real estate and project finance; 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; principal investing and aircraft financing activities. The Company's Individual Investor Group business provides comprehensive financial planning and investment advisory services designed to accommodate individual investment goals and risk profiles. The Company's Investment Management business provides global asset management products and services for individual and institutional investors through three principal distribution channels: a proprietary channel consisting of the Company's financial advisors and investment representatives; a non-proprietary channel consisting of third-party broker-dealers, banks, financial planners and other intermediaries; and the Company's institutional channel. The Company's private equity activities also are included within the Investment Management business segment. The Company's Credit Services business offers Discover-branded cards and other consumer finance products and services and includes the operation of Discover Business Services, a network of merchant and cash access locations primarily in the U.S.

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 revenues or other relevant measures.

As previously disclosed, the Company has been reviewing its segment allocation methodology. This review resulted in the reallocation of certain revenues and expenses in the third quarter of fiscal 2003 among the Company's business segments: Institutional Securities, Individual Investor Group, Investment Management and Credit Services. The Company believes that the results of these reallocations better reflect the economics of each business segment by representing transactions as if conducted between a segment and an external party. Prior periods have been restated to reflect these segment allocation changes. While the segment allocation changes had no effect on the Company's consolidated net income, they affected the net income of each segment.

The principal revenues and expenses that have been reallocated among the segments are:

- *Retail Customer Fixed Income Transactions.* The results of the individual fixed income business are now allocated between Institutional Securities and Individual Investor Group to reflect the relative value from both the execution of the retail customer trading activities through Institutional Securities and the retail customer relationship management through Individual Investor Group. Previously, the trading results of this business were reflected entirely in Institutional Securities.
- *Money Market Funds.* Retail customers of Individual Investor Group invest in money market funds managed by the Company. A percentage of the fund management fees associated with these investments is now allocated to Individual Investor Group. Previously, all of these fees were reflected in Investment Management.
- *Transfer Agency Costs.* Individual Investor Group provides certain transfer agency-related activities for mutual funds, including funds managed by the Company. Investment Management receives revenues from these funds and now reimburses certain transfer agency-related costs, including costs related to mailings, to Individual Investor Group. Previously, these costs were not reimbursed by Investment Management.
- *Certain Mutual Fund Distribution Fees.* Certain retail customers invest in shares of mutual funds managed by the Company. The segment results now reflect the establishment of a third party distribution relationship between Investment Management and Individual Investor Group relating to the

sales of these funds. Accordingly, Investment Management now reports the distribution fees, contingent deferred sales charge revenues and commission expenses paid to Individual Investor Group associated with these sales. Individual Investor Group results now reflect these commission revenues associated with current period sales. Previously, all of the revenues and expenses associated with these transactions were reported by Individual Investor Group.

As a result of treating these intersegment transactions as transactions with external parties, the Company has included a new "Intersegment Eliminations" category to reconcile the segment results to the Company's consolidated results. The net income in Intersegment Eliminations represents the effect of timing differences associated with the revenue and expense recognition of commissions paid by Investment Management to Individual Investor Group and the related compensation costs paid to Individual Investor Group's financial advisors.

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

Three Months Ended August 31, 2003	Institutional Securities	Individual Investor Group	Investment Management	Credit Services	Intersegment Eliminations	Total
			(dollars in millions)			
Net revenues excluding net interest	$3,003	$1,000	$655	$510	$(83)	$5,085
Net interest	(210)	54	(2)	324	—	166
Net revenues	$2,793	$1,054	$653	$834	$(83)	$5,251
Income before income taxes and dividends on preferred securities subject to mandatory redemption	$1,204	$ 193	$157	$292	$ 31	$1,877
Provision for income taxes	332	68	41	107	13	561
Dividends on preferred securities subject to mandatory redemption	47	—	—	—	—	47
Net income	$ 825	$ 125	$116	$185	$ 18	$1,269

Three Months Ended August 31, 2002(1)	Institutional Securities	Individual Investor Group	Investment Management	Credit Services	Intersegment Eliminations	Total
			(dollars in millions)			
Net revenues excluding net interest	$1,383	$ 963	$637	$549	$(81)	$3,451
Net interest	734	65	5	384	—	1,188
Net revenues	$2,117	$1,028	$642	$933	$(81)	$4,639
Income before income taxes and dividends on preferred securities subject to mandatory redemption	$ 418	$ 35	$165	$316	$ 35	$ 969
Provision for income taxes	133	17	68	107	12	337
Dividends on preferred securities subject to mandatory redemption	21	—	—	—	—	21
Net income	$ 264	$ 18	$ 97	$209	$ 23	$ 611

Nine Months Ended August 31, 2003	Institutional Securities	Individual Investor Group	Investment Management	Credit Services	Intersegment Eliminations	Total
			(dollars in millions)			
Net revenues excluding net interest	$ 7,839	$ 2,771	$1,854	$ 1,639	$(232)	$13,871
Net interest	768	157	(3)	977	—	1,899
Net revenues	$ 8,607	$ 2,928	$1,851	$ 2,616	$(232)	$15,770
Income before income taxes and dividends on preferred securities subject to mandatory redemption	$ 2,545	$ 306	$ 390	$ 884	$93	$ 4,218
Provision for income taxes	725	120	125	327	39	1,336
Dividends on preferred securities subject to mandatory redemption	109	—	—	—	—	109
Net income	$ 1,711	$ 186	$ 265	$ 557	$54	$ 2,773

Nine Months Ended August 31, 2002(1)	Institutional Securities	Individual Investor Group	Investment Management	Credit Services	Intersegment Eliminations	Total
			(dollars in millions)			
Net revenues excluding net interest	$ 5,371	$ 2,941	$2,082	$ 1,618	$(264)	$11,748
Net interest	1,901	193	15	1,012	—	3,121
Net revenues	$ 7,272	$ 3,134	$2,097	$ 2,630	$(264)	$14,869
Income before income taxes and dividends on preferred securities subject to mandatory redemption	$ 1,909	$ 130	$ 550	$ 879	$95	$ 3,563
Provision for income taxes	625	60	216	310	31	1,242
Dividends on preferred securities subject to mandatory redemption	65	—	—	—	—	65
Net income	$ 1,219	$ 70	$ 334	$ 569	$64	$ 2,256

Total Assets(1)(2)	Institutional Securities	Individual Investor Group	Investment Management	Credit Services	Intersegment Eliminations	Total
			(dollars in millions)			
August 31, 2003	$536,612	$14,063	$5,912	$24,358	$(313)	$580,632
November 30, 2002	$484,891	$11,054	$5,508	$28,443	$(397)	$529,499

(1) Certain reclassifications have been made to prior period amounts to conform to the current presentation.
(2) Corporate assets have been fully allocated to the Company's business segments.

12. Asset Impairment.

As disclosed in Note 19 to the Company's consolidated financial statements included in the Form 10-K, the Company has determined to use "market value" estimates provided by independent appraisers to estimate fair value for its impaired aircraft. Prior to fiscal 2003, the Company had used "base value" estimates provided by independent appraisers to estimate the fair value of its impaired aircraft. Accordingly, during the first quarter of fiscal 2003, the Company recorded a non-cash pre-tax charge of $36 million to adjust the carrying value of previously impaired aircraft to "market value". The charge is reflected in Other expenses in the Company's condensed consolidated statements of income. The results of the aircraft financing business are included in the Company's Institutional Securities business segment (see Note 11).

In accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," during the quarter ended May 31, 2003, the Company reviewed its aircraft assets for impairment. The Company believed that the review was necessary given the difficult conditions existing in the commercial aircraft industry during

the quarter, including the adverse impact of the military conflict in Iraq, the outbreak of Severe Acute Respiratory Syndrome and the bankruptcy of several airlines.

In accordance with SFAS No. 144, the Company tested each of its aircraft for impairment by comparing each aircraft's projected undiscounted cash flows to its respective carrying value. For each aircraft for which impairment was indicated (because the projected undiscounted cash flows were less than the carrying value), the Company adjusted the carrying value of each aircraft to its fair value, if lower than carrying value. To determine each aircraft's fair value, the Company used market value estimates provided by independent appraisers (BK Associates, Inc., Morten Beyer & Agnew, Inc. and Airclaims Limited). As a result of this review, the Company recorded a non-cash pre-tax asset impairment charge of $287 million based on the average market value provided by independent appraisers in the quarter ended May 31, 2003. The impairment charge is included within Other expenses in the Company's condensed consolidated statement of income.

The Company has followed a valuation methodology designed to align the changes in projected undiscounted cash flows for impaired aircraft with the change in carrying value of such aircraft. Under this methodology, the Company calculated the $36 million impairment charge in the quarter ended February 28, 2003 using the highest portfolio valuation provided by the appraisers and calculated the $287 million impairment charge recorded in the quarter ended May 31, 2003 based on the average of the three appraisal values. The Company has determined that future impairment charges, if required, will be based upon the average market appraisal values from independent appraisers. If the average market appraisal values had been used to measure impairment in each of the prior quarters in which impairment was recognized pre-tax income would have differed as follows:

	Change in Pre-Tax Income Increase (Decrease)
	(in millions)
Quarter Ended:	
November 30, 2001	$(70.9)
February 28, 2002	1.0
May 31, 2002	1.5
August 31, 2002	(71.9)
November 30, 2002	2.7
February 28, 2003	38.3
May 31, 2003	97.0
Aggregate Difference	$ (2.3)

The current market environment continues to be characterized by distressed sellers and limited sales activity. If the Company chose to liquidate its entire fleet ($4.5 billion carrying value at August 31, 2003) at this time, which is not currently contemplated, the Company believes that, given these distressed market conditions and based upon the range of values provided by independent appraisers at the last impairment date, it could be forced to accept a value for its entire fleet that is substantially lower (up to approximately 30%) than the carrying value of the fleet. The Company has not recorded an impairment charge of this magnitude because at the last impairment date there was no indication of impairment for the majority of the individual aircrafts as their undiscounted cash flows exceeded their respective carrying values.

13. Variable Interest Entities.

In January 2003, the FASB issued FIN 46, which clarifies the application of Accounting Research Bulletin No. 51, "Consolidated Financial Statements," 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 ("VIEs") are required to be consolidated by their primary beneficiaries if they do not effectively disperse risks among parties involved. Under FIN 46, 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. FIN 46 also requires new disclosures about VIEs.

On February 1, 2003, the Company adopted FIN 46 for VIEs created after January 31, 2003 and for VIEs in which the Company obtains an interest after January 31, 2003. In October 2003, the FASB agreed to defer the effective date of FIN 46 for arrangements with VIEs existing prior to February 1, 2003 to fiscal periods ending after December 15, 2003. Therefore, the Company plans to adopt FIN 46 in the first quarter of fiscal 2004 for VIEs in which it holds a variable interest that it had acquired before February 1, 2003. For these variable interests, the Company will consolidate, in the first quarter of fiscal 2004, those VIEs (including financial asset-backed securitization, credit-linked note, structured note, municipal bond trust, collateralized loan obligation and exchangeable trust entities) in which the Company is the primary beneficiary. This accounting change is not expected to have a material effect on the Company's consolidated results of operations or consolidated financial position. In limited instances, the Company may deconsolidate VIEs for which it is not the primary beneficiary as a result of the adoption of FIN 46 in the first quarter of fiscal 2004. This is further discussed in Note 6 with respect to the statutory trust entities (Capital Trusts II, III, IV and V.) 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 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 currently consolidates entities in which it has a controlling financial interest in accordance with accounting principles generally accepted in the U.S. 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.

At August 31, 2003, in connection with its Institutional Securities business, the aggregate size of VIEs, including collateralized debt obligation and municipal bond trust entities, for which the Company was the primary beneficiary of the entities was approximately $450 million, 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 was to issue a series of notes to investors that provide the investors a return based on the holdings of the entities. These transactions were executed to facilitate customer investment objectives. The municipal bond transactions were also executed as a means of selling financial assets. The Company retained either the entire class or a majority of the class of subordinated notes and as a result bears the majority of the expected losses of the entities. The Company consolidates these entities, in accordance with its consolidation accounting policy, and as a result eliminates all intercompany transactions, including derivatives and other intercompany transactions such as fees received to underwrite the notes or structure the transactions. The Company accounts for the assets held by the entities as Financial instruments owned and the liabilities of the entities as financings. For the collateralized debt obligation entity, the liabilities include an embedded derivative that the Company has bifurcated in accordance with SFAS No. 133. For the municipal bond trust entities, the Company treats the transfers of assets as secured borrowings and then consolidates the entities. The beneficial interests of these consolidated entities are payable solely from the cash flows of the related collateral. At August 31, 2003, also in connection with its Institutional Securities business, the aggregate size of the entities for which the Company holds significant variable interests, which were acquired after January 31, 2003 and consist of subordinated and other classes of beneficial interests, was approximately $1.3 billion. The Company's variable interests associated with these entities, primarily credit-linked note, structured note, loan and bond issuing and collateralized debt obligation entities, was approximately $863 million, which represents the Company's maximum exposure to loss at August 31, 2003.

The Company believes that it is reasonably possible that it will either disclose information in its Form 10-Q for the first quarter of fiscal 2004 about certain VIEs created before February 1, 2003 for which it holds a significant variable interest or it will be the primary beneficiary of the entity and thus required to consolidate the VIE in the first quarter of fiscal 2004. At August 31, 2003, in connection with its Institutional Securities business, the aggregate size of the entities for which the Company's interest is either significant or for which the Company could be deemed to be the primary beneficiary of the entity was approximately $2.4 billion. The Company's variable interests associated with these entities, primarily financial asset-backed securitization, credit-linked note, collateralized bond obligation, exchangeable trust, municipal bond trust and structured note entities, was approximately $425 million, which represents the Company's maximum exposure to loss at August 31, 2003. The Company hedges 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. In connection with its Investment Management business, where the Company is the asset manager for collateralized bond and loan obligation entities, the aggregate size of a potential VIE at August 31, 2003 was approximately $713 million where it is reasonably possible that the Company will be the primary beneficiary in the first quarter of fiscal 2004. The Company's variable interests associated with this VIE was approximately $0.7 million, which represents the Company's maximum exposure to loss at August 31, 2003.

The Company purchases and sells interests in entities that may be deemed to be VIEs in its market-making capacity in the ordinary course of its Institutional Securities business. As a result of these activities, it is reasonably possible that such entities may be consolidated and deconsolidated at various points in time. Therefore, the Company's variable interests included above may not be held by the Company at the end of the first quarter of fiscal 2004.

14. Guarantees.

FASB Interpretation No. 45 ("FIN 45"), "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others," requires the Company to disclose information about its obligations under certain guarantee arrangements. FIN 45 defines guarantees as contracts and indemnification agreements that contingently require a guarantor to make payments to the guaranteed party based on changes in an underlying (such as an interest or foreign exchange rate, security or commodity price, an index or the occurrence or nonoccurrence of a specified event) related to an asset, liability or equity security of a guaranteed party. FIN 45 also defines guarantees as 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. There was no change in the amount of liability recognized for non-derivative guarantees issued or modified after December 31, 2002 as a result of the adoption of FIN 45.

Under FIN 45, 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 FIN 45 definition of a guarantee. 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. However, 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.

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 records all derivative contracts on its condensed consolidated statements of financial condition at fair value and believes that the notional amounts of the derivative contracts generally overstate its exposure. For further discussion of the Company's derivative risk management activities see Note 11 to the Company's consolidated financial statements in the Form 10-K and "Quantitative and Qualitative Disclosures about Market Risk—Risk Management" in Part II, Item 7A of the Form 10-K.

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. The Company has also entered into liquidity facilities with special purpose entities ("SPEs") 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 SPEs in the event payments are required under such liquidity facilities. 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.

The table below summarizes certain information regarding these guarantees at August 31, 2003:

	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)						
Derivative contracts	$310,518	$136,336	$144,541	$144,675	$736,070	$16,062	$ 66
Standby letters of credit and other financial guarantees	487	238	89	23	837	14	90
Market value guarantees	—	13	107	202	322	19	24
Liquidity facilities	475	—	20	218	713	—	—

In the normal course of its business, the Company provides standard indemnities to counterparties for taxes, including U.S. and foreign withholding taxes, on interest and other payments made on derivatives, securities and stock lending transactions and certain annuity products. These indemnity payments could be required based on a change in the tax laws or change in interpretation of applicable tax rulings. 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.

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.

As a general partner in certain private equity and real estate partnerships, the Company receives distributions from the partnerships according to the provisions of the partnership agreements. The Company may, from time to time, be required to return all or a portion of such distributions to the limited partners in the event the limited partners do not achieve a certain return as specified in various partnership agreements, subject to certain limitations. The maximum potential amount of future payments that the Company could be required to make under these provisions at August 31, 2003 was $123 million. As of August 31, 2003, the Company's liability for distributions that the Company has determined it is probable it will be required to refund based on the applicable refund criteria specified in the various partnership agreements was $64 million.

As part of the Company's Institutional Securities and Credit Services 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 if the collateral maintained in the securities accounts (along with the associated real estate collateral) is insufficient to cover losses that purchasers experience as a result of defaults by borrowers on the underlying residential mortgage loans. The Company requires the borrowers to meet daily collateral calls to ensure the marketable securities pledged in lieu of a cash down payment are sufficient. At August 31, 2003, the maximum potential amount of future payments the Company may be required to make under its surety bond was $184 million, which represents the value of the marketable securities pledged by the borrowers as collateral in lieu of a cash down payment. 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.

In connection with its Credit Services business, the Company owns and operates merchant processing services in the U.S. related to its general purpose credit cards. As a merchant processor in the U.S. and an issuer of credit cards in the U.K., the Company is contingently liable for processed credit card sales transactions in the event of a dispute between the cardmember and a merchant. If a dispute is resolved in the cardmember's favor, the Company will credit or refund the amount to the cardmember and chargeback the transaction to the merchant. If the Company is unable to collect the amount from the merchant, the Company will bear the loss for the amount credited or refunded to the cardmember. In most instances, a payment requirement by the Company 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 Company increases. The maximum potential amount of future payments related to this contingent liability is estimated to be the total cardmember sales transaction volume to date that could qualify as a valid disputed transaction under the Company's merchant processing network and cardmember agreements; however, the Company believes that this amount is not representative of

the Company's actual potential loss exposure based on the Company's historical experience. For example, the Company processes cardmember transactions for airline ticket purchases. In the event an airline ceases operations, the Company could be contingently liable to its cardmembers for refunds of the ticket purchase prices. The maximum potential amount of future payments related to this contingent liability is estimated to be the total cardmember airline ticket transaction volume as of August 31, 2003 to the extent that such travel has not yet occurred.

During the quarter and nine months ended August 31, 2003, the Company incurred losses related to merchant chargebacks of $3 million and $12 million, respectively, and processed aggregate credit card transaction volume of $24.8 billion and $74.8 billion, respectively. The amount of the liability related to the Company's credit cardmember merchant guarantee was not material at August 31, 2003. 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. At August 31, 2003, the Company had settlement withholdings and escrow deposits of $37 million.

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 are therefore generally short-term in nature. The maximum potential amount of future payments that the Company could be required to make can not be estimated. 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 and therefore no contingent liability has been recorded.

15. Equity-Based Compensation Program.

Effective December 1, 2002, the Company adopted SFAS No. 123, "Accounting for Stock-Based Compensation," as amended by SFAS No. 148, "Accounting for Stock-Based Compensation—Transition and Disclosure, an amendment of FASB Statement No. 123," using the prospective adoption method (see Note 2 to the Company's consolidated financial statements included in the Form 10-K). The Company now records compensation expense based upon the fair value of stock-based awards (both restricted stock and stock options). In prior years, the Company accounted for its stock-based awards under the intrinsic value approach in accordance with Accounting Principles Board ("APB") Opinion No. 25 ("APB 25"), "Accounting for Stock Issued to Employees." Under the approach in APB 25, the Company recognized compensation expense for restricted stock awards in the year of grant; however, no compensation expense was generally recognized for stock option grants.

During the third quarter of fiscal 2003, the Company completed an extensive analysis of its stock-based compensation program and revised elements of its program to encourage and incent long-term performance, enhance employee retention, and better align employee and shareholder interests. The revisions to fiscal 2003 awards will include extending the vesting and non-compete provisions and raising the eligibility requirements to participate in such awards.

As a result of the revisions to its stock-based compensation program, the Company will recognize the fair value of stock-based awards granted in fiscal 2003 over service periods of 3 or 4 years, including the year of grant. Historically, the service period for stock-based awards was deemed to be the year of grant.

The year-to-date impact of these revisions is included in the Company's compensation and benefits expense for the third quarter of fiscal 2003. The effect of the changes for the quarter and nine month period ended August 31, 2003 reduced compensation and benefits expense by $519 million as compared to the quarter and nine month period expense had the Company continued to recognize the full expense in the year of grant. Net income increased by $350 million (or $0.32 per share) in the quarter and nine month period ended August 31, 2003 as compared to the quarter and nine month period net income had the Company continued to recognize the full expense in the year of grant.

16. Stock Option Awards.

Effective for fiscal 2003, the Company adopted the fair value-based method of SFAS No. 123, using the prospective adoption method. Under this method of adoption, compensation expense is recognized based on the fair value of stock options and restricted stock granted during fiscal 2003 and future years.

Stock option awards have been granted pursuant to several equity-based compensation plans. Historically, these plans have generally provided for the granting of stock options having an exercise price not less than the fair value of the Company's common stock (as defined in the plans) on the date of grant. Such options generally become exercisable over a one- to five-year period and expire seven to 10 years from the date of grant.

The following table presents the effect on net income and earnings per share if the fair value based method had been applied to all awards in each period:

	Three Months Ended August 31,		Nine Months Ended August 31,	
	2003	2002	2003	2002
	(dollars in millions)			
Net income, as reported	$1,269	$ 611	$2,773	$2,256
Add: Employee stock-based compensation expense included in reported net income, net of related tax effects	1	—	4	—
Deduct: Employee stock-based compensation expense determined under fair value based method for all awards, net of related tax effects	(1)	(5)	(4)	(34)
Pro forma net income	$1,269	$ 606	$2,773	$2,222

	Three Months Ended August 31,		Nine Months Ended August 31,	
	2003	2002	2003	2002
Earnings per share:				
Basic—as reported	$ 1.18	$0.57	$ 2.57	$ 2.08
Basic—pro forma	$ 1.18	$0.56	$ 2.57	$ 2.05
Diluted—as reported	$ 1.15	$0.55	$ 2.52	$ 2.03
Diluted—pro forma	$ 1.15	$0.55	$ 2.52	$ 1.99

The weighted average fair value at date of grant for stock options granted during the quarters ended August 31, 2003 and 2002 was $15.20 and $17.21 per option, respectively. The weighted average fair value at date of grant for stock options granted during the nine month periods ended August 31, 2003 and 2002 was $14.74 and $24.05 per option, respectively. The fair value of stock options at date of grant was estimated using the Black-Scholes option pricing model.

17. Restructuring and Other Charges.

In the fourth quarter of fiscal 2002, the Company recognized restructuring and other charges of $235 million (pre-tax). The charge reflected several actions that were intended to resize and refocus certain business areas in order to address the difficult conditions in the global financial markets. Such conditions, including significantly lower levels of investment banking activity and decreased retail investor participation in the equity markets, have had an adverse impact on the Company's results of operations, particularly in its Institutional Securities and Individual Investor Group businesses.

This charge consisted of space-related costs of $162 million and severance-related costs of $73 million. The space-related costs were attributable to the closure or subletting of excess office space, primarily in the U.S. and the U.K., as well as the Company's decision to consolidate its Individual Investor Group branch locations. The majority of the space-related costs consisted of rental charges and the write-off of furniture, fixtures and other fixed assets at the affected office locations. The severance-related costs were attributable to workforce reductions. The Company reduced the number of its employees by approximately 2,200 during the fourth quarter of fiscal 2002, primarily in the Institutional Securities and Individual Investor Group businesses. The majority of the severance-related costs consisted of severance payments provided to the affected individuals.

At August 31, 2003, the remaining liability associated with these charges was approximately $120 million, which was included in Other liabilities and accrued expenses in the Company's condensed consolidated statement of financial condition. The majority of the decrease from the original liability of $235 million was due to cash payments of severance-related costs that were made by the Company during the nine month period ended August 31, 2003. The decline in the liability balance during the nine month period ended August 31, 2003 also reflected net rental payments associated with the office locations referred to above.

18. Asset Disposition.

During the third quarter of fiscal 2002, the Company sold its self-directed online brokerage accounts to Bank of Montreal's Harris*direct.* The Company recorded gross proceeds of approximately $100 million (included within Other revenues) and related costs of approximately $50 million (included within Other expenses) in the Individual Investor Group segment.

19. Gain on Sale of Building.

During the nine month period ended August 31, 2002, the Company recorded a pre-tax gain of $73 million (included within Other revenues) related to the sale of an office tower in New York City. The pre-tax gain was included within the Institutional Securities ($53 million), Individual Investor Group ($7 million) and Investment Management ($13 million) business segments. The allocation of the gain among segments was based upon occupancy levels originally planned for the building.

INDEPENDENT ACCOUNTANTS' REPORT

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 as of August 31, 2003, and the related condensed consolidated statements of income and comprehensive income for the three-month and nine-month periods ended August 31, 2003 and 2002, and condensed consolidated statements of cash flows for the nine-month periods ended August 31, 2003 and 2002. These condensed consolidated financial statements are the responsibility of the management of Morgan Stanley.

We conducted our review in accordance with standards established by the American Institute of Certified Public Accountants. A review of interim financial information consists principally of applying analytical procedures to financial data and of making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with auditing standards generally accepted in the United States of America, 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 review, we are not aware of any material modifications that should be made to such condensed consolidated 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 auditing standards generally accepted in the United States of America, the consolidated statement of financial condition of Morgan Stanley and subsidiaries as of November 30, 2002, 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 Annual Report on Form 10-K for the fiscal year ended November 30, 2002; and, in our report dated January 10, 2003, 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, 2002 is fairly stated, in all material respects, in relation to the consolidated statement of financial condition from which it has been derived.

/S/ DELOITTE & TOUCHE LLP

New York, New York
October 10, 2003

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 leading market positions in each of its business segments—Institutional Securities, Individual Investor Group, Investment Management and Credit Services. The Company's Institutional Securities business includes securities underwriting and distribution; financial advisory services, including advice on mergers and acquisitions, restructurings, real estate and project finance; 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; principal investing and aircraft financing activities. The Company's Individual Investor Group business provides comprehensive financial planning and investment advisory services designed to accommodate individual investment goals and risk profiles. The Company's Investment Management business provides global asset management products and services for individual and institutional investors through three principal distribution channels: a proprietary channel consisting of the Company's financial advisors and investment representatives; a non-proprietary channel consisting of third-party broker-dealers, banks, financial planners and other intermediaries; and the Company's institutional channel. The Company's private equity activities also are included within the Investment Management business segment. The Company's Credit Services business offers Discover®-branded cards and other consumer finance products and services and includes the operation of Discover Business Services, a network of merchant and cash access locations primarily in the U.S.

Results of Operations*

Certain Factors Affecting Results of Operations. The Company's results of operations may be materially affected by market fluctuations and by economic factors. In addition, results of operations in the past have been, and in the future may continue to be, materially affected by many factors of a global nature, including political, economic and market conditions; the availability and cost of capital; the level and volatility of equity prices, commodity prices and interest rates; currency values and other market indices; technological changes and events; the availability and cost of credit; inflation; and investor sentiment and confidence in the financial markets. In addition, there has been a heightened level of legislative, legal and regulatory developments related to the financial services industry that may affect future results of operations. Such factors also may have an impact on the Company's ability to achieve its strategic objectives on a global basis.

The Company's Institutional Securities business, particularly its involvement in primary and secondary markets for all types of financial products, including derivatives, is subject to substantial positive and negative fluctuations due to a variety of factors that cannot be predicted with great certainty, including variations in the fair value of securities and other financial products and the volatility and liquidity of global trading markets. Fluctuations also occur due to the level of global market activity, which, among other things, affects the size, number, and timing of investment banking client assignments and transactions and the realization of returns from the Company's principal investments. Such factors also affect the level of individual investor participation in the financial markets, which impacts the results of the Individual Investor Group. The level of global market activity also could impact the flow of investment capital into or from assets under management and supervision and the way in which such capital is allocated among money market, equity, fixed income or other investment alternatives, which could cause fluctuations to occur in the Company's Investment Management business. In the Company's Credit Services business, changes in economic variables, such as the number and size of personal bankruptcy filings, the rate of unemployment, and the level of consumer confidence and consumer debt, may substantially affect consumer loan levels and credit quality, which, in turn, could impact the results of Credit Services.

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* This Management's Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements as well as a discussion of some of the risks and uncertainties involved in the Company's businesses that could affect the matters referred to in such statements.

The Company's results of operations also may be materially affected by competitive factors. Included among the principal competitive factors affecting the Institutional Securities and Individual Investor Group businesses are the Company's reputation, the quality of its personnel, its products, services and advice, capital commitments, relative pricing and innovation. Competition in the Company's Investment Management business is affected by a number of factors, including the Company's reputation, investment objectives, relative performance of investment products, advertising and sales promotion efforts, fee levels, distribution channels, and types and quality of services offered. In the Credit Services business, competition centers on merchant acceptance of credit cards, account acquisition and customer utilization of credit cards, all of which are impacted by the types of fees, interest rates and other features offered.

Besides competition from firms traditionally engaged in the financial services business, competition exists from other sources, such as commercial banks, insurance companies, sponsors of mutual funds and other companies offering financial services in the U.S., globally and through the Internet. The financial services industry has experienced consolidation and convergence, as financial institutions involved in a broad range of financial services industries have merged. Such convergence may continue and could result in the Company's competitors gaining greater capital and other resources, such as a broader range of products and services and geographic diversity. In addition, the Company has experienced competition for qualified employees. The Company's ability to sustain or improve its competitive position will substantially depend on its ability to continue to attract and retain qualified employees while managing compensation costs.

For a detailed discussion of the competitive and regulatory factors in the Company's businesses, see "Competition" and "Regulation" in Part I, Item 1 of the Company's Annual Report on Form 10-K for the fiscal year ended November 30, 2002 (the "Form 10-K").

As a result of the above economic and competitive factors, net income and revenues in any particular period may not be representative of full-year results and may vary significantly from year to year and from quarter to quarter. The Company intends to manage its business for the long term and to mitigate the potential effects of market downturns by strengthening its competitive position in the global financial services industry through diversification of its revenue sources, enhancement of its global franchise, and management of costs and its capital structure. The Company's overall financial results will continue to be affected by its ability and success in addressing client goals; maintaining high levels of profitable business activities; emphasizing fee-based products that are designed to generate a continuing stream of revenues; evaluating credit product pricing; managing risks, costs and its capital position; and maintaining its strong reputation and franchise. In addition, the complementary trends in the financial services industry of consolidation and globalization present, among other things, technological, risk management and other infrastructure challenges that will require effective resource allocation in order for the Company to remain competitive.

Global Market and Economic Conditions in the Quarter Ended August 31, 2003. During the third quarter of fiscal 2003, the financial markets responded to an increase in positive economic news, particularly in the U.S. Although expectations increased, it still appeared that a global economic recovery had not yet fully materialized.

In the U.S., economic conditions improved from the difficult conditions that existed in the first half of fiscal 2003. U.S. equity markets, in particular the NASDAQ composite index, rallied on improved economic data despite mixed corporate earnings, while interest rates rose sharply during the quarter. The U.S. dollar strengthened against the euro supported by higher capital flows into the U.S., which also contributed to the rise in equity markets. Higher government spending, improved business investment and consumer consumption contributed to the indications of economic growth during the quarter. Government spending increased due to higher defense costs, and corporate investment improved due to signs of returning business confidence. Consumer spending also increased, although the unemployment rate remained at a nine year high. In June 2003, the Federal Reserve Board lowered both the overnight lending rate and the discount rate by 0.25%.

In Europe, equity market values increased although economies within the region continued to struggle. Consumer confidence improved, resulting in increased consumer spending. However, corporate spending and corporate

earnings remained weak, the euro depreciated relative to the U.S. dollar and negative economic growth in Germany, France and Italy raised concerns regarding future economic growth in the region. During the quarter, the European Central Bank ("ECB") lowered the benchmark interest rate by 0.50% and the Bank of England reduced its benchmark interest rate by 0.25%.

In Japan, economic activity increased, the yen strengthened and capital spending improved. However, unemployment remained relatively high and the ongoing decline in wages continued, although at a slower pace than the first six months of fiscal 2003. Consumer spending remained low, and despite increased exports to China, net exports were virtually flat. During the quarter, Severe Acute Respiratory Syndrome ("SARS") and its negative impact on economies throughout Asia diminished.

Results of the Company for the Quarter and Nine Month Period Ended August 31, 2003. The Company's net income in the quarter and nine month period ended August 31, 2003 was $1,269 million and $2,773 million, respectively, an increase of 108% and 23% from the comparable periods of fiscal 2002. The Company's results for the quarter and nine month period ended August 31, 2003 included the impact of changes to the terms of the Company's equity-based compensation program, which increased net income by $350 million (see "Equity-Based Compensation Program" herein). The Company's results in the nine month period ended August 31, 2003 included a pre-tax asset impairment charge of $287 million in connection with its aircraft financing activities (see Note 12 to the condensed consolidated financial statements).

Diluted earnings per common share were $1.15 and $2.52 in the quarter and nine month period ended August 31, 2003 as compared with $0.55 and $2.03 in the quarter and nine month period ended August 31, 2002. The Company's annualized return on common equity for the quarter and nine month period was 22.0% and 16.3% as compared with 11.4% and 14.3% in the comparable periods of fiscal 2002.

At August 31, 2003, the Company had approximately 52,000 worldwide employees, a decrease of 10% from August 31, 2002. The reduction in staffing levels reflected the Company's continuing efforts to manage costs in light of the weakened global economy and reduced business activity.

Equity-Based Compensation Program. Effective December 1, 2002, the Company adopted Statement of Financial Accounting Standards ("SFAS") No. 123 ("SFAS No. 123"), "Accounting for Stock-Based Compensation," as amended by SFAS No. 148, "Accounting for Stock-Based Compensation—Transition and Disclosure, an amendment of FASB Statement No. 123," using the prospective adoption method (see Note 2 to the Company's consolidated financial statements included in the Form 10-K). The Company now records compensation expense based upon the fair value of stock-based awards (both restricted stock and stock options). In prior years, the Company accounted for its stock-based awards under the intrinsic value approach in accordance with Accounting Principles Board Opinion No. 25 ("APB 25"), "Accounting for Stock Issued to Employees." Under the approach in APB 25, the Company recognized compensation expense for restricted stock awards in the year of grant; however, no compensation expense was generally recognized for stock option grants.

During the third quarter of fiscal 2003, the Company completed an extensive analysis of its stock-based compensation program and revised elements of its program to encourage and incent long-term performance, enhance employee retention, and better align employee and shareholder interests. The revisions to fiscal 2003 awards will include extending the vesting and non-compete provisions and raising the eligibility requirements to participate in such awards.

As a result of the revisions to its stock-based compensation program, the Company will recognize the fair value of stock-based awards granted in fiscal 2003 over service periods of 3 or 4 years, including the year of grant. Historically, the service period for stock-based awards was deemed to be the year of grant.

The year-to-date impact of these revisions is included in the Company's compensation and benefits expense for the third quarter of fiscal 2003. The effect of the changes for the quarter and nine month period ended August 31, 2003 reduced compensation and benefits expense by $519 million as compared to the quarter and nine month period expense had the Company continued to recognize the full expense in the year of grant. Net income increased by $350 million (or $0.32 per share) in the quarter and nine month period ended August 31, 2003 as compared to the quarter and nine month period net income had the Company continued to recognize the full expense in the year of grant. The annualized return on average common equity increased by 6.1% and 2.1% in the quarter and nine month period ended August 31, 2003 as a result of this change.

Restructuring and Other Charges. In the fourth quarter of fiscal 2002, the Company recognized restructuring and other charges of $235 million (pre-tax). The charge reflected several actions that were intended to resize and refocus certain business areas in order to address the difficult conditions in the global financial markets. Such conditions, including significantly lower levels of investment banking activity and decreased retail investor participation in the equity markets, have had an adverse impact on the Company's results of operations, particularly in its Institutional Securities and Individual Investor Group businesses.

This charge consisted of space-related costs of $162 million and severance-related costs of $73 million. The space-related costs were attributable to the closure or subletting of excess office space, primarily in the U.S. and the U.K., as well as the Company's decision to consolidate its Individual Investor Group branch locations. The majority of the space-related costs consisted of rental charges and the write-off of furniture, fixtures and other fixed assets at the affected office locations. The severance-related costs were attributable to workforce reductions. The Company reduced the number of its employees by approximately 2,200 during the fourth quarter of fiscal 2002, primarily in the Institutional Securities and Individual Investor Group businesses. The majority of the severance-related costs consisted of severance payments provided to the affected individuals.

At August 31, 2003, the remaining liability associated with these charges was approximately $120 million, which was included in Other liabilities and accrued expenses in the Company's condensed consolidated statement of financial condition. The majority of the decrease from the original liability of $235 million was due to cash payments of severance-related costs that were made by the Company during the nine month period ended August 31, 2003. The decline in the liability balance during the nine month period ended August 31, 2003 also reflected net rental payments associated with the office locations referred to above.

Asset Disposition. During the third quarter of fiscal 2002, the Company sold its self-directed online brokerage accounts to Bank of Montreal's Harris*direct*. The Company recorded gross proceeds of approximately $100 million (included within Other revenues) and related costs of approximately $50 million (included within Other expenses) in the Individual Investor Group segment.

Business Segments. As previously disclosed, the Company has been reviewing its segment allocation methodology. This review resulted in the reallocation of certain revenues and expenses in the third quarter of fiscal 2003 among the Company's business segments: Institutional Securities, Individual Investor Group, Investment Management and Credit Services. The Company believes that the results of these reallocations better reflect the economics of each business segment by representing transactions as if conducted between a segment and an external party. Prior periods have been restated to reflect these segment allocation changes. While the segment allocation changes had no effect on the Company's consolidated net income, they affected the net income of each segment.

The principal revenues and expenses that have been reallocated among the segments are:

- *Retail Customer Fixed Income Transactions.* The results of the individual fixed income business are now allocated between Institutional Securities and Individual Investor Group to reflect the relative value from both the execution of the retail customer trading activities through Institutional Securities and the retail customer relationship management through Individual Investor Group. Previously, the trading results of this business were reflected entirely in Institutional Securities.

- *Money Market Funds.* Retail customers of Individual Investor Group invest in money market funds managed by the Company. A percentage of the fund management fees associated with these investments is now allocated to Individual Investor Group. Previously, all of these fees were reflected in Investment Management.
- *Transfer Agency Costs.* Individual Investor Group provides certain transfer agency-related activities for mutual funds, including funds managed by the Company. Investment Management receives revenues from these funds and now reimburses certain transfer agency-related costs, including costs related to mailings, to Individual Investor Group. Previously, these costs were not reimbursed by Investment Management.
- *Certain Mutual Fund Distribution Fees.* Certain retail customers invest in shares of mutual funds managed by the Company. The segment results now reflect the establishment of a third party distribution relationship between Investment Management and Individual Investor Group relating to the sales of these funds. Accordingly, Investment Management now reports the distribution fees, contingent deferred sales charge revenues and commission expenses paid to Individual Investor Group associated with these sales. Individual Investor Group results now reflect these commission revenues associated with current period sales. Previously, all of the revenues and expenses associated with these transactions were reported by Individual Investor Group.

As a result of treating these intersegment transactions as transactions with external parties, the Company has included a new "Intersegment Eliminations" category to reconcile the segment results to the Company's consolidated results. The net income in Intersegment Eliminations represents the effect of timing differences associated with the revenue and expense recognition of commissions paid by Investment Management to Individual Investor Group and the related compensation costs paid to Individual Investor Group's financial advisors. Net income recorded in Intersegment Eliminations was $18 million and $23 million for the quarters ended August 31, 2003 and 2002, and $54 million and $64 million for the nine month periods ended August 31, 2003 and August 31, 2002.

A substantial portion of the Company's compensation expense represents performance-based bonuses, which are determined at the end of the Company's fiscal year. The segment allocation of these bonuses reflects, among other factors, the overall performance of the Company as well as the performance of individual business units. The timing and magnitude of changes in the Company's bonus accruals can have a significant effect on segment operating results in a given period.

The remainder of Results of Operations is presented on a business segment basis. Substantially all of the operating revenues and operating expenses of the Company can be directly attributed to its business segments: Institutional Securities, Individual Investor Group, Investment Management and Credit Services. Certain revenues and expenses have been allocated to each business segment, generally in proportion to their respective revenues or other relevant measures.

Certain reclassifications have been made to prior-period segment amounts to conform to the current year's presentation.

Critical Accounting Policies

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 (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, 2002 in the Form 10-K), the following may involve a higher degree of judgment and complexity.

Fair Value. Financial instruments owned of $184 billion and financial instruments sold, not yet purchased of $112 billion at August 31, 2003, 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 in principal trading revenues in the condensed consolidated statements of income. Fair value is the amount at which financial instruments could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

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 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.

A substantial percentage of the fair value of the Company's financial instruments owned and financial instruments sold, not yet purchased, 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, observable market prices or market parameters are not available for all products, and fair value is determined using techniques appropriate for each particular product. These analyses may involve a degree of judgment.

The Company's cash products include securities issued by the U.S. government and its agencies and instrumentalities, other sovereign debt obligations, 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 from 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 and instrumentalities, exchange traded corporate equity securities, most municipal debt securities, most corporate debt securities, most high-yield debt securities, physical commodities, certain traded loan products and most mortgage-backed securities.

By contrast, some cash products exhibit little or no price transparency, and the determination of the 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 traded 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. At August 31, 2003, the fair value of cash products with little or no price transparency recorded in financial instruments owned and financial instruments sold, not yet purchased was $9.2 billion and $0.1 billion, respectively.

The Company's derivative products include listed and over-the-counter ("OTC") derivatives. Listed derivatives have valuation attributes similar to the cash products valued using observable market prices or market parameters described above. Fair values for listed derivatives recorded as financial instruments owned and financial instruments sold, not yet purchased amounted to $4.0 billion and $5.2 billion, respectively, at August 31, 2003. OTC derivatives 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. Fair values for OTC derivative products recorded as financial instruments owned and

financial instruments sold, not yet purchased, which amounted to $39.5 billion and $30.8 billion, respectively, at August 31, 2003, were derived from pricing models.

The fair value of OTC derivative contracts is derived from pricing models, which may require multiple market input parameters. This technique is deemed more reliable than subjective adjustment to prices obtained for similar instruments. The Company relies on pricing models as a valuation methodology to determine fair value for OTC derivative products because market convention is to quote input parameters to models rather than prices, not because of a lack of an active trading market. The term "model" typically refers to a mathematical calculation methodology based on accepted financial theories. 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 quoted market parameters such as interest rates, volatility and the creditworthiness of the counterparty.

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 falls 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 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 related financial instruments. The Company's trading divisions and the Market Risk Department continuously monitor the price changes of the OTC derivatives in relation to the hedges. 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 in the Form 10-K.

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 prices 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 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 divisions. Additionally, groups independent from the trading divisions within the Controllers and Market Risk Departments participate in the review and validation of the fair values generated from pricing models, as appropriate. Where a pricing model utilizes historical and statistical analysis to determine fair value, recently executed comparable transactions are considered for purposes of validating assumptions underlying the model. Where the fair value of the transaction deviates significantly from the fair value derived from the model, the transaction fair value will be used to further refine the model's input or statistical techniques in determining fair value in future periods. 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 validation 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 further validates 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.

Transfers of Financial Assets. The Company engages in securitization activities in connection with certain of its businesses. Gains and losses from securitizations are recognized in the condensed consolidated statements of

income when the Company relinquishes control of the transferred financial assets in accordance with SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities—a replacement of FASB Statement No. 125" and other related pronouncements. The gain or loss on the sale of financial assets depends in part on the previous carrying amount of the assets involved in the transfer, allocated between the assets sold and the retained interests based upon their respective fair values at the date of sale.

In connection with its Institutional Securities business, the Company engages in securitization transactions to facilitate client needs and as a means of selling financial assets. The Company recognizes any interests in the transferred assets and any liabilities incurred in securitization transactions in its condensed consolidated statements of financial condition at fair value. Subsequently, changes in the fair value of such interests are recognized in the condensed consolidated statements of income. The use of different pricing models or assumptions could produce different financial results.

In connection with its Credit Services business, the Company periodically sells consumer loans through asset securitizations and continues to service these loans. The present value of the future net servicing revenues that the Company estimates it will receive over the term of the securitized loans is recognized in income as the loans are securitized. A corresponding asset also is recorded and then amortized as a charge to income over the term of the securitized loans. The securitization gain or loss involves the Company's best estimates of key assumptions, including forecasted credit losses, payment rates, forward yield curves and appropriate discount rates. The use of different estimates or assumptions could produce different financial results.

Allowance for Consumer Loan Losses. The allowance for consumer loan losses in the Company's Credit Services 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 an allowance primarily applicable to the owned homogeneous consumer credit card loan portfolio that is evaluated quarterly for adequacy.

In calculating the allowance for consumer loan losses, the Company uses a systematic and consistently applied approach. The Company regularly performs 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 addition, the Company estimates the losses inherent in the consumer loan portfolio based on coverage of a rolling average of historical credit losses. In evaluating the adequacy of the allowance for consumer loan losses, management also considers factors that may impact future credit loss experience, including current economic conditions, recent trends in delinquencies and bankruptcy filings, 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 "Credit Services—Provision for Consumer Loan Losses" herein).

Aircraft under Operating Leases. Aircraft under operating leases are stated at cost less accumulated depreciation. Depreciation is calculated on a straight-line basis over the estimated useful life of the aircraft asset, which is generally 25 years from the date of manufacture. In accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," which the Company adopted on December 1, 2002, the Company's aircraft are reviewed for impairment whenever events or changes in circumstances indicate that the carrying value of the aircraft may not be recoverable. Under SFAS No. 144, the carrying value of an aircraft may not be recoverable if its projected undiscounted cash flows are less than its carrying value. If an aircraft's projected undiscounted cash flows are less than its carrying value, the Company will recognize an impairment charge equal to the excess of the carrying value over the fair value of the aircraft. The fair value of the Company's impaired aircraft is based upon valuation information obtained from independent appraisal companies. Estimates of future cash flows associated with the aircraft assets as well as the appraisals of fair value are critical to the determination of whether an impairment exists and the amount of the impairment charge, if any (see Note 12 to the condensed consolidated financial statements).

INSTITUTIONAL SECURITIES

STATEMENTS OF INCOME
(dollars in millions)

	Three Months Ended August 31,		Nine Months Ended August 31,	
	2003	2002	2003	2002
	(unaudited)		(unaudited)	
Revenues:				
Investment banking	$ 518	$ 399	$ 1,481	$ 1,584
Principal transactions:				
Trading	1,931	326	4,749	1,809
Investments	30	14	65	28
Commissions	440	548	1,279	1,577
Asset management, distribution and administration fees	24	24	68	66
Interest and dividends	2,943	3,618	9,212	9,968
Other	60	72	197	307
Total revenues	5,946	5,001	17,051	15,339
Interest expense	3,153	2,884	8,444	8,067
Net revenues	2,793	2,117	8,607	7,272
Non-interest expenses	1,589	1,699	6,062	5,363
Income before income taxes and dividends on preferred securities subject to mandatory redemption	1,204	418	2,545	1,909
Provision for income taxes	332	133	725	625
Dividends on preferred securities subject to mandatory redemption	47	21	109	65
Net income	$ 825	$ 264	$ 1,711	$ 1,219

Institutional Securities net revenues were $2,793 million and $8,607 million in the quarter and nine month period ended August 31, 2003, increases of 32% and 18% from the comparable periods of fiscal 2002. Net income for the quarter and nine month period ended August 31, 2003 was $825 million and $1,711 million, increases of $561 million and $492 million from the comparable periods of fiscal 2002. The increases in net revenues for both periods were primarily attributable to higher revenues from fixed income sales and trading activities, partially offset by lower commission revenues. The increase in net income in the quarter primarily reflected higher net revenues and lower non-interest expenses. The increase in net income in the nine month period primarily reflected higher net revenues, partially offset by higher non-interest expenses. Non-interest expenses in the nine month period ended August 31, 2003 included a $287 million ($172 million after-tax) asset impairment charge in connection with the Company's aircraft financing activities. Compensation expense in both the quarter and nine month period reflected a $405 million ($273 million after-tax) benefit related to a change in the terms of the Company's equity-based compensation program (see "Equity-Based Compensation Program" herein). Excluding this benefit, compensation costs were higher in both periods due to a higher level of net revenues. Net income for both periods of fiscal 2003 also reflected a decrease in the effective income tax rate, primarily reflecting lower taxes attributable to non-U.S. earnings, as well as an increase in the utilization of domestic tax credits, including synthetic fuel credits.

Investment Banking. Investment banking revenues are derived from the underwriting of securities offerings and fees from advisory services. Investment banking revenues in the quarter ended August 31, 2003 increased 30% from the comparable period of fiscal 2002, as higher revenues from equity underwriting transactions were partially offset by lower revenues from merger, acquisition and restructuring activities.

Revenues from merger, acquisition and restructuring activities were $130 million in the quarter ended August 31, 2003, a decrease of 13% from the comparable period of fiscal 2002. The decrease primarily reflected an industry-wide decline in the volume of global merger and acquisition transaction activity. In addition, the Company's backlog of merger, acquisition and restructuring transactions remained at relatively low levels.

Underwriting revenues were $388 million in the quarter ended August 31, 2003, an increase of 55% from the comparable period of fiscal 2002.

Equity underwriting revenues increased from relatively depressed levels, led by technology related offerings in the U.S. and Japan and convertible offerings in the U.S. manufacturing sector.

Fixed income underwriting revenues increased modestly. Transaction activity was broad-based and remained steady, despite the increase in interest rates during the quarter.

Investment banking revenues in the nine month period ended August 31, 2003 decreased 7% from the comparable period of fiscal 2002. The decrease was due to lower revenues from merger, acquisition and restructuring activities, partially offset by higher revenues from fixed income and equity underwriting transactions.

Sales and Trading Revenues. Sales and trading revenues are composed of principal transaction trading revenues, commissions and interest and dividend revenues, less interest expense. In assessing the profitability of its business activities, the Company views principal trading, commissions and net interest revenues in the aggregate. In addition, decisions relating to principal transactions in securities are based on an overall review of aggregate revenues and costs associated with each transaction or series of transactions. This review includes an assessment of the potential gain or loss associated with a trade, including any associated commissions, and the interest income or expense associated with financing or hedging the Company's positions.

The components of the Company's sales and trading revenues are described below:

Principal Transactions. Principal transaction trading revenues include revenues from customers' purchases and sales of securities in which the Company acts as principal and gains and losses on the Company's securities positions. The Company also engages in proprietary trading activities for its own account.

Commissions. Commission revenues primarily arise from agency transactions in listed and over-the-counter equity securities and options.

Net Interest. Interest and dividend revenues and interest expense are a function of the level and mix of total assets and liabilities, including financial instruments owned and financial instruments sold, not yet purchased, reverse repurchase and repurchase agreements, trading strategies, customer activity in the Company's prime brokerage business, and the prevailing level, term structure and volatility of interest rates. Reverse repurchase and repurchase agreements and securities borrowed and securities loaned transactions may be entered into with different customers using the same underlying securities, thereby generating a spread between the interest revenue on the reverse repurchase agreements or securities borrowed transactions and the interest expense on the repurchase agreements or securities loaned transactions.

Sales and trading revenues include the following:

	Three Months Ended August 31,		Nine Months Ended August 31,	
	2003	2002	2003	2002
	(dollars in millions)			
Equities	$ 830	$1,052	$2,672	$2,907
Fixed income(1)	$1,462	$ 697	$4,379	$2,657

(1) Amounts include interest rate and currency products, credit products and commodities.

Sales and trading revenues increased 34% in the quarter ended August 31, 2003 from the comparable period of fiscal 2002, reflecting higher fixed income sales and trading revenues, partially offset by lower equity sales and trading revenues.

Equity sales and trading revenues decreased 21% in the quarter ended August 31, 2003 from the comparable period of fiscal 2002. The decrease reflected lower revenues from both cash and derivative products, as well as from proprietary trading activities. The decline was primarily due to lower market volatility and a less favorable trading environment.

Fixed income sales and trading revenues increased 110% in the quarter ended August 31, 2003 from the comparable period of fiscal 2002. The increase was broad-based and included higher revenues from the Company's credit product, interest rate and currency product, and commodities groups. The increase in credit product revenues (which increased 155%) reflected strong capital markets activity and included higher revenues from residential and commercial mortgage loan securitization activities. The increase in interest rate and currency product revenues (which increased 70%) primarily reflected a generally favorable trading environment, including a sharp rise in interest rates and a higher level of interest rate volatility in both the U.S. and European markets. The increase in commodity revenues (which increased 146%) was primarily associated with activities in the energy sector, reflecting higher levels of volatility in certain energy markets, higher customer flow activity and increased trading activity in support of client securitizations.

In addition, sales and trading revenues include the net interest expense associated with the Company's aircraft financing activities (see "Other" herein), as well as the Company's corporate lending activities. In the quarter ended August 31, 2003, sales and trading revenues associated with these activities increased, reflecting a lower level of markdowns (by approximately $100 million) in the Company's corporate lending activities as compared with the third quarter of fiscal 2002.

Sales and trading revenues increased 29% in the nine month period ended August 31, 2003 from the comparable period of fiscal 2002, primarily reflecting higher fixed income sales and trading revenues, partially offset by lower equity sales and trading revenues. The increase in fixed income sales and trading revenues was broad-based, reflecting higher revenues from the Company's credit product, interest rate and currency product, and commodities groups. The decrease in equity sales and trading revenues was primarily due to lower revenues from cash equity products, reflecting the difficult conditions that existed in the U.S. equity markets.

Principal Investments. Principal transaction net investment gains were $30 million in the quarter and $65 million in the nine month period ended August 31, 2003 as compared with net gains of $14 million in the quarter and $28 million in the nine month period ended August 31, 2002. The increase in both periods was primarily due to higher revenues from the Company's real estate investments and certain principal investments.

Securities purchased in principal investment transactions generally are held for appreciation and are not readily marketable. It is not possible to determine when the Company will realize the value of such investments since, among other factors, such investments generally are subject to significant sales restrictions. Moreover, estimates of the fair value of the investments involve significant judgment and may fluctuate significantly over time in light of business, market, economic and financial conditions generally or in relation to specific transactions.

Asset Management, Distribution and Administration Fees. Asset management, distribution and administration fees include revenues from asset management services, primarily fees associated with the Company's real estate investment activities.

Asset management, distribution and administration fees were unchanged in the quarter and increased 3% in the nine month period ended August 31, 2003. The increase in the nine month period was primarily due to higher management fees associated with the Company's real estate investment activities.

Other. Other revenues consist primarily of net rental and other revenues associated with the Company's aircraft financing business.

Other revenues decreased 17% and 36% in the quarter and nine month period ended August 31, 2003 from the comparable periods of fiscal 2002. The decrease in both periods was partially due to lower revenues from the Company's aircraft financing business, reflecting a decline in lease rates. The decrease in the nine month period also reflects the inclusion of a gain (of which $53 million was allocated to the Institutional Securities segment) related to the Company's sale of an office tower in the fiscal 2002 period.

Net revenues from the Company's aircraft financing business continued to be adversely affected by the slowdown in the commercial aircraft industry that began in 2001. In fiscal 2002 and the first half of fiscal 2003, declining aircraft passenger volume and financial difficulties experienced by major airlines contributed significantly to a decline in lease rates for operating lessors, including the Company's aircraft financing business.

Non-Interest Expenses. Non-interest expenses decreased 6% in the quarter and increased 13% in the nine month period ended August 31, 2003 from the comparable periods of fiscal 2002. Compensation expense in both the quarter and nine month period reflected a $405 million ($273 million after-tax) benefit related to a change in the terms of the Company's equity-based compensation program (see "Equity-Based Compensation Program" herein). Excluding this benefit, compensation and benefits expense increased 42% and 20% in the quarter and nine month period primarily due to a higher level of net revenues. The decrease in non-interest expenses in the quarter was primarily due to an asset impairment charge of $74 million associated with the Company's aircraft financing business, which occurred in the quarter ended August 31, 2002 (see Note 12 to the condensed consolidated financial statements). The decrease in the quarter also included lower marketing and business development expenses, which declined 19% due to lower advertising and travel and entertainment costs. The increase in non-interest expenses in the nine month period included a $287 million asset impairment charge related to the Company's aircraft financing activities and higher aircraft repossession costs, as well as a $36 million charge to adjust the carrying value of previously impaired aircraft to market value (see Note 12 to the condensed consolidated financial statements). The increase in the nine month period ended August 31, 2003 also reflected accruals of approximately $140 million for loss contingencies related to *IPO Allocation Matters*, as well as higher brokerage, clearing and exchange fees, which increased 12% primarily due to higher global securities trading volumes.

INDIVIDUAL INVESTOR GROUP

STATEMENTS OF INCOME
(dollars in millions)

	Three Months Ended August 31,		Nine Months Ended August 31,	
	2003	2002	2003	2002
	(unaudited)		(unaudited)	
Revenues:				
Investment banking	$ 79	$ 63	$ 224	$ 198
Principal transactions:				
Trading	174	143	495	488
Investments	—	(46)	—	(45)
Commissions	348	325	919	1,030
Asset management, distribution and administration fees	364	352	1,034	1,087
Interest and dividends	92	112	272	342
Other	35	126	99	183
Total revenues	1,092	1,075	3,043	3,283
Interest expense	38	47	115	149
Net revenues	1,054	1,028	2,928	3,134
Non-interest expenses	861	993	2,622	3,004
Income before income taxes	193	35	306	130
Provision for income taxes	68	17	120	60
Net income	$ 125	$ 18	$ 186	$ 70

Individual Investor Group net revenues were $1,054 million and $2,928 million in the quarter and nine month period ended August 31, 2003, an increase of 3% and a decrease of 7% from the comparable periods of fiscal 2002. The net income for the quarter and nine month period ended August 31, 2003 was $125 million and $186 million, as compared with net income of $18 million and $70 million in the quarter and nine month period ended August 31, 2002. The increase in net revenues in the quarter primarily reflected higher principal transaction trading and commissions revenues, partially offset by a decrease in other revenues. The increase in net revenues in the quarter also reflected net principal investment losses incurred during the quarter ended August 31, 2002. The decrease in net revenues in the nine month period was primarily attributable to lower commissions and other revenues. The increase in net income for the quarter and nine month period was primarily due to lower non-interest expenses, including lower compensation costs. Compensation and benefits expense in both the quarter and nine month period reflected a $71 million ($48 million after-tax) benefit related to a change in the terms of the Company's equity-based compensation program (see "Equity-Based Compensation Program" herein).

The Company sold its self-directed online brokerage accounts to Bank of Montreal's Harris*direct* during the third quarter of fiscal 2002, and recorded gross proceeds of approximately $100 million (included within other revenues) and related costs of approximately $50 million (included within non-interest expenses).

During the third quarter of fiscal 2003, consumer confidence and individual investor participation in the U.S. equity markets increased. However, the Company remains cautiously optimistic regarding the level of individual investor participation in the financial markets as the high level of economic and market uncertainty that existed in the first half of fiscal 2003 may continue to have an adverse impact on the results of its Individual Investor Group business.

Investment Banking. Investment banking revenues are derived from the Individual Investor Group's distribution of equity and fixed income securities underwritten by the Institutional Securities business, as well as

underwritings of Unit Investment Trust products. Investment banking revenues increased 25% and 13% in the quarter and nine month period ended August 31, 2003 from the comparable periods of fiscal 2002. The increase in the quarter and nine month period was primarily due to higher revenues from equity underwriting transactions and from underwriting Unit Investment Trust products. The nine month period also reflected higher revenues from fixed income underwriting transactions.

Principal Transactions. Principal transactions include revenues from customers' purchases and sales of securities in which the Company acts as principal and gains and losses on the Company's securities positions. The Company maintains certain security positions primarily to facilitate Individual Investor Group customer transactions. Principal transaction trading revenues increased 22% and 1% in the quarter and nine month period ended August 31, 2003 from the comparable periods of fiscal 2002. The increase in the quarter was due to higher revenues from fixed income products. The increase in the nine month period was due to higher revenues from fixed income products, partially offset by lower revenues from equity products. The increase in fixed income products in both periods reflected higher revenues from investment grade corporate fixed income securities. The decrease in equity revenues in the nine month period reflected the difficult conditions that existed in the equity markets during the first half of fiscal 2003. Equity revenues in the nine month period were also negatively affected by the Company's new pricing structure for executing transactions on the NASDAQ (see "Commissions" herein).

Fiscal 2002's principal transaction net investment losses of $46 million in the quarter and $45 million in the nine month period primarily reflected the write-down of an equity investment related to the Company's European individual securities business.

Commissions. Commission revenues primarily arise from agency transactions in listed and OTC equity securities and sales of mutual funds, futures, insurance products and options. Commission revenues increased 7% and decreased 11% in the quarter and nine month period ended August 31, 2003 from the comparable periods of fiscal 2002. The increase in the quarter was due to higher levels of individual investor participation in the U.S. equity markets and an increase in the volume of mutual fund sales. The decrease in the nine month period was due to lower levels of individual investor participation in the U.S. equity markets during the first half of fiscal 2003. In the nine month period ended August 31, 2003, the decrease was partially offset by the impact of a new commission-based pricing structure for executing transactions on the NASDAQ.

In January 2002, the Company began implementing a commission-based pricing structure for executing transactions on the NASDAQ. Prior to January 2002, the Company operated its NASDAQ equity business through market-making activities, which were primarily based on earning a spread between the bid and ask prices, and the results of such market-making activities were reported in principal transaction trading revenues. As a result of the new pricing structure, revenues earned from NASDAQ equity trading activities now are included in commission revenues.

Through Morgan Stanley Choice℠, a service and technology platform available to individual investors, the Company provides its individual investor clients with the choice of self-directed investing online; a traditional full-service brokerage relationship through a financial advisor; or some combination of both. Morgan Stanley Choice provides a range of pricing options, including fee-based pricing. As a result, revenues recorded within the Commissions and Asset management, distribution and administration fees income statement categories are affected by the number of the Company's clients electing a fee-based pricing arrangement.

Asset Management, Distribution and Administration Fees. Asset management, distribution and administration fees include revenues from individual investors electing a fee-based pricing arrangement under Morgan Stanley Choice. Asset management, distribution and administration fees also include revenues from asset management services and fees for investment management services provided to segregated customer accounts pursuant to various contractual arrangements in connection with the Company's Investment Consulting Services ("ICS") business. The Company receives fees for services it provides in distributing certain open-ended mutual funds.

These fees are based on either the average daily fund net asset balances or average daily aggregate net fund sales and are affected by changes in the overall level and mix of assets under management or supervision.

Asset management, distribution and administration fees increased 3% and decreased 5% in the quarter and nine month period ended August 31, 2003 from the comparable periods of fiscal 2002. The increase in the quarter was primarily attributable to higher fee-based revenues from ICS as client assets rose during the quarter, higher fees from promoting and distributing mutual funds, reflecting an increase in individual investors' mutual fund asset levels and higher fees from Morgan Stanley Choice accounts. Client assets increased in the quarter due to improved conditions in the U.S. equity markets. The decrease in asset management, distribution and administration fees in the nine month period was primarily attributable to lower fees from promoting and distributing mutual funds, reflecting a decrease in individual investors' mutual fund asset levels and a less favorable asset mix that generated lower fees. In the nine month period, fees from Morgan Stanley Choice accounts also declined, reflecting a decrease in client assets due to the difficult conditions that existed in the U.S. equity markets during the first half of fiscal 2003.

Net Interest. Interest and dividend revenues and interest expense are a function of the level and mix of total assets and liabilities, including customer margin loans and securities borrowed and securities loaned transactions. Net interest revenues decreased 17% and 19% in the quarter and nine month period ended August 31, 2003 from the comparable periods of fiscal 2002, primarily due to lower net interest revenues from brokerage services provided to individual customers, including a decrease in securities borrowed and securities loaned transactions and the level of margin loans, partially offset by a decline in interest expense due to a decrease in the Company's average cost of borrowings.

Other. Other revenues primarily include account fees and other miscellaneous service fees. Other revenues decreased 72% and 46% in the quarter and nine month period ended August 31, 2003 from the comparable periods of fiscal 2002. The decrease in both periods was primarily due to approximately $100 million of revenue received in connection with the sale of the Company's self-directed online brokerage accounts (see "Asset Disposition" herein) during fiscal 2002. The decrease in the nine month period also reflected the inclusion of a gain (of which $7 million was allocated to the Individual Investor Group segment) related to the Company's sale of an office tower in the fiscal 2002 period.

Non-Interest Expenses. Non-interest expenses decreased 13% in both the quarter and nine month period ended August 31, 2003 from the comparable periods of fiscal 2002. The majority of the decrease was attributable to lower compensation and benefits expense, which decreased 15% and 13% in the quarter and nine month period. Compensation and benefits expense in both the quarter and nine month period reflected a $71 million ($48 million after-tax) benefit related to a change in the terms of the Company's equity-based compensation program (see "Equity-Based Compensation Program" herein). Excluding this benefit, compensation and benefits expense decreased 5% and 9% in the quarter and nine month period, principally reflecting lower employment levels. In the quarter, the decrease was partially offset by higher incentive-based compensation accruals due to higher revenues. Non-interest expenses, excluding compensation and benefits expense, decreased 9% and 13% in the quarter and nine month period. Occupancy and equipment expense decreased 16% and 11% in the quarter and nine month period reflecting a reduction in branch locations. Marketing and business development expense decreased 44% and 46% in the quarter and nine month period due to lower advertising costs. Other expenses decreased 9% in the nine month period reflecting lower miscellaneous operating expenses. Other expenses in the comparable periods of fiscal 2002 included a benefit from the resolution of a mutual fund litigation matter, partially offset by costs associated with the Company's sale of its self-directed online brokerage accounts (see "Asset Disposition" herein).

INVESTMENT MANAGEMENT

STATEMENTS OF INCOME
(dollars in millions)

	Three Months Ended August 31,		Nine Months Ended August 31,	
	2003	2002	2003	2002
	(unaudited)		(unaudited)	
Revenues:				
Investment banking	$ 11	$ 8	$ 28	$ 25
Principal transactions:				
Investments	8	(32)	10	(30)
Commissions	16	11	41	36
Asset management, distribution and administration fees	612	635	1,752	2,004
Interest and dividends	—	7	2	17
Other	8	15	23	47
Total revenues	655	644	1,856	2,099
Interest expense	2	2	5	2
Net revenues	653	642	1,851	2,097
Non-interest expenses	496	477	1,461	1,547
Income before income taxes	157	165	390	550
Provision for income taxes	41	68	125	216
Net income	$116	$ 97	$ 265	$ 334

Investment Management net revenues were $653 million and $1,851 million in the quarter and nine month period ended August 31, 2003, an increase of 2% and a decrease of 12% from the comparable periods of fiscal 2002. Net income for the quarter and nine month period ended August 31, 2003 was $116 million and $265 million, an increase of 20% and a decrease of 21% from the comparable periods of fiscal 2002. The increase in net revenues in the quarter primarily reflected higher principal investment revenues, partially offset by lower fee-based revenues due to a decline in average assets under management or supervision. The decrease in net revenues for the nine month period primarily reflected lower fee-based revenues due to a decline in average assets under management or supervision, partially offset by higher principal investment revenues. The increase in net income in the quarter was primarily due to a lower effective income tax rate and higher net revenues, partially offset by higher non-interest expenses. The decrease in net income for the nine month period was due to lower net revenues, partially offset by a decline in non-interest expenses, including lower compensation costs. Compensation and benefits expense in both the quarter and nine month period reflected a $33 million ($22 million after-tax) benefit related to a change in the terms of the Company's equity-based compensation program (see "Equity-Based Compensation Program" herein).

Investment Banking. Investment Management primarily generates investment banking revenues from the underwriting of Unit Investment Trust products. Investment banking revenues increased 38% in the quarter and 12% in the nine month period from the comparable periods of fiscal 2002. The increases reflected a higher volume of Unit Investment Trust sales.

Principal Transactions. Investment Management principal transaction revenues consist primarily of gains and losses on investments associated with the Company's private equity activities and net gains and losses on capital investments in certain of the Company's investment funds.

The Company recorded net principal investment gains of $8 million in the quarter and $10 million in the nine month period ended August 31, 2003, primarily reflecting unrealized gains in the Company's private equity

portfolio. In fiscal 2002, the Company recorded net principal investment losses of $32 million in the quarter and $30 million in the nine month period ended August 31, 2002, primarily attributable to unrealized losses in the Company's private equity portfolio.

Securities purchased in principal investment transactions generally are held for appreciation and are not readily marketable. It is not possible to determine when the Company will realize the value of such investments since, among other factors, such investments generally are subject to significant sales restrictions. Moreover, estimates of the fair value of the investments involve significant judgment and may fluctuate significantly over time in light of business, market, economic and financial conditions generally or in relation to specific transactions.

Commissions. Investment Management primarily generates commission revenues from dealer and distribution concessions on sales of certain funds as well as certain allocated commission revenues. Commission revenues increased 45% and 14% in the quarter and nine month period ended August 31, 2003 from the comparable periods of fiscal 2002 reflecting a higher sales volume of certain fund and insurance products.

Net Interest. Investment Management generates net interest revenues from certain investment positions and from allocated interest revenues and expenses. Net interest revenues decreased $7 million and $18 million in the quarter and nine month period ended August 31, 2003 as compared to the respective periods in fiscal 2002, reflecting lower net interest revenues earned on investment positions due to the lower interest rate environment and a lower level of allocated net interest revenues.

Asset Management, Distribution and Administration Fees. Asset management, distribution and administration fees primarily include revenues from the management and supervision of assets, including fees for distributing certain open-ended mutual funds and management fees associated with the Company's private equity activities. These fees arise from investment management services the Company provides to investment vehicles pursuant to various contractual arrangements. The Company receives fees primarily based upon mutual fund daily average net assets or quarterly assets for other vehicles.

The Company's customer assets under management or supervision were as follows:

	At August 31,	
	2003	**2002**
	(dollars in billions)	
Assets under management or supervision by distribution channel:		
Retail	$268	$260
Institutional	165	164
Total(1)	$433	$424
Assets under management or supervision by asset class:		
Equity	$189	$175
Fixed income	123	127
Money market	66	66
Other(2)	55	56
Total(1)	$433	$424

(1) Revenues and expenses associated with certain assets are included in the Company's Individual Investor Group and Institutional Securities segments.

(2) Amounts include alternative investment vehicles.

Asset management, distribution and administration fees decreased 4% and 13% in the quarter and nine month period ended August 31, 2003. The decrease in both periods reflected lower distribution and redemption fees and other revenues resulting from lower average assets under management or supervision. The decrease in the nine month period also reflected lower fund management and administration fees. In the quarter, the decrease in asset management, distribution and administration fees was partially offset by a more favorable asset mix that generated higher fees.

As of August 31, 2003, customer assets under management or supervision increased $9 billion from August 31, 2002. The increase was primarily due to market appreciation, reflecting improvement in the global financial markets during the second and third quarters of fiscal 2003, partially offset by net outflows of customer assets as redemptions exceeded new sales during the period from September 1, 2002 to August 31, 2003.

Other. Other revenues decreased 47% and 51% in the quarter and nine month period ended August 31, 2003 from the comparable periods of fiscal 2002. The decrease in both periods was primarily due to a decrease in certain miscellaneous fees. The decrease in the nine month period also reflected the inclusion of a gain (of which $13 million was allocated to the Investment Management segment) related to the Company’s sale of an office tower in the fiscal 2002 period.

Non-Interest Expenses. Non-interest expenses increased 4% and decreased 6% in the quarter and nine month period ended August 31, 2003 from the comparable periods of fiscal 2002. Compensation and benefits expense decreased 7% and 14% in the quarter and nine month period. Compensation and benefits expense in both the quarter and nine month period also reflected a $33 million ($22 million after-tax) benefit related to a change in the terms of the Company’s equity-based compensation program (see “Equity-Based Compensation Program” herein). Excluding this benefit, compensation and benefits expense increased 14% in the quarter and decreased 8% in the nine month period. The increase in the quarter reflected higher compensation and benefits expense associated with higher incentive-based compensation accruals. The decrease in the nine month period principally reflected lower employment levels and lower incentive-based compensation accruals. Non-interest expenses, excluding compensation and benefits expense, increased 9% in the quarter and decreased 1% in the nine month period. Brokerage, clearing, and exchange fees decreased 7% and 8% in the quarter and nine month period, reflecting lower amortization expense associated with certain open-ended funds. The decrease in amortization expense reflected a lower level of deferred costs in the current year due to a decrease in past sales. Professional services expense increased 16% in the quarter due to higher sub-advisory fees. Other expenses increased $38 million in the quarter and $44 million in the nine month period, principally reflecting the net benefit from certain legal matters, including the resolution of a mutual fund litigation matter, which was recognized in the third quarter of fiscal 2002.

CREDIT SERVICES

STATEMENTS OF INCOME
(dollars in millions)

	Three Months Ended August 31,		Nine Months Ended August 31,	
	2003	2002	2003	2002
	(unaudited)		(unaudited)	
Fees:				
Merchant and cardmember	$340	$359	$1,042	$1,048
Servicing	462	510	1,532	1,556
Other	18	12	20	31
Total non-interest revenues	820	881	2,594	2,635
Interest revenue	515	646	1,604	1,801
Interest expense	191	262	627	789
Net interest income	324	384	977	1,012
Provision for consumer loan losses	310	332	955	1,017
Net credit income	14	52	22	(5)
Net revenues	834	933	2,616	2,630
Non-interest expenses	542	617	1,732	1,751
Income before income taxes	292	316	884	879
Provision for income taxes	107	107	327	310
Net income	$185	$209	$ 557	$ 569

Credit Services net revenues were $834 million and $2,616 million in the quarter and nine month period ended August 31, 2003, a decrease of 11% and 1% from the comparable periods of fiscal 2002. Net income was $185 million and $557 million in the quarter and nine month period ended August 31, 2003, a decrease of 11% and 2% from the comparable periods of fiscal 2002. The decrease in net revenues for both periods was primarily attributable to lower non-interest revenues and lower net interest income, partially offset by a lower provision for consumer loan losses. The decrease in net income for both periods reflected a decrease in net revenues, partially offset by lower non-interest expenses, including lower compensation and benefits expense. Compensation and benefits expense in both the quarter and nine month period reflected a $10 million ($7 million after-tax) benefit related to a change in the terms of the Company's equity-based compensation program (see "Equity-Based Compensation Program" herein).

Merchant and Cardmember Fees. Merchant and cardmember fees include revenues from fees charged to merchants on credit card sales, as well as charges to cardmembers for late payment fees, overlimit fees, credit protection fees and cash advance fees, net of cardmember rewards. Cardmember rewards includes various reward programs including the Cashback Bonus® award program, pursuant to which the Company pays certain cardmembers awards based upon a cardmember's level and type of purchases.

Merchant and cardmember fees decreased 5% and 1% in the quarter and nine month period ended August 31, 2003. The decrease in both periods was due to a decline in late payment fees, partially offset by higher merchant discount revenue. The decrease in the quarter was also due to higher cardmember rewards. In both periods, the decline in late payment fees reflected a higher level of charge-offs of late payment fees and fewer late fee occurrences. The increase in merchant discount revenue in both periods was due to higher sales volume and an increase in the average merchant discount rate. The increase in cardmember rewards in the quarter reflected higher Cashback Bonus costs due to increased sales volume and higher costs related to merchant partner programs.

Servicing Fees. Servicing fees are revenues derived from consumer loans that have been sold to investors through asset securitizations and mortgage whole loan sales. Cash flows from the interest yield and cardmember fees generated by securitized general purpose credit card loans and the interest yield generated by securitized mortgage loans are used to pay investors in these loans a predetermined fixed or floating rate of return on their investment, to reimburse investors for losses of principal resulting from charged-off loans and to pay the Company a fee for servicing the loans. Any excess cash flows remaining are paid to the Company. The servicing fees and excess net cash flows paid to the Company are reported as servicing fees in the condensed consolidated statements of income. The sale of general purpose credit card loans and mortgage loans through asset securitizations, therefore, has the effect of converting portions of net credit income and fee income to servicing fees. The Company did not complete any credit card asset securitization transactions during the third quarters of fiscal 2003 and fiscal 2002. The Company completed credit card asset securitization transactions of $5.7 billion in the nine month period ended August 31, 2003 and $2.8 billion in the comparable period of fiscal 2002. The Company did not complete any mortgage loan securitization transactions during the third quarter of fiscal 2003, while the Company completed a mortgage loan securitization transaction of $0.5 billion during the third quarter of fiscal 2002. The Company completed mortgage loan securitization transactions of $0.8 billion during the nine month period ended August 31, 2003 and $0.5 billion in the comparable fiscal 2002 period. The credit card asset securitization transactions completed in the nine month period ended August 31, 2003 have expected maturities ranging from approximately two to seven years from the date of issuance. The mortgage loan securitization transactions completed in the nine month period ended August 31, 2003 have expected maturities ranging from approximately eight to nine years from the date of issuance.

The table below presents the components of servicing fees:

	Three Months Ended August 31,		Nine Months Ended August 31,	
	2003	2002	2003	2002
	(dollars in millions)		(dollars in millions)	
Merchant and cardmember fees	$ 183	$ 166	$ 552	$ 520
Interest revenue	1,061	997	3,144	3,067
Other revenue	1	13	88	46
Interest expense	(200)	(221)	(615)	(673)
Provision for consumer loan losses	(583)	(445)	(1,637)	(1,404)
Servicing fees	$ 462	$ 510	$ 1,532	$ 1,556

Servicing fees are affected by the level of securitized loans and mortgage whole loan sales, the spread between the interest yield on the securitized loans and the yield paid to the investors, the rate of credit losses on securitized loans and the level of cardmember fees earned from securitized general purpose credit card loans. Servicing fees decreased 9% and 2% in the quarter and nine month period ended August 31, 2003 from the comparable periods in fiscal 2002. The decrease in both periods reflected higher credit losses associated with a higher level of average securitized general purpose credit card loans and a higher rate of charge-offs related to the securitized general purpose credit card loan portfolio. In both periods, the decreases were partially offset by higher net interest cash flows and cardmember fees on securitized general purpose credit card loans associated with a higher level of securitized general purpose credit card loans. The Other revenue component of servicing fees is primarily composed of net securitization gains and losses on general purpose credit card loans and mortgage loans as well as net revenues from mortgage servicing rights on mortgage whole loan sales. Net gains of $70 million and $37 million were recorded in the nine month periods ended August 31, 2003 and August 31, 2002, respectively. The increase in Other revenue in the nine month period was attributable to higher levels of general purpose credit card and mortgage loan securitization transactions offset in part by higher gain amortization related to certain securitization transactions.

Net Interest Income. Net interest income represents the difference between interest revenue derived from consumer loans and short-term investment assets and interest expense incurred to finance those loans and assets. Assets, consisting primarily of consumer loans, currently earn interest revenue at both fixed rates and market-indexed variable rates. The Company incurs interest expense at fixed and floating rates. Interest expense also includes the effects of any interest rate contracts entered into by the Company as part of its interest rate risk management program. This program is designed to reduce the volatility of earnings resulting from changes in interest rates by having a financing portfolio that reflects the existing repricing schedules of consumer loans as well as the Company's right, with notice to cardmembers, to reprice certain fixed rate consumer loans to a new interest rate in the future.

Net interest income decreased 16% and 3% in the quarter and nine month period ended August 31, 2003 from the comparable periods of fiscal 2002, as a decline in interest revenue was partially offset by lower interest expense. The decline in interest revenue was due to a lower yield on general purpose credit card loans and a decrease in average general purpose credit card loans. The lower yield on general purpose credit card loans in both periods was primarily due to lower interest rates offered to new cardmembers and certain existing cardmembers. The decrease in average general purpose credit card loans in both the quarter and nine month period ended August 31, 2003 was primarily due to a higher level of securitized loans and higher payments by cardmembers, partially offset by record levels of sales volume. The decrease in interest expense in both periods was primarily due to a decrease in the Company's average cost of borrowings and a lower level of average interest bearing liabilities. The Company's average cost of borrowings were 4.2% and 5.4% for the quarters and 4.4% and 5.4% for the nine month periods ended August 31, 2003 and 2002, respectively. The decline in the average cost of borrowings reflected the Fed's aggressive easing of interest rates that began in fiscal 2001 and the favorable impact of replacing certain maturing fixed rate debt with lower cost financing, reflecting the lower interest rate environment.

The following tables present analyses of average balance sheets and interest rates for the quarters and nine month periods ended August 31, 2003 and 2002 and changes in net interest income during those periods:

Average Balance Sheet Analysis

	Three Months Ended August 31,					
	2003			2002(3)		
	Average Balance	Rate	Interest	Average Balance	Rate	Interest
			(dollars in millions)			
ASSETS						
Interest earning assets:						
General purpose credit card loans	$18,600	10.28%	$ 482	$20,083	12.09%	$ 612
Other consumer loans	1,407	5.62	20	1,262	5.99	19
Investment securities	80	0.75	—	57	1.49	—
Other	2,615	1.87	13	2,379	2.47	15
Total interest earning assets	22,702	8.99	515	23,781	10.78	646
Allowance for loan losses	(982)			(902)		
Non-interest earning assets	2,610			2,432		
Total assets	$24,330			$25,311		
LIABILITIES AND SHAREHOLDER'S EQUITY						
Interest bearing liabilities:						
Interest bearing deposits						
Savings	$ 789	1.05%	$ 2	$ 974	1.54%	$ 4
Brokered	10,585	5.17	138	10,390	5.87	154
Other time	1,676	4.10	17	1,789	4.88	22
Total interest bearing deposits	13,050	4.79	157	13,153	5.41	180
Other borrowings	4,857	2.75	34	6,045	5.41	82
Total interest bearing liabilities	17,907	4.23	191	19,198	5.41	262
Shareholder's equity/other liabilities	6,423			6,113		
Total liabilities and shareholder's equity	$24,330			$25,311		
Net interest income			$ 324			$ 384
Net interest margin(1)			5.65%			6.41%
Interest rate spread(2)		4.76%			5.37%	

(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.

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

Average Balance Sheet Analysis

	Nine Months Ended August 31,					
	2003			2002(3)		
	Average Balance	Rate	Interest	Average Balance	Rate	Interest
			(dollars in millions)			
ASSETS						
Interest earning assets:						
General purpose credit card loans	$19,991	10.00%	$1,501	$20,333	11.15%	$1,702
Other consumer loans	1,536	5.53	64	1,165	6.05	53
Investment securities	69	0.91	—	59	1.52	1
Other	2,680	1.93	39	2,474	2.48	45
Total interest earning assets	24,276	8.80	1,604	24,031	9.99	1,801
Allowance for loan losses	(957)			(877)		
Non-interest earning assets	2,491			2,552		
Total assets	$25,810			$25,706		
LIABILITIES AND SHAREHOLDER'S EQUITY						
Interest bearing liabilities:						
Interest bearing deposits						
Savings	$ 824	1.03%	$ 6	$ 1,051	1.59%	$ 13
Brokered	10,682	5.32	427	9,527	6.10	436
Other time	1,655	4.42	55	2,141	5.18	83
Total interest bearing deposits	13,161	4.94	488	12,719	5.57	532
Other borrowings	5,991	3.09	139	6,877	4.97	257
Total interest bearing liabilities	19,152	4.36	627	19,596	5.36	789
Shareholder's equity/other liabilities	6,658			6,110		
Total liabilities and shareholder's equity	$25,810			$25,706		
Net interest income			$ 977			$1,012
Net interest margin(1)			5.36%			5.61%
Interest rate spread(2)		4.44%			4.63%	

(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.

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

Rate/Volume Analysis

	Three Months Ended August 31, 2003 vs. 2002 Increase/(Decrease) due to Changes in:			Nine Months Ended August 31, 2003 vs. 2002 Increase/(Decrease) due to Changes in:		
	Volume	Rate	Total	Volume	Rate	Total
	(dollars in millions)					
INTEREST REVENUE						
General purpose credit card loans	$(45)	$ (85)	$(130)	$(29)	$(172)	$(201)
Other consumer loans	2	(1)	1	16	(5)	11
Investment securities	—	—	—	—	(1)	(1)
Other	1	(3)	(2)	4	(10)	(6)
Total interest revenue	(30)	(101)	(131)	19	(216)	(197)
INTEREST EXPENSE						
Interest bearing deposits:						
Savings	(1)	(1)	(2)	(3)	(4)	(7)
Brokered	3	(19)	(16)	53	(62)	(9)
Other time	(2)	(3)	(5)	(19)	(9)	(28)
Total interest bearing deposits	(2)	(21)	(23)	18	(62)	(44)
Other borrowings	(16)	(32)	(48)	(33)	(85)	(118)
Total interest expense	(18)	(53)	(71)	(18)	(144)	(162)
Net interest income	$(12)	$ (48)	$ (60)	$ 37	$ (72)	$ (35)

In response to regulatory changes, the Company is reviewing the minimum payment requirements and overlimit practices on its general purpose credit card loans. A change in the minimum payment requirements or overlimit practices may impact future levels of general purpose credit card loans and related interest and fee revenues.

Provision for Consumer Loan Losses. The provision for consumer loan losses is the amount necessary to establish the allowance for loan losses at a level that the Company believes is adequate to absorb estimated losses in its consumer loan portfolio at the balance sheet date. The Company's provision for consumer loan losses was $310 million and $955 million for the quarter and nine month period ended August 31, 2003 and $332 million and $1,017 million for the comparable periods of fiscal 2002. The Company's allowance for consumer loan losses was $988 million at August 31, 2003 and $928 million at November 30, 2002.

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 an allowance primarily applicable to the owned homogeneous consumer credit card loan portfolio that is evaluated quarterly for adequacy and is established through a charge to the provision for consumer loan losses.

In calculating the allowance for consumer loan losses, the Company uses a systematic and consistently applied approach. The Company regularly performs 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 addition, the Company estimates the losses inherent in the consumer loan portfolio based on coverage of a rolling average of historical credit losses. In evaluating the adequacy of the allowance for consumer loan losses, management also considers factors that may impact future credit loss experience, including current economic conditions, recent trends in delinquencies and bankruptcy filings, account collection management, policy 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 provision for consumer loan losses is affected by net principal charge-offs, delinquencies, bankruptcy filings and loan growth as well as changes in the amount of consumer loans estimated to be uncollectible. In the quarter and nine month period ended August 31, 2003, the provision for consumer loan losses decreased 7% and 6%, respectively, primarily due to a lower level of average general purpose credit card loans. In the nine month period ended August 31, 2003, lower net principal charge-off rates also contributed to the decrease in the provision for consumer loan losses. In response to unfavorable trends in U.S. consumer bankruptcy filings, high unemployment levels along with higher net total charge-offs (inclusive of interest and fees), the Company recorded a provision for consumer loan losses that exceeded the amount of net consumer loans charged off by $15 million and $59 million in the quarter and nine month period ended August 31, 2003. In response to similar trends, the Company recorded a provision for consumer loan losses in excess of net consumer loans charged off by $25 million and $75 million in the quarter and nine month period ended August 31, 2002.

General purpose credit card loans are considered delinquent when interest or principal payments become 30 days past due. General purpose credit card loans are charged off at the end of the month during which an account becomes 180 days past due, except in the case of bankruptcies, probate and fraudulent transactions, where loans are charged off earlier. In the second quarter of fiscal 2003, the Company changed its policy related to accounts in probate to charge-off 60 days after notification as compared to charging-off 180 days past due. This change accelerated charge-offs beginning in the third quarter of fiscal 2003 and increased charge-offs in the quarter. The remaining effect of the change on charge-offs will be reflected in the fourth quarter of fiscal 2003. Loan delinquencies and charge-offs are affected by changes in economic conditions, account collection management and policy changes and may vary throughout the year due to seasonal consumer spending and payment behaviors.

The practice of re-aging an account also may affect general purpose credit card loan delinquencies and charge-offs, potentially delaying and reducing delinquencies and charge-offs. A re-age is intended to assist delinquent cardmembers who have overcome financial difficulties and have demonstrated both the ability and willingness to resume making regular payments but are unable to pay the entire past due amount required to cure a delinquency status. An account is re-aged when the Company and the customer agree on a repayment schedule that does not require the customer to repay the total amount of principal, interest and fees that is past due. The re-aged account and related balance is then returned to current status and is no longer past due. Generally, to qualify for a re-age, an account must have at least nine months of activity and may not have been re-aged more than once within any twelve-month period or twice within any five-year period. Additionally, a cardmember must also have made three consecutive minimum monthly payments or the equivalent cumulative amount. Cardmembers may also qualify for an additional re-age once enrolled in a workout program. Such programs are limited to no more than one over a five-year period. A workout is defined as a former open-end credit card account upon which credit availability has been closed, and the amount owed has been placed on a fixed repayment schedule in accordance with modified terms and conditions. The Company believes its re-age practices are consistent with regulatory guidelines.

During the second half of fiscal 2002 and the first half of fiscal 2003, the Company made various policy changes that, in part, responded to industry-wide regulatory issues. These policy changes included a tightening of the terms used to re-age accounts that, along with the ongoing economic challenges as evidenced by high levels of unemployment and U.S. bankruptcy filings, have resulted in a significant decrease in the number of cardmembers eligible for re-age versus comparable periods in 2002. For the quarter and nine month period ended August 31, 2003, the Company's re-age volumes decreased by approximately 40% and 45%, respectively, from the comparable periods of fiscal 2002. The Company believes the reduction in re-age volume is a contributing factor to the higher delinquencies and charge-off levels experienced in fiscal 2003.

During the quarter ended August 31, 2003, net principal charge-off rates increased in both the owned and the managed portfolio as compared to the fiscal 2002 period, reflecting the impact of lower re-age volumes and the change in the Company's probate policy discussed above. During the nine month period ended August 31, 2003, net principal charge-off rates increased in the managed portfolio as compared to the fiscal 2002 period. In the

U.S., high levels of unemployment, coupled with the seasoning of the Company's general purpose credit card loan portfolio, a high level of bankruptcy filings and policy changes contributed to the higher net principal charge-off rate in the managed portfolio during the nine month period ended August 31, 2003. In addition, the Company's delinquency rates in both the over 30- and over 90-day categories were higher in the managed portfolio at August 31, 2003 as compared with August 31, 2002. At August 31, 2003, the Company's delinquency rate in the over 90-day category was higher in the owned portfolio as compared with August 31, 2002. These increases reflected re-aging policy changes and higher unemployment rates.

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, the seasoning of the Company's general purpose credit card loan portfolio, interest rate movements and their impact on consumer behavior, and the rate and magnitude of changes in the Company's general purpose credit card loan portfolio, including the overall mix of accounts, products and loan balances within the portfolio. If high levels of unemployment and bankruptcy filings continue to persist, the rate of net total charge-offs (inclusive of interest and fees) may be higher in future periods.

Non-Interest Expenses. Non-interest expenses decreased 12% and 1% in the quarter and nine month period ended August 31, 2003 from the comparable periods of fiscal 2002. Compensation and benefits expense decreased 7% in the quarter and increased 2% in the nine month period. Compensation and benefits expense in both the quarter and nine month period reflected a $10 million ($7 million after-tax) benefit related to a change in the terms of the Company's equity-based compensation program (see "Equity-Based Compensation Program" herein). Excluding this benefit, compensation and benefits expense was relatively unchanged in the quarter and increased 4% in the nine month period. The increase in the nine month period reflected an increase in personnel costs, including salaries and benefits. Non-interest expenses, excluding compensation and benefits expense, decreased 15% and 3% in the quarter and nine month period. Marketing and business development expenses decreased 38% in the quarter due to lower direct mailing and other marketing expenses. Other expenses decreased 14% in the nine month period primarily reflecting a decrease in certain operating expenses, including lower costs associated with cardmember fraud and merchant bankruptcies.

Managed General Purpose Credit Card Loan Data. The Company analyzes its financial performance on both a "managed" loan basis and as reported under generally accepted accounting principles ("owned" loan basis). Managed loan data assumes that the Company's securitized loan receivables have not been sold and presents the results of the securitized loan receivables in the same manner as the Company's owned loans. The Company operates its Credit Services 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 to industry competitors.

The following tables provide a reconciliation of owned and managed average loan balances, interest yield and interest rate spreads for the periods indicated. Certain reclassifications have been made to prior period amounts to conform to the current presentation.

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

	Three Months Ended August 31,					
	2003			2002		
	Average Balance	Interest Yield	Interest Rate Spread(1)	Average Balance	Interest Yield	Interest Rate Spread(1)
General Purpose Credit Card Loans:						
Owned	$18,600	10.28%	6.05%	$20,083	12.09%	6.68%
Securitized	32,063	12.91%	10.52%	29,261	13.40%	10.41%
Managed	$50,663	11.94%	8.91%	$49,344	12.86%	8.91%

	Nine Months Ended August 31,					
	2003			2002		
	Average Balance	Interest Yield	Interest Rate Spread(1)	Average Balance	Interest Yield	Interest Rate Spread(1)
General Purpose Credit Card Loans:						
Owned	$19,991	10.00%	5.64%	$20,333	11.15%	5.79%
Securitized	31,546	13.10%	10.56%	29,368	13.79%	10.75%
Managed	$51,537	11.90%	8.69%	$49,701	12.71%	8.75%

(1) Interest rate spread represents the difference between the rate on general purpose credit card loans and the rate on total interest bearing liabilities.

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)

	Three Months ended August 31, 2003				Three Months ended August 31, 2002			
			Delinquency Rates(1)				Delinquency Rates(1)	
	Period End	Net Principal Charge-offs	Over 30 Days	Over 90 Days	Period End	Net Principal Charge-offs	Over 30 Days	Over 90 Days
General Purpose Credit Card Loans:								
Owned	$18,106	6.26%	5.28%	2.54%	$21,452	6.07%	5.37%	2.38%
Securitized	31,859	7.26%	6.48%	3.12%	28,225	6.07%	5.98%	2.57%
Managed	$49,965	6.90%	6.05%	2.91%	$49,677	6.07%	5.72%	2.49%

	Nine Months ended		Twelve Months ended
	August 31, 2003	August 31, 2002	November 30, 2002
Net Principal Charge-offs			
Owned	5.90%	6.14%	6.06%
Securitized	6.91%	6.37%	6.29%
Managed	6.52%	6.28%	6.19%

	Three Months ended		Nine Months ended		Twelve Months ended
	August 31, 2003	August 31, 2002	August 31, 2003	August 31, 2002	November 30, 2002
Net Total Charge-offs—(inclusive of interest and fees)					
Owned	8.61%	7.87%	8.12%	8.00%	7.97%
Securitized	10.24%	8.22%	9.64%	8.62%	8.51%
Managed	9.64%	8.08%	9.05%	8.37%	8.28%

(1) General purpose credit card loans contractually past due as a percentage of period-end general purpose credit card loans.

LIQUIDITY AND CAPITAL RESOURCES

Liquidity and Capital Policies

The Company's senior management establishes the overall liquidity and capital policies of the Company, reviews the Company's performance relative to these policies, monitors the availability of sources of financing, and oversees the liquidity and interest rate sensitivity of the Company's asset and liability position. The primary goal of the Company's funding and liquidity activities is to ensure adequate financing over a wide range of potential credit ratings and market environments. The major components of the Company's liquidity framework are the cash capital policy, contingency planning and the liquidity reserve. The cash liquidity reserve averaged approximately $20 billion in the nine month period ended August 31, 2003 in the form of immediately available cash and cash equivalents. The Company's capital policies seek to ensure that its equity base adequately supports the economic risk inherent in its businesses.

For a more detailed summary of the Company's Liquidity and Capital Policies, 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's total assets increased to $580.6 billion at August 31, 2003 from $529.5 billion at November 30, 2002, primarily attributable to increases in securities borrowed, receivables from customers, securities received as collateral and financial instruments owned, including corporate and other debt and derivative contracts. A substantial portion of the Company's total assets consists of highly liquid marketable securities and short-term receivables arising principally from securities transactions. The highly liquid nature of these assets provides the Company with flexibility in financing and managing its business.

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 relevant measure of financial risk when comparing financial services firms and evaluating leverage trends. This ratio is adjusted to reflect the low-risk nature of assets attributable to matched resale agreements, certain securities borrowed transactions, segregated customer cash balances and assets recorded under certain provisions of SFAS No. 140. In addition, the adjusted leverage ratio reflects the deduction from shareholders' equity of the amount of equity used to support goodwill, as the Company does not view this amount of equity as available to support its risk capital needs.

The following table sets forth the Company's total assets, adjusted assets, leverage ratios and book value per share:

	Balance at	
	August 31, 2003	November 30, 2002
	(dollars in millions, except ratio and per share data)	
Total assets	$580,632	$529,499
Less:		
Lesser of securities purchased under agreements to resell or securities sold under agreements to repurchase	(74,271)	(76,910)
Assets recorded under certain provisions of SFAS No. 140	(28,920)	(19,224)
Lesser of securities borrowed or securities loaned	(57,490)	(43,229)
Segregated customer cash and securities balances	(25,670)	(30,217)
Goodwill	(1,466)	(1,449)
Adjusted assets	$392,815	$358,470
Shareholders' equity	$ 23,707	$ 21,885
Preferred securities subject to mandatory redemption	2,810	1,210
Less: Goodwill	(1,466)	(1,449)
Tangible shareholders' equity	$ 25,051	$ 21,646
Leverage ratio(1)	23.2x	24.5x
Adjusted leverage ratio(2)	15.7x	16.6x
Book value per share(3)	$ 21.79	$ 20.24

(1) Leverage ratio equals total assets divided by tangible shareholders' equity.

(2) Adjusted leverage ratio equals adjusted assets divided by tangible shareholders' equity.

(3) Book value per share equals shareholders' equity divided by common shares outstanding of 1,088 million at August 31, 2003 and 1,081 million at November 30, 2002.

Principal Sources of Funding

The Company funds its balance sheet on a global basis through diverse sources. These sources include the Company's equity capital; long-term debt; repurchase agreements; U.S., Canadian, Euro, Japanese and Australian commercial paper; asset-backed securitizations; letters of credit; unsecured bond borrowings; securities lending; buy/sell agreements; municipal reinvestments; master notes; and committed and uncommitted lines of credit. Repurchase agreement transactions, securities lending and a portion of the Company's borrowings are made on a collateralized basis and, therefore, provide a more stable source of funding than short-term unsecured borrowings.

For a more detailed discussion of the Company's 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.

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 otherwise affect the ability of the Company to raise short-term and long-term financing include its: level and volatility of earnings, relative positions in the markets in which it

operates, global and product diversification, risk management policies, cash liquidity and capital structure, credit risk in connection with corporate lending activities and recent 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 financings. 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 over-the-counter derivative transactions, including credit derivatives and interest rate swaps.

In connection with certain over-the-counter trading agreements and certain term repurchase 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 Standard & Poor's or Moody's Investors Service. At August 31, 2003, 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 $860 million.

As of September 30, 2003, the Company's credit ratings were as follows:

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

Activity in the Nine Month Period Ended August 31, 2003

During the nine month period ended August 31, 2003, the Company issued senior notes aggregating $18.8 billion, including non-U.S. dollar currency notes aggregating $4.9 billion. The Company has entered into certain transactions to obtain floating interest rates based primarily on short-term London Interbank Offered Rates ("LIBOR") trading levels. At August 31, 2003, the aggregate outstanding principal amount of the Company's Senior Indebtedness (as defined in the Company's public debt shelf registration statements) was approximately $91.4 billion (including Senior Indebtedness consisting of guaranteed obligations of the indebtedness of subsidiaries).

During the nine month period ended August 31, 2003, the Company purchased approximately $350 million of its common stock through open market purchases at an average cost of $39.12 per share.

During the nine month period ended August 31, 2003, Morgan Stanley Capital Trust III, a consolidated Delaware statutory trust (the "Capital Trust III"), all of the common securities of which are owned by the Company, issued $880 million of 6.25% Capital Securities (the "Capital Securities III") that are guaranteed by the Company. The Capital Trust III issued the Capital Securities III and invested the proceeds in 6.25% Junior Subordinated Deferrable Interest Debentures issued by the Company, which are due March 1, 2033.

During the nine month period ended August 31, 2003, Morgan Stanley Capital Trust IV, a consolidated Delaware statutory trust (the "Capital Trust IV"), all of the common securities of which are owned by the Company, issued $620 million of 6.25% Capital Securities (the "Capital Securities IV") that are guaranteed by the Company. The Capital Trust IV issued the Capital Securities IV and invested the proceeds in 6.25% Junior Subordinated Deferrable Interest Debentures issued by the Company, which are due April 1, 2033.

During the quarter ended August 31, 2003, Morgan Stanley Capital Trust V, a consolidated Delaware statutory trust (the "Capital Trust V"), all of the common securities of which are owned by the Company, issued $500 million of 5.75% Capital Securities (the "Capital Securities V") that are guaranteed by the Company. The Capital Trust V issued the Capital Securities V and invested the proceeds in 5.75% Junior Subordinated Deferrable Interest Debentures issued by the Company, which are due July 15, 2033.

During the quarter ended August 31, 2003, the Company redeemed all $400 million of its 7.10% Junior Subordinated Deferrable Interest Debentures held by MSDW Capital Trust I. The Company also simultaneously redeemed all of the outstanding 7.10% Capital Securities of MSDW Capital Trust I at a redemption price of $25 per share.

Commitments

The Company's commitments associated with outstanding letters of credit, private equity and other principal investment activities and financing commitments as of August 31, 2003 are summarized below by period of expiration. Since commitments associated with letters of credit and financing arrangements may expire unused, the amounts shown do not necessarily reflect actual future cash funding requirements:

	Remaining Fiscal 2003	Fiscal 2004-2005	Fiscal 2006-2007	Thereafter	Total
	(dollars in millions)				
Letters of credit(1)(2)	$ 4,961	$ 598	$ —	$ —	$ 5,559
Private equity and other principal investments(1)(3)	28	225	122	96	471
Investment grade lending commitments(1)(4)(6)	1,728	7,889	2,882	1,324	13,823
Non-investment grade lending commitments (1)(4)(6)	203	411	253	269	1,136
Commitments for secured lending transactions(1)(5)	3,488	4,289	346	—	8,123
Total	$10,408	$13,412	$3,603	$1,689	$29,112

(1) See Note 9 to the condensed consolidated financial statements.
(2) This amount represents the Company's outstanding letters of credit, which are primarily used to satisfy various collateral requirements.
(3) This amount represents the Company's commitments in connection with its private equity and other principal investment activities.
(4) The Company's investment grade and non-investment grade lending commitments are made in connection with its corporate lending activities. See "Less Liquid Assets—Lending Activities" herein.
(5) This amount represents lending commitments extended by the Company to companies that are secured by assets of the borrower. Loans made under these arrangements typically are at variable rates and generally provide for over-collateralization based upon the creditworthiness of the borrower.
(6) Credit ratings are determined by the Company's Credit Department, using methodologies generally consistent with those employed by external rating agencies. Credit ratings of BB+ or lower are considered non-investment grade.

The table above does not include commitments to extend credit for consumer loans of approximately $262 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 (see Note 4 to the condensed consolidated financial statements). 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 August 31, 2003, the Company had commitments to enter into reverse repurchase and repurchase agreements of approximately $35 billion and $34 billion, respectively.

Less Liquid Assets

At August 31, 2003, certain assets of the Company, such as real property, equipment and leasehold improvements of $2.4 billion, aircraft assets of $4.5 billion and goodwill of $1.5 billion, were illiquid. Certain equity investments made in connection with the Company's private equity and other principal investment activities, certain high-yield debt securities, certain collateralized mortgage obligations and mortgage-related loan products, bridge financings, and certain senior secured loans and positions also are not highly liquid.

At August 31, 2003, the Company had aggregate principal investments associated with its private equity and other principal investment activities (including direct investments and partnership interests) with a carrying value of approximately $800 million, of which approximately $300 million represented the Company's investments in its real estate funds.

High-Yield Instruments. In connection with the Company's fixed income securities activities, the Company underwrites, trades, invests and makes markets in non-investment grade instruments ("high-yield instruments"). For purposes of this discussion, high-yield instruments are defined as fixed income, emerging market, preferred equity securities and distressed debt rated BB+ or lower (or equivalent ratings by recognized credit rating agencies) as well as non-rated securities which, in the opinion of the Company, contain credit risks associated with non-investment grade instruments. For purposes of this discussion, positions associated with the Company's credit derivatives business are not included because reporting gross market value exposures would not accurately reflect the risks associated with these positions due to the manner in which they are risk-managed. High-yield instruments generally involve greater risk than investment grade securities due to the lower credit ratings of the issuers, which typically have relatively high levels of indebtedness and, therefore, are more sensitive to adverse economic conditions. In addition, the market for high-yield instruments is, and may continue to be, characterized by periods of volatility and illiquidity. The Company monitors total inventory positions and risk concentrations for high-yield instruments in a manner consistent with the Company's market risk management policies and control structure. The Company manages its aggregate and single-issuer net exposure through the use of derivatives and other financial instruments. The Company records high-yield instruments at fair value. Unrealized gains and losses are recognized currently in the Company's condensed consolidated statements of income. At August 31, 2003 and November 30, 2002, the Company had high-yield instruments owned with a market value of approximately $3.3 billion and $2.6 billion, respectively, and had high-yield instruments sold, not yet purchased with a market value of $0.8 billion and $0.7 billion, respectively.

Lending Activities. In connection with certain of its business activities, the Company provides to corporate clients, on a selective basis, through subsidiaries (including Morgan Stanley Bank), loans or lending commitments, including bridge financing. The borrowers may be rated investment grade or non-investment grade. These loans and commitments have varying terms, may be senior or subordinated, are generally contingent upon representations, warranties and contractual conditions applicable to the borrower, and may be syndicated or traded by the Company. At August 31, 2003 and November 30, 2002, the aggregate value of investment grade loans and positions was $1.2 billion and $1.3 billion, respectively, and the aggregate value of non-investment grade loans and positions was $1.0 billion and $1.2 billion, respectively. In connection with these business activities (which include the loans and positions discussed above and the lending commitments included in the table on page 63), the Company had hedges with a notional amount of $4.0 billion at August 31, 2003 and $4.4 billion at November 30, 2002. Requests to provide loans or lending commitments in connection with investment banking activities are expected to continue and may grow in the future.

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 trading positions generating market risk are not included in VaR (e.g., credit default baskets) and the modeling of the risk characteristics of some positions relies upon approximations that could be significant under certain circumstances (e.g., mortgage-backed securities prepayment risk). 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 Company's quarter-end Trading & Non-trading VaR for each primary risk exposure and on an aggregate basis at August 31, 2003, May 31, 2003 and November 30, 2002 (see Table 1 below); the Company's average daily Trading VaR for each primary risk exposure and on an aggregate basis for the quarters ended August 31, 2003, May 31, 2003, and November 30, 2002 (see Table 2 below); and the Company's quarterly average, high, and low Trading VaR for each primary risk exposure and on an aggregate basis for the quarter ended August 31, 2003 (see Table 3 below). Trading & Non-trading VaR incorporates certain non-trading positions, which are not included in Trading VaR, including (a) the funding liabilities related to institutional trading positions and (b) public-company equity positions recorded as principal investments by the Company.

Aggregate Trading & Non-trading VaR at August 31, 2003 increased from the quarter ended May 31, 2003, primarily due to a reduction in the diversification benefit. The two largest contributors to VaR (Interest rate & credit spread and Equity price risk) increased, while Commodity price and Foreign exchange rate VaR declined relative to the previous quarter. Interest rate & credit spread VaR increased primarily as a result of ongoing improvements in VaR methodology that more precisely captures the risk characteristics of certain long option positions embedded in the Company's long-term funding liabilities included in Non-trading VaR. The incremental impact of non-trading positions on Aggregate Trading & Non-trading VaR as of August 31, 2003 was $2 million and $8 million at the 95% and 99% VaR levels, respectively (i.e., the Trading & Non-trading VaR rose relative to Trading VaR by these amounts when non-trading positions were included).

Table 1: Aggregate Trading & Non-trading VaR	**95%/One-Day VaR(1)**			**99%/One-Day VaR(1)**		
	At August 31, 2003	**At May 31, 2003**	**At November 30, 2002**	**At August 31, 2003**	**At May 31, 2003**	**At November 30, 2002**
Primary Market Risk Category	**(dollars in millions, pre-tax)**			**(dollars in millions, pre-tax)**		
Interest rate & credit spread	$28	$25	$26	$ 48	$ 38	$41
Equity price	17	15	10	25	21	14
Foreign exchange rate	5	10	4	7	15	6
Commodity price	17	21	15	25	33	22
Subtotal	67	71	55	105	107	83
Less diversification benefit(2)	28	33	23	45	53	35
Aggregate Trading and Non-trading VaR	$39	$38	$32	$ 60	$ 54	$48

(1) 95% VaR represents the loss amount that one would not expect to exceed, on average, more than five times every one hundred trading days if the portfolio were held constant for a one-day period. 99% VaR represents the loss amount that one would not expect to exceed, on average, more than one time every one hundred trading days if the portfolio were held constant for a one-day period.

(2) Equals the difference between Aggregate 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 table below, which presents average Trading VaR, provides a comparative summary of the Company's trading and related activities market-risk profile average over the quarters ended August 31, 2003, May 31, 2003 and November 30, 2002.

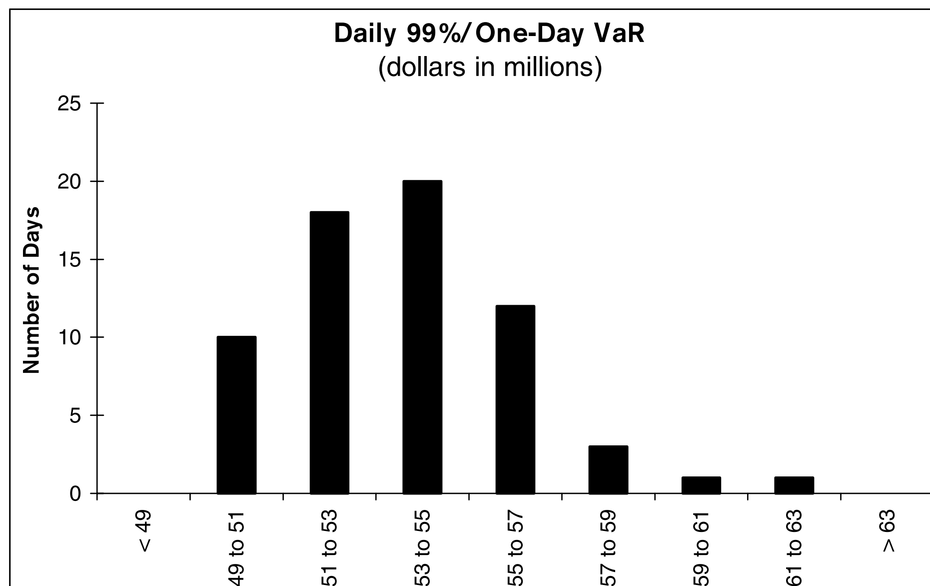
Table 2: Average Trading VaR	Average Daily 95%/One-Day VaR			Average Daily 99%/One-Day VaR		
	Quarter Ended August 31, 2003	Quarter Ended May 31, 2003	Quarter Ended November 30, 2002	Quarter Ended August 31, 2003	Quarter Ended May 31, 2003	Quarter Ended November 30, 2002
	(dollars in millions, pre-tax)			(dollars in millions, pre-tax)		
Primary Market Risk Category						
Interest rate & credit spread	$25	$25	$25	$42	$41	$40
Equity price	17	16	10	25	23	15
Foreign exchange rate	5	7	4	7	11	6
Commodity price	19	17	16	27	27	23
Aggregate Trading VaR	$37	$36	$36	$54	$54	$54

The Average Trading VaR table shows that the level of trading risk, as measured by VaR, has been stable since the quarter ended November 30, 2002. Equity price risk rose during the year from unusually low levels during the quarter ended November 30, 2002 to a level more consistent with historical risk exposure for this asset class.

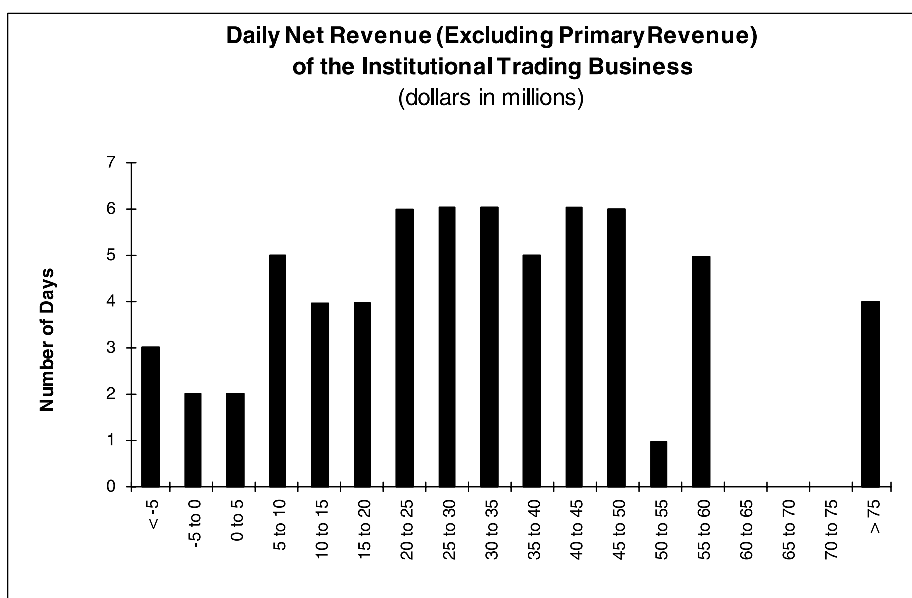
The table below, which presents average, high and low Trading VaR, provides a representative summary of the Company's trading and related activities market-risk profile during the course of the quarter ended August 31, 2003.

Table 3: Average/High/Low Trading VaR	Daily 95%/One-Day VaR for the Quarter Ended August 31, 2003			Daily 99%/One-Day VaR for the Quarter Ended August 31, 2003		
	High	Low	Average	High	Low	Average
	(dollars in millions, pre-tax)			(dollars in millions, pre-tax)		
Primary Market Risk Category						
Interest rate & credit spread	$33	$20	$25	$54	$35	$42
Equity price	28	13	17	40	19	25
Foreign exchange rate	16	2	5	23	3	7
Commodity price	23	16	19	36	23	27
Aggregate Trading VaR	$42	$32	$37	$61	$49	$54

The Company's average 99%/one-day Aggregate Trading VaR for the quarter ended August 31, 2003 was $54 million. Around this average, the Company's Aggregate Trading VaR varied from day to day. The histogram below presents the distribution of the Company's daily 99%/one-day Aggregate Trading VaR and illustrates that, for more than 90% of trading days during the quarter ended August 31, 2003, Aggregate Trading VaR ranged between $49 million and $57 million.



One method of evaluating the accuracy of the Company's VaR model as a measure of the Company's potential volatility of net revenues is to compare the VaR with actual trading revenues. For a 99%/one-day VaR, the expected number of times that trading losses should exceed VaR during the fiscal year is three, and, in general, if trading losses were to exceed VaR more than five 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 revenues during the quarter ended August 31, 2003 for the Company's institutional trading businesses (including net interest and commissions and excluding primary revenue credited to the institutional trading businesses). There were no days during the quarter ended August 31, 2003 in which the Company incurred daily trading losses in its institutional trading business in excess of the 99%/one-day Aggregate Trading VaR.



As of August 31, 2003, interest rate risk exposure associated with the Company's consumer lending activities, 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, 2002.

Credit Risk. Credit risk is the risk of loss to the Company arising from possible borrower or counterparty default on a contractual financial commitment. Credit risk arising in connection with the Company's Institutional Securities activities is managed by the Credit Department and various business lines, within parameters set by the Company's senior management. Credit risk management takes place at transaction, obligor and portfolio levels. At the transaction level, the Company seeks to mitigate credit risk through management of key risk elements such as size, tenor, seniority and collateral. At the obligor level, the Company makes use of: credit syndication, assignment and sale; netting agreements and collateral arrangements; and purchased credit protection. In addition, the Credit Department periodically reviews the financial soundness of obligors of the Company. For portfolios of credit exposure, the Company, as appropriate, assesses credit risk concentrations and purchases portfolio credit hedges.

The Company has credit guidelines that limit current and potential credit exposure to any one borrower or counterparty. The Credit Department administers these limits and monitors and reports credit exposure relative to limits.

The Company incurs credit exposure as a dealer in OTC derivatives activities. The table below presents a summary by counterparty credit rating and remaining contract maturity of the fair value of OTC derivatives in a gain position at August 31, 2003. Fair value is shown taking into account the risk reduction arising from master netting agreements 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)

Counterparty Credit Rating(2)	Years to Maturity Less than 1	1-3	3-5	Over 5	Cross-Maturity Netting(3)	Net Exposure Pre-Collateral	Net Exposure Post-Collateral
					(dollars in millions)		
AAA	$ 872	$1,652	$1,672	$ 5,364	$ (2,317)	$ 7,243	$ 3,417
AA	5,308	3,350	2,424	7,908	(5,396)	13,594	7,477
A	3,276	2,452	2,403	3,960	(2,317)	9,774	4,906
BBB	2,244	1,490	897	1,842	(733)	5,740	4,066
Non-investment grade	940	472	253	542	(221)	1,986	1,190
Unrated(4)	777	298	82	64	(12)	1,209	51
Total	$13,417	$9,714	$7,731	$19,680	$(10,996)	$39,546	$21,107

(1) Fair values shown present the Company's exposure to counterparties relating to the Company's OTC derivative products. The table excludes fair values corresponding to other credit exposures, such as those arising from the Company's lending activities.
(2) Credit ratings are determined for both rated and unrated counterparties by the Company's Credit Department, 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 net within such maturity category where appropriate.
(4) In lieu of making an individual assessment of the credit of unrated counterparties, 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 August 31, 2003, including on a net basis, reflecting the fair value of related 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 Netting(1)	Net-Exposure Pre-Collateral	Net Exposure Post-Collateral
					(dollars in millions)		
Interest rate and currency swaps and options, credit derivatives and other fixed income securities contracts	$ 4,241	$6,884	$6,715	$19,124	$(10,184)	$26,780	$11,400
Foreign exchange forward contracts and options	3,783	268	60	8	(87)	4,032	3,716
Equity securities contracts (including equity swaps, warrants and options)	1,529	622	285	94	(97)	2,433	1,166
Commodity forwards, options and swaps	3,864	1,940	671	454	(628)	6,301	4,825
Total	$13,417	$9,714	$7,731	$19,680	$(10,996)	$39,546	$21,107

OTC Derivative Products—Financial Instruments Sold, Not Yet Purchased

Product Type	Years to Maturity: Less than 1	1-3	3-5	Over 5	Cross-Maturity Netting(1)	Total
	(dollars in millions)					
Interest rate and currency swaps and options, credit derivatives and other fixed income securities contracts	$ 5,468	$6,561	$5,925	$11,602	$(10,184)	$19,372
Foreign exchange forward contracts and options	3,528	280	54	17	(87)	3,792
Equity securities contracts (including equity swaps, warrants and options)	986	916	397	326	(97)	2,528
Commodity forwards, options and swaps	3,669	1,405	516	142	(628)	5,104
Total	$13,651	$9,162	$6,892	$12,087	$(10,996)	$30,796

(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.

Each category of OTC derivative products in the above table 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 fair values recorded in the above tables are determined by the Company using various pricing models. For a discussion of fair value as it affects the Company's condensed consolidated financial statements, see "Management's Discussion and Analysis of Financial Condition and Results of Operations—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 range up to five 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.

Item 4. Controls and Procedures

An evaluation was carried out under the supervision and with the participation of the Company's management, including its Chief Executive Officer and Chief Financial Officer, of the effectiveness of the disclosure controls and procedures (as defined in Rule 13a-15(e) of the Securities Exchange Act of 1934, as amended). Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the 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 Securities Exchange Act of 1934, as amended) 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*

The following developments have occurred with respect to certain matters previously reported in the Company's Annual Report on Form 10-K for the fiscal year ended November 30, 2002, the Company's Quarterly Reports on Form 10-Q for the fiscal quarters ended February 28, 2003 and May 31, 2003 and the Company's Current Report on Form 8-K dated April 28, 2003.

Penalty Bid Litigation. On October 6, 2003, the U.S. Supreme Court denied plaintiffs' petition for *certiorari.*

Research Matters. On July 10, 2003, a securities class action captioned *Shah v. Morgan Stanley, et al.*, was filed in the U.S. District Court for the District of Nevada against the Company and certain individuals on behalf of purchasers of the Company's common stock from July 1, 1999 through May 6, 2002. The complaint alleges that the Company misrepresented the objectivity of its analysts' research and failed to disclose conflicts of interest between research analysts and bankers, the later revelation of which caused the price of the Company's common stock to decline. The complaint claims breach of fiduciary duty and violations of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, as amended (the "Exchange Act") and Rule 10b-5 thereunder.

On July 29, 2003, two securities fraud actions were filed in the U.S. District Court for the Southern District of New York ("SDNY") against the Company and other defendants alleging that defendants issued materially false and misleading research reports on Homestore.com, Inc., which reports artificially inflated the price of Homestore's stock. The complaint claims violations of Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5 thereunder.

Regarding the matter captioned *Dacey v. Morgan Stanley Dean Witter & Co*. filed on May 8, 2002, the Company, on July 21, 2003, filed a motion to dismiss the remanded complaint.

Regarding the matter captioned *Cannon v. Citigroup Global Markets, et al.,* on August 5, 2003, plaintiff filed a voluntary dismissal without prejudice.

Regarding the matter captioned *Kraussmann v. Morgan Stanley & Co., Inc. and UBS Warburg LLC*, in July 2003, two additional cases alleging the same facts and violations were filed in the SDNY.

Regarding the June 24, 2003 suit brought by the Attorney General of West Virginia, the Company and other defendants, on August 25, 2003, filed motions to dismiss the complaint and disqualify plaintiff's counsel.

In *Pfeiffer, et al. v. Goldman, Sachs & Co., et al.,* one of the three consolidated actions beginning on August 30, 2002, on August 4, 2003, plaintiffs filed a notice of appeal of the court's decision to dismiss the complaint for the second time.

On August 29, 2003, the SDNY entered an Order approving the parties' stipulation to stay the Technology Fund and Information Fund cases pending the decision of the U.S. Circuit Court of Appeals for the Second Circuit in an appeal from the dismissal of a similar case brought against another party by the same plaintiffs' law firm.

Regarding the December 19, 2002 global research settlement involving the Company, other financial services firms, and various regulators, the settlement has been approved by the SEC, the NYSE and the NASD. The settlement has also been approved and executed by a number of states. The parties are awaiting approval and entry of final judgments by the SDNY.

Electricity Trading Matters. On July 7, 2003, one of the class actions, *Millar v. Allegheny Energy,* was remanded to California Superior Court.

On July 10, 2003, the Company agreed with the State of California to settle the long-term power contract cases.

On August 29, 2003, the Company, without admitting any wrongdoing, agreed with the Federal Energy Regulatory Commission (“FERC”) staff to settle all of the charges in the June 25, 2003 Orders to Show Cause. The settlement agreement has been submitted to the FERC for approval.

Mutual Fund Matters. On July 14, 2003, the Massachusetts Securities Division (“the Division”) filed an administrative complaint alleging that the Company filed false information in response to an inquiry from the Division pertaining to mutual fund sales practices. On August 11, 2003, the Division filed another administrative complaint, alleging that the Company failed to make disclosures of incentive compensation for proprietary and partnered mutual fund transactions. The Company answered the complaints on August 4 and September 16, 2003, respectively.

In July 2003, the Company received a subpoena from the Attorney General of the State of New York requesting information relating to possible late trading and market-timing activities in mutual funds. In September 2003, the SEC and NASD commenced industry-wide examinations of broker-dealers and mutual fund complexes, including the Company, relating to possible late trading and market-timing activities in mutual funds. The Company is cooperating with these investigations.

On September 15, 2003, the Company and one of its officers entered into a settlement with the NASD pursuant to a Letter of Acceptance, Waiver and Consent (“AWC”). The AWC alleges violations of applicable NASD rules in connection with various sales contests conducted from October 1999 to December 2002. Under the terms of the settlement, the Company and its officer neither admitted nor denied the allegations of the AWC and accepted a censure and the imposition of monetary fines in the amounts of $2 million and $250,000, respectively.

On September 23, 2003, the staff of the SEC informed the Company that it is considering recommending enforcement action in connection with the Company’s mutual fund sales practices. The staff advised the Company that the proposed action against it would be based upon, among other things, (i) the Company’s alleged failure to disclose the sources, types and amounts of compensation received by it from investment companies for selling their products; (ii) the Company’s alleged failure to disclose adequately its compensation arrangements for financial advisors; and (iii) the Company’s alleged favored sale or distribution of shares of specified investment companies based upon brokerage commissions received or expected from such investment companies. On October 8, 2003, the staff advised the Company that it is also considering recommending enforcement action based upon, among other things, the Company’s alleged sales practices in connection with Class B investment company shares.

Regarding the matter captioned *Hicks v. Morgan Stanley & Co., et al.*, on July 16, 2003, the Court granted plaintiffs’ motion for class certification.

Regarding the matter captioned *Edward Benzon, et al., v. Morgan Stanley Distributors Inc., et al.*, on September 2, 2003, defendants filed a motion to dismiss the complaint.

AOL Time Warner Litigation. Several additional lawsuits relating to the Company’s role as financial advisor to Time Warner and/or as underwriter of AOL Time Warner bonds have been filed in various state courts, including Ohio, West Virginia, Pennsylvania, and three additional actions in California. These complaints allege facts and violations similar to *In re AOL Time Warner, Inc. Securities & “ERISA” Litigation, Regents of the University of California, et al., v. Parsons, et al.,* and *Treasurer of New Jersey, et al., v. AOL Time Warner Inc. et al.*

Item 6. *Exhibits and Reports on Form 8-K*

(a) Exhibits

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

(b) Reports on Form 8-K

Form 8-K dated June 18, 2003 reporting Item 7 and Item 9 in connection with the announcement of the Company’s financial results for the fiscal quarter ended May 31, 2003.

Form 8-K dated August 26, 2003 reporting Item 5 and Item 7.

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/ ALEXANDER C. FRANK
Alexander C. Frank,
Controller and Treasurer

By: /s/ DAVID S. MOSER
David S. Moser,
Principal Accounting Officer

Date: October 14, 2003

EXHIBIT INDEX

MORGAN STANLEY

Quarter Ended August 31, 2003

Exhibit No.	Description
4	Amended and Restated Trust Agreement of Morgan Stanley Capital Trust V dated as of July 16, 2003 among Morgan Stanley, as depositor, The Bank of New York, as property trustee, The Bank of New York (Delaware), as Delaware trustee and the administrators named therein.
11	Statement Re: Computation of Earnings Per Common Share (The calculation of per share earnings is in Part I, Item 1, Note 8 to the Condensed Consolidated Financial Statements (Earnings per Share) and is omitted in accordance with Section (b)(11) of Item 601 of Regulation S-K.)
12	Statement Re: Computation of Ratio of Earnings to Fixed Charges and Computation of Earnings to Fixed Charges and Preferred Stock Dividends.
15	Letter of awareness from Deloitte & Touche LLP, dated October 10, 2003, concerning unaudited interim financial information.
23.1	Consent of BK Associates, Inc.
23.2	Consent of Morten Beyer & Agnew, Inc.
23.3	Consent of Airclaims Limited.
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.