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, 2004

OR

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

For the transition period from to

Commission file number 1-11758

Morgan Stanley
(Exact Name of Registrant as Specified in its Charter)

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

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

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

Indicate by check mark whether the Registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes ☒ No ☐

As of September 30, 2004, there were 1,094,573,359 shares of the Registrant's Common Stock, par value $.01 per share, outstanding.

INDEX TO QUARTERLY REPORT ON FORM 10-Q
Quarter Ended August 31, 2004

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 with the SEC at the SEC's public reference room at 450 Fifth Street, NW, Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for information on the public reference room. The SEC maintains an internet site that contains annual, quarterly and current reports, proxy and information statements and other information that issuers (including the Company) file electronically with the SEC. The SEC's internet site is *www.sec.gov.* The Company's internet site is *www.morganstanley.com.* The Company makes available free of charge through its internet site, via a link to the SEC's internet site at *www.sec.gov*, its annual reports on Form 10-K; quarterly reports on Form 10-Q; current reports on Form 8-K and any amendments to those reports filed or furnished pursuant to the Securities Exchange Act of 1934, as amended (the "Exchange Act"), as soon as reasonably practicable after such material is electronically filed with, or furnished to, the SEC. The Company also makes available, through its internet site, via a link to the SEC's internet site, statements of beneficial ownership of the Company's equity securities filed by its directors, officers, 10% or greater shareholders and others under Section 16 of the Exchange Act. 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. 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 Reader, a link to Adobe's internet site, from which you can download the software, is provided. 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, its Policy Regarding Shareholder Communication with the Board of Directors, its Policy Regarding Director Candidates Recommended by Shareholders and its Code of Ethics and Business Conduct for its directors, officers and employees. You can request a copy of these documents, excluding exhibits, at no cost, by writing or telephoning us at 1585 Broadway, New York, NY 10036, Attention: Investor Relations (212-761-4000). The information on the Company's website is not incorporated by reference into this report.

MORGAN STANLEY

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

	August 31, 2004	November 30, 2003
	(unaudited)	
Assets		
Cash and cash equivalents	$ 46,243	$ 29,692
Cash and securities deposited with clearing organizations or segregated under federal and other regulations (including securities at fair value of $35,640 at August 31, 2004 and $18,957 at November 30, 2003)	45,595	28,526
Financial instruments owned (approximately $104 billion at August 31, 2004 and $73 billion at November 30, 2003 were pledged to various parties):		
U.S. government and agency securities	56,040	24,133
Other sovereign government obligations	26,260	21,592
Corporate and other debt	77,048	80,594
Corporate equities	26,407	29,984
Derivative contracts	49,633	44,652
Physical commodities	932	671
Securities purchased under agreements to resell	92,816	78,205
Securities received as collateral	33,251	27,278
Securities borrowed	202,863	153,813
Receivables:		
Consumer loans (net of allowances of $954 at August 31, 2004 and $1,002 at November 30, 2003)	18,738	19,382
Customers, net	40,081	37,321
Brokers, dealers and clearing organizations	6,649	5,563
Fees, interest and other	4,799	4,349
Office facilities, at cost (less accumulated depreciation of $2,791 at August 31, 2004 and $2,506 at November 30, 2003)	2,530	2,433
Aircraft under operating leases (less accumulated depreciation of $1,156 at August 31, 2004 and $1,041 at November 30, 2003)	4,028	4,407
Goodwill and intangible assets	2,191	1,523
Other assets	8,929	8,725
Total assets	$745,033	$602,843

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

	August 31, 2004	November 30, 2003
	(unaudited)	
Liabilities and Shareholders' Equity		
Commercial paper and other short-term borrowings	$ 30,417	$ 28,386
Deposits	12,392	12,839
Financial instruments sold, not yet purchased:		
U.S. government and agency securities	26,139	17,072
Other sovereign government obligations	21,891	17,505
Corporate and other debt	11,869	10,141
Corporate equities	30,651	25,615
Derivative contracts	39,425	36,242
Physical commodities	2,643	4,873
Securities sold under agreements to repurchase	195,739	147,618
Obligation to return securities received as collateral	33,251	27,278
Securities loaned	84,079	64,375
Payables:		
Customers	119,438	96,794
Brokers, dealers and clearing organizations	6,748	5,706
Interest and dividends	3,091	2,138
Other liabilities and accrued expenses	13,771	12,918
Long-term borrowings	86,003	65,600
	717,547	575,100
Capital Units	66	66
Preferred securities subject to mandatory redemption	—	2,810
Commitments and contingencies		
Shareholders' equity:		
Common stock, $0.01 par value;		
Shares authorized: 3,500,000,000 at August 31, 2004 and November 30, 2003;		
Shares issued: 1,211,701,552 at August 31, 2004 and 1,211,699,552 at November 30, 2003;		
Shares outstanding: 1,096,707,183 at August 31, 2004 and 1,084,696,446 at November 30, 2003	12	12
Paid-in capital	3,865	4,028
Retained earnings	30,500	28,038
Employee stock trust	2,839	3,008
Accumulated other comprehensive income (loss)	(140)	(156)
Subtotal	37,076	34,930
Note receivable related to ESOP	(3)	(4)
Common stock held in treasury, at cost, $0.01 par value; 114,994,369 shares at August 31, 2004 and 127,003,106 shares at November 30, 2003	(6,155)	(6,766)
Common stock issued to employee trust	(2,839)	(2,420)
Unearned stock-based compensation	(659)	(873)
Total shareholders' equity	27,420	24,867
Total liabilities and shareholders' equity	$745,033	$602,843

See Notes to Condensed Consolidated Financial Statements.

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

	Three Months Ended August 31, 2004	Three Months Ended August 31, 2003	Nine Months Ended August 31, 2004	Nine Months Ended August 31, 2003
	(unaudited)	(unaudited) (As Restated, See Note 19)	(unaudited)	(unaudited)
Revenues:				
Investment banking	$ 783	$ 608	$ 2,595	$ 1,733
Principal transactions:				
Trading	695	1,818	4,591	5,200
Investments	125	38	345	75
Commissions	768	775	2,546	2,157
Fees:				
Asset management, distribution and administration	1,088	956	3,273	2,733
Merchant and cardmember	349	340	992	1,042
Servicing	459	462	1,516	1,532
Interest and dividends	5,410	3,821	12,855	11,059
Other	177	108	416	305
Total revenues	9,854	8,926	29,129	25,836
Interest expense	4,189	3,367	10,111	9,111
Provision for consumer loan losses	240	310	702	955
Net revenues	5,425	5,249	18,316	15,770
Non-interest expenses:				
Compensation and benefits	2,347	2,287	7,982	6,763
Occupancy and equipment	228	191	634	582
Brokerage, clearing and exchange fees	231	212	692	605
Information processing and communications	326	315	964	945
Marketing and business development	279	197	796	711
Professional services	400	283	1,074	767
Other	332	236	1,176	1,143
Total non-interest expenses	4,143	3,721	13,318	11,516
Income from continuing operations before losses from unconsolidated investees, income taxes and dividends on preferred securities subject to mandatory redemption	1,282	1,528	4,998	4,254
Losses from unconsolidated investees	77	105	251	175
Provision for income taxes	343	342	1,392	1,175
Dividends on preferred securities subject to mandatory redemption	—	47	45	109
Income from continuing operations	862	1,034	3,310	2,795
Discontinued operations:				
Loss/(gain) from discontinued operations (including loss on disposal of $42 million in fiscal 2004)	42	(2)	40	36
Income tax (benefit)/provision	(17)	1	(16)	(14)
Loss/(gain) on discontinued operations	25	(1)	24	22
Net income	$ 837	$ 1,035	$ 3,286	$ 2,773
Basic earnings per common share:				
Income from continuing operations	$ 0.80	$ 0.96	$ 3.06	$ 2.59
Loss from discontinued operations	(0.02)	—	(0.02)	(0.02)
Basic earnings per common share	$ 0.78	$ 0.96	$ 3.04	$ 2.57
Diluted earnings per common share:				
Income from continuing operations	$ 0.78	$ 0.94	$ 2.99	$ 2.54
Loss from discontinued operations	(0.02)	—	(0.02)	(0.02)
Diluted earnings per common share	$ 0.76	$ 0.94	$ 2.97	$ 2.52
Average common shares outstanding:				
Basic	1,081,448,663	1,077,680,996	1,081,160,252	1,077,140,296
Diluted	1,105,546,130	1,100,593,303	1,107,494,887	1,098,234,894

See Notes to Condensed Consolidated Financial Statements.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(dollars in millions)

	Three Months Ended August 31,		Nine Months Ended August 31,	
	2004	2003	2004	2003
	(unaudited)	(As Restated, See Note 19)	(unaudited)	
Net income	$837	$1,035	$3,286	$2,773
Other comprehensive income (loss), net of tax:				
Foreign currency translation adjustment	(6)	(14)	30	25
Net change in cash flow hedges	(52)	46	(14)	(13)
Comprehensive income	$779	$1,067	$3,302	$2,785

See Notes to Condensed Consolidated Financial Statements.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(dollars in millions)

	Nine Months Ended August 31, 2004	Nine Months Ended August 31, 2003
	(unaudited)	
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 3,286	$ 2,773
Loss on discontinued operations	24	22
Income from continuing operations	3,310	2,795
Adjustments to reconcile net income to net cash used for operating activities:		
Non-cash charges (credits) included in net income:		
Aircraft-related charges	107	288
Compensation payable in common stock and options	201	(49)
Depreciation and amortization	463	558
Provision for consumer loan losses	702	955
Changes in assets and liabilities:		
Cash and securities deposited with clearing organizations or segregated under federal and other regulations	(17,069)	5,296
Financial instruments owned, net of financial instruments sold, not yet purchased	(16,624)	11,995
Securities borrowed, net of securities loaned	(29,346)	(17,701)
Receivables and other assets	(4,036)	(14,689)
Payables and other liabilities	25,434	8,483
Net cash used for operating activities	(36,858)	(2,069)
CASH FLOWS FROM INVESTING ACTIVITIES		
Net (payments for) proceeds from:		
Office facilities and aircraft under operating leases	(293)	(524)
Purchase of Barra, Inc., net of cash acquired	(758)	—
Net principal disbursed on consumer loans	(5,233)	(6,361)
Sales of consumer loans	5,175	9,972
Net cash (used for) provided by investing activities	(1,109)	3,087
CASH FLOWS FROM FINANCING ACTIVITIES		
Net proceeds from (payments for):		
Short-term borrowings	2,031	(22,007)
Securities sold under agreements to repurchase, net of securities purchased under agreements to resell and certain derivatives financing activities	36,006	8,203
Deposits	(447)	(445)
Net proceeds from:		
Issuance of common stock	240	172
Issuance of long-term borrowings	28,688	18,182
Issuance of Preferred securities subject to mandatory redemption	—	2,000
Payments for:		
Repayments of long-term borrowings	(10,734)	(10,566)
Repurchases of common stock	(444)	(350)
Redemption of Preferred securities subject to mandatory redemption	—	(400)
Cash dividends	(822)	(747)
Net cash provided by (used for) financing activities	54,518	(5,958)
Net increase (decrease) in cash and cash equivalents	16,551	(4,940)
Cash and cash equivalents, at beginning of period	29,692	29,212
Cash and cash equivalents, at end of period	$ 46,243	$ 24,272

See 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, including real estate investment vehicles; and aircraft financing activities. The Company's Individual Investor Group business provides comprehensive financial planning, investment advisory and brokerage 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 Network, a network of merchant and cash access locations primarily in the U.S. Morgan Stanley-branded credit cards and personal loan products that are offered in the U.K. are also included in the Credit Services business segment. The Company provides its products and services to a large and diversified group of clients and customers, including corporations, governments, financial institutions and individuals.

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"), as revised, the Company also consolidates any variable interest entities for which it is the primary beneficiary (see Note 12). 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 year's 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/A for the fiscal year ended November 30, 2003 (the "Form 10-K/A") as supplemented by the first and second quarter fiscal 2004 Quarterly Reports on Form 10-Q/A. 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.

Discontinued Operations. Revenues and expenses associated with certain aircraft designated as "held for sale" have been classified as discontinued operations for all periods presented in accordance with Statement of Financial Accounting Standards ("SFAS") No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." See Note 17 for additional discussion of discontinued operations.

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 fair value of the Company's Financial instruments owned and Financial instruments sold, not yet purchased are generally based on observable market prices, observable market parameters or derived from such prices or parameters based on bid prices or parameters for Financial instruments owned and ask prices or parameters for Financial instruments sold, not yet purchased. In the case of financial instruments transacted on recognized exchanges the observable prices represent quotations for completed transactions from the exchange on which the financial instrument is principally traded. Bid prices represent the price a buyer is willing to pay for a financial instrument at a particular time. Ask prices represent the lowest price a seller is willing to accept for a financial instrument at a particular time.

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 techniques involve some degree of judgment.

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

The fair value of over-the-counter ("OTC") derivative contracts is derived primarily using pricing models, which may require multiple market input parameters. Where appropriate, valuation adjustments are made to account for credit quality and market liquidity. These adjustments are applied on a consistent basis and are based upon observable market data where available. In the absence of observable market prices or parameters in an active market, observable prices or parameters of other comparable current market transactions, or other observable data supporting a fair value based on a pricing model at the inception of a contract, fair value is based on the transaction price. The Company also uses pricing models to manage the risks introduced by OTC derivatives. Depending on the product and the terms of the transaction, the fair value of OTC derivative products can be modeled using a series of techniques, including closed form analytic formulae, such as the Black-Scholes option pricing model, simulation models or a combination thereof, applied consistently. In the case of more established derivative products, the pricing models used by the Company are widely accepted by the financial services industry. Pricing models take into account the contract terms, including the maturity, as well as market parameters such as interest rates, volatility and the creditworthiness of the counterparty.

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 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 liabilities. 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 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 (loss) in Shareholders' equity, net of tax effects, and amounts in Accumulated other comprehensive income (loss) 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 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 (loss) in Shareholders' equity, net of tax effects, with the related unrealized amounts due from or to counterparties included in Financial instruments owned or Financial instruments sold, not yet purchased. 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 and fees ("accrued interest receivable") on securitized credit card receivables, 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.

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 is 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 and Intangible Assets.

During the first quarter of fiscal 2004, the Company completed the annual goodwill impairment test, which did not indicate any goodwill impairment and therefore did not have an effect on the condensed consolidated financial condition or results of operations.

Changes in the carrying amount of the goodwill for the nine month period ended August 31, 2004 were as follows:

	Institutional Securities	Individual Investor Group	Investment Management	Total
		(dollars in millions)		
Balance as of November 30, 2003(1)	$ 6	$542	$966	$1,514
Translation adjustments	—	13	—	13
Goodwill acquired during the year	314	—	—	314
Balance as of August 31, 2004	$320	$555	$966	$1,841

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

Acquired intangible assets as of August 31, 2004 were as follow:

	Gross Carrying Amount	Accumulated Amortization
	(dollars in millions)	
Amortizable intangible assets:		
Trademarks	$102	$1
Technology-related	222	6
Customer relationships	26	1
Other	9	1
Total amortizable intangible assets	$359	$9

The estimated amortization expense is approximately $40 million per year over the next five fiscal years.

For additional information on goodwill and intangible assets acquired in connection with the acquisition of Barra, Inc., see Note 18.

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, 2004	At November 30, 2003
	(dollars in millions)	
Financial instruments owned:		
U.S. government and agency securities	$14,728	$ 5,717
Other sovereign government obligations	148	164
Corporate and other debt	17,523	12,089
Corporate equities	5,475	3,477
Total	$37,874	$21,447

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, 2004 and November 30, 2003, the fair value of securities received as collateral where the Company is permitted to sell or repledge the securities was $653 billion and $511 billion, respectively, and the fair value of the portion that has been sold or repledged was $596 billion and $462 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, adherence to the Company's collateral policies significantly limits the Company's credit exposure in the event of customer default. The Company may request additional margin collateral from customers, if appropriate, and if necessary may sell securities that have not been paid for or purchase securities sold but not delivered from customers.

In connection with its Institutional Securities business, the Company engages in securitization activities related to 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 $3.9 billion at August 31, 2004, the majority of which were related to residential mortgage loan, U.S. agency collateralized mortgage obligation and commercial mortgage loan securitization transactions. Net gains at the time of securitization during the quarter and nine month period ended August 31, 2004 were not material. The assumptions that the Company used to determine the fair value of its retained interests at the time of securitization related to those transactions that occurred during the quarter and nine month period ended August 31, 2004 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 results of operations.

The following table presents information on the Company's residential mortgage loan, U.S. agency collateralized mortgage obligation and commercial mortgage loan securitization transactions. Key economic assumptions and the sensitivity of the current fair value of the retained interests to immediate 10% and 20% adverse changes in those assumptions at August 31, 2004 were as follows (dollars in millions):

	Residential Mortgage Loans	U.S. Agency Collateralized Mortgage Obligations	Commercial Mortgage Loans
Retained interests (carrying amount/fair value)	$ 1,885	$1,401	$435
Weighted average life (in months)	33	75	83
Credit losses (rate per annum)	0.05-45.90%	—	0.27-12.89%
Impact on fair value of 10% adverse change	$ (59)	—	$ (1)
Impact on fair value of 20% adverse change	$ (115)	—	$ (1)
Weighted average discount rate (rate per annum)	9.21%	6.27%	6.13%
Impact on fair value of 10% adverse change	$ (27)	$ (35)	$ (13)
Impact on fair value of 20% adverse change	$ (52)	$ (69)	$ (25)
Prepayment speed assumption(1)	270-1375PSA	156-816PSA	—
Impact on fair value of 10% adverse change	$ (27)	$ (12)	—
Impact on fair value of 20% adverse change	$ (27)	$ (22)	—

(1) Commercial mortgage loans typically contain provisions that either prohibit or economically penalize the borrower from prepaying the loan for a specified period of time.

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

In connection with its Institutional Securities business, during both the nine month periods ended August 31, 2004 and 2003, the Company received $55 billion of proceeds from new securitization transactions and cash flows from retained interests in securitization transactions of $4.2 billion and $3.6 billion, respectively.

4. Consumer Loans.

Consumer loans were as follows:

	At August 31, 2004	At November 30, 2003
	(dollars in millions)	
General purpose credit card, mortgage and consumer installment	$19,692	$20,384
Less:		
Allowance for consumer loan losses	954	1,002
Consumer loans, net	$18,738	$19,382

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

	Three Months Ended August 31,		Nine Months Ended August 31,	
	2004	2003	2004	2003
	(dollars in millions)			
Balance at beginning of period	$956	$975	$1,002	$928
Additions:				
Provision for consumer loan losses	240	310	702	955
Deductions:				
Charge-offs	276	328	847	976
Recoveries	(34)	(31)	(97)	(81)
Net charge-offs	242	297	750	895
Balance at end of period	$954	$988	$ 954	$988

Interest accrued on general purpose credit card loans subsequently charged off, net of recoveries, recorded as a reduction of interest revenue, was $49 million and $172 million in the quarter and nine month period ended August 31, 2004 and $67 million and $202 million in the quarter and nine month period ended August 31, 2003. Cardmember fees accrued on general purpose credit card loans subsequently charged off, net of recoveries, recorded as a reduction to merchant and cardmember fee revenue, was $30 million and $108 million in the quarter and nine month period ended August 31, 2004 and $43 million and $133 million in the quarter and nine month period ended August 31, 2003.

At August 31, 2004, the Company had commitments to extend credit for consumer loans of approximately $260 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.

The Company received net proceeds from consumer loan sales of $740 million and $5,175 million in the quarter and nine month period ended August 31, 2004 and $1,241 million and $9,972 million in the quarter and nine month period ended August 31, 2003.

Credit Card Securitization Activities. The Company's retained interests in credit card asset securitizations include undivided seller's interests, accrued interest receivable on securitized credit card receivables, cash collateral accounts, 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. Accrued interest receivable and cash collateral accounts are recorded in Other assets at amounts that approximate 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, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities") 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. At August 31, 2004, the Company had $10.7 billion of retained interests, including $7.7 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 month periods ended August 31, 2004 and 2003, the Company completed credit card asset securitizations of $1.9 billion and $5.7 billion, respectively, and recognized net securitization losses of $7 million and net securitization gains of $37 million, respectively, as servicing fees in the condensed consolidated statements of income. The uncollected balances of securitized general purpose credit card loans were $28.6 billion at August 31, 2004 and $29.4 billion at November 30, 2003.

Key economic assumptions used in measuring the Residual Interests at the date of securitization resulting from credit card asset securitizations completed during the nine month periods ended August 31, 2004 and August 31, 2003 were as follows:

	Nine Months Ended August 31,	
	2004	**2003**
Weighted average life (in months)	6.1	5.6-7.1
Payment rate (rate per month)	18.00%	14.89-18.00%
Credit losses (rate per annum)	6.90%	3.86-6.90%
Discount rate (rate per annum)	14.00%	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, 2004
Residual Interests (carrying amount/fair value)	$ 250
Weighted average life (in months)	5.4
Weighted average payment rate (rate per month)	18.35%
Impact on fair value of 10% adverse change	$ (16)
Impact on fair value of 20% adverse change	$ (30)
Weighted average credit losses (rate per annum)	6.44%
Impact on fair value of 10% adverse change	$ (66)
Impact on fair value of 20% adverse change	$ (131)
Weighted average discount rate (rate per annum)	12.00%
Impact on fair value of 10% adverse change	$ (2)
Impact on fair value of 20% adverse change	$ (4)

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,	
	2004	2003
Proceeds from new credit card asset securitizations	$ 1.9	$ 5.7
Proceeds from collections reinvested in previous credit card asset securitizations	$47.1	$45.8
Contractual servicing fees received	$ 0.5	$ 0.5
Cash flows received from retained interests	$ 1.3	$ 1.3

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

	At August 31, 2004		Nine Months Ended August 31, 2004	
	Loans Outstanding	Loans Delinquent	Average Loans	Net Principal Credit Losses
Managed general purpose credit card loans	$47.1	$2.3	$47.5	$2.2
Less: Securitized general purpose credit card loans	28.6			
Owned general purpose credit card loans	$18.5			

5. Long-Term Borrowings.

Long-term borrowings at August 31, 2004 scheduled to mature within one year aggregated $12,252 million.

During the nine month period ended August 31, 2004, the Company issued senior notes aggregating $28,764 million, including non-U.S. dollar currency notes aggregating $4,599 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: 2005, $515 million; 2006, $173 million; 2007, $4,819 million; 2008, $2,388 million; and thereafter, $20,869 million. In the nine month period ended August 31, 2004, $10,734 million of senior notes were repaid.

The weighted average maturity of the Company's long-term borrowings, based upon stated maturity dates, was approximately 5.5 years at August 31, 2004.

The Company issues U.S. dollar index/equity linked borrowings, including various structured instruments whose payments and redemption values are linked to the performance of a specific index (e.g., Standard & Poor's 500), a basket of stocks or a specific equity security. The Company accounts for such structured borrowings as having an embedded derivative. To minimize the exposure resulting from movements in the underlying equity position or index, the Company enters into various equity swap contracts and purchased options that effectively convert the borrowing costs into floating rates based upon LIBOR. The equity swaps and purchased options are derivatives and are accounted for at fair value in accordance with SFAS No. 133, with changes in fair value included in principal transaction trading revenue. Principal transaction trading revenues in the nine month periods ended August 31, 2004 and August 31, 2003 include changes in the fair value of embedded derivatives in the Company's structured borrowings. Prior to the second quarter of fiscal 2004, such amounts were included in interest expense. Prior period information has been reclassified to conform to the current period's presentation. In the quarter and nine month period ended August 31, 2003, principal transaction trading revenues included $287 million and $44 million that were previously recorded as increases to interest expense. These reclassifications are recorded within the Company's Institutional Securities business segment and had no impact on net revenues.

6. Capital Units, Capital Securities and Junior Subordinated Deferrable Interest Debentures.

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, 2004 and November 30, 2003.

Prior to February 29, 2004, Preferred Securities Subject to Mandatory Redemption (also referred to as "Capital Securities" herein) represented preferred minority interests in certain of the Company's subsidiaries. Accordingly, dividends paid on Preferred Securities Subject to Mandatory Redemption were presented as a deduction to after-tax income (similar to minority interests in the income of subsidiaries) in the condensed consolidated statements of income.

In December 2003, the FASB issued certain revisions to FIN 46 to clarify and expand on the accounting guidance for variable interest entities. In accordance with this revised guidance, the Company deconsolidated all of its statutory trusts that had issued Capital Securities as of February 29, 2004. As a result, the junior subordinated deferrable interest debentures issued by the Company to the statutory trusts are included within Long-term borrowings, and the common securities issued by the statutory trusts and owned by the Company are recorded in Other assets. In addition, the Capital Securities issued by the statutory trusts are no longer included in the condensed consolidated statement of financial condition. Subsequent to February 29, 2004, dividends on the junior subordinated deferrable interest debentures have been recorded within interest expense. The impact of the deconsolidation of the statutory trusts did not have a material effect on the condensed consolidated financial position or results of operations. See Note 12 to the consolidated financial statements for the fiscal year ended November 30, 2003 included in the Form 10-K/A.

7. Common Stock and Shareholders' Equity.

Regulatory Requirements. 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 SEC, the NYSE and the Commodity Futures Trading Commission. MS&Co. and MSDWI have consistently operated in excess of these requirements. MS&Co.'s net capital totaled $3,552 million at August 31, 2004, which exceeded the amount required by $2,817 million. MSDWI's net capital totaled $1,203 million at August 31, 2004, which exceeded the amount required by $1,077 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 subsidiary, 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, 2004, the leverage ratio, Tier 1 risk-weighted capital ratio and total risk-weighted capital ratio of each of the Company's FDIC-insured financial institutions exceeded these regulatory minimums.

Certain other U.S. and non-U.S. subsidiaries are subject to various securities, commodities and banking regulations, and capital adequacy requirements promulgated by the regulatory and exchange authorities of the countries in which they operate. These subsidiaries have consistently operated in excess of their local capital adequacy requirements. Morgan Stanley Derivative Products Inc., the Company's triple-A rated derivative products subsidiary, maintains certain operating restrictions that have been reviewed by various rating agencies.

Regulatory Developments. The SEC approved a rule (the "CSE Rule") on April 28, 2004 in response to industry requests to establish a voluntary framework for comprehensive, group-wide risk management procedures and consolidated supervision of certain financial services holding companies by the SEC. The framework is designed to minimize the duplicative regulatory burdens on U.S. securities firms resulting from the European Union ("EU") Directive (2002/87/EC) concerning the supplementary supervision of financial conglomerates active in the EU. The CSE Rule also would allow MS&Co., one of the Company's U.S. broker-dealers, to use an alternative method, based on mathematical models, to calculate net capital charges for market and derivatives-related credit risk. Under the CSE Rule, the SEC will regulate the holding company and any unregulated affiliate of a registered broker-dealer, including subjecting the holding company to capital requirements generally consistent with the standards of the Basel Committee on Banking Supervision ("Basel II"). The Company currently expects to apply to the SEC later this year for permission to operate under the rule.

The Company continues to work with its regulators to understand and assess the impact of the CSE Rule and Basel II capital standards. Many important elements of the new regulations are still being finalized. The Company cannot fully predict the impact that these changes will have on its businesses; however, compliance with consolidated supervision and the imposition of revised capital standards are likely to impose additional costs and may affect decisions with respect to raising and using capital.

Treasury Shares. During the nine month periods ended August 31, 2004 and 2003, the Company purchased approximately $444 million and $350 million of its common stock, respectively, under its publicly announced repurchase programs through open market purchases at an average cost of $51.26 and $39.12 per share, respectively.

8. Earnings per Share.

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

	Three Months Ended August 31,		Nine Months Ended August 31,	
	2004	2003	2004	2003
Basic EPS:				
Income from continuing operations	$ 862	$1,034	$3,310	$2,795
Loss/(gain) on discontinued operations	25	(1)	24	22
Net income applicable to common shareholders	$ 837	$1,035	$3,286	$2,773
Weighted average common shares outstanding	1,081	1,078	1,081	1,077
Basic earnings per common share:				
Income from continuing operations	$ 0.80	$ 0.96	$ 3.06	$ 2.59
Loss from discontinued operations	(0.02)	—	(0.02)	(0.02)
Basic EPS	$ 0.78	$ 0.96	$ 3.04	$ 2.57
Diluted EPS:				
Income from continuing operations	$ 862	$1,034	$3,310	$2,795
Loss/(gain) on discontinued operations	25	(1)	24	22
Net income applicable to common shareholders	$ 837	$1,035	$3,286	$2,773
Weighted average common shares outstanding	1,081	1,078	1,081	1,077
Effect of dilutive securities	25	23	26	21
Weighted average common shares outstanding and common stock equivalents	1,106	1,101	1,107	1,098
Diluted earnings per common share:				
Income from continuing operations	$ 0.78	$ 0.94	$ 2.99	$ 2.54
Loss from discontinued operations	(0.02)	—	(0.02)	(0.02)
Diluted EPS	$ 0.76	$ 0.94	$ 2.97	$ 2.52

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

	Three Months Ended August 31,		Nine Months Ended August 31,	
	2004	2003	2004	2003
	(in millions)			
Number of antidilutive securities (including stock options and restricted stock units) outstanding at end of period	117	63	108	63

9. Commitments and Contingencies.

Letters of Credit. At August 31, 2004 and November 30, 2003, the Company had approximately $9.6 billion and $7.7 billion, respectively, of letters of credit outstanding to satisfy various collateral requirements.

Securities Activities. In connection with certain of its Institutional Securities business activities, the Company provides to selected clients 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, 2004 and November 30, 2003, the aggregate value of investment grade loans and positions was $0.8 billion and $1.0 billion, respectively, and the aggregate value of non-investment grade loans and positions was $1.0 billion and $0.7 billion, respectively. At August 31, 2004 and November 30, 2003, the Company's aggregate investment grade lending commitments were $18.3 billion and $14.2 billion, respectively, and its aggregate non-investment grade lending commitments were $2.7 billion and $1.9 billion, respectively. In connection with these business activities (which include the loans and positions and lending commitments), the Company had hedges (primarily credit default swaps) with a notional amount of $9.5 billion at August 31, 2004 and $5.5 billion at November 30, 2003.

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.

The Company has commitments to fund other less liquid investments, including at August 31, 2004, $194 million in connection with its principal investment and private equity 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.

At August 31, 2004, the Company had commitments to enter into reverse repurchase and repurchase agreements of approximately $40 billion and $35 billion, respectively.

Legal. In addition to the matters described in the Company's Annual Report on Form 10-K/A for the fiscal year ended November 30, 2003 and in the Company's Quarterly Reports on Form 10-Q/A for fiscal 2004, in the normal course of business, the Company has been named, from time to time, as a defendant in various legal actions, including arbitrations, class actions, and other litigation, arising in connection with its activities as a global diversified financial services institution. Certain of the legal actions include claims for substantial compensatory and/or punitive damages or claims for indeterminate amounts of damages. In some cases, the issuers that would otherwise be the primary defendants in such cases are bankrupt or in financial distress.

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

The Company contests liability and/or the amount of damages in each pending matter. In view of the inherent difficulty of predicting the outcome of such matters, particularly in cases where claimants seek substantial or indeterminant damages or where investigations and proceedings are in the early stages, the Company cannot predict with certainty the loss or range of loss related to such matters, how such matters will be resolved, when they will ultimately be resolved, or what the eventual settlement, fine, penalty or other relief might be. Subject to the foregoing, the Company believes, based on current knowledge and after consultation with counsel, that the outcome of each such pending 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 or a business segment's operating results for a particular future period, depending on, among other things, the level of the Company's or a business segment'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 these instruments for trading and investment purposes, as well as for asset and liability management (see Note 1). 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 Note 11 to the consolidated financial statements for the fiscal year ended November 30, 2003, included in the Form 10-K/A.

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 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.

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, 2004 will not have a material effect on the Company's financial condition.

The Company's derivatives (both listed and OTC) at August 31, 2004 and November 30, 2003 are summarized in the table below, showing the fair value of the related assets and liabilities by product:

	At August 31, 2004		At November 30, 2003	
	Assets	Liabilities	Assets	Liabilities
	(dollars in millions)			
Interest rate and currency swaps and options, credit derivatives and other fixed income securities contracts	$30,354	$20,124	$27,280	$18,950
Foreign exchange forward contracts and options	3,605	3,471	5,964	5,561
Equity securities contracts (including equity swaps, warrants and options)	5,364	7,543	4,503	5,781
Commodity forwards, options and swaps	10,310	8,287	6,905	5,950
Total	$49,633	$39,425	$44,652	$36,242

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.

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 (see Notes 5 and 17).

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, including real estate investment vehicles; and aircraft financing activities. The Company's Individual Investor Group business provides comprehensive financial planning, investment advisory and brokerage 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 Network, a network of merchant and cash access locations primarily in the U.S. Morgan Stanley-branded credit cards and personal loan products that are offered in the U.K. are also included in the Credit Services business segment. The Company provides its products and services to a large and diversified group of clients and customers, including corporations, governments, financial institutions and individuals.

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 a result of treating certain intersegment transactions as transactions with external parties, the Company includes an "Intersegment Eliminations" category to reconcile the segment results to the Company's consolidated results. Income before taxes in Intersegment Eliminations represents, among other things, the effect of timing differences associated with the revenue and expense recognition of commissions paid by Investment Management to Individual Investor Group associated with sales of certain products 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, 2004	Institutional Securities	Individual Investor Group	Investment Management	Credit Services	Intersegment Eliminations	Total
			(dollars in millions)			
Net revenues excluding net interest	$1,949	$1,065	$691	$563	$ (64)	$4,204
Net interest	827	59	1	334	—	1,221
Net revenues	$2,776	$1,124	$692	$897	$ (64)	$5,425
Income from continuing operations before losses from unconsolidated investees, income taxes and discontinued operations	$ 682	$ 22	$217	$330	$ 31	$1,282
Losses from unconsolidated investees	77	—	—	—	—	77
Income before taxes and discontinued operations(1)	$ 605	$ 22	$217	$330	$ 31	$1,205

Three Months Ended August 31, 2003(2)	Institutional Securities	Individual Investor Group	Investment Management	Credit Services	Intersegment Eliminations	Total
			(dollars in millions)			
Net revenues excluding net interest	$2,716	$1,046	$600	$510	$ (77)	$4,795
Net interest	76	56	(2)	324	—	454
Net revenues	$2,792	$1,102	$598	$834	$ (77)	$5,249
Income from continuing operations before losses from unconsolidated investees, income taxes, dividends on preferred securities subject to mandatory redemption and discontinued operations	$ 925	$ 143	$142	$287	$ 31	$1,528
Losses from unconsolidated investees	105	—	—	—	—	105
Dividends on preferred securities subject to mandatory redemption	47	—	—	—	—	47
Income before taxes and discontinued operations(1)	$ 773	$ 143	$142	$287	$ 31	$1,376

Nine Months Ended August 31, 2004(2)	Institutional Securities	Individual Investor Group	Investment Management	Credit Services	Intersegment Eliminations	Total
			(dollars in millions)			
Net revenues excluding net interest	$ 8,575	$3,365	$2,023	$1,822	$(213)	$15,572
Net interest	1,652	179	1	912	—	2,744
Net revenues	$10,227	$3,544	$2,024	$2,734	$(213)	$18,316
Income from continuing operations before losses from unconsolidated investees, income taxes, dividends on preferred securities subject to mandatory redemption and discontinued operations	$ 3,000	$ 320	$ 596	$ 993	$ 89	$ 4,998
Losses from unconsolidated investees	251	—	—	—	—	251
Dividends on preferred securities subject to mandatory redemption	45	—	—	—	—	45
Income before taxes and discontinued operations(1)	$ 2,704	$ 320	$ 596	$ 993	$ 89	$ 4,702

Nine Months Ended August 31, 2003(2)	Institutional Securities	Individual Investor Group	Investment Management	Credit Services	Intersegment Eliminations	Total
			(dollars in millions)			
Net revenues excluding net interest	$ 7,792	$2,929	$1,686	$1,639	$(224)	$13,822
Net interest	816	160	(5)	977	—	1,948
Net revenues	$ 8,608	$3,089	$1,681	$2,616	$(224)	$15,770
Income from continuing operations before losses from unconsolidated investees, income taxes, dividends on preferred securities subject to mandatory redemption and discontinued operations	$ 2,581	$ 311	$ 385	$ 884	$ 93	$ 4,254
Losses from unconsolidated investees	175	—	—	—	—	175
Dividends on preferred securities subject to mandatory redemption	109	—	—	—	—	109
Income before taxes and discontinued operations(1)	$ 2,297	$ 311	$ 385	$ 884	$ 93	$ 3,970

Total Assets	Institutional Securities	Individual Investor Group	Investment Management	Credit Services	Intersegment Eliminations	Total
			(dollars in millions)			
At August 31, 2004	$699,954	$17,051	$4,287	$23,945	$(204)	$745,033
At November 30, 2003(2)	$557,501	$16,665	$3,778	$25,185	$(286)	$602,843

(1) See Note 17 for a discussion of discontinued operations.

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

12. Variable Interest Entities.

In January 2003, the FASB issued FIN 46, which clarified 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 ("VIE") 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 disclosures about VIEs.

The Company is involved with various entities in the normal course of business that may be deemed to be VIEs and may hold interests therein, including debt securities, interest-only strip investments and derivative instruments, that may be considered variable interests. Transactions associated with these entities include asset- and mortgage-backed securitizations and structured financings (including collateralized debt, bond or loan obligations and credit-linked notes). The Company engages in these transactions principally to facilitate client needs and as a means of selling financial assets. The Company consolidates entities in which it 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.

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 deferred the effective date of FIN 46 for arrangements with VIEs existing prior to February 1, 2003 to fiscal periods ending after December 15, 2003. In December 2003, the FASB issued a revision of FIN 46 ("FIN 46R") to address certain technical corrections and implementation issues that have arisen. As of February 29, 2004, the Company adopted FIN 46 or FIN 46R for all of its variable interests. For these variable interests, the Company consolidated those VIEs (including financial asset-backed securitization, mortgage-backed securitization, collateral debt obligation, credit-linked note, structured note, municipal bond trust, equity-linked note and exchangeable trust entities) in which the Company was the primary beneficiary. In limited instances, the Company deconsolidated VIEs for which it was not the primary beneficiary as a result of the adoption of FIN 46R. This is further discussed in Note 6 with respect to statutory trusts that had issued Capital Securities. As of May 31, 2004, the Company adopted FIN 46R for those variable interests that were previously accounted for under FIN 46. The effect of adopting FIN 46 and FIN 46R as of February 29, 2004 and May 31, 2004 did not have a material effect on the condensed consolidated results of operations or condensed consolidated financial position.

Institutional Securities. At August 31, 2004, in connection with its Institutional Securities business, the aggregate size of VIEs, including financial asset-backed securitization, collateralized debt obligation, credit-linked note, structured note, municipal bond trust, loan issuing, equity-linked note and exchangeable trust entities, for which the Company was the primary beneficiary of the entities was approximately $3.1 billion, which is the carrying amount of the consolidated assets recorded as Financial instruments owned that are collateral for the entities' obligations. The nature and purpose of these entities that the Company consolidated were to issue a series of notes to investors that provide the investors a return based on the holdings of the entities. These transactions were executed to facilitate client investment objectives. The structured note, equity-linked note, certain credit-linked note, certain financial asset-backed securitization and municipal bond transactions also were executed as a means of selling financial assets. The Company holds either the entire class or a majority of the class of subordinated notes or entered into a derivative instrument with the VIE, which bears the majority of the expected losses or receives a majority of the expected residual returns of the entities. The Company 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 to 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 those liabilities that include an embedded derivative, the Company has bifurcated such derivative in accordance with SFAS No. 133, as amended by SFAS No. 149. The beneficial interests of these consolidated entities are payable solely from the cash flows of the assets held by the VIE.

At August 31, 2004, also in connection with its Institutional Securities business, the aggregate size of the entities for which the Company holds significant variable interests, which consist of subordinated and other classes of beneficial interests, limited partnership investments and secondary guarantees, was approximately $12.6 billion. The Company's variable interests associated with these entities, primarily credit-linked note, loan and bond issuing, collateralized debt obligation, financial asset-backed securitization and tax credit limited liability entities, including investments in affordable housing tax credit funds and underlying synthetic fuel production plants, were approximately $6.1 billion consisting primarily of senior beneficial interests, which represent the Company's maximum exposure to loss at August 31, 2004. The Company may hedge the risks inherent in its variable interest holdings, thereby reducing its exposure to loss. The Company's maximum exposure to loss does not include the offsetting benefit of any financial instruments that the Company utilizes to hedge these risks.

Investment Management. At August 31, 2004, in connection with its Investment Management business, where the Company is the asset manager for collateralized bond and loan obligation entities, the Company was neither the primary beneficiary of nor held any significant variable interests in such VIEs due to the modification of the treatment of fees paid to a decision maker under FIN 46R. FIN 46 included a requirement that expected residual returns include the total amount of fees on a gross basis paid to decision makers instead of including only the variability in such fees as is the guidance in FIN 46R.

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

13. 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.

Derivative Contracts. 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. The maximum potential payout for certain derivative contracts, such as written interest rate caps and written foreign currency options, cannot be estimated as increases in interest or foreign exchange rates in the future could possibly be unlimited. Therefore, in order to provide information regarding the maximum potential amount of future payments that the Company could be required to make under certain derivative contracts, the notional amount of the contracts has been disclosed.

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

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

Liquidity Guarantees. The Company has entered into liquidity facilities with special purpose entities (“SPE”) 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. 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, 2004:

	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	$365,764	$221,076	$232,779	$235,328	$1,054,947	$17,130	$110
Standby letters of credit and other financial guarantees	351	140	58	19	568	1	148
Market value guarantees	11	15	257	438	721	39	54
Liquidity facilities	773	890	—	177	1,840	—	—

Indemnities. 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, certain annuity products and other financial arrangements. These indemnity payments could be required based on a change in the tax laws or change in interpretation of applicable tax rulings. Certain contracts contain provisions that enable the Company to terminate the agreement upon the occurrence of such events. The maximum potential amount of future payments that the Company could be required to make under these indemnifications cannot be estimated. The Company has not recorded any contingent liability in the condensed consolidated financial statements for these indemnifications and believes that the occurrence of any events that would trigger payments under these contracts is remote.

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

General Partner Guarantees. As a general partner in certain private equity and real estate partnerships, the Company receives distributions from the partnerships according to the provisions of the partnership agreements. The Company may, from time to time, be required to return all or a portion of such distributions to the limited partners in the event the limited partners do not achieve a certain return as specified in various partnership agreements, subject to certain limitations. The maximum potential amount of future payments that the Company could be required to make under these and other similar provisions at August 31, 2004 was $246 million. As of August 31, 2004, 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 $76 million.

Securitized Asset Guarantees. 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. The Company does not monitor the total value of assets historically transferred to securitization vehicles. Therefore, the Company is unable to develop an estimate of the maximum payout under these guarantees. However, the Company believes that it is unlikely it will have to make material payments under the arrangement, and no liabilities related to these arrangements have been recorded. Also, in connection with originations of residential mortgage loans under the Company's FlexSource® program, the Company may permit borrowers to pledge marketable securities as collateral instead of requiring cash down payments for the purchase of the underlying residential property. Upon sale of the residential mortgage loans, the Company may provide a surety bond that reimburses the purchasers for shortfalls in the borrowers' securities accounts up to certain limits if the collateral maintained in the securities accounts (along with the associated real estate collateral) is insufficient to cover losses that purchasers experience as a result of defaults by borrowers on the underlying residential mortgage loans. The Company requires the borrowers to meet daily collateral calls to ensure the marketable securities pledged in lieu of a cash down payment are sufficient. At August 31, 2004, the maximum potential amount of future payments the Company may be required to make under its surety bond was $200 million. The Company has not recorded any contingent liability in the condensed consolidated financial statements for these representations and warranties and reimbursement agreements and believes that the probability of any payments under these arrangements is remote.

Merchant Chargeback Guarantees. In connection with its 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 charge back 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. 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 these contingent liabilities 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. This amount cannot be quantified as the Company cannot determine whether current or cumulative transaction volumes may include or result in disputed transactions.

During the quarter and nine month period ended August 31, 2004, the Company incurred losses related to merchant chargebacks of $3 million and $5 million, respectively, and processed aggregate credit card transaction volume of $25.4 billion and $73.9 billion, respectively. The amount of the liability related to the Company's credit cardmember merchant guarantee was not material at August 31, 2004. 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, 2004, the Company had settlement withholdings and escrow deposits of $34 million.

Other. The Company may, from time to time, in its role as investment banking advisor, be required to provide guarantees in connection with certain European merger and acquisition transactions. If required by the regulating authorities, the Company provides a guarantee that the acquirer in the merger and acquisition transaction has or will have sufficient funds to complete the transaction and would then be required to make the acquisition payments in the event the acquirer's funds are insufficient at the completion date of the transaction. These arrangements generally cover the time frame from the transaction offer date to its closing date and therefore are generally short-term in nature. The maximum potential amount of future payments that the Company could be required to make cannot be estimated. The 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. There were no such arrangements outstanding at August 31, 2004.

14. Investments in Unconsolidated Investees.

The Company invests in unconsolidated investees that own synthetic fuel production plants. The Company accounts for these investments under the equity method of accounting. The Company's share of the operating losses generated by these investments is recorded within Losses from unconsolidated investees, and the tax credits and the tax benefits associated with these operating losses are recorded within the Company's Provision for income taxes. The synthetic fuel produced qualifies for tax credits based on Section 29 of the Internal Revenue Code. Under Section 29, tax credits are not available for synthetic fuel produced after 2007. The Company recorded Losses from unconsolidated investees of $77 million and $251 million in the quarter and nine month period ended August 31, 2004, respectively, and $105 million and $175 million in the quarter and nine month period ended August 31, 2003, respectively. These losses were more than offset by tax credits of $88 million and $270 million in the quarter and nine month period ended August 31, 2004, respectively, and $114 million and $202 million in the quarter and nine month period ended August 31, 2003, respectively, and tax benefits on the losses of $31 million and $101 million in the quarter and nine month period ended August 31, 2004, respectively, and $43 million and $71 million in the quarter and nine month period ended August 31, 2003, respectively.

One of the Company's unconsolidated investees (the "LLC") has informed the Company that the Internal Revenue Service ("IRS") field auditors intend to challenge the placed-in-service date of several synthetic fuel facilities owned by the LLC. One of the conditions to qualify for tax credits under Section 29 of the Internal Revenue Code is that the production facility must have been placed-in-service before July 1, 1998.

The LLC is contesting the IRS proposed position vigorously. If the IRS succeeds in disallowing any or all of the tax credits related to these facilities, it could have an adverse effect on the Company's tax liability or results of operations. The Company has recognized cumulative tax credits of approximately $100 million associated with the LLC's synthetic fuel facilities.

15. Employee Benefit Plans.

The Company maintains various pension and benefit plans to eligible employees (see Note 15 to the consolidated financial statements for the fiscal year ended November 30, 2003 included in the Form 10-K/A).

The components of the Company's net periodic benefit expense were as follows:

	Three Months Ended August 31,		Nine Months Ended August 31,	
	2004	2003	2004	2003
	(dollars in millions)			
Service cost, benefits earned during the period	$ 28	$ 29	$ 84	$ 87
Interest cost on projected benefit obligation	33	31	99	93
Expected return on plan assets	(32)	(29)	(96)	(87)
Net amortization and other	6	7	18	21
Net periodic benefit expense	$ 35	$ 38	$105	$114

16. Aircraft under Operating Leases.

Aircraft Held for Sale.

As part of its overall strategic objectives with respect to the aircraft portfolio fleet management, the Company has been considering the sale of certain aircraft. In connection with this strategy, the Company has been soliciting bids from various third parties for certain aircraft in the fleet. In the third quarter of fiscal 2004 the Company entered into an agreement with a third party for the sale of 18 aircraft. Although there are several outstanding contingencies with respect to this sale, the Company believes that the aircraft have met the criteria, as defined in SFAS No. 144, to be classified as held for sale at August 31, 2004. The Company recorded a $42 million loss related to the writedown of these aircraft to fair value less selling costs in the third quarter of fiscal 2004, which is included in discontinued operations (see Note 17). After recording the writedown, the carrying value of these 18 aircraft at August 31, 2004 was $105 million. The Company's aircraft leasing business is included in the Institutional Securities business segment.

Fiscal 2004 Activity.

In accordance with SFAS No. 144, the Company's aircraft are reviewed for impairment whenever events or changes in circumstances indicate that the carrying value of an aircraft may not be recoverable. During the second quarter of fiscal 2004, the Company evaluated various financing strategies for its aircraft financing business. As part of that evaluation and to determine the potential debt ratings associated with the financing strategies, the Company commissioned appraisals of the aircraft portfolio from three independent aircraft appraisal firms. The appraisals indicated a decrease in the aircraft portfolio average market value of 12% from the appraisals obtained at the date of the prior impairment charge (May 31, 2003). In accordance with SFAS No. 144, the Company considered the decline in appraisal values a significant decrease in the market price of its aircraft portfolio and thus a trigger event to test for impairment in the carrying value of its aircraft.

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 those 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 the carrying value. To determine each aircraft's fair value, the Company used the market value appraisals 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 $109 million (of which $2 million is included in loss/(gain) from discontinued operations) in the second quarter of fiscal 2004 based on the average of the market value appraisals provided by the three independent appraisers. The impairment charge was primarily concentrated in two particular types of aircraft, the MD-83 and A300-600R, which contributed approximately $85 million of the total $109 million charge. The decrease in the projected undiscounted cash flows and the significant decline in the appraisal values for these aircraft reflects, among other things, a very small operator base and therefore limited opportunities to lease such aircraft. The impairment charge for aircraft to be held and used is included within Other expenses while the impairment charge for aircraft that were classified as held for sale are included in loss/(gain) from discontinued operations in the condensed consolidated statement of income.

If the Company liquidated its aircraft portfolio ($3.9 billion carrying value at August 31, 2004, excluding those aircraft that were classified as held for sale) at this time, which is not currently contemplated, the Company believes that, based upon the range of values provided by independent appraisers, the Company would realize a value for its entire fleet that is substantially lower than the carrying value of the fleet. The most recent (May 2004) portfolio appraisal market values (excluding the aircraft classified as held for sale), based on the above three appraisals, range from a high of $3.63 billion to a low of $2.68 billion with an average of $3.0 billion. The Company has not recorded an impairment charge of this magnitude because there was no indication of impairment for the majority of the individual aircraft as their projected undiscounted cash flows exceeded their respective carrying values.

Fiscal 2003 Activity.

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 (of which $19 million is included in loss/(gain) from discontinued operations) to adjust the carrying value of previously impaired aircraft to "market value."

In accordance with SFAS No. 144, the Company reviewed the carrying value of its aircraft portfolio for impairment during the second quarter of fiscal 2003 given the difficult conditions that existed in the commercial aircraft industry at the time, including the adverse impact of the military conflict in Iraq, the outbreak of Severe Acute Respiratory Syndrome and the bankruptcy of several airlines.

In the second quarter of fiscal 2003, 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, 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 (of which $16 million is included in loss/(gain) from discontinued operations) based on the average market value provided by independent appraisers in the second quarter of fiscal 2003.

The Company had 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 first quarter of fiscal 2003 using the highest portfolio valuation provided by the appraisers and calculated the $287 million impairment charge recorded in the second quarter of fiscal 2003 based on the average of the three appraisal values. The Company has determined that future impairment charges 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 (including both continuing and discontinued operations) would have differed as follows:

	Change in Pre-tax Income Increase (Decrease)
	(dollars 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)

17. Discontinued Operations.

In the third quarter of fiscal 2004, the Company recorded a pre-tax loss of $42 million in its Institutional Securities business related to the writedown of certain aircraft that are subject to a probable sale and, accordingly, have been designated as "held for sale" in accordance with SFAS No. 144. The revenues and expenses associated with these aircraft have been classified as discontinued operations for all periods presented. The pre-tax (loss)/gain on discontinued operations was $(42) million and $(40) million in the quarter and nine month period ended August 31, 2004, and $2 million and $(36) million in the quarter and nine month period ended August 31, 2003. Included in these amounts are aircraft impairment charges of $2 million and $16 million in the nine month periods ended August 31, 2004 and 2003, respectively. The nine month period of fiscal 2003 also included a $19 million charge to adjust the carrying value of previously impaired aircraft to market value.

18. Business Combination.

On June 3, 2004, the Company completed the acquisition of Barra, Inc. (“Barra”) following approval of the previously announced merger agreement by Barra’s shareholders. Barra is a global leader in delivering risk management systems and services to managers of portfolio and firm-wide investment risk. The combination of Morgan Stanley Capital International Inc. (“MSCI”), a majority-owned subsidiary of the Company, and Barra will create a leading global provider of benchmark indices and risk management analytics. Since the date of acquisition, the results of Barra have been included within the Institutional Securities business segment. The acquisition price was $41.00 per share in cash, or an aggregate consideration of approximately $800 million.

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the date of acquisition. The allocation of the purchase price may be subject to refinement.

	At June 3, 2004
	(dollars in millions)
Cash and cash equivalents	$ 46
Receivables and prepaid expenses	54
Financial instruments owned	169
Office facilities	6
Other assets	10
Amortizable intangible assets	350
Goodwill	314
Total assets acquired	949
Total liabilities assumed	145
Net assets acquired	$804

The $350 million of acquired amortizable intangible assets include technology-related assets of $222 million (7 year weighted-average useful life), trademarks of $102 million (21 year weighted-average useful life) and customer relationships of $26 million (11 year weighted-average useful life).

The $314 million of goodwill and $350 million of amortizable intangible assets are included within the Institutional Securities business segment.

19. Restatement Relating to Fiscal 2003 Interim Compensation and Benefits Expense.

Subsequent to the issuance of the August 31, 2003 condensed consolidated financial statements, the Company determined the need to adjust the timing of the recognition of expense related to equity-based compensation awards during fiscal 2003 in connection with the Company’s adoption, effective December 1, 2002, of SFAS No. 123, “Accounting for Stock-Based Compensation.”

Prior to the Company’s adoption of SFAS No. 123 in fiscal 2003, the Company recorded compensation expense for equity-based awards in accordance with Accounting Principles Board Opinion (“APB”) 25, “Accounting for Stock Issued to Employees.” APB 25 states that equity-based awards should be expensed based upon the period or periods during which an employee performs services, and that the service period or periods should be inferred from the award terms or from the past pattern of granting awards in the absence of a stated service period. Based upon the terms of the Company’s pre-fiscal 2003 equity-based awards, which did not state a service period, and the past pattern of granting such awards, the Company determined that the appropriate service period under APB 25 was the year of grant, and accordingly recognized 100% of the compensation expense for equity-based awards in such year. In accordance with APB 28, "Interim Financial Reporting," the Company accrued the estimated expense of the equity-based awards on a quarterly basis to reflect the interim periods' portion of the annual costs.

The Company adopted SFAS No. 123 effective December 1, 2002. In the absence of a defined service period, SFAS No. 123 presumptively defines the service period (over which compensation costs should be recognized) as the vesting period. In the third quarter of fiscal 2003, the Company revised its equity-based compensation program (including extending the vesting period by an additional year for half of the awards), and determined that under SFAS No. 123 the service period for fiscal 2003 awards would be three and four years (depending upon the vesting provisions of the awards). As specified under the terms of the Company's fiscal 2003 awards, the service period included the year of grant and the subsequent vesting periods.

In the first and second quarters of fiscal 2003, the Company continued to accrue compensation expense on the basis that equity-based awards would be expensed in the year of grant. In the third quarter of fiscal 2003, the Company determined that the expense recognized in the first and second quarters of fiscal 2003 should have been recognized over the longer service period. The Company reflected a cumulative adjustment to its compensation accruals for the three and nine month periods ended August 31, 2003 in the third quarter of fiscal 2003. Subsequently, after discussions with the accounting staff of the Securities and Exchange Commission, the Company determined that with the adoption of SFAS No. 123, it should have begun to amortize the expense related to equity-based awards over a longer service period beginning in the first quarter of fiscal 2003.

The following summarizes the restatement for the three months ended August 31, 2003:

	Three Months Ended	
	August 31, 2003(1)	August 31, 2003
	(dollars in millions, except per share data)	
	(Previously Reported)	(Restated)
Compensation and benefits expense	$1,940	$2,287
Total non-interest expenses	$3,374	$3,721
Income from continuing operations before losses from unconsolidated investees, income taxes and dividends on preferred securities subject to mandatory redemption	$1,875	$1,528
Provision for income taxes	$ 455	$ 342
Income from continuing operations	$1,268	$1,034
Net income	$1,269	$1,035
Earnings per common share:		
Basic	$ 1.18	$ 0.96
Diluted	$ 1.15	$ 0.94

(1) The previously reported amounts give effect to the discontinued operations discussed in Note 17 and certain reclassifications to conform to the current year presentation.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of
Morgan Stanley:

We have reviewed the accompanying condensed consolidated statement of financial condition of Morgan Stanley and subsidiaries ("Morgan Stanley") as of August 31, 2004, and the related condensed consolidated statements of income and comprehensive income for the three-month and nine-month periods ended August 31, 2004 and 2003, and condensed consolidated statements of cash flows for the nine-month periods ended August 31, 2004 and 2003. These interim financial statements are the responsibility of the management of Morgan Stanley.

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

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

As discussed in Note 19, the August 31, 2003 condensed consolidated financial statements have been restated.

We have previously audited, in accordance with standards of the Public Company Accounting Oversight Board (United States), the consolidated statement of financial condition of Morgan Stanley and subsidiaries as of November 30, 2003, 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/A for the fiscal year ended November 30, 2003; and, in our report dated February 23, 2004, (which report contains an explanatory paragraph relating to the adoption of Statement of Financial Accounting Standards ("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," in 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, 2003 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 13, 2004

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, including real estate investment vehicles; and aircraft financing activities. The Company's Individual Investor Group business provides comprehensive financial planning, investment advisory and brokerage 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 Network, a network of merchant and cash access locations primarily in the U.S. Morgan Stanley-branded credit cards and personal loan products that are offered in the U.K. are also included in the Credit Services business segment. The Company provides its products and services to a large and diversified group of clients and customers, including corporations, governments, financial institutions and individuals.

The discussion of the Company's results of operations below may contain forward-looking statements. These statements, which reflect management's beliefs and expectations, are subject to risks and uncertainties that may cause actual results to differ materially. For a discussion of the risks and uncertainties that may affect the Company's future results, please see "Forward-Looking Statements" immediately preceding Part I, Item 1, "Competition" and "Regulation" in Part I, Item 1 and "Certain Factors Affecting Results of Operations" under "Management's Discussion and Analysis of Financial Condition and Results of Operations" in Part II, Item 7 of the Company's Annual Report on Form 10-K/A for the fiscal year ended November 30, 2003 (the "Form 10-K/A").

The Company's results of operations for the three and nine month periods ended August 31, 2004 and 2003 are discussed below. See Note 19 to the condensed consolidated financial statements for a discussion of the restatement relating to compensation and benefits expense for the quarter ended August 31, 2003. The following discussion reflects the effects of this restatement, which changes the timing of the recognition of equity-based compensation expense during the first three quarters of fiscal 2003. The restatement does not affect either the compensation expense or the net income recognized by the Company for the nine months ended August 31, 2003 and the twelve months ended November 30, 2003.

Results of Operations.

Executive Summary.

Financial Information.

	Three Months Ended August 31, 2004	Three Months Ended August 31, 2003(1)	Nine Months Ended August 31, 2004(1)	Nine Months Ended August 31, 2003(1)
Net revenues (dollars in millions):				
Institutional Securities	$ 2,776	$ 2,792	$10,227	$ 8,608
Individual Investor Group	1,124	1,102	3,544	3,089
Investment Management	692	598	2,024	1,681
Credit Services	897	834	2,734	2,616
Intersegment Eliminations	(64)	(77)	(213)	(224)
Consolidated net revenues	$ 5,425	$ 5,249	$18,316	$15,770
Income before taxes(2) (dollars in millions):				
Institutional Securities	$ 682	$ 925	$ 3,000	$ 2,581
Individual Investor Group	22	143	320	311
Investment Management	217	142	596	385
Credit Services	330	287	993	884
Intersegment Eliminations	31	31	89	93
Consolidated income before taxes	$ 1,282	$ 1,528	$ 4,998	$ 4,254
Consolidated net income (dollars in millions)	$ 837	$ 1,035	$ 3,286	$ 2,773
Basic earnings per common share:				
Income from continuing operations	$ 0.80	$ 0.96	$ 3.06	$ 2.59
Loss from discontinued operations	(0.02)	—	(0.02)	(0.02)
Basic earnings per common share	$ 0.78	$ 0.96	$ 3.04	$ 2.57
Diluted earnings per common share:				
Income from continuing operations	$ 0.78	$ 0.94	$ 2.99	$ 2.54
Loss from discontinued operations	(0.02)	—	(0.02)	(0.02)
Diluted earnings per common share	$ 0.76	$ 0.94	$ 2.97	$ 2.52

Statistical Data.

	Three Months Ended August 31, 2004	Three Months Ended August 31, 2003(1)	Nine Months Ended August 31, 2004(1)	Nine Months Ended August 31, 2003(1)
Return on average common equity	12.3%	17.8%	16.6%	16.3%
Book value per common share(3)	$ 25.00	$ 21.79	$ 25.00	$ 21.79
Effective income tax rate	28.0%	24.9%	29.5%	29.5%
Consolidated assets under management or supervision (dollars in billions):				
Equity	$ 224	$ 189	$ 224	$ 189
Fixed income	130	123	130	123
Money market	80	66	80	66
Other(4)	76	55	76	55
Total(5)	$ 510	$ 433	$ 510	$ 433
Worldwide employees	52,812	52,205	52,812	52,205

	Three Months Ended August 31,		Nine Months Ended August 31,	
	2004	2003	2004	2003
Institutional Securities:				
Mergers and acquisitions completed transactions (dollars in billions)(6):				
Global market volume	$ 135.4	$ 36.1	$ 283.5	$ 131.7
Rank	2	6	2	3
Market share	32.2%	13.9%	31.7%	18.9%
Mergers and acquisitions announced transactions (dollars in billions)(6):				
Global market volume	$ 79.4	$ 62.4	$ 261.9	$ 113.1
Rank	4	3	4	5
Market share	20.3%	21.9%	24.4%	15.4%
Global equity and equity-linked issues (dollars in billions)(6):				
Global market volume	$ 9.4	$ 8.4	$ 38.1	$ 22.4
Rank	2	6	1	3
Market share	9.4%	7.3%	12.2%	10.3%
Global fixed income issues (dollars in billions)(6):				
Global market volume	$ 86.9	$ 88.6	$ 251.0	$ 242.5
Rank	2	3	2	3
Market share	7.6%	7.8%	7.3%	7.2%
Individual Investor Group:				
Global financial advisors	10,785	11,326	10,785	11,326
Total client assets (dollars in billions)	$ 576	$ 544	$ 576	$ 544
Fee-based assets as a percentage of total client assets	25%	22%	25%	22%
Investment Management:				
Assets under management or supervision (dollars in billions)	$ 394	$ 345	$ 394	$ 345
Percent of fund assets in top half of Lipper rankings(7)	60%	62%	60%	62%
Credit Services (dollars in millions, unless otherwise noted)(8):				
Period-end credit card loans—Owned	$18,471	$18,106	$18,471	$18,106
Period-end credit card loans—Managed	$47,126	$49,965	$47,126	$49,965
Average credit card loans—Owned	$17,787	$18,600	$17,287	$19,991
Average credit card loans—Managed	$46,873	$50,663	$47,485	$51,537
Net principal charge-off rate—Owned	5.36%	6.26%	5.72%	5.90%
Net principal charge-off rate—Managed	5.76%	6.90%	6.19%	6.52%
Transaction volume (dollars in billions)	$ 25.4	$ 24.8	$ 73.9	$ 74.8

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

(2) Represents income from continuing operations before losses from unconsolidated investees, income taxes, dividends on preferred securities subject to mandatory redemption and discontinued operations.

(3) Book value per common share equals shareholders' equity of $27,420 million at August 31, 2004 and $23,707 million at August 31, 2003, divided by common shares outstanding of 1,097 million at August 31, 2004 and 1,088 million at August 31, 2003.

(4) Amounts include alternative investment vehicles.

(5) Revenues and expenses associated with these assets are included in the Company's Investment Management, Individual Investor Group and Institutional Securities segments.

(6) Source: Thomson Financial, data as of September 13, 2004—The data for the three months ended August 31 is for the periods from June 1 to August 31, 2004 and June 1 to August 31, 2003, respectively. The data for the nine months ended August 31 is for the periods from January 1 to August 31, 2004 and January 1 to August 31, 2003, respectively, as Thomson Financial presents this data on a calendar year basis.

(7) Source: Lipper, one-year performance as of August 31, 2004 and 2003, respectively.

(8) Managed data include owned and securitized credit card loans. For an explanation of managed data and a reconciliation of credit card loan and asset quality data, see "Credit Services—Managed General Purpose Credit Card Loan Data" herein.

Third Quarter 2004 Performance.

Company Results. The Company recorded net income of $837 million for the quarter ended August 31, 2004, a decrease of $198 million, or 19%, from the third quarter of fiscal 2003. Diluted earnings per share were $0.76 compared with $0.94 in the third quarter of fiscal 2003. The annualized return on average common equity was 12.3% in the current quarter, as compared with 17.8% in the third quarter of fiscal 2003. Net revenues (total revenues less interest expense and the provision for loan losses) of $5.4 billion were 3% higher than last year's third quarter. Total non-interest expenses were $4.1 billion in the third quarter, an increase of 11% from the prior year.

The Company recorded a pre-tax loss of $42 million in the current quarter related to the markdown of certain aircraft that are subject to a probable sale and, accordingly, have been designated as "held for sale." The revenues and expenses associated with these aircraft have been classified as "discontinued operations" for all periods presented (see "Discontinued Operations" herein).

Losses from unconsolidated investees were $77 million in the quarter ended August 31, 2004, as compared with $105 million in the prior year. These losses were more than offset by tax credits of $88 million in the quarter ended August 31, 2004 and $114 million in the quarter ended August 31, 2003 and tax benefits on the losses of $31 million in the quarter ended August 31, 2004 and $43 million in the quarter ended August 31, 2003.

The Company's effective tax rate was 28.0% for the quarter ended August 31, 2004 as compared with 28.9% for the second quarter of fiscal 2004 (which brings the effective tax rate for the nine months ended August 31, 2004 to 29.5%). The decrease reflects the current forecast of lower tax rates attributable to non-U.S. earnings, which more than offset lower than expected domestic tax credits.

For the first nine months of fiscal 2004, net income was $3,286 million, an 18% increase over $2,773 million a year ago. Diluted earnings per share were $2.97, up 18% from a year ago. Net revenues in the nine month period rose 16% to $18.3 billion and non-interest expenses increased 16% to $13.3 billion. The annualized return on average common equity for the nine month period was 16.6% compared with 16.3% last year.

Institutional Securities. The Company's Institutional Securities business recorded income from continuing operations before losses from unconsolidated investees, income taxes, dividends on preferred securities subject to mandatory redemption and discontinued operations of $682 million in the third quarter of fiscal 2004, a decrease of 26% from last year's third quarter, largely driven by higher non-interest expenses. Net revenues decreased 1% to $2.8 billion, reflecting a decline in fixed income sales and trading revenues, largely offset by improved results in advisory and underwriting activities, and higher equity sales and trading revenues.

In investment banking, total underwriting revenues rose 3% to $401 million from last year's third quarter. Equity underwriting revenues rose 9%, reflecting the Company's increased volume of activity. Fixed income underwriting revenues declined 2%. Advisory revenues were $310 million, a 138% increase from last year's third quarter, reflecting significant improvement in the Company's market share in completed merger, acquisition and restructuring transactions. During the quarter, the Company generally maintained or improved its investment banking rankings and market share (see "Executive Summary—Statistical Data" herein).

Fixed income sales and trading revenues were $1.2 billion, a 19% decrease from the third quarter of fiscal 2003. Lower revenues from interest rate and currency products contributed to the decrease. Mixed U.S. economic data coupled with higher global energy prices and concerns about the strength of economic growth resulted in market conditions that the Company was not correctly positioned for, which led to lower trading results. Revenues from credit products and commodities were slightly lower than last year's third quarter. Equity sales and trading net revenues increased 6% from last year to $883 million, reflecting higher revenues from the Company's prime brokerage business. Revenues from other equity sales and trading activities were impacted by continuing low levels of market volatility, which reduced trading opportunities. The Company's Aggregate Trading Value-at-Risk averaged $79 million in the current quarter compared with $54 million in the third quarter of last year, and

$72 million in the second quarter of fiscal 2004 (see Part I, Item 3 “Quantitative and Qualitative Disclosures About Market Risk—Market Risk”).

Non-interest expenses rose 12% from last year’s third quarter to $2.1 billion. Higher levels of business activity resulted in increases in the professional services and other expense categories. Expected costs related to legal and regulatory matters increased to approximately $50 million, driven by a failure to deliver certain prospectuses pursuant to regulatory requirements (see “Other Matters — Institutional Securities and Individual Investor Group” herein).

Individual Investor Group. The Individual Investor Group recorded pre-tax income of $22 million in the third quarter of fiscal 2004, an 85% decline from last year’s third quarter. The decline in earnings resulted from higher non-interest expenses, partially offset by a modest increase in net revenues. Total net revenues rose 2% from a year ago to $1.1 billion, driven by a 28% increase in asset management, distribution and administration fees, reflecting higher client asset levels in fee-based accounts. This increase was largely offset by declines of 12% in commissions and 25% in principal transaction trading revenues, the latter resulting from lower sales of fixed income products. Non-interest expenses increased 15% from a year ago to $1.1 billion. Legal and regulatory expenses increased approximately $70 million, primarily driven by expected costs associated with a failure to deliver certain prospectuses pursuant to regulatory requirements (see “Other Matters — Institutional Securities and Individual Investor Group” herein).

Total client assets were $576 billion, a 6% increase from last year’s third quarter. Client assets in fee-based accounts rose 20% to $146 billion over the past twelve months and increased as a percentage of total client assets to 25% from 22% over the same period. At quarter-end, the number of global financial advisors was 10,785, a decrease of 541 over the past year.

Investment Management. Investment Management pre-tax income rose 53% from last year’s third quarter to $217 million. Net revenues increased 16% to $692 million, reflecting an increase in average assets under management. In addition, principal transaction investment revenues increased to $90 million from $10 million in the prior year, reflecting higher investment gains in Private Equity. Non-interest expenses increased 4% to $475 million on higher compensation expenses reflecting the increase in net revenues. Assets under management within Investment Management were $394 billion, $49 billion above the third quarter of last year. The increase resulted from both market appreciation and positive net flows. At quarter-end, the percent of the Company’s fund assets performing in the top half of the Lipper rankings was 60% over one year, 70% over three years and 76% over five years.

Credit Services. Credit Services recorded pre-tax income of $330 million, an increase of 15% from last year’s third quarter. The increase on a managed basis was driven by a lower provision for loan losses, due in part to improved credit quality, partially offset by lower merchant and cardmember fees and higher non-interest expenses driven by an increase in marketing expenditures. Managed credit card loans of $47.1 billion at quarter end were 6% lower than a year ago. The managed credit card net charge-off rate for the third quarter was 5.76%, 114 basis points below a year ago and its lowest level in more than three years. The decrease reflects the effect of the Company’s credit and collection initiatives and the stabilization of personal bankruptcy filings. The managed credit card over-30-day delinquency rate was 4.81%, a decrease of 124 basis points from the third quarter of 2003 and the lowest level in nearly ten years. The managed credit card over-90-day delinquency rate was 2.22%, 69 basis points lower than a year ago and the lowest level since the third quarter of fiscal 2000.

Business Outlook.

Entering the fourth quarter of fiscal 2004, investors remain concerned about the pace of global economic growth, corporate profits, investor and consumer confidence levels, higher oil prices, the U.S. Presidential election and high levels of geopolitical risk. To the extent that these factors remain in place through the remainder of the year, the Company’s operating results are likely to be negatively affected.

Global Market and Economic Conditions in the Quarter and Nine Month Period Ended August 31, 2004.

In the U.S., the strong rate of economic expansion that began during the second half of 2003 slowed in the third quarter of fiscal 2004. Major equity market indices declined during the quarter as higher energy prices, concern over continued turmoil in Iraq and global geopolitical tension depressed market sentiment and activity. Consumer confidence was mixed, reflecting conflicting economic news. These factors exacerbated the lower level of business activity that typically occurs during the summer months in the financial markets. Job creation continued in the third quarter of fiscal 2004, although at a slower pace than the previous fiscal quarter. The unemployment rate declined to 5.4%, its lowest level since September 2001. In response to indications of inflationary pressures, the Federal Reserve Board (the "Fed") raised both the overnight lending rate and the discount rate by 0.50% during the quarter and nine month period ended August 31, 2004. Subsequent to quarter end, on September 21, 2004, the Fed raised both the overnight lending rate and the discount rate by an additional 0.25%.

In Europe, the recovery of economic activity continued. The European Central Bank left the benchmark interest rate unchanged during the quarter. In the U.K., the labor market continued to strengthen and business investment continued to grow. There were, however, some indications of a slowdown in the housing market. During the quarter and nine month period ended August 31, 2004, the Bank of England raised the benchmark interest rate by 0.50% and 1.00%, respectively.

In Japan, the economic recovery continued primarily driven by higher exports, consumer spending and production. The pace of Japan's recovery may weaken during the remainder of the year as a result of slowing global economic activity. In China, there are signs that the growth rate may be slowing, though the pace of expansion nevertheless remains rapid. Economies elsewhere in Asia also improved.

Other Matters.

Institutional Securities and Individual Investor Group.

In September 2004, the Company announced that it had reached an agreement in principle with the New York Stock Exchange (the "NYSE") relating to the Company's failure to comply with certain prospectus delivery requirements, operational deficiencies, employee defalcations (including the Carlos Soto matter) and other matters. The settlement will include a fine of $19 million. Negotiations with the NYSE about the details of the settlement have not concluded, and no assurance can be given that a resolution will be achieved.

In connection with the prospectus delivery matter, the Company agreed to offer rescission to certain customers who failed to receive prospectuses. The Company expects to complete this offer in its fourth fiscal quarter. The Company anticipates it will have future cash requirements to repurchase securities in connection with the rescission offer, but does not believe any such requirements will have a material impact on its daily financing activities. The Company intends to resell any such securities repurchased or to close out any related short trading positions maintained by the Company.

In the quarter ended August 31, 2004, the Company recorded aggregate expected costs related to the prospectus delivery matter of approximately $95 million in the Institutional Securities (see page 46) and Individual Investor Group (see page 48) business segments. This amount represents the Company's best estimate of costs associated with the prospectus delivery matter, including the expected NYSE fine described above. The number of customers who will tender securities into the Company's rescission offer is currently not certain and depends on a number of factors, including the market price of a security subject to rescission and a customer's personal financial goals and objectives. If all customers choose to tender, which the Company does not believe is probable, the Company expects that the actual costs associated with the prospectus delivery matter should not exceed $150 million.

Credit Services.

On October 4, 2004, the U.S. Supreme Court rejected an appeal by Visa and MasterCard in *U.S. v. Visa/ MasterCard*. The trial and appellate courts found that the Visa and MasterCard rules and policies that prevented virtually all U.S. financial institutions from doing business with competing networks violated the antitrust laws. Now that these rules have been struck down as illegal, financial institutions are able to partner with Discover to issue credit and debit cards on the Discover Network. Following this decision, Discover filed a lawsuit in federal court in New York seeking damages for harm caused by the anti-competitive rules.

Business Acquisition.

On June 3, 2004, the Company completed the acquisition of Barra, Inc. ("Barra") following approval of the previously announced merger agreement by Barra's shareholders. Barra is a global leader in delivering risk management systems and services to managers of portfolio and firm-wide investment risk. The combination of Morgan Stanley Capital International Inc. ("MSCI"), a majority-owned subsidiary of the Company, and Barra will create a leading global provider of benchmark indices and risk management analytics. Since the date of acquisition, the results of Barra have been included within the Institutional Securities business segment. The acquisition price was $41.00 per share in cash, or an aggregate consideration of approximately $800 million. The Company recorded goodwill and other intangible assets totaling $664 million in connection with the acquisition. The allocation of the purchase price may be subject to refinement (see Note 18 to the condensed consolidated financial statements).

Discontinued Operations.

As described in Note 17 to the condensed consolidated financial statements, in the third quarter of fiscal 2004, the Company recorded a pre-tax loss of $42 million in its Institutional Securities business related to the writedown of certain aircraft that are subject to a probable sale and, accordingly, have been designated as "held for sale" in accordance with Statement of Financial Accounting Standards ("SFAS") No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." The revenues and expenses associated with these aircraft have been classified as discontinued operations for all periods presented. The pre-tax (loss)/gain on discontinued operations was $(42) million and $(40) million in the quarter and nine month period ended August 31, 2004 and $2 million and $(36) million in the quarter and nine month period ended August 31, 2003. Included in these amounts are aircraft impairment charges of $2 million and $16 million in the nine month periods ended August 31, 2004 and 2003, respectively. The nine month period of fiscal 2003 also included a $19 million charge to adjust the carrying value of previously impaired aircraft to market value (see Note 16 to the condensed consolidated financial statements). The Company may sell additional aircraft from time to time.

Income Tax Examinations.

The Company is under continuous examination by the Internal Revenue Service (the "IRS") and other tax authorities in major countries such as Japan and the United Kingdom, and states in which the Company has significant business operations, such as New York. The tax years under examination vary by jurisdiction; for example, the current IRS examination covers 1994-1998. The Company regularly assesses the likelihood of additional assessments in each of the tax jurisdictions resulting from these examinations. Tax reserves have been established, which the Company believes to be adequate in relation to the potential for additional assessments. Once established, reserves are adjusted when there is more information available or when an event occurs requiring a change to the reserve. The resolution of tax matters could have an impact on the Company's effective tax rate.

Business Segments.

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

As a result of treating certain intersegment transactions as transactions with external parties, the Company includes an "Intersegment Eliminations" category to reconcile the segment results to the Company's consolidated results. Income before taxes in Intersegment Eliminations represents, among other things, the effect of timing differences associated with the revenue and expense recognition of commissions paid by Investment Management to Individual Investor Group associated with sales of certain products and the related compensation costs paid to Individual Investor Group's financial advisors. Income before taxes in Intersegment Eliminations was $31 million in both quarters ended August 31, 2004 and 2003, and $89 million and $93 million in the nine month periods ended August 31, 2004 and 2003, respectively.

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

INSTITUTIONAL SECURITIES

INCOME STATEMENT INFORMATION
(dollars in millions)

	Three Months Ended August 31, 2004	Three Months Ended August 31, 2003	Nine Months Ended August 31, 2004	Nine Months Ended August 31, 2003
Revenues:				
Investment banking	$ 711	$ 518	$ 2,341	$ 1,480
Principal transactions:				
Trading	565	1,644	4,179	4,705
Investments	38	31	190	65
Commissions	462	441	1,494	1,279
Asset management, distribution and administration fees	36	24	102	69
Interest and dividends	4,831	3,231	11,207	9,256
Other	137	58	269	194
Total revenues	6,780	5,947	19,782	17,048
Interest expense	4,004	3,155	9,555	8,440
Net revenues	2,776	2,792	10,227	8,608
Non-interest expenses	2,094	1,867	7,227	6,027
Income from continuing operations before losses from unconsolidated investees, income taxes, dividends on preferred securities subject to mandatory redemption and discontinued operations	682	925	3,000	2,581
Losses from unconsolidated investees	77	105	251	175
Dividends on preferred securities subject to mandatory redemption	—	47	45	109
Income before taxes and discontinued operations	$ 605	$ 773	$ 2,704	$ 2,297

Institutional Securities recorded net revenues of $2,776 million and $10,227 million in the quarter and nine month period ended August 31, 2004, a decrease of 1% and an increase of 19%, respectively, from the comparable periods of fiscal 2003. Income before taxes and discontinued operations for the quarter and nine month period ended August 31, 2004 was $605 million and $2,704 million, a decrease of 22% and an increase of 18%, respectively, from the comparable periods of fiscal 2003. The decrease in net revenues in the quarter was primarily due to lower sales and trading revenues partially offset by higher investment banking and other revenues. The increase in net revenues in the nine month period primarily reflected higher revenues from investment banking and sales and trading activities. The decrease in income before taxes and discontinued operations for the quarter was largely driven by higher non-interest expenses. The increase in income before taxes and discontinued operations in the nine month period primarily reflected higher net revenues, partially offset by higher non-interest expenses, including higher compensation and benefits expense and costs associated with certain legal and regulatory matters.

Investment Banking. Investment banking revenues increased 37% in the quarter ended August 31, 2004, primarily reflecting higher revenues from merger, acquisition and restructuring activities and from equity underwriting transactions.

Revenues from merger, acquisition and restructuring activities were $310 million in the quarter ended August 31, 2004, an increase of 138% from the comparable period of fiscal 2003. The increase reflected higher merger, acquisition and restructuring transaction activity across several sectors, particularly in healthcare, financial services, retail and technology. The Company’s volume of completed transactions more than doubled as compared with the prior year period.

Underwriting revenues were $401 million, an increase of 3% from the comparable period of fiscal 2003.

Equity underwriting revenues were $200 million, an increase of 9% from the comparable prior year period. The increase reflected higher industry-wide new issuance volume, primarily in Europe and Asia. The increases in the Company's volume of global equity offerings in the quarter ended August 31, 2004 included several sectors, such as financial services, media and telecommunications, and healthcare.

Fixed income underwriting revenues were $201 million, a decrease of 2%, reflecting lower revenues from global corporate issuances. The reduction in new issue volume was partially attributable to issuers' concern about a higher interest rate environment.

The backlog of merger, acquisition and restructuring transactions and equity and fixed income underwriting transactions are subject to the risk that transactions may not be completed due to unforeseen economic and market conditions, adverse developments regarding one of the parties to the transaction, a failure to obtain required regulatory approval, or a decision on the part of the parties involved not to pursue a transaction at the current time. The backlog for merger, acquisition and restructuring transactions and equity underwriting transactions increased from the second quarter of fiscal 2004, while the backlog of fixed income underwriting transactions declined.

Investment banking revenues in the nine month period ended August 31, 2004 increased 58% from the comparable period of fiscal 2003. The increase reflected stronger performance in all investment banking businesses.

Sales and Trading Revenues. Sales and trading revenues are composed of principal transaction trading revenues, commissions and net interest revenues. In assessing the profitability of its sales and trading activities, the Company views principal trading, commissions and net interest revenues in the aggregate. In addition, decisions relating to principal transactions 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.

Principal transaction trading revenues in the nine month periods ended August 31, 2004 and August 31, 2003 include changes in the fair value of embedded derivatives in the Company's structured borrowings. Prior to the second quarter of fiscal 2004, such amounts were included in interest expense (see Note 5 to the condensed consolidated financial statements). In the quarter and nine month period ended August 31, 2003, principal transaction trading revenues included $287 million and $44 million that were previously recorded as increases to interest expense. These reclassifications had no impact on net revenues.

Sales and trading revenues include the following:

	Three Months Ended August 31,		Nine Months Ended August 31,	
	2004	**2003**	**2004**	**2003**
		(dollars in millions)		
Equities	$ 883	$ 830	$3,101	$2,672
Fixed income(1)	$1,186	$1,462	$4,665	$4,379

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

Total sales and trading revenues decreased 14% in the quarter ended August 31, 2004 from the comparable period of fiscal 2003, reflecting lower revenues from fixed income products, partially offset by higher revenues from equity products.

Equity sales and trading revenues increased 6% in the quarter ended August 31, 2004. The increase was primarily driven by higher revenues in the prime brokerage business. The increase in prime brokerage revenues was primarily due to higher customer balances. The quarter's revenues from other equity sales and trading activities were negatively impacted by continuing low levels of market volatility, which reduced trading opportunities.

Fixed income sales and trading revenues decreased 19% in the quarter ended August 31, 2004. Mixed U.S. economic data coupled with higher global energy prices and concerns about the strength of economic growth resulted in market conditions that the Company was not correctly positioned for, which led to lower trading results. Interest rate and currency product revenues decreased approximately 36% primarily due to lower trading results and lower customer volumes. Commodities had another strong quarter, although slightly lower (approximately 10%) than last year, as tight oil supplies, concerns about production disruptions and growing demand drove energy prices higher. Credit product revenues decreased approximately 4%, reflecting modestly lower revenues from investment grade products due to lower new issue volume and related concerns about a rising interest rate environment. This decrease was partially offset by increased revenues from securitized products and global high yield fixed income securities.

Total sales and trading revenues increased 8% in the nine month period ended August 31, 2004 from the comparable period of fiscal 2003, reflecting higher equity and fixed income sales and trading revenues. Equity sales and trading revenues increased 16% in the nine month period ended August 31, 2004, driven by higher revenues in the prime brokerage and cash products businesses. The prime brokerage business experienced significant increases in customer balances that contributed to higher revenues. The cash products business benefited from higher market volumes and increased inflows to U.S. equity mutual funds. Fixed income sales and trading increased 7% in the nine month period ended August 31, 2004, driven by higher revenues from credit products, interest rate and currency products and commodities. Higher revenues from interest rate and currency products were driven by improved results in derivatives and foreign exchange products. Credit product revenues, including securitized products and global high yield fixed income securities, benefited from increased securitization flows and strong customer volumes. Revenues from commodities products reflected higher revenues from electricity and oil products as tight supply and rising demand drove prices and volatilities higher.

In addition to the equity and fixed income sales and trading revenues discussed above, sales and trading revenues include the net interest expense associated with the Company's aircraft financing activities, as well as corporate lending activities. In the quarter ended August 31, 2004, revenues associated with corporate lending activities decreased by approximately $20 million due to mark-to-market valuations associated with new loans made during the period. In the nine month period ended August 31, 2004, revenues associated with corporate lending activities increased by approximately $60 million, reflecting growth in the loan portfolio and improved conditions in the credit market.

Principal Transactions—Investments. Principal transaction net investment revenue increased $7 million and $125 million in the quarter and nine month period ended August 31, 2004. The increase in the nine month period was primarily related to gains associated with real estate and principal investment activities, including a gain on the sale of an investment in TradeWeb, an electronic trading platform.

Asset Management, Distribution and Administration Fees. Asset management, distribution and administration fees increased 50% and 48% in the quarter and nine month period ended August 31, 2004 due to higher fees associated with real estate investment and advisory activities, primarily due to the acquisition of a majority of the U.S. real estate equity investment management business of Lend Lease Corporation in November 2003.

Other. Other revenues increased 136% and 39% in the quarter and nine month period ended August 31, 2004 from the comparable periods of fiscal 2003. The increases were primarily attributable to Barra, which was acquired on June 3, 2004, as well as higher revenues from the aircraft financing business. During the quarter ended August 31, 2004, the Company received cash proceeds of approximately $80 million from the sale of a bankruptcy claim to an investor group, which is the indirect principal shareholder of the bankrupt airline. The Company had previously filed a claim in bankruptcy court for unsecured damages associated with certain leases with a now-bankrupt airline, which were amended or rejected in the bankruptcy process. During the quarter ended August 31, 2004, the Company assigned all of its rights and obligations under the bankruptcy claim to the investor group and collected proceeds from the investor group of approximately $80 million in connection with such sale. The Company recognized a gain of $13 million associated with the terminated lease. In addition, $67 million is recognized as deferred lease income, which will be recognized over the remaining life of the amended leases.

Non-Interest Expenses. Non-interest expenses increased 12% and 20% in the quarter and the nine month period ended August 31, 2004. Compensation and benefits expense increased 24% in the nine month period, due to higher incentive-based compensation accruals. Excluding compensation and benefits expense, non-interest expenses increased 35% and 13% in the quarter and nine month period ended August 31, 2004. Occupancy and equipment increased 41% and 24% from the prior year periods primarily due to higher rental costs, primarily in North America and London. Brokerage, clearing and exchange fees increased 16% and 20% in the quarter and nine month period, primarily reflecting increased trading activity. Professional services expense increased 72% and 48% for the quarter and nine month period, primarily due to higher consulting, legal and employee recruitment costs. Other expenses increased 31% in the quarter and decreased 14% in the nine month period. The increase from the third quarter of fiscal 2003 was primarily attributable to expenses of approximately $50 million related to legal and regulatory matters, driven by a failure to deliver certain prospectuses pursuant to regulatory requirements (see "Other Matters" herein). The decrease in the nine month period ended August 31, 2004 primarily reflected a lower aircraft impairment charge of $107 million in fiscal 2004 as compared with $271 million in the comparable period of fiscal 2003. The nine month period of fiscal 2003 also included a $17 million charge to adjust the carrying value of previously impaired aircraft to market value (see Note 16 to the condensed consolidated financial statements). The decrease in other expenses in the nine month period was partially offset by legal accruals of approximately $50 million in the third quarter of fiscal 2004 (see "Other Matters — Institutional Securities and Individual Investor Group" herein) and approximately $110 million in the second quarter of fiscal 2004 related to the *Parmalat Matter* and *IPO Allocation Matters* (see "Legal Proceedings" in Part I, Item 3 of the Form 10-K/A and Part II, Item 1 of this Report and the Company's Quarterly Reports on Form 10-Q/A for the quarters ended May 31, 2004 and February 29, 2004).

INDIVIDUAL INVESTOR GROUP

INCOME STATEMENT INFORMATION
(dollars in millions)

	Three Months Ended August 31, 2004	Three Months Ended August 31, 2003	Nine Months Ended August 31, 2004	Nine Months Ended August 31, 2003
Revenues:				
Investment banking	$ 64	$ 79	$ 223	$ 225
Principal transactions:				
Trading	130	174	412	495
Investments	(3)	(3)	(3)	4
Commissions	315	356	1,099	946
Asset management, distribution and administration fees	514	403	1,497	1,159
Interest and dividends	103	93	291	274
Other	45	37	137	100
Total revenues	1,168	1,139	3,656	3,203
Interest expense	44	37	112	114
Net revenues	1,124	1,102	3,544	3,089
Non-interest expenses	1,102	959	3,224	2,778
Income before taxes	$ 22	$ 143	$ 320	$ 311

Individual Investor Group net revenues were $1,124 million and $3,544 million in the quarter and nine month period ended August 31, 2004, an increase of 2% and 15% from the comparable periods of fiscal 2003. Individual Investor Group income before taxes was $22 million and $320 million in the quarter and nine month period ended August 31, 2004, a decrease of 85% and an increase of 3% from the comparable periods of fiscal 2003. The increase in net revenues in both periods was primarily attributable to higher asset management, distribution and administration fees, partially offset by lower principal transaction trading revenues. The increase in the nine month period also reflected an increase in commission revenues. The decrease in income before taxes in the quarter was primarily due to higher non-interest expenses, including higher costs associated with legal and regulatory matters. The increase in income before taxes in the nine month period was primarily due to higher net revenues, partially offset by higher non-interest expenses.

Client assets were $576 billion at August 31, 2004, an increase of 6% from August 31, 2003.

Investment Banking. Investment banking revenues decreased 19% and 1% in the quarter and nine month period ended August 31, 2004 from the comparable periods of fiscal 2003. The decrease in both periods was primarily due to lower revenues from equity underwriting transactions. The decrease in the quarter also reflected lower revenues from Unit Investment Trust sales. The decrease in the nine month period was partially offset by higher revenues from Unit Investment Trust sales.

Principal Transactions. Principal transaction trading revenues decreased 25% and 17% in the quarter and nine month period ended August 31, 2004 from the comparable periods of fiscal 2003. Both periods of fiscal 2004 included lower revenues from fixed income products, reflecting lower customer transaction activity in corporate, government and municipal fixed income securities.

Commissions. Commission revenues decreased 12% in the quarter and increased 16% in the nine month period ended August 31, 2004 from the comparable periods of fiscal 2003. The decrease in the quarter was due to lower sales of equity products as individual investor participation in the U.S. equity markets slowed. The increase in the nine month period was due to higher customer trading volumes as compared with the nine months ended August 31, 2003.

Net Interest. Net interest revenues increased 5% and 12% in the quarter and nine month periods ended August 31, 2004 from the comparable periods of fiscal 2003. The increase in both periods was primarily due to higher net interest revenues from brokerage services provided to individual customers as a result of an increase in the level of customer margin loans.

Asset Management, Distribution and Administration Fees. Asset management, distribution and administration fees increased 28% and 29% in the quarter and nine month periods ended August 31, 2004 from the comparable periods of fiscal 2003. An increase in client asset balances as compared with the prior periods resulted in higher fees from investors electing fee-based pricing arrangements, including separately managed and Morgan Stanley Choice^{SM} accounts. The increase in client asset balances was primarily due to market appreciation, reflecting improvement in the global financial markets. Client assets in fee-based accounts rose 20% to $146 billion during the period from September 1, 2003 to August 31, 2004 and increased as a percentage of total client assets to 25% from 22%.

Other. Other revenues increased 22% and 37% in the quarter and nine month period ended August 31, 2004 from the comparable periods of fiscal 2003, primarily due to higher revenues from customer service and account fees.

Non-Interest Expenses. Non-interest expenses increased 15% and 16% in the quarter and nine month period ended August 31, 2004 from the comparable periods of fiscal 2003. Compensation and benefits expense increased 11% in the nine month period ended August 31, 2004. The increase in the nine month period reflected higher incentive-based compensation accruals due to higher net revenues. Excluding compensation and benefits expense, non-interest expenses increased 42% in the quarter and 27% in the nine month period. Professional services expense increased 52% and 57% in the quarter and nine month period largely due to higher sub-advisory fees related to the Investment Consulting Services business, as well as higher consulting and legal fees. Marketing and business development expense increased 75% and 41% in the quarter and nine month period, primarily reflecting an increase in brand advertising. Other expenses increased 126% and 84% in the quarter and nine month period, primarily resulting from an increase of approximately $70 million in legal and regulatory expenses that included, among other things, the expected costs associated with a failure to deliver certain prospectuses pursuant to regulatory requirements (see “Other Matters — Institutional Securities and Individual Investor Group” herein).

INVESTMENT MANAGEMENT

INCOME STATEMENT INFORMATION
(dollars in millions)

	Three Months Ended August 31,		Nine Months Ended August 31,	
	2004	2003	2004	2003
Revenues:				
Investment banking	$ 8	$ 11	$ 31	$ 28
Principal transactions:				
Investments	90	10	158	6
Commissions	8	7	24	14
Asset management, distribution and administration fees	578	567	1,788	1,618
Interest and dividends	3	(2)	6	—
Other	7	5	22	20
Total revenues	694	598	2,029	1,686
Interest expense	2	—	5	5
Net revenues	692	598	2,024	1,681
Non-interest expenses	475	456	1,428	1,296
Income before taxes	$217	$142	$ 596	$ 385

Investment Management net revenues were $692 million and $2,024 million for the quarter and nine month period ended August 31, 2004, an increase of 16% and 20% from the comparable periods of fiscal 2003. Investment Management income before taxes was $217 million and $596 million for the quarter and nine month period ended August 31, 2004, an increase of 53% and 55% from the comparable periods of fiscal 2003. The increase in net revenues in both periods primarily reflected higher principal transaction investment revenues and asset management, distribution and administration fees. The increase in income before taxes in both periods was primarily due to higher net revenues, partially offset by an increase in non-interest expenses, including higher compensation and benefits expense.

During the third quarter of fiscal 2004, a team of investment professionals from the private equity business established an independent private equity firm that will manage, through a long-term sub-advisory role, the Morgan Stanley Capital Partners ("MSCP") funds. The Company will continue as general partner for the MSCP funds and retain its limited partner interests. The Company will operate its other existing principal and real estate investment vehicles (that are included in the Investment Management and Institutional Securities business segments) as before and will actively pursue additional principal investing opportunities for its clients.

Investment Banking. Investment banking revenues decreased 27% in the quarter and increased 11% in the nine month period ended August 31, 2004 from the comparable periods of fiscal 2003. The decrease in the quarter reflected lower fees related to Unit Investment Trust sales. The increase in the nine month period was primarily due to a higher volume of Unit Investment Trust sales.

Principal Transactions—Investments. Principal transaction net investment gains aggregating $90 million and $158 million were recognized in the quarter and nine month period ended August 31, 2004 as compared with net gains of $10 million and $6 million in the quarter and nine month period ended August 31, 2003. The increases in both periods were primarily related to higher net gains on certain investments in the Company's private equity portfolio (including Vanguard Health Systems, Inc.) as compared with the prior year periods.

Commissions. Commission revenues increased 14% and 71% in the quarter and nine month period ended August 31, 2004. The increase in both periods reflected an increase in commissionable sales of certain fund products.

Asset Management, Distribution and Administration Fees. Investment Management's period end and average customer assets under management or supervision were as follows:

	At August 31, 2004	At August 31, 2003	Average For the Three Months Ended August 31, 2004	Average For the Three Months Ended August 31, 2003	Average For the Nine Months Ended August 31, 2004	Average For the Nine Months Ended August 31, 2003
			(dollars in billions)			
Assets under management or supervision by distribution channel:						
Retail	$194	$190	$195	$188	$198	$184
Institutional	200	155	193	153	184	149
Total	$394	$345	$388	$341	$382	$333
Assets under management or supervision by asset class:						
Equity	$179	$153	$180	$147	$181	$136
Fixed income	116	111	115	114	115	117
Money market	76	63	70	63	65	64
Other(1)	23	18	23	17	21	16
Total	$394	$345	$388	$341	$382	$333

(1) Amounts include alternative investment vehicles.

Asset management, distribution and administration fees increased 2% and 11% in the quarter and nine month period, reflecting higher fund management and administration fees associated with a 14% and 15% increase in average assets under management or supervision. The increase in the quarter was partially offset by lower performance fees and a shift in mix to lower fee-earning products. The increase in the nine month period reflected a more favorable average asset mix, including a greater percentage of equity assets under management.

As of August 31, 2004, customer assets under management or supervision increased $49 billion from August 31, 2003. The increase was primarily due to market appreciation, reflecting improvement in the global equity markets as compared with the prior year period. Net flows into institutional products were positive for the third consecutive quarter, led by the Morgan Stanley Institutional Liquidity Funds and alternative investment products.

Non-Interest Expenses. Non-interest expenses increased 4% and 10% in the quarter and nine month period ended August 31, 2004. Compensation and benefits expense increased 26% and 34% in the quarter and nine month period, principally reflecting higher incentive-based compensation accruals due to higher net revenues. Excluding compensation and benefits expense, non-interest expenses decreased 7% and 1% in the quarter and nine month period ended August 31, 2004. Professional services expenses increased 41% in the nine month period, primarily reflecting an increase in sub-advisory, consulting and legal fees. Marketing and business development expenses decreased 22% in the nine month period, primarily due to lower promotional costs. Brokerage, clearing and exchange fees decreased 11% and 7% 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 recent periods due to a decrease in sales of certain open-end funds.

CREDIT SERVICES

INCOME STATEMENT INFORMATION
(dollars in millions)

	Three Months Ended August 31,		Nine Months Ended August 31,	
	2004	**2003**	**2004**	**2003**
Fees:				
Merchant and cardmember	$349	$340	$ 992	$1,042
Servicing	459	462	1,516	1,532
Other	(5)	18	16	20
Total non-interest revenues	803	820	2,524	2,594
Interest revenue	496	515	1,411	1,604
Interest expense	162	191	499	627
Net interest income	334	324	912	977
Provision for consumer loan losses	240	310	702	955
Net credit income	94	14	210	22
Net revenues	897	834	2,734	2,616
Non-interest expenses	567	547	1,741	1,732
Income before taxes	$330	$287	$ 993	$ 884

Credit Services net revenues were $897 million and $2,734 million in the quarter and nine month period ended August 31, 2004, an increase of 8% and 5% from the comparable periods of fiscal 2003. Income before taxes was $330 million and $993 million in the quarter and nine month period ended August 31, 2004, an increase of 15% and 12% from the comparable periods of fiscal 2003. The increase in net revenues for both periods was primarily due to a lower provision for consumer loan losses, partially offset by lower non-interest revenues. The increase in net revenues in the nine month period was also partially offset by lower net interest income. The increase in income before taxes in both periods primarily reflected higher net revenues.

Merchant and Cardmember Fees. Merchant and cardmember fees increased 3% in the quarter primarily due to higher merchant discount revenue and balance transfer fees, partially offset by lower late payment and overlimit fees. Merchant and cardmember fees decreased 5% in the nine month period due to lower late payment and overlimit fees and higher cardmember rewards, net of estimated future forfeitures, partially offset by higher balance transfer fees and merchant discount revenues. The decline in late payment and overlimit fees in both periods reflected fewer late fee occurrences and a decline in overlimit accounts, partially offset by lower charge-offs. Late fee occurrences were lower primarily due to a decline in the over 30-day delinquency rates from 5.28% at August 31, 2003 to 4.35% at August 31, 2004. The increase in net cardmember rewards reflected increased sales volume and the impact of promotional programs. Balance transfer fees increased in the quarter and nine month periods as a result of the Company's continued focus on improving balance transfer profitability. The increase in merchant discount revenue in both periods was due to an increase in sales volume.

The Company has modified its overlimit fee policies on accounts meeting specific criteria, and will continue to review the criteria under which cardmembers who exceed their credit limit are charged an overlimit fee. These modifications will result in lower cardmember fee revenue in future periods, which is expected to be partially offset by lower net charge-offs.

Servicing Fees.

The table below presents the components of servicing fees:

	Three Months Ended August 31,		Nine Months Ended August 31,	
	2004	2003	2004	2003
	(dollars in millions)			
Merchant and cardmember fees	$150	$ 183	$ 493	$ 552
Other revenue	(5)	1	25	88
Total non-interest revenues	145	184	518	640
Interest revenue	926	1,061	2,985	3,144
Interest expense	175	200	525	615
Net interest income	751	861	2,460	2,529
Provision for consumer loan losses	437	583	1,462	1,637
Net credit income	314	278	998	892
Servicing fees	$459	$ 462	$1,516	$1,532

Servicing fees decreased 1% in the quarter and nine month period ended August 31, 2004 reflecting lower cardmember fees and net interest cash flows partially offset by a lower provision for consumer loan losses. Cardmember fees were lower due to lower late payment and overlimit fees, partially offset by higher balance transfer fees and lower fee net charge-offs. The decrease in net interest cash flows in both periods was largely attributable to a lower level of average securitized general purpose credit card loans. The decrease in the nine month period ended August 31, 2004 was offset in part by a lower interest rate environment, including the favorable impact of maturing fixed rate securitizations and higher levels of lower cost floating rate securitizations. The decrease in the provision for consumer loan losses in both periods was attributable to a lower level of average securitized general purpose credit card loans and a lower rate of net principal charge-offs related to the securitized general purpose credit card loan portfolio. The decrease in the Other revenue component of servicing fees in the nine month period ended August 31, 2004 was attributable to lower levels of general purpose credit card and mortgage loan securitization transactions, partially offset by higher revenue associated with mortgage whole loan sales as compared with the nine month period in fiscal 2003.

The Company did not complete any general purpose credit card asset securitization transactions during the third quarters of fiscal 2004 and fiscal 2003. The Company completed general purpose credit card asset securitizations of $1.9 billion in the nine month period ended August 31, 2004 and $5.7 billion in the comparable period of fiscal 2003. The credit card asset securitization transactions completed in the nine month period ended August 31, 2004 have expected maturities ranging from approximately five to seven years from the date of issuance. The Company did not complete any mortgage loan securitization transactions in the fiscal 2004 periods or the third quarter of fiscal 2003. The Company completed mortgage loan securitization transactions of $0.8 billion during the nine month period of fiscal 2003. The Company also received net proceeds from mortgage whole loan sales of $0.7 billion and $3.3 billion in the quarter and nine month period ended August 31, 2004 and $1.2 billion and $3.5 billion in the quarter and nine month period ended August 31, 2003.

Net Interest Income. Net interest income increased 3% in the quarter and decreased 7% in the nine month period ended August 31, 2004. In the quarter, a decline in interest revenue was more than offset by a decline in interest expense. In the nine month period, the decline in interest revenue was partially offset by lower interest expense. In both fiscal 2004 periods, the decline in interest revenue was primarily due to a decrease in average general purpose credit card loans partially offset by a higher average yield. The decrease in average general purpose credit card loans in the quarter was primarily due to higher payment rates while the decrease in the nine month period was primarily due to higher payment rates and a lower level of balance transfer volume. The higher yield on general purpose credit card loans in both periods was partly due to a decline in interest charge offs. The higher yield in the nine month period also reflected a lower percentage of loan balances subject to promotional rates. The decrease in interest expense in the quarter and nine month period was primarily due to a lower level of average interest bearing liabilities and a decrease in the Company's average cost of borrowings. The Company's average cost of borrowings was 3.91% and 4.23% for the quarters ended August 31, 2004 and 2003, and 4.07% and 4.36% for the nine month periods ended August 31, 2004 and 2003, respectively. The decline in the average cost of borrowings reflected the favorable impact of replacing certain maturing fixed rate debt with lower cost financing.

The following tables present analyses of Credit Services average balance sheets and interest rates for the quarters and nine month periods ended August 31, 2004 and 2003 and changes in net interest income during those periods:

Average Balance Sheet Analysis.

	Three Months Ended August 31,					
	2004			2003		
	Average Balance	Rate	Interest	Average Balance	Rate	Interest
	(dollars in millions)					
ASSETS						
Interest earning assets:						
General purpose credit card loans	$17,787	10.45%	$ 467	$18,600	10.28%	$ 482
Other consumer loans	1,161	5.51	16	1,407	5.62	20
Investment securities	127	0.57	—	80	0.75	—
Other	2,380	2.16	13	2,615	1.87	13
Total interest earning assets	21,455	9.21	496	22,702	8.99	515
Allowance for loan losses	(950)			(982)		
Non-interest earning assets	2,611			2,610		
Total assets	$23,116			$24,330		
LIABILITIES AND SHAREHOLDER'S EQUITY						
Interest bearing liabilities:						
Interest bearing deposits						
Savings	$ 666	1.00%	$ 2	$ 789	1.05%	$ 2
Brokered	8,073	5.10	103	10,585	5.17	138
Other time	1,947	3.40	17	1,676	4.10	17
Total interest bearing deposits	10,686	4.54	122	13,050	4.79	157
Other borrowings	5,784	2.74	40	4,857	2.75	34
Total interest bearing liabilities	16,470	3.91	162	17,907	4.23	191
Shareholder's equity/other liabilities	6,646			6,423		
Total liabilities and shareholder's equity	$23,116			$24,330		
Net interest income			$ 334			$ 324
Net interest margin(1)			6.21%			5.65%
Interest rate spread(2)		5.30%			4.76%	

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

Average Balance Sheet Analysis.

	Nine Months Ended August 31,					
	2004			2003		
	Average Balance	Rate	Interest	Average Balance	Rate	Interest
			(dollars in millions)			
ASSETS						
Interest earning assets:						
General purpose credit card loans	$17,287	10.18%	$1,322	$19,991	10.00%	$1,501
Other consumer loans	1,285	5.30	51	1,536	5.53	64
Investment securities	114	0.66	—	69	0.91	—
Other	2,579	1.93	38	2,680	1.93	39
Total interest earning assets	21,265	8.83	1,411	24,276	8.80	1,604
Allowance for loan losses	(981)			(957)		
Non-interest earning assets	2,509			2,491		
Total assets	$22,793			$25,810		
LIABILITIES AND SHAREHOLDER'S EQUITY						
Interest bearing liabilities:						
Interest bearing deposits						
Savings	$ 701	0.89%	$ 5	$ 824	1.03%	$ 6
Brokered	8,857	5.10	340	10,682	5.32	427
Other time	1,765	3.65	48	1,655	4.42	55
Total interest bearing deposits	11,323	4.62	393	13,161	4.94	488
Other borrowings	4,994	2.82	106	5,991	3.09	139
Total interest bearing liabilities	16,317	4.07	499	19,152	4.36	627
Shareholder's equity/other liabilities	6,476			6,658		
Total liabilities and shareholder's equity	$22,793			$25,810		
Net interest income			$ 912			$ 977
Net interest margin(1)			5.71%			5.36%
Interest rate spread(2)		4.76%			4.44%	

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

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

Rate/Volume Analysis.

Increase/(Decrease) due to Changes in:	Three Months Ended August 31, 2004 vs. 2003 Increase/(Decrease) due to Changes in:			Nine Months Ended August 31, 2004 vs. 2003 Increase/(Decrease) due to Changes in:		
	Volume	Rate	Total	Volume	Rate	Total
			(dollars in millions)			
Interest Revenue						
General purpose credit card loans	$ (21)	$ 6	$ (15)	$(203)	$ 24	$(179)
Other consumer loans	(4)	—	(4)	(11)	(2)	(13)
Other	(1)	1	—	(1)	—	(1)
Total interest revenue	(29)	10	(19)	(199)	6	(193)
Interest Expense						
Interest bearing deposits:						
Savings	—	—	—	(1)	—	(1)
Brokered	(33)	(2)	(35)	(73)	(14)	(87)
Other time	3	(3)	—	3	(10)	(7)
Total interest bearing deposits	(28)	(7)	(35)	(68)	(27)	(95)
Other borrowings	6	—	6	(23)	(10)	(33)
Total interest expense	(15)	(14)	(29)	(93)	(35)	(128)
Net interest income	$ (14)	$ 24	$ 10	$(106)	$ 41	$ (65)

In response to industry-wide regulatory guidance, the Company continues to review the minimum payment requirements on its general purpose credit card loans. A change in the minimum payment requirements may impact future levels of general purpose credit card loans and related interest and fee revenues and charge-offs.

Provision for Consumer Loan Losses. The provision for consumer loan losses decreased 23% and 26% in the quarter and nine month period ended August 31, 2004 primarily due to lower net principal charge-offs. In both the quarter and nine month periods of fiscal 2004, the decline in net principal charge-offs was primarily due to an improvement in credit quality. In addition, both periods reflected lower bankruptcy charge-offs driven by a decline in U.S. personal bankruptcy filings. The Company reduced the allowance for consumer loan losses by $50 million in the nine month period ended August 31, 2004. This reduction was due to the improvement in credit quality, including lower delinquency rates and dollars. In contrast, the Company recorded a provision for consumer loan losses that exceeded the amount of net consumer loans charged off by approximately $15 million and $60 million in the quarter and nine month period ended August 31, 2003, respectively, which reflected unfavorable trends in cardmember delinquencies, higher net total charge-offs and higher levels of personal bankruptcy filings.

Delinquencies. Delinquency rates in both the over 30- and over 90-day categories were lower in both the owned and managed portfolios at August 31, 2004 as compared with August 31, 2003, reflecting improvements in portfolio credit quality. The managed over-30-day delinquency rate was the lowest level in nearly ten years and the managed over-90-day delinquency rate was the lowest level since the third quarter of fiscal 2000.

Non-Interest Expenses. Non-interest expenses increased 4% and 1% in the quarter and nine month period ended August 31, 2004 from the comparable periods of fiscal 2003. Compensation and benefits expense decreased 4% in the quarter and 3% in the nine month period, reflecting lower salaries and benefits expense. Lower employment levels due, in part, to workforce reductions conducted during the fourth quarter of fiscal 2003 partially contributed to the decrease in the nine month period. Excluding compensation and benefits expense, non-interest expenses increased 8% and 3% in the quarter and nine month period. Other expenses decreased 20%

in the quarter and 10% in the nine month period primarily reflecting a decrease in certain operating expenses, including lower losses associated with cardmember fraud. Marketing and business development expense increased 51% and 9% in the quarter and nine month period due to increased marketing efforts. Professional services expense increased 9% in the nine month period reflecting increased costs associated with enhanced credit and collection strategies.

Managed General Purpose Credit Card Loan Data. The Company analyzes its financial performance on both a "managed" loan basis and as reported under U.S. Generally Accepted Accounting Principles ("U.S. GAAP") ("owned" loan basis). Managed loan data assume that the Company's securitized loan receivables have not been sold and present the results of the securitized loan receivables in the same manner as the Company's owned loans. 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 table provides a reconciliation of owned and managed average loan balances, interest yields and interest rate spreads for the periods indicated. Certain reclassifications have been made to prior-period amounts to conform to the current year's presentation:

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

	Three Months Ended					
	August 31, 2004			August 31, 2003		
	Average Balance	Interest Yield	Interest Rate Spread	Average Balance	Interest Yield	Interest Rate Spread
General Purpose Credit Card Loans:						
Owned	$17,787	10.45%	6.54%	$18,600	10.28%	6.05%
Securitized	29,086	12.44%	10.15%	32,063	12.91%	10.52%
Managed	$46,873	11.69%	8.83%	$50,663	11.94%	8.91%

	Nine Months Ended					
	August 31, 2004			August 31, 2003		
	Average Balance	Interest Yield	Interest Rate Spread	Average Balance	Interest Yield	Interest Rate Spread
General Purpose Credit Card Loans:						
Owned	$17,287	10.18%	6.11%	$19,991	10.00%	5.64%
Securitized	30,198	12.92%	10.71%	31,546	13.10%	10.56%
Managed	$47,485	11.93%	9.09%	$51,537	11.90%	8.69%

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, 2004			August 31, 2003		
		Delinquency Rates			Delinquency Rates	
	Period End Loans	Over 30 Days	Over 90 Days	Period End Loans	Over 30 Days	Over 90 Days
General Purpose Credit Card Loans:						
Owned	$18,471	4.35%	2.01%	$18,106	5.28%	2.54%
Securitized	28,655	5.10%	2.35%	31,859	6.48%	3.12%
Managed	$47,126	4.81%	2.22%	$49,965	6.05%	2.91%

	Three Months Ended		Nine Months Ended	
	August 31, 2004	August 31, 2003	August 31, 2004	August 31, 2003
Net Principal Charge-offs:				
Owned	5.36%	6.26%	5.72%	5.90%
Securitized	6.01%	7.26%	6.45%	6.91%
Managed	5.76%	6.90%	6.19%	6.52%
Net Total Charge-offs (inclusive of interest and fees):				
Owned	7.14%	8.61%	7.88%	8.12%
Securitized	8.74%	10.24%	9.29%	9.64%
Managed	8.14%	9.64%	8.78%	9.05%

Critical Accounting Policies.

The condensed consolidated financial statements are prepared in accordance with U.S. GAAP, 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, 2003 included in the Form 10-K/A), the following may involve a higher degree of judgment and complexity.

Fair Value. 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. 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 fair value of the Company's Financial instruments owned and Financial instruments sold, not yet purchased are generally based on observable market prices, observable market parameters or derived from such prices or parameters based on bid prices or parameters for Financial instruments owned and ask prices or parameters for Financial instruments sold, not yet purchased. In the case of financial instruments transacted on recognized exchanges the observable prices represent quotations for completed transactions from the exchange on which the financial instrument is principally traded. Bid prices represent the price a buyer is willing to pay for a financial instrument at a particular time. Ask prices represent the lowest price a seller is willing to accept for a financial instrument at a particular time.

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 techniques involve some degree of judgment.

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

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 using observable market parameters. These products generally do not entail a significant degree of judgment in determining fair value. Examples of products for which actively quoted prices or pricing parameters are available or for which fair value is derived from actively quoted prices or pricing parameters include securities issued by the U.S. government and its agencies and instrumentalities, exchange traded corporate equity securities, most municipal debt securities, most corporate debt securities, most high-yield debt securities, physical commodities, certain tradable loan products and most mortgage-backed securities.

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

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

The following table presents the valuation of the Company's cash products by level of price transparency (dollars in millions):

	At August 31, 2004		At November 30, 2003	
	Assets	**Liabilities**	**Assets**	**Liabilities**
Observable market prices, parameters or derived from observable prices or parameters	$177,919	$92,484	$147,032	$75,058
Reduced or no price transparency	8,768	709	9,942	148
Total	$186,687	$93,193	$156,974	$75,206

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

The following table presents the fair value of the Company's exchange traded and OTC derivative assets and liabilities (dollars in millions):

	At August 31, 2004		At November 30, 2003	
	Assets	**Liabilities**	**Assets**	**Liabilities**
Exchange traded	$ 2,662	$ 5,349	$ 2,306	$ 3,091
OTC	46,971	34,076	42,346	33,151
Total	$49,633	$39,425	$44,652	$36,242

The fair value of OTC derivative contracts is derived primarily using pricing models, which may require multiple market input parameters. Where appropriate, valuation adjustments are made to account for credit quality and market liquidity. These adjustments are applied on a consistent basis and are based upon observable market data where available. In the absence of observable market prices or parameters in an active market, observable prices or parameters of other comparable current market transactions, or other observable data supporting a fair value based on a pricing model at the inception of a contract, fair value is based on the transaction price. The Company also uses pricing models to manage the risks introduced by OTC derivatives. Depending on the product and the terms of the transaction, the fair value of OTC derivative products can be modeled using a series of techniques, including closed form analytic formulae, such as the Black-Scholes option pricing model, simulation models or a combination thereof, applied consistently. In the case of more established derivative products, the pricing models used by the Company are widely accepted by the financial services industry. Pricing models take into account the contract terms, including the maturity, as well as market parameters such as interest rates, volatility and the creditworthiness of the counterparty.

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 complexity of the modeling assumptions and the reduced price transparency surrounding the model's market parameters. The Company manages its market exposure for OTC derivative products primarily by entering into offsetting derivative contracts or other related financial instruments. The Company's trading divisions, the Controllers Department 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 of the Form 10-K/A.

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

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.

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 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 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 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. The Company's aircraft portfolio consists of aircraft to be held and used and aircraft that are to be disposed of by sale ("held for sale").

Aircraft under operating leases that are to be held and used are stated at cost less accumulated depreciation and impairment charges. 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, the Company's aircraft that are to be held and used 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 the average market appraisal values 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 16 to the condensed consolidated financial statements).

Aircraft under operating leases that fulfill the criteria to be classified as held for sale in accordance with SFAS No. 144 are stated at the lower of carrying value (i.e. cost less accumulated depreciation and impairment charges) or fair value less estimated cost to sell. Depreciation expense is not recorded for aircraft that are classified as held for sale. The Company will recognize a charge for any initial or subsequent write-down to fair value less estimated cost to sell (see Notes 16 and 17 to the condensed consolidated financial statements). A gain would be recognized for any subsequent increase in fair value less cost to sell, but not in excess of the cumulative loss previously recognized (for a write-down to fair value less cost to sell). A gain or loss not previously recognized that results from the sale of an aircraft would be recognized at the date of sale.

Liquidity and Capital Resources.

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

Equity Capital Management Policies. The Company's senior management views equity capital as an important source of financial strength and, therefore, pursues a strategy of ensuring that the Company's equity base adequately reflects and provides some protection from the economic risks inherent in its businesses. The Company also considers return on common equity to be an important measure of its performance, in the context of both the particular business environment in which the Company is operating and its peer group's results. In this regard, the Company actively manages its consolidated equity capital position based upon, among other things, business opportunities, capital availability and rates of return together with internal capital policies, regulatory requirements and rating agency guidelines and, therefore, in the future may expand or contract its equity capital base to address the changing needs of its businesses. The Company attempts to maintain total equity, on a consolidated basis, at least equal to the sum of its operating subsidiaries' equity. At August 31, 2004, the Company's equity capital (which includes shareholders' equity and junior subordinated debt issued to capital trusts) was $30.3 billion.

Liquidity Management Policies. 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. Given the highly liquid nature of the Company's balance sheet, day-to-day funding requirements are largely fulfilled through the use of collateralized financing. In order to meet target liquidity requirements and withstand an unforeseen contraction in credit availability, the Company has designed a liquidity management framework. This framework is intended to ensure that the Company maintains sufficient liquidity to continue to fund its ongoing business and to meet all of its financial obligations maturing within a one-year period without issuing any new unsecured debt.

Liquidity Management Framework:	**Designed to:**
Cash Capital Policy	Ensure that the Company can fund its balance sheet while repaying its financial obligations maturing within one year without issuing new unsecured debt. The Company attempts to achieve this by maintaining sufficient Cash Capital (long-term debt and equity capital) to finance illiquid assets and the portion of its securities inventory that is not expected to be financed on a secured basis in a credit-stressed environment.
Liquidity Reserve	Maintain, at all times, a liquidity reserve in the form of immediately available cash and cash equivalents to cover volatility in day-to-day funding needs. The reserve is periodically assessed and determined based on funding volatility and liquidity targets and averaged approximately $25 billion during the nine month period ended August 31, 2004.
Contingency Planning	Maintain the Company's Contingency Funding Plan to ascertain the Company's ability to manage a prolonged liquidity contraction and provide a course of action over a one-year time period to ensure orderly functioning of the Company's businesses. The Company's Contingency Funding Plan sets forth the process and the internal and external communication flows necessary to ensure effective management of the contingency event. Also see "Commitments" herein.

The Company also pursues a strategy of diversification of funding sources (by products and markets) and attempts to ensure that the tenor of the Company's liabilities equals or exceeds the expected holding period of the assets being financed. Maturities of financings are designed to manage exposure to refinancing risk in any one period. The Company maintains a surplus of unused short-term funding sources at all times to withstand any unforeseen contraction in credit capacity. In addition, the Company attempts to maintain cash and unhypothecated marketable securities equal to at least 110% of its outstanding short-term unsecured borrowings. The Company also maintains committed credit facilities to support its ongoing borrowing programs.

The level of the Company's borrowings is continually adjusted to maintain the target cash liquidity reserve after meeting the Company's daily funding requirements. The Company's funding requirements will vary based on changes in the level and composition of its balance sheet, timing of specific transactions, client financing activity, market conditions and seasonal factors.

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/A.

The Balance Sheet.

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

The Company's total assets increased to $745.0 billion at August 31, 2004 from $602.8 billion at November 30, 2003. The increase was primarily due to increases in securities borrowed, financial instruments owned (largely driven by U.S. government and agency securities), cash and cash equivalents, cash and securities deposited with clearing organizations or segregated under federal and other regulations and securities purchased under agreements to resell. The increase in securities borrowed and securities purchased under agreements to resell was largely due to growth in the Company's equity financing related activities. Cash and securities segregated under federal and other regulations increased in line with increased levels of customer activity.

Balance sheet leverage ratios are one indicator of capital adequacy when viewed in the context of a company's overall liquidity and capital policies. The Company views the adjusted leverage ratio as a more relevant measure of financial risk when comparing financial services firms and evaluating leverage trends. The Company has adopted a definition of adjusted assets that excludes certain self-funded assets considered to have minimal market, credit and/or liquidity risk. These low-risk assets generally are attributable to the Company's matched book and securities lending businesses, as measured by aggregate resale agreements and securities borrowed less non-derivative short positions. In addition, the adjusted leverage ratio reflects the deduction from shareholders' equity of the amount of equity used to support goodwill and intangible assets, as the Company does not view this amount of equity as available to support its risk capital needs.

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

	Balance at		Average Monthly Balance	
	August 31, 2004	November 30, 2003	For the Quarter Ended August 31, 2004	For the Nine Month Period Ended August 31, 2004
	(dollars in millions, except ratio and per share data)			
Total assets	$ 745,033	$ 602,843	$ 742,314	$ 694,916
Less: Securities purchased under agreements to resell	(92,816)	(78,205)	(99,391)	(93,106)
Securities borrowed	(202,863)	(153,813)	(202,844)	(185,931)
Add: Financial instruments sold, not yet purchased	132,618	111,448	130,435	128,379
Less: Derivative contracts sold, not yet purchased	(39,425)	(36,242)	(41,119)	(41,741)
Subtotal	542,547	446,031	529,395	502,517
Less: Segregated customer cash and securities balances	(35,194)	(20,705)	(31,328)	(24,602)
Assets recorded under certain provisions of SFAS No. 140 and Financial Accounting Standards Board ("FASB") Interpretation No. 46R	(40,057)	(35,217)	(40,078)	(38,814)
Goodwill and intangible assets	(2,191)	(1,523)	(1,776)	(1,628)
Adjusted assets	$ 465,105	$ 388,586	$ 456,213	$ 437,473
Shareholders' equity	$ 27,420	$ 24,867	$ 27,248	$ 26,433
Junior subordinated debt issued to capital trusts(1)	2,897	2,810	2,897	2,871
Subtotal	30,317	27,677	30,145	29,304
Less: Goodwill and intangible assets	(2,191)	(1,523)	(1,776)	(1,628)
Tangible shareholders' equity	$ 28,126	$ 26,154	$ 28,369	$ 27,676
Leverage ratio(2)	26.5x	23.0x	26.2x	25.1x
Adjusted leverage ratio(3)	16.5x	14.9x	16.1x	15.8x

(1) The Company views the junior subordinated debt issued to capital trusts as a component of its equity capital base given the inherent characteristics of the securities. These characteristics include the long dated nature (final maturity at issuance of thirty years extendable at the Company's option by a further nineteen years), the Company's ability to defer coupon interest for up to 20 consecutive quarters, and the subordinated nature of the obligations in the capital structure. The Company also receives rating agency equity credit for these securities.

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

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

Principal Sources of Funding.

For a 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/A.

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, geographic and product diversification, risk management policies, cash liquidity and capital structure. In addition, the agencies that rate the Company's debt have focused on changes in the market that may require financial services firms to assume more credit risk in connection with their corporate lending activities, and legal and regulatory developments. A deterioration in any of the previously mentioned factors or combination of these factors may lead rating agencies to downgrade the credit ratings of the Company, thereby increasing the cost to the Company in obtaining unsecured 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 OTC derivative transactions, including credit derivatives and interest rate swaps.

In connection with certain OTC trading agreements and certain other agreements associated with the Institutional Securities business, the Company would be required to provide additional collateral to certain counterparties in the event of a downgrade by either Moody's Investors Service or Standard & Poor's. At August 31, 2004, 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 $845 million. Of this amount, $342 million (approximately 40%) relates to bilateral arrangements between the Company and other parties where upon the downgrade of one party, the downgraded party must deliver incremental collateral to the other. These bilateral downgrade arrangements are a risk management tool used extensively by the Company as credit exposures are reduced if counterparties are downgraded.

As of September 30, 2004, 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(1)	A-1	A+

(1) On September 29, 2004, Standard & Poor's placed the Company's senior debt ratings on Positive Outlook.

Activity in the Nine Month Period Ended August 31, 2004.

During the nine month period ended August 31, 2004, the Company issued senior notes aggregating $28.8 billion, including non-U.S. dollar currency notes aggregating $4.6 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, 2004, the aggregate outstanding principal amount of the Company's Senior Indebtedness (as defined in the Company's public debt shelf registration statements) was approximately $107 billion (including Senior Indebtedness consisting of guaranteed obligations of the indebtedness of subsidiaries). The weighted average maturity of the Company's long-term borrowings, based upon stated maturity dates, was approximately 5.5 years at August 31, 2004.

During the nine month period ended August 31, 2004, the Company purchased approximately $444 million of its common stock under its publicly announced repurchase programs through open market purchases at an average cost of $51.26 per share (see also "Changes in Securities, Use of Proceeds and Issuer Repurchases of Equity Securities" in Part II, Item 2).

Commitments.

The Company's commitments associated with outstanding letters of credit, principal investments and private equity activities, and lending and financing commitments as of August 31, 2004 are summarized below by period of expiration. Since commitments associated with letters of credit and lending and financing arrangements may expire unused, the amounts shown do not necessarily reflect the actual future cash funding requirements:

	Remaining Fiscal 2004	Fiscal 2005-2006	Fiscal 2007-2008	Thereafter	Total
	(dollars in millions)				
Letters of credit(2)	$ 3,872	$ 5,713	$ —	$ —	$ 9,585
Principal investment and private equity activities	36	66	6	86	194
Investment grade lending commitments(3)(5)	1,241	7,545	4,184	5,337	18,307
Non-investment grade lending commitments(3)(5)	61	1,309	434	865	2,669
Commitments for secured lending transactions(4)	663	7,375	185	177	8,400
Commitments to purchase mortgage loans(6)	10,693	934	—	—	11,627
Total(1)	$16,566	$22,942	$4,809	$6,465	$50,782

(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) 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.
(4) 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.
(5) 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.
(6) This amount represents the Company's forward purchase contracts involving mortgage loans.

The table above does not include commitments to extend credit for consumer loans of approximately $260 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 condensed consolidated financial statements.

At August 31, 2004, the Company had commitments to enter into reverse repurchase and repurchase agreements of approximately $40 billion and $35 billion, respectively.

Less Liquid Assets.

At August 31, 2004, certain assets of the Company, such as real property, equipment and leasehold improvements of $2.5 billion, aircraft assets of $4.0 billion and goodwill and intangible assets of $2.2 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, 2004, 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 $920 million, of which approximately $350 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 can be characterized as having periods of higher volatility and reduced liquidity. 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 condensed consolidated statements of income. At August 31, 2004 and November 30, 2003, the Company had high-yield instruments owned with a market value of approximately $8.1 billion and $3.7 billion, respectively, and had high-yield instruments sold, not yet purchased with a market value of $2.3 billion and $0.8 billion, respectively.

Lending Activities. In connection with certain of its Institutional Securities business activities, the Company provides to selected clients 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, 2004 and November 30, 2003, the aggregate value of investment grade loans and positions was $0.8 billion and $1.0 billion, respectively, and the aggregate value of non-investment grade loans and positions was $1.0 billion and $0.7 billion, respectively. At August 31, 2004 and November 30, 2003, the aggregate value of loans and positions and lending commitments (see the table under "Commitments" herein) outstanding was $22.8 billion and $17.8 billion, respectively. In connection with these business activities (including the loans and positions and the lending commitments), the Company had hedges (primarily credit default swaps) with a notional amount of $9.5 billion at August 31, 2004 and $5.5 billion at November 30, 2003.

Regulatory Developments.

The SEC approved a rule (the "CSE Rule") on April 28, 2004 in response to industry requests to establish a voluntary framework for comprehensive, group-wide risk management procedures and consolidated supervision of certain financial services holding companies by the SEC. The framework is designed to minimize the duplicative regulatory burdens on U.S. securities firms resulting from the European Union ("EU") Directive (2002/87/EC) concerning the supplementary supervision of financial conglomerates active in the EU. The CSE Rule also would allow MS&Co., one of the Company's U.S. broker-dealers, to use an alternative method, based on mathematical models, to calculate net capital charges for market and derivatives-related credit risk. Under the CSE Rule, the SEC will regulate the holding company and any unregulated affiliate of a registered broker-dealer, including subjecting the holding company to capital requirements generally consistent with the standards of the Basel Committee on Banking Supervision ("Basel II"). The Company currently expects to apply to the SEC later this year for permission to operate under the rule.

The Company continues to work with its regulators to understand and assess the impact of the CSE Rule and Basel II capital standards. Many important elements of the new regulations are still being finalized. The Company cannot fully predict the impact that these changes will have on its businesses; however, compliance with consolidated supervision and the imposition of revised capital standards are likely to impose additional costs and may affect decisions with respect to raising and using capital.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Market Risk. The Company (other than Credit Services) uses 99%/One-Day Value-at-Risk ("VaR") as one of a range of risk management tools. The Company also presents 95%/One-Day VaR to facilitate comparisons with other global financial services firms. VaR values should be interpreted in light of the method's strengths and limitations. A small proportion of trading positions generating market risk is not included in VaR (e.g., certain 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/A.

The tables below present the following: the Company's quarter-end Trading & Non-trading VaR for each primary risk exposure (as defined by asset class) and on an aggregate basis at August 31, 2004, May 31, 2004, and November 30, 2003 (see Table 1 below); the Company's quarter-end Trading VaR for each primary risk exposure and on an aggregate basis at August 31, 2004, May 31, 2004, and November 30, 2003 (see Table 2 below); the Company's average daily Trading VaR for each primary risk exposure and on an aggregate basis for the quarters ended August 31, 2004, May 31, 2004, and November 30, 2003 (see Table 3 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, 2004 (see Table 4 below). Trading & Non-trading VaR incorporates certain non-trading positions which are not included in Trading VaR; these include (a) the funding liabilities related to institutional trading positions and (b) public-company equity positions recorded as principal investments by the Company. Table 3 below, which reports average Trading VaR for the current and previous quarter, provides the most representative summary of trends in Trading VaR during the period.

At August 31, 2004, Quarter-end Aggregate Trading and Non-Trading VaR increased modestly to $92 million at a 99% confidence level as compared with $90 million at May 31, 2004.

Table 1: Quarter-end Trading & Non-trading VaR

Primary Market Risk Category	95%/One-Day VaR(1) At August 31, 2004	95%/One-Day VaR(1) At May 31, 2004	95%/One-Day VaR(1) At November 30, 2003	99%/One-Day VaR(1) At August 31, 2004	99%/One-Day VaR(1) At May 31, 2004	99%/One-Day VaR(1) At November 30, 2003
	(dollars in millions)					
Interest rate and credit spread	$43	$46	$30	$ 67	$ 67	$ 52
Equity price	26	22	22	36	32	32
Foreign exchange rate	7	6	5	9	8	7
Commodity price	23	24	15	39	36	22
Subtotal	99	98	72	151	143	113
Less diversification benefit(2)	33	35	30	59	53	50
Aggregate VaR	$66	$63	$42	$ 92	$ 90	$ 63

(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.

At August 31, 2004, Aggregate Trading VaR was $78 million at a 99% confidence level as compared with $72 million at May 31, 2004. The increase in Aggregate Trading VaR was primarily driven by an increase in the contribution of equity price VaR to total Aggregate Trading VaR. Equity price VaR increased to $33 million from $29 million at May 31, 2004, driven predominately by larger position taking.

Table 2: Quarter-end Trading VaR

Primary Market Risk Category	95%/One-Day VaR At August 31, 2004	95%/One-Day VaR At May 31, 2004	95%/One-Day VaR At November 30, 2003	99%/One-Day VaR At August 31, 2004	99%/One-Day VaR At May 31, 2004	99%/One-Day VaR At November 30, 2003
	(dollars in millions)					
Interest rate and credit spread	$33	$31	$29	$ 51	$ 49	$ 45
Equity price	23	20	21	33	29	30
Foreign exchange rate	7	6	5	9	8	7
Commodity price	22	24	15	39	36	22
Subtotal	85	81	70	132	122	104
Less diversification benefit	32	32	30	54	50	46
Aggregate trading VaR	$53	$49	$40	$ 78	$ 72	$ 58

As shown in Table 3 below, average Trading VaR during the quarter ended August 31, 2004 increased to $79 million from $72 million for the quarter ended May 31, 2004. Higher interest rate and credit spread, equity price and commodity price VaR accounted for the increase in Aggregate Trading VaR as a result of greater position taking in the interest rate, equity and energy markets.

Table 3: Average Trading VaR

Primary Market Risk Category	Average Daily 95%/One-Day VaR Quarter Ended August 31, 2004	Average Daily 95%/One-Day VaR Quarter Ended May 31, 2004	Average Daily 95%/One-Day VaR Quarter Ended November 30, 2003	Average Daily 99%/One-Day VaR Quarter Ended August 31, 2004	Average Daily 99%/One-Day VaR Quarter Ended May 31, 2004	Average Daily 99%/One-Day VaR Quarter Ended November 30, 2003
	(dollars in millions)					
Interest rate and credit spread	$33	$32	$27	$52	$50	$45
Equity price	25	22	20	36	32	29
Foreign exchange rate	8	8	8	12	12	13
Commodity price	25	22	17	40	34	26
Aggregate trading VaR	$55	$49	$41	$79	$72	$61

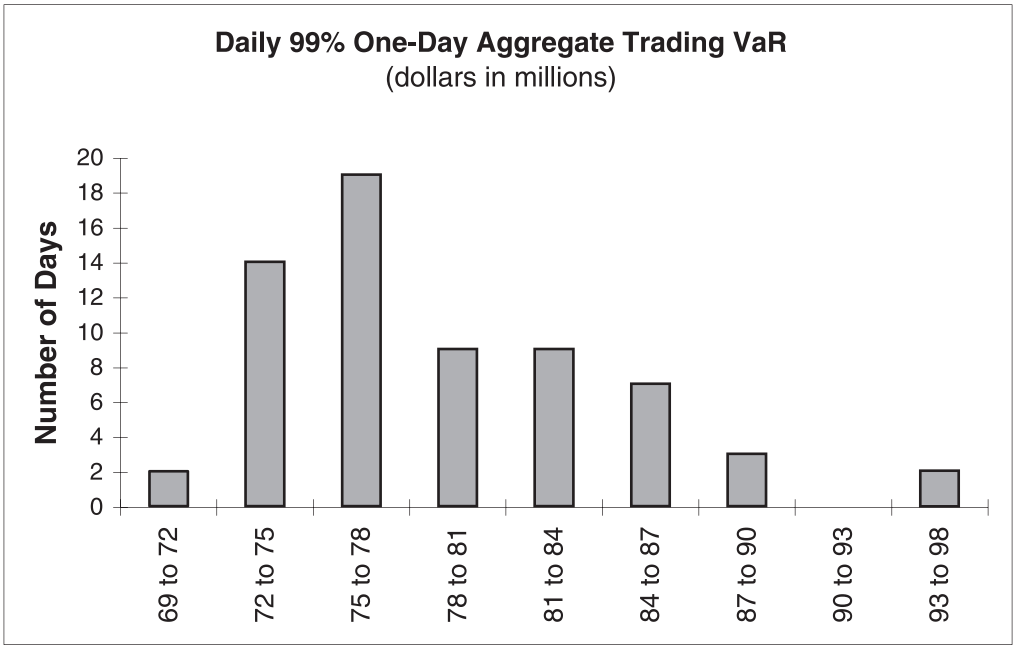
In order to facilitate comparison with other global financial services firms that report Trading VaR with respect to a 10-business day holding period, the Company's 99% and 95% average 10-day Aggregate Trading VaR amounts for the quarter ended August 31, 2004 were $251 million and $175 million, respectively.

Table 4 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, 2004.

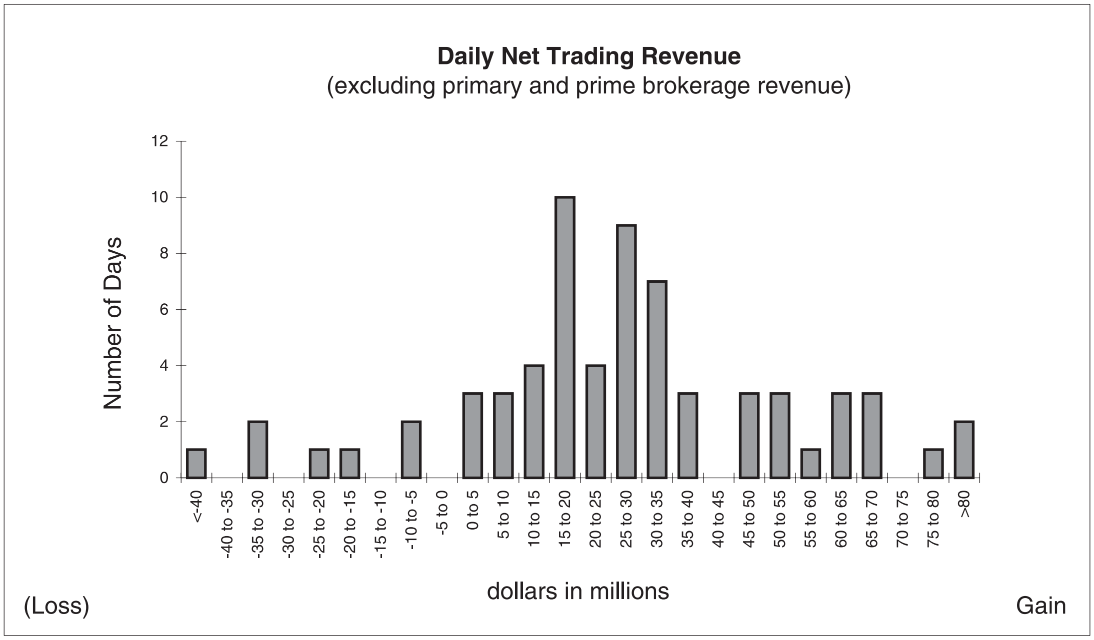
Table 4: Average/High/Low Trading VaR

Primary Market Risk Category	Daily 95%/One-Day VaR for the Quarter Ended August 31, 2004			Daily 99%/One-Day VaR for the Quarter Ended August 31, 2004		
	High	Low	Average	High	Low	Average
	(dollars in millions, pre-tax)			(dollars in millions, pre-tax)		
Interest rate and credit spread	$50	$26	$33	$80	$41	$52
Equity price	32	19	25	46	28	36
Foreign exchange rate	12	5	8	17	7	12
Commodity price	31	22	25	49	33	40
Aggregate trading VaR	$69	$46	$55	$97	$69	$79

As shown in the tables above, the Company's average 99%/one-day Aggregate Trading VaR for the quarter ended August 31, 2004 was $79 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, 2004, Aggregate Trading VaR ranged between $69 million and $87 million.



One method of evaluating the reasonableness 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. Assuming no intra-day trading, 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, 2004 for the Company's trading businesses (including net interest and commissions but excluding primary and prime brokerage revenues credited to the trading businesses). There were no days during the quarter ended August 31, 2004 in which the Company incurred daily trading losses in its trading business in excess of the 99%/one-day Aggregate Trading VaR. Additionally, there were no days during the quarter where the largest one-day loss exceeded the lowest 99% one-day Aggregate Trading VaR reported in Table 4 above.



As of August 31, 2004, interest rate risk exposure associated with the Company's consumer lending activities, included within Credit Services, 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, 2003.

Credit Risk.

For a further discussion of the Company's credit risks, see "Quantitative and Qualitative Disclosures about Market Risks—Credit Risk" in Part II, Item 7A of the Form 10-K/A. In addition, for a discussion of the Company's corporate lending activities, see "Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources—Lending Activities" herein.

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, 2004. 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)

	Years to Maturity						
Credit Rating(2)	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	$ 1,405	$ 2,105	$1,414	$ 6,435	$ (2,714)	$ 8,645	$ 4,529
AA	5,770	3,553	2,257	9,896	(7,122)	14,354	7,955
A	4,074	3,161	2,345	4,041	(3,210)	10,411	6,025
BBB	2,906	2,231	1,396	4,330	(1,502)	9,361	5,551
Non-investment grade	1,675	750	476	762	(640)	3,023	1,316
Unrated(4)	798	445	71	68	(205)	1,177	89
Total	$16,628	$12,245	$7,959	$25,532	$(15,393)	$46,971	$25,465

(1) Fair values shown present the Company's exposure to counterparties relating to the Company's OTC derivative products. The table does not include the effect of any related hedges utilized by the Company. The table also excludes fair values corresponding to other credit exposures, such as those arising from the Company's lending activities.

(2) Credit ratings are determined 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, 2004, 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	$ 4,283	$ 6,336	$6,465	$23,256	$(10,154)	$30,186	$14,079
Foreign exchange forward contracts and options	6,736	457	103	18	(3,815)	3,499	2,917
Equity securities contracts (including equity swaps, warrants and options)	1,086	800	368	1,041	(241)	3,054	632
Commodity forwards, options and swaps	4,523	4,652	1,023	1,217	(1,183)	10,232	7,837
Total	$16,628	$12,245	$7,959	$25,532	$(15,393)	$46,971	$25,465

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	$ 3,516	$ 7,370	$6,039	$13,231	$(10,154)	$20,002
Foreign exchange forward contracts and options	6,694	388	72	30	(3,815)	3,369
Equity securities contracts (including equity swaps, warrants and options)	1,153	963	557	313	(241)	2,745
Commodity forwards, options and swaps	3,527	3,946	1,010	660	(1,183)	7,960
Total	$14,890	$12,667	$7,678	$14,234	$(15,393)	$34,076

(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 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 ranging up to 10 years, while equity and foreign exchange derivative products with standardized terms in major currencies can have price transparency from published external sources within a two-year maturity range. Commodity derivatives with standardized terms and delivery locations can have price transparency from published external sources within various maturity ranges up to 10 years, depending on the commodity. In most instances of limited price transparency based on published external sources, dealers in these markets, in their capacities as market-makers and liquidity providers, provide price transparency beyond the above maturity ranges.

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*

(a) The following is a new matter reported by the Company.

New York Stock Exchange Matter.

On September 22, 2004, the Company announced that it had reached an agreement in principle with the New York Stock Exchange (the "NYSE") relating to the Company's failure to comply with certain prospectus delivery requirements, operational deficiencies, employee defalcations (including the Carlos Soto matter) and other matters. The settlement will include a fine of $19 million. Negotiations with the NYSE about the details of the settlement have not concluded, and no assurance can be given that a resolution will be achieved.

(b) The following developments have occurred with respect to certain matters previously reported in the Company's Annual Report on Form 10-K/A for the fiscal year ended November 30, 2003 and the Company's Quarterly Reports on Form 10-Q/A for the fiscal quarters ended February 29, 2004 and May 31, 2004.

IPO Fee Matters.

On September 16, 2004, plaintiffs filed motions for class certification in both the purchaser and issuer class actions.

IPO Allocation Matters.

On June 23, 2004, in *In re Initial Public Offering Antitrust Litigation*, plaintiffs submitted their appeal to the U.S. Court of Appeals for the Second Circuit.

On August 27, 2004, in *Breakaway Solutions, Inc. v. Morgan Stanley & Co. Incorporated, et al.*, the Delaware Court of Chancery granted in part and denied in part defendants' motion to dismiss, dismissing a breach of contract claim and the claims for indemnification and/or contribution.

On October 13, 2004, in *In re Initial Public Offering Securities Litigation*, the Court granted in large part plaintiffs' motions for class certification in the six focus cases selected for class certification briefing.

Research Matters.

On July 23, 2004, in *State of West Virginia ex rel. Darrell v. Bear Stearns & Co., Inc., et al*., the Circuit Court of Marshall County denied defendants' motion to dismiss in writing and certified a question for the Supreme Court of Appeals of West Virginia. On September 21, 2004 defendants filed a Petition for Review of Certified Question with the Supreme Court of Appeals of West Virginia.

On July 30, 2004, in *Striffler v. Purcell, et al.*, plaintiff filed a notice of appeal from the Supreme Court of the State of New York's dismissal of the case.

On September 29, 2004, the U.S. District Court for the Southern District of New York dismissed *Shah v. Morgan Stanley & Co. Inc., et al*., a shareholder class action alleging that the Company's stock price declined upon disclosure of the 2003 global research settlement and alleged banking-research conflicts.

In connection with the SEC's continuing investigation of supervision of equity research and investment banking, the Company continues to receive, and respond to, subpoenas and requests for documents, information and witness testimony.

Mutual Fund Matters.

Sales Practices. Regarding the administrative complaint filed by the Massachusetts Securities Division (the "Division") on July 14, 2003, the Company waived its right to a hearing and agreed to pay an administrative fine of $25,000. Regarding the Division's complaint filed on August 11, 2003, alleging, *inter alia*, improper sales contests and other sales practices constituting impermissible conflicts of interest, hearings were held on October 5-8, 2004 and are scheduled to resume on November 1, 2004.

On October 8, 2004, plaintiff in *Starr v. Van Kampen Investments Inc., et al*., filed a First Amended Derivative Complaint.

Late Trading and Market Timing. On August 10, 2004, in *Jackson v. Van Kampen Series Fund, Inc., et al.,* the state court denied defendants' motion to dismiss. The appeal in the U.S. Court of Appeals for the Seventh Circuit of the decision of the U.S. District Court for the Southern District of Illinois to remand the case to state court remains pending.

The Company continues to receive, and respond to, subpoenas and requests for documents and information from the SEC, NASD and other regulators.

AOL Time Warner Litigation.

In April 2004, the Company was named as a defendant in another individual state court action filed in Alaska state court. On May 19, and August 13, 2004, respectively, defendants filed motions to dismiss the West Virginia and Alaska action. On September 10, 2004, defendants filed demurrers seeking dismissal of the California coordinated actions. On July 20, 2004, plaintiffs and bank defendants entered into a tolling agreement and stipulation of discontinuance and dismissal in the Pennsylvania action.

On October 8, 2004, in the Ohio state individual action, the Ohio Court of Common Pleas denied the Company's motion to dismiss the state securities law claims, but dismissed the common law claims.

Coleman Litigation.

On July 23, 2004, in the action naming Arthur Andersen LLP and certain of its affiliates and former partners as defendants, the Court granted certain defendants' motion for a more definite statement. On August 6, 2004, the Company, Morgan Stanley Senior Funding, Inc. and Morgan Stanley & Co. Incorporated filed a first amended complaint. Between August 23 and September 10, 2004, all defendants moved to dismiss the action.

Carlos Soto Matter.

The Company has reached an agreement in principle with the NYSE to resolve this matter (see New York Stock Exchange Matter above). The Company is continuing to (1) assist other regulators in their investigations of Mr. Soto's activities, and (2) resolve customer claims concerning those activities.

Indonesian Litigation.

On September 16 and September 29, 2004, in the PT Lontar Papyrus proceeding and the PT Indah Kiat proceeding, respectively, the Courts issued their oral judgments. In each proceeding, the Court declared the bond issues to be illegal and void, holding that defendants (including the Company) had committed unspecified tortious acts, but no damages were awarded. On September 24 and October 12, 2004, the Company filed notifications of appeal with the Courts in the PT Lontar Papyrus proceeding and the PT Indah Kiat proceeding, respectively.

SEC Matter.

On October 11, 2004, the Company reached agreement with the Staff of the SEC (the "Staff") to resolve an informal accounting investigation by executing an offer of settlement and agreeing to entry of a cease-and-desist order. The Staff found that the Company valued certain impaired aircraft in its aircraft leasing business in late 2001, late 2002 and early 2003 and certain bonds in its high-yield bond portfolio in late 2000, in a manner that did not comply with generally accepted accounting principles, and thus violated financial reporting, recordkeeping and internal controls provisions of the federal securities laws. As previously disclosed, the resolution does not involve any restatement of past financial statements, any monetary penalty or allegation of fraud. The agreement will not be final until accepted by the Commission, and no assurance can be given that such approval will be granted.

Other.

In addition to the matters described in the Company's Annual Report on Form 10-K/A for the year ended November 30, 2003 and in the Company's Quarterly Reports on Form 10-Q/A for fiscal 2004, in the normal course of business, the Company has been named, from time to time, as a defendant in various legal actions, including arbitrations, class actions, and other litigation, arising in connection with its activities as a global diversified financial services institution. Certain of the legal actions include claims for substantial compensatory and/or punitive damages or claims for indeterminate amounts of damages. In some cases, the issuers that would otherwise be the primary defendants in such cases are bankrupt or in financial distress.

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

The Company contests liability and/or the amount of damages in each pending matter. In view of the inherent difficulty of predicting the outcome of such matters, particularly in cases where claimants seek substantial or indeterminant damages or where investigations and proceedings are in the early stages, the Company cannot predict with certainty the loss or range of loss related to such matters, how such matters will be resolved, when they will ultimately be resolved, or what the eventual settlement, fine, penalty or other relief might be. Subject to the foregoing, the Company believes, based on current knowledge and after consultation with counsel, that the outcome of each such pending 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 or a business segment's operating results for a particular future period, depending on, among other things, the level of the Company's or a business segment's income for such period.

Item 2. *Changes in Securities, Use of Proceeds and Issuer Purchases of Equity Securities*

The table below sets forth the information with respect to purchases made by or on behalf of the Company of the Company's common stock during the quarter ended August 31, 2004.

Issuer Purchases of Equity Securities

(dollars in millions, except per share amounts)

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased As Part of Publicly Announced Plans or Programs (C)	Approximate Dollar Value of Shares that May Yet be Purchased Under the Plans or Programs
Month #1 (June 1, 2004 – June 30, 2004)				
Equity Anti-dilution Program (A)	266,000	$52.7984	266,000	(A)
Capital Management Program (B)	—	N/A	—	$600
Employee Transactions (D)	46,153	$52.7167	N/A	N/A
Month #2 (July 1, 2004 – July 31, 2004)				
Equity Anti-dilution Program (A)	2,893,273	$49.7696	2,893,273	(A)
Capital Management Program (B)	—	N/A	—	$600
Employee Transactions (D)	878,777	$50.6054	N/A	N/A
Month #3 (August 1, 2004 – August 31, 2004)				
Equity Anti-dilution Program (A)	2,050,330	$48.4759	2,050,330	(A)
Capital Management Program (B)	—	N/A	—	$600
Employee Transactions (D)	108,251	$49.6351	N/A	N/A
Total				
Equity Anti-dilution Program (A)	5,209,603	$49.4151	5,209,603	(A)
Capital Management Program (B)	—	N/A	—	$600
Employee Transactions (D)	1,033,181	$50.5981	N/A	N/A

(A) The Company's board of directors authorized this program to purchase common stock to offset the dilutive impact of grants and exercises of awards under the Company's equity-based compensation and benefit plans. The program was publicly announced on January 7, 1999 and has no set expiration or termination date. There is no maximum amount of shares that may be purchased under the program.

(B) The Company's board of directors authorized this program to purchase common stock for capital management purposes. The program was publicly announced on February 12, 1998 at which time up to $3 billion of stock was authorized to be purchased. The program was subsequently increased by $1 billion on December 18, 1998, $1 billion on December 20, 1999 and $1.5 billion on June 20, 2000. This program has a remaining capacity of $600 million at August 31, 2004 and has no set expiration or termination date.

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

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

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 22, 2004 reporting Item 7 and Item 12 in connection with the announcement of the Company's financial results for the fiscal quarter ended May 31, 2004.

Form 8-K dated July 22, 2004 reporting 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

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

Date: October 15, 2004