MORGAN STANLEY
Form 10-Q
July 09, 2008
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES

EXCHANGE ACT OF 1934

For the quarterly period ended May 31, 2008

OR

¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES

EXCHANGE ACT OF 1934

Commission File Number 1-11758

(Exact Name of Registrant as specified in its charter)

Delaware	**1585 Broadway**	**36-3145972**	**(212) 761-4000**
(State or other jurisdiction of incorporation or organization)	**New York, NY 10036**	(I.R.S. Employer Identification No.)	(Registrant s telephone number, including area code)
	(Address of principal executive offices, including zip code)		

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

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

Large Accelerated Filer x	Accelerated Filer ¨
Non-Accelerated Filer ¨	Smaller reporting company ¨
(Do not check if a smaller reporting company)	

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

As of June 30, 2008, there were 1,109,013,816 shares of the Registrant s Common Stock, par value $0.01 per share, outstanding.

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QUARTERLY REPORT ON FORM 10-Q

For the quarter ended May 31, 2008

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AVAILABLE INFORMATION

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

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

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

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

Integrity Hotline.

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

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Part I Financial Information.

Item 1. Financial Statements.

MORGAN STANLEY

CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

(dollars in millions, except share data)

	May 31, 2008 (unaudited)	November 30, 2007
Assets		
Cash and cash equivalents	$ 23,782	$ 25,598
Cash and securities deposited with clearing organizations or segregated under federal and other regulations or requirements (including securities at fair value of $15,270 at May 31, 2008 and $31,354 at November 30, 2007)	53,393	61,608
Financial instruments owned, at fair value (approximately $140 billion and $131 billion were pledged to various parties at May 31, 2008 and November 30, 2007, respectively):		
U.S. government and agency securities	26,498	23,887
Other sovereign government obligations	32,467	21,606
Corporate and other debt	130,943	147,724
Corporate equities	89,075	87,377
Derivative contracts	92,305	77,003
Investments	15,451	14,270
Physical commodities	3,654	3,096
Total financial instruments owned, at fair value	390,393	374,963
Securities received as collateral, at fair value	25,528	82,229
Collateralized agreements:		
Securities purchased under agreements to resell	165,928	126,887
Securities borrowed	257,796	239,994
Receivables:		
Customers	58,172	76,352
Brokers, dealers and clearing organizations	15,035	16,011
Other loans	3,769	11,629
Fees, interest and other	8,628	8,320
Other investments	5,886	4,524
Premises, equipment and software costs, at cost (net of accumulated depreciation of $3,282 at May 31, 2008 and $3,449 at November 30, 2007)	4,856	4,372
Goodwill	2,988	3,024
Intangible assets (net of accumulated amortization of $218 at May 31, 2008 and $175 at November 30, 2007) (includes $344 at fair value at May 31, 2008 and $428 at fair value at November 30, 2007)	902	1,047
Other assets	14,172	8,851
Total assets	$ 1,031,228	$ 1,045,409

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MORGAN STANLEY

CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION (Continued)

(dollars in millions, except share data)

	May 31, 2008 (unaudited)	November 30, 2007
Liabilities and Shareholders Equity		
Commercial paper and other short-term borrowings (includes $6,427 at fair value at May 31, 2008 and $3,068 at fair value at November 30, 2007)	$ 23,816	$ 34,495
Deposits (includes $35 at fair value at May 31, 2008 and $3,769 at fair value at November 30, 2007)	35,227	31,179
Financial instruments sold, not yet purchased, at fair value:		
U.S. government and agency securities	11,278	8,221
Other sovereign government obligations	19,033	15,627
Corporate and other debt	6,784	7,592
Corporate equities	46,632	30,899
Derivative contracts	77,439	71,604
Physical commodities	582	398
Total financial instruments sold, not yet purchased, at fair value	161,748	134,341
Obligation to return securities received as collateral, at fair value	25,528	82,229
Collateralized financings:		
Securities sold under agreements to repurchase	136,998	162,840
Securities loaned	45,981	110,423
Other secured financings (includes $28,237 at fair value at May 31, 2008 and $27,772 at fair value at November 30, 2007)	29,878	27,772
Payables:		
Customers	293,344	203,453
Brokers, dealers and clearing organizations	6,146	10,454
Interest and dividends	4,056	1,724
Other liabilities and accrued expenses	23,289	24,606
Long-term borrowings (includes $45,502 at fair value at May 31, 2008 and $38,392 at fair value at November 30, 2007)	210,724	190,624
	996,735	1,014,140
Commitments and contingencies		
Shareholders equity:		
Preferred stock	1,100	1,100
Common stock, $0.01 par value;		
Shares authorized: 3,500,000,000 at May 31, 2008 and November 30, 2007;		
Shares issued: 1,211,701,552 at May 31, 2008 and November 30, 2007;		
Shares outstanding: 1,108,865,416 at May 31, 2008 and 1,056,289,659 at November 30, 2007	12	12
Paid-in capital	340	1,902
Retained earnings	39,581	38,045
Employee stock trust	7,468	5,569
Accumulated other comprehensive loss	(218)	(199)
Common stock held in treasury, at cost, $0.01 par value;		
102,836,136 shares at May 31, 2008 and 155,411,893 shares at November 30, 2007	(6,322)	(9,591)
Common stock issued to employee trust	(7,468)	(5,569)
Total shareholders equity	34,493	31,269

Total liabilities and shareholders equity	$ 1,031,228	$ 1,045,409

See Notes to Condensed Consolidated Financial Statements.

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MORGAN STANLEY

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

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

	Three Months Ended May 31, 2008	Three Months Ended May 31, 2007	Six Months Ended May 31, 2008	Six Months Ended May 31, 2007
	(unaudited)		(unaudited)	
Revenues:				
Investment banking	$ 1,049	$ 1,913	$ 2,158	$ 3,140
Principal transactions:				
Trading	1,403	4,838	4,793	8,996
Investments	(464)	1,004	(810)	1,884
Commissions	1,155	1,123	2,354	2,128
Asset management, distribution and administration fees	1,464	1,596	3,014	3,075
Interest and dividends	10,117	15,400	24,082	29,571
Other	1,799	321	2,116	593
Total revenues	16,523	26,195	37,707	49,387
Interest expense	10,013	15,671	22,875	28,869
Net revenues	6,510	10,524	14,832	20,518
Non-interest expenses:				
Compensation and benefits	2,960	4,994	7,031	9,769
Occupancy and equipment	329	279	615	539
Brokerage, clearing and exchange fees	448	366	892	727
Information processing and communications	312	286	617	563
Marketing and business development	207	199	390	352
Professional services	472	510	851	929
Other	336	366	776	659
Total non-interest expenses	5,064	7,000	11,172	13,538
Income from continuing operations before gains (losses) from unconsolidated investees and income taxes	1,446	3,524	3,660	6,980
Gains (losses) from unconsolidated investees	19	(20)	21	(46)
Provision for income taxes	439	1,141	1,104	2,257
Income from continuing operations	1,026	2,363	2,577	4,677
Discontinued operations:				
Net gain from discontinued operations		349		913
Provision for income taxes		130		336
Net gain on discontinued operations		219		577
Net income	$ 1,026	$ 2,582	$ 2,577	$ 5,254
Preferred stock dividend requirements	$ 14	$ 17	$ 31	$ 34

Earnings applicable to common shareholders	$ 1,012	$ 2,565	$ 2,546	$ 5,220
Earnings per basic common share:				
Income from continuing operations	$ 0.97	$ 2.35	$ 2.47	$ 4.63
Gain on discontinued operations		0.22		0.58
Earnings per basic common share	$ 0.97	$ 2.57	$ 2.47	$ 5.21
Earnings per diluted common share:				
Income from continuing operations	$ 0.95	$ 2.24	$ 2.40	$ 4.41
Gain on discontinued operations		0.21		0.55
Earnings per diluted common share	$ 0.95	$ 2.45	$ 2.40	$ 4.96
Average common shares outstanding:				
Basic	1,038,145,038	996,544,761	1,029,473,636	1,002,894,369
Diluted	1,067,184,178	1,045,643,087	1,062,525,833	1,051,684,753

See Notes to Condensed Consolidated Financial Statements.

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MORGAN STANLEY

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(dollars in millions)

	Three Months Ended May 31, 2008	Three Months Ended May 31, 2007	Six Months Ended May 31, 2008	Six Months Ended May 31, 2007
	(unaudited)		(unaudited)	
Net income	$ 1,026	$ 2,582	$ 2,577	$ 5,254
Other comprehensive income (loss), net of tax:				
Foreign currency translation adjustments(1)	(92)	5	(37)	(97)
Net change in cash flow hedges(2)	5	3	9	11
Minimum pension liability adjustment(3)				2
Net amortization of actuarial loss(4)	5		10	
Net amortization of prior-service credit(5)	(2)		(3)	
Comprehensive income	$ 942	$ 2,590	$ 2,556	$ 5,170

(1) Amounts are net of (benefit from) income taxes of $(4) million and $(24) million for the quarters ended May 31, 2008 and 2007, respectively. Amounts are net of provision for (benefit from) income taxes of $(69) million and $13 million for the six months ended May 31, 2008 and 2007, respectively.

(2) Amounts are net of provision for income taxes of $2 million and $3 million for the quarters ended May 31, 2008 and 2007, respectively. Amounts are net of provision for income taxes of $4 million and $7 million for the six months ended May 31, 2008 and 2007, respectively.

(3) Amount is net of provision for income taxes of $2 million for the six months ended May 31, 2007.

(4) Amount is net of provision for income taxes of $3 million for the quarter ended May 31, 2008.
Amount is net of provision for income taxes of $6 million for the six months ended May 31, 2008.

(5) Amount is net of (benefit from) income taxes of $(1) million for the quarter ended May 31, 2008.
Amount is net of (benefit from) income taxes of $(2) million for the six months ended May 31, 2008.

See Notes to Condensed Consolidated Financial Statements.

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MORGAN STANLEY

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(dollars in millions)

	Six Months Ended May 31, 2008	2007
	(unaudited)	
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 2,577	$ 5,254
Adjustments to reconcile net income to net cash used for operating activities:		
(Gains) losses from unconsolidated investees	(21)	46
Compensation payable in common stock and options	1,267	1,266
Depreciation and amortization	209	254
Provision for consumer loan losses		399
Gains on business dispositions	(1,500)	(168)
Changes in assets and liabilities:		
Cash and securities deposited with clearing organizations or segregated under federal and other regulations or requirements	8,408	(17,546)
Financial instruments owned, net of financial instruments sold, not yet purchased	20,567	(35,451)
Securities borrowed	(17,802)	47,418
Securities loaned	(64,442)	(3,041)
Receivables and other assets	20,184	(45,980)
Payables and other liabilities	84,768	16,599
Securities purchased under agreements to resell	(39,041)	31,736
Securities sold under agreements to repurchase	(25,842)	(15,491)
Net cash used for operating activities	(10,668)	(14,705)
CASH FLOWS FROM INVESTING ACTIVITIES		
Net (payments for) proceeds from:		
Premises, equipment and software costs	(810)	(607)
Business acquisitions, net of cash acquired	(174)	(1,167)
Business dispositions	1,523	476
Net principal disbursed on consumer loans		(4,697)
Sales of consumer loans		5,301
Purchases of securities available for sale		(7,975)
Net cash provided by (used for) investing activities	539	(8,669)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net (payments for) proceeds from:		
Short-term borrowings	(10,679)	4,441
Derivatives financing activities	(910)	(89)
Other secured financings	2,106	(8,547)
Deposits	4,048	15,214
Tax benefits associated with stock-based awards	114	181
Net proceeds from:		
Issuance of common stock	352	602
Issuance of long-term borrowings	30,939	40,395
Issuance of junior subordinated debentures related to China Investment Corporation	5,579	
Payments for:		
Repayments of long-term borrowings	(22,810)	(14,160)
Redemption of Capital Units		(66)
Repurchases of common stock through open market share repurchase program		(2,609)
Repurchases of common stock for employee tax withholding	(68)	(216)
Cash dividends	(626)	(608)

Net cash provided by financing activities	8,045	34,538
Effect of exchange rate changes on cash and cash equivalents	268	16
Net (decrease) increase in cash and cash equivalents	(1,816)	11,180
Cash and cash equivalents, at beginning of period	25,598	20,606
Cash and cash equivalents, at end of period	$ 23,782	$ 31,786

SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION

Cash payments for interest were $21,305 million and $28,715 million for the six month periods ended May 31, 2008 and 2007, respectively.

Cash payments for income taxes were $348 million and $1,969 million for the six month periods ended May 31, 2008 and 2007, respectively.

See Notes to Condensed Consolidated Financial Statements.

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MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

1. Basis of Presentation and Summary of Significant Accounting Policies.

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

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

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

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

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

Discontinued Operations.

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

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

See Note 14 for additional information on discontinued operations.

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

All material intercompany balances and transactions have been eliminated.

The condensed consolidated financial statements should be read in conjunction with the Company s consolidated financial statements and notes thereto included in the Company s Annual Report on Form 10-K for the fiscal year ended November 30, 2007 (the Form 10-K). The condensed consolidated financial statements reflect all 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.

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MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

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

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

Notwithstanding the above, certain securitization vehicles, commonly known as qualifying special purpose entities (QSPEs), are not consolidated by the Company if they meet certain criteria regarding the types of assets and derivatives they may hold, the types of sales they may engage in and the range of discretion they may exercise in connection with the assets they hold (see Note 4).

For investments in entities in which the Company does not have a controlling financial interest but has significant influence over operating and financial decisions, the Company generally applies the equity method of accounting, except in instances where the Company has elected to measure certain eligible investments at fair value as defined in Statement of Financial Accounting Standards (SFAS) No. 159, The Fair Value Option for Financial Assets and Financial Liabilities (SFAS No. 159) (see Note 2).

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

The Company s U.S. and international subsidiaries include Morgan Stanley & Co. Incorporated (MS&Co.), Morgan Stanley & Co. International plc (MSIP), Morgan Stanley Japan Securities Co., Ltd. (MSJS) and Morgan Stanley Investment Advisors Inc.

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

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

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

Revenue Recognition.

Investment Banking. Underwriting revenues and advisory fees from mergers, acquisitions and restructuring transactions are recorded when services for the transactions are determined to be completed, generally as set

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MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

forth under the terms of the engagement. Transaction-related expenses, primarily consisting of legal, travel and other costs directly associated with the transaction, are deferred and recognized in the same period as the related investment banking transaction revenue. Underwriting revenues are presented net of related expenses. Non-reimbursed expenses associated with advisory transactions are recorded within Non-interest expenses.

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

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

Financial Instruments and Fair Value.

A significant portion of the Company s financial instruments is carried at fair value with changes in fair value recognized in earnings each period. A description of the Company s policies regarding fair value measurement and its application to these financial instruments follows.

Financial Instruments Measured at Fair Value. All of the instruments within Financial instruments owned and Financial instruments sold, not yet purchased, are measured at fair value, either through the fair value option election (discussed below) or as required by other accounting pronouncements. These instruments primarily represent the Company s trading and investment activities and include both cash and derivative products. In addition, Securities received as collateral and Obligation to return securities received as collateral are measured at fair value as required by other accounting pronouncements. Additionally, certain Commercial paper and other short-term borrowings (primarily structured notes), certain Deposits, certain Other secured financings and certain Long-term borrowings (primarily structured notes and certain junior subordinated debentures) are measured at fair value through the fair value option election. Gains and losses on all of these instruments carried at fair value are reflected in Principal transactions trading revenues or Principal transactions investments revenues in the condensed consolidated statements of income. Interest income and expense and dividend income are recorded within the condensed consolidated statements of income depending on the nature of the instrument and related market conventions. When interest and dividends are included as a component of the instruments fair value, interest and dividends are included within Principal transactions trading revenues or Principal transactions investments revenues. Otherwise, they are included within Interest and dividend income or Interest expense.

Fair Value Option. The Company adopted the provisions of SFAS No. 159, effective December 1, 2006. SFAS No. 159 provides entities the option to measure certain financial assets and financial liabilities at fair value with changes in fair value recognized in earnings each period. SFAS No. 159 permits the fair value option election on an instrument-by-instrument basis at initial recognition of an asset or liability or upon an event that gives rise to a new basis of accounting for that instrument. The Company applies the fair value option for certain eligible

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MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

instruments, including certain loans and loan commitments, certain equity method investments, certain structured notes and certain junior subordinated debentures, certain certificates of deposits and certain Other secured financings.

Fair Value Measurement Definition and Hierarchy. The Company adopted the provisions of SFAS No. 157, Fair Value Measurements (SFAS No. 157), effective December 1, 2006. Under this standard, fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (*i.e.*, the exit price) in an orderly transaction between market participants at the measurement date.

In determining fair value, the Company uses various valuation approaches. SFAS No. 157 establishes a hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available. Observable inputs are inputs that market participants would use in pricing the asset or liability developed based on market data obtained from sources independent of the Company. Unobservable inputs are inputs that reflect the Company s assumptions about the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. The hierarchy is broken down into three levels based on the reliability of inputs as follows:

Level 1 Valuations based on quoted prices in active markets for identical assets or liabilities that the Company has the ability to access. Valuation adjustments and block discounts are not applied to Level 1 instruments. Since valuations are based on quoted prices that are readily and regularly available in an active market, valuation of these products does not entail a significant degree of judgment.

Examples of assets and liabilities utilizing Level 1 inputs are: most U.S. Government securities; certain U.S. agency securities; certain other sovereign government obligations; and exchange-traded equity securities and listed derivatives that are actively traded.

Level 2 Valuations based on quoted prices in markets that are not active or for which all significant inputs are observable, either directly or indirectly.

Examples of assets and liabilities utilizing Level 2 inputs are: certain U.S. agency securities; municipal bonds; corporate bonds; certain corporate loans and loan commitments; certain residential and commercial mortgage-related instruments (including loans, securities and derivatives); most over-the-counter (OTC) derivatives; physical commodities; mortgage servicing rights; deposits; and most structured notes.

Level 3 Valuations based on inputs that are unobservable and significant to the overall fair value measurement.

Examples of assets and liabilities utilizing Level 3 inputs are: certain corporate loans and loan commitments; certain residential and commercial mortgage-related instruments (including loans, securities and derivatives); real estate and private equity investments; and long-dated or complex OTC derivatives.

The availability of observable inputs can vary from product to product and is affected by a wide variety of factors, including, for example, the type of product, whether the product is new and not yet established in the marketplace, and other characteristics particular to the transaction. To the extent that valuation is based on models or inputs that are less observable or unobservable in the market, the determination of fair value requires more judgment. Accordingly, the degree of judgment exercised by the Company in determining fair value is greatest for instruments categorized in Level 3. In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, for disclosure purposes the level in the fair value

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MORGAN STANLEY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

hierarchy within which the fair value measurement in its entirety falls is determined based on the lowest level input that is significant to the fair value measurement in its entirety.

Fair value is a market-based measure considered from the perspective of a market participant rather than an entity-specific measure. Therefore, even when market assumptions are not readily available, the Company s own assumptions are set to reflect those that market participants would use in pricing the asset or liability at the measurement date. The Company uses prices and inputs that are current as of the measurement date, including during periods of market dislocation. In periods of market dislocation, the observability of prices and inputs may be reduced for many instruments. This condition could cause an instrument to be reclassified from Level 1 to Level 2 or Level 2 to Level 3 (see Note 2).

Valuation Techniques. Many cash and OTC contracts have bid and ask prices that can be observed in the marketplace. Bid prices reflect the highest price that the Company and others are willing to pay for an asset. Ask prices represent the lowest price that the Company and others are willing to accept for an asset. For financial instruments whose inputs are based on bid-ask prices, the Company does not require that the fair value estimate always be a predetermined point in the bid-ask range. The Company s policy is to allow for mid-market pricing and adjusting to the point within the bid-ask range that meets the Company s best estimate of fair value. For offsetting positions in the same financial instrument, the same price within the bid-ask spread is used to measure both the long and short positions.

Fair value for many cash and OTC contracts is derived using pricing models. Pricing models take into account the contract terms (including maturity) as well as multiple inputs, including, where applicable, commodity prices, equity prices, interest rate yield curves, credit curves, creditworthiness of the counterparty, option volatility and currency rates. In accordance with SFAS No. 157, the impact of the Company s own credit spreads is also considered when measuring the fair value of liabilities, including OTC derivative contracts. Where appropriate, valuation adjustments are made to account for various factors, including bid-ask spreads, credit quality, market liquidity and the unit of account. These adjustments are subject to judgment, are applied on a consistent basis and are based upon observable inputs where available. The Company subjects all valuations and models to a review process on a periodic basis.

Financial Instruments Owned/Financial Instruments Sold, Not Yet Purchased U.S. Government and Agency Securities

U.S. Government Securities. U.S. government securities are valued using quoted market prices. Valuation adjustments are not applied. Accordingly, U.S. government securities are categorized in Level 1 of the fair value hierarchy.

U.S. Agency Securities. U.S. agency securities are comprised of two main categories consisting of agency issued debt and mortgage pass-throughs. Non-callable agency issued debt securities are generally valued using quoted market prices. To the extent these securities are actively traded, they are categorized in Level 1 of the fair value hierarchy. Callable agency issued debt securities are valued through benchmarking model derived prices to quoted market prices and trade data for identical or comparable securities. Mortgage pass-throughs include To-be-announced (TBA) securities and mortgage pass-through certificates. TBA securities are generally valued using quoted market prices or are benchmarked thereto. Fair value of mortgage pass-through certificates are model driven with respect to the comparable TBA security. Callable agency issued debt securities and mortgage pass-throughs are generally categorized in Level 2 of the fair value hierarchy.

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Financial Instrument Owned/Financial Instruments Sold, Not Yet Purchased Other Sovereign Government Obligations. The fair value of foreign sovereign government obligations is generally based on quoted prices in active markets. When quoted prices are not available, fair value is determined based on a valuation model that has as inputs interest rate yield curves, cross-currency basis index spreads, and country credit spreads for structures similar to the bond in terms of issuer, maturity and seniority. These bonds are generally categorized in Levels 1 or 2 of the fair value hierarchy.

Financial Instruments Owned/Financial Instruments Sold, Not Yet Purchased Corporate and Other Debt

Corporate Bonds. The fair value of corporate bonds is estimated using recently executed transactions, market price quotations (where observable), bond spreads or credit default swap spreads. The spread data used are for the same maturity as the bond. If the spread data do not reference the issuer, then data that reference a comparable issuer is used. When observable price quotations are not available, fair value is determined based on cash flow models with yield curves, bond or single name credit default swap spreads and recovery rates based on collateral values as key inputs. Corporate bonds are generally categorized in Level 2 of the fair value hierarchy; in instances where significant inputs are unobservable, they are categorized in Level 3 of the hierarchy.

Corporate Loans and Loan Commitments. The fair value of corporate loans is estimated using recently executed transactions, market price quotations (where observable) and market observable credit default swap levels along with proprietary valuation models and default recovery analysis where such transactions and quotations are unobservable. The fair value of contingent corporate loan commitments is estimated by using executed transactions on comparable loans and the anticipated market price based on pricing indications from syndicate banks and customers. The valuation of these commitments also takes into account certain fee income. While certain corporate loans, closed loan commitments and revolving loans are Level 2 instruments, certain other corporate loans and contingent corporate loan commitments are categorized in Level 3 of the fair value hierarchy.

Municipal Bonds. The fair value of municipal bonds is estimated using recently executed transactions, market price quotations and pricing models that factor in, where applicable, interest rates, bond or credit default swap spreads and volatility. These bonds are generally categorized in Level 2 of the fair value hierarchy.

Mortgage Loans. The valuation of mortgage loans depends upon the exit market for the loan. Loans not intended for securitization are valued based on the analysis of the underlying collateral performance, capital structure and market spreads for comparable positions as prices and/or spreads for specific credits tend to be unobservable. Where comparables do not exist, such loans are valued based on origination price and collateral performance (credit events) since origination. These loans are classified in Levels 2 or 3 of the fair value hierarchy.

The Company may hold certain loan products and mortgage products with the intent to securitize them. When structuring of the related securitization is substantially complete, 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 these products, the Company marks them to the expected securitized value. Factors affecting the value of loan and mortgage products intended to be securitized 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, updated cumulative loan loss data, prepayment rates, yields, investor demand, any significant market volatility since the last securitization, and credit enhancement. While these valuation factors may be supported by historical and actual external observations, the determination of their value as it relates to specific positions may require significant judgment. These instruments are classified in Levels 2 or 3 of the fair value hierarchy.

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Commercial Mortgage-Backed Securities (CMBS) and Asset-Backed Securities (ABS). CMBS and ABS may be valued based on external price/spread data. When position-specific external price data are not observable, the valuation is based on prices of comparable bonds. Valuation levels of ABS and CMBS indices are used as an additional data point for benchmarking purposes or to price outright index positions. CMBS and ABS are categorized in Level 3 if external prices or inputs are unobservable; otherwise they are categorized in Level 2 of the fair value hierarchy.

Retained Interests in Securitization Transactions. The Company engages in securitization activities related to various types of loans and bonds. The Company may retain interests in securitized financial assets in the form of one or more tranches of the securitization. To determine fair values, observable inputs are used if available. Observable inputs, however, may not be available for certain retained interests so the Company estimates fair value based on the present value of expected future cash flows using its best estimates of the key assumptions, including forecasted credit losses, prepayment rates, forward yield curves and discount rates commensurate with the risks involved. When there are no significant unobservable inputs, retained interests are categorized in Level 2 of the fair value hierarchy. When unobservable inputs are significant to the fair value measurement, albeit generally supportable by historical and actual benchmark data, retained interests are categorized in Level 3 of the fair value hierarchy.

Financial Instruments Owned/Financial Instruments Sold, Not Yet Purchased Corporate Equities

Exchange-Traded Equity Securities. Exchange-traded equity securities are generally valued based on quoted prices from the exchange. To the extent these securities are actively traded, valuation adjustments are not applied and they are categorized in Level 1 of the fair value hierarchy.

Financial Instruments Owned/Financial Instrument Sold, Not Yet Purchased Derivative Contracts

Listed Derivative Contracts. Listed derivatives that are actively traded are valued based on quoted prices from the exchange and are categorized in Level 1 of the fair value hierarchy. Listed derivatives that are not actively traded are valued using the same approaches as those applied to OTC derivatives; they are generally categorized in Level 2 of the fair value hierarchy.

OTC Derivative Contracts. OTC derivative contracts include forward, swap and option contracts related to interest rates, foreign currencies, credit standing of reference entities, equity prices or commodity prices.

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, and simulation models or a combination thereof. 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. In the case of more established derivative products, the pricing models used by the Company are widely accepted by the financial services industry. A substantial majority of OTC derivative products valued by the Company using pricing models fall into this category and are categorized within Level 2 of the fair value hierarchy.

Other derivative products, typically the newest and most complex products, require more judgment in the implementation of the valuation technique applied due to the complexity of the valuation assumptions and the reduced observability of inputs. This includes derivative interests in certain mortgage-related collateralized debt obligation (CDO) securities, mortgage-related credit default swaps, basket credit

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default swaps and CDO-squared positions where direct trading activity or quotes are unobservable. These instruments involve significant unobservable inputs and are categorized in Level 3 of the fair value hierarchy.

Derivative interests in mortgage-related CDOs, for which observability of external price data is extremely limited, are valued based on an evaluation of the market for similar positions as indicated by primary and secondary market activity in the cash CDO and synthetic CDO markets. Each position is evaluated independently taking into consideration the underlying collateral performance and pricing, behavior of the tranche under various cumulative loss and prepayment scenarios, deal structures (*e.g.*, non-amortizing reference obligations, call features) and liquidity. While these factors may be supported by historical and actual external observations, the determination of their value as it relates to specific positions nevertheless requires significant judgment.

Mortgage-related credit default swaps are valued based on data from comparable credit instruments in the cash market and trades in comparable swaps as benchmarks, as prices and spreads for the specific credits subject to valuation tend to be of limited observability.

For basket credit default swaps and CDO-squared positions, the correlation between reference credits is often a significant input into the pricing model, in addition to several other more observable inputs such as credit spread, interest and recovery rates. As the correlation input is unobservable for each specific swap, it is benchmarked to standardized proxy baskets for which external data are available.

The Company trades various derivative structures with commodity underlyings. Depending on the type of structure, the model inputs generally include interest rate yield curves, commodity underlier spread curves, volatility of the underlying commodities and, in some cases, the correlation between these inputs. The fair value of these products is estimated using executed trades and broker and consensus data to provide values for the aforementioned inputs. Where these inputs are unobservable, relationships to observable commodities and data points, based on historic and/or implied observations, are employed as a technique to estimate the model input values. Commodity derivatives are generally categorized in Level 2 of the fair value hierarchy; in instances where significant inputs are unobservable, they are categorized in Level 3 of the fair value hierarchy.

Financial Instruments Owned Investments

Investments in Private Equity and Real Estate. The Company s investments in private equity and real estate take the form of direct private equity investments and investments in private equity and real estate funds. The transaction price is used as the best estimate of fair value at inception. Thereafter, valuation is based on an assessment of each underlying investment, incorporating valuations that consider the evaluation of financing and sale transactions with third parties, expected cash flows and market-based information, including comparable company transactions, performance multiples and changes in market outlook, among other factors. These nonpublic investments are included in Level 3 of the fair value hierarchy because they trade infrequently, and, therefore, the fair value is unobservable.

Financial Instruments Owned/Financial Instruments Sold, Not Yet Purchased Physical Commodities. The Company trades various physical commodities, including crude oil and refined products, metals and agricultural products. Fair value for physical commodities is determined using observable inputs, including broker quotations and published indices. Physical commodities are categorized in Level 2 of the fair value hierarchy.

Deposits. The fair value of certificates of deposit is estimated using third-party quotations. These deposits are categorized in Level 2 of the fair value hierarchy.

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Commercial Paper and Other Short-term Borrowings/Long-Term Borrowings

Structured Notes. The Company issues structured notes that have coupons or repayment terms linked to the performance of debt or equity securities, indices, currencies or commodities. Fair value of structured notes is estimated using valuation models described in this section for the derivative and debt features of the notes. These models incorporate observable inputs referencing identical or comparable securities, including prices that the notes are linked to, interest rate yield curves, option volatility and currency rates. The impact of the Company s own credit spreads also is included based on the Company s observed secondary bond market spreads. Most structured notes are categorized in Level 2 of the fair value hierarchy.

Fair Value Measurement Other.

The fair value of OTC financial instruments, including derivative contracts related to financial instruments and commodities, is presented in the accompanying condensed consolidated statements of financial condition on a net-by-counterparty basis, when appropriate. Additionally, the Company nets fair value of cash collateral paid or received against fair value amounts recognized for net derivative positions executed with the same counterparty under the same master netting arrangement.

***Hedge Accounting*.**

The Company applies hedge accounting for hedges involving various derivative financial instruments and non-U.S. dollar-denominated debt used to hedge interest rate, foreign exchange and credit risk arising from assets and liabilities not held at fair value. These derivative financial instruments are included within Financial instruments owned Derivative contracts or Financial instruments sold, not yet purchased Derivative contracts in the condensed consolidated statements of financial condition.

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

For all hedges where hedge accounting is being applied, effectiveness testing and other procedures to ensure the ongoing validity of the hedges are performed at least monthly. The impact of hedge ineffectiveness on the condensed consolidated statements of income, primarily related to fair value hedges, was a gain of $98 million and $114 million for the quarter and six month period ended May 31, 2008, respectively, and $47 million and $60 million for the quarter and six month period ended May 31, 2007, respectively. The amount excluded from the assessment of hedge effectiveness was immaterial. If a derivative is de-designated as a hedge, it is thereafter accounted for as a financial instrument used for trading.

Fair Value Hedges Interest Rate Risk. In the first quarter of fiscal 2007, the Company began using regression analysis to perform an ongoing prospective and retrospective assessment of the effectiveness of these hedging relationships (*i.e.*, the Company applied the long-haul method of hedge accounting). A hedging relationship is deemed effective if the fair values of the hedging instrument (derivative) and the hedged item (debt liability) change inversely within a range of 80% to 125%. The Company considered the impact of valuation adjustments related to the Company s own credit spreads and counterparty credit spreads to determine whether they are material to the fair value of the individual derivatives designated in hedging relationships and whether they would cause the hedging relationship to be ineffective.

Previously, the Company s designated fair value hedges consisted primarily of interest rate swaps designated as fair value hedges of changes in the benchmark interest rate of fixed rate borrowings, including both certificates of

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deposit and senior long-term borrowings. For these hedges, the Company ensured that the terms of the hedging instruments and hedged items matched and that other accounting criteria were met so that the hedges were assumed to have no ineffectiveness (*i.e.*, the Company applied the shortcut method of hedge accounting). The Company also used interest rate swaps as fair value hedges of the benchmark interest rate risk of host contracts of equity-linked notes that contained embedded derivatives. For these hedging relationships, regression analysis was used for the prospective and retrospective assessments of hedge effectiveness.

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

Fair Value Hedges Credit Risk. Until the fourth quarter of fiscal 2007, the Company had designated a portion of a credit derivative embedded in a non-recourse structured note liability as a fair value hedge of the credit risk arising from a loan receivable to which the structured note liability was specifically linked. Regression analysis was used to perform prospective and retrospective assessments of hedge effectiveness for this hedge relationship. The changes in the fair value of the derivative and the changes in the fair value of the hedged item provided offset of one another and, together with any resulting ineffectiveness, were recorded in Principal transactions trading revenues. This hedge was terminated in the fourth quarter of fiscal 2007 upon derecognition of both the hedging instrument and the hedged item.

Cash Flow Hedges. The Company applies cash flow hedge accounting to interest rate swaps designated as hedges of the variability of future cash flows from floating rate liabilities due to the benchmark interest rate. The Company uses regression analysis to perform an ongoing prospective and retrospective assessment of the effectiveness of these hedging relationships. Changes in fair value of these interest rate swaps are recorded to Net change in cash flow hedges as a component of Accumulated other comprehensive income (loss) in Shareholders equity, net of tax effects, to the extent they are effective. Amounts recorded to Accumulated other comprehensive income (loss) are then reclassified to Interest expense as interest on the hedged borrowings is recognized. Any ineffective portion of the change in fair value of these instruments is recorded to Interest expense.

Before the sale of the aircraft leasing business in 2006, the Company applied hedge accounting to interest rate swaps used to hedge variable rate long-term borrowings associated with this business. Changes in the fair value of the swaps were recorded in Accumulated other comprehensive income (loss) in Shareholders equity, net of tax effects, and then reclassified to Interest expense as interest on the hedged borrowings was recognized.

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

Net Investment Hedges. The Company utilizes forward foreign exchange contracts and non-U.S. dollar-denominated debt to manage the currency exposure relating to its net investments in non-U.S. dollar functional currency operations. No hedge ineffectiveness is recognized in earnings since the notional amounts of the hedging instruments equal the portion of the investments being hedged, and, where forward contracts are used, the currencies being exchanged are the functional currencies of the parent and investee; where debt instruments

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are used as hedges, they are denominated in the functional currency of the investee. The gain or loss from revaluing hedges of net investments in foreign operations at the spot rate is deferred and reported within Accumulated other comprehensive income (loss) in Shareholders equity, net of tax effects. The forward points on the hedging instruments are recorded in Interest and dividend revenues.

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 connection with business acquisitions, the Company assumed liabilities of $77 million and $7,679 million in the six month periods ended May 31, 2008 and 2007, respectively. At May 31, 2008, the Company consolidated real estate limited partnership assets and liabilities of approximately $4.6 billion and $3.8 billion, respectively.

Securitization Activities.

The Company engages in securitization activities related to commercial and residential mortgage loans, corporate bonds and loans, U.S. agency collateralized mortgage obligations and other types of financial assets (see Note 4). Generally, such transfers of financial assets are accounted for as sales when the Company has relinquished control over the transferred assets. The gain or loss on sale of such 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. Transfers that are not accounted for as sales are accounted for as secured borrowings.

Gains (losses) from Unconsolidated Investees.

The Company invests in unconsolidated investees that provide funds to develop low income communities, renewable energy sources and other structured transactions. These structures provide the Company with tax benefits and are not integral to the operations of the Company. The Company accounts for these investments under the equity method with gains and losses from these investments recorded within Gains (losses) from unconsolidated investees and the applicable tax credits, expenses and benefits recorded within Provision for income taxes.

Deferred Compensation Arrangements.

The Company also maintains various deferred compensation plans for the benefit of certain employees that provide a return to the participating employees based upon the performance of various referenced investments. The Company often invests directly, as a principal, in such referenced investments related to its obligations to perform under the deferred compensation plans. Changes in value of such investments made by the Company are recorded primarily in Principal transactions Investments. Expenses associated with the related deferred compensation plans are recorded in Compensation and benefits.

Accounting Developments.

Accounting for Uncertainty in Income Taxes. In July 2006, the Financial Accounting Standards Board (the FASB) issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109 (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in a company s financial statements and prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in an

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income tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. As a result of the adoption of FIN 48 on December 1, 2007, the Company recorded a cumulative effect adjustment of approximately $92 million as a decrease to the opening balance of Retained earnings as of December 1, 2007 (see Note 12).

Employee Benefit Plans. In September 2006, the FASB issued SFAS No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132(R) (SFAS No. 158). In fiscal 2007, the Company adopted SFAS No. 158 s requirement to recognize the overfunded or underfunded status of its defined benefit and postretirement plans as an asset or liability. In the first quarter of fiscal 2008, the Company recorded an after-tax charge of approximately $13 million ($21 million pre-tax) to Shareholders equity upon early adoption of SFAS No. 158 s other requirement to use the fiscal year-end date as the measurement date.

Offsetting of Amounts Related to Certain Contracts. In April 2007, the FASB issued FASB Staff Position (FSP) No. FIN 39-1, Amendment of FASB Interpretation No. 39 , (FSP FIN 39-1). FSP FIN 39-1 amends certain provisions of FIN 39, Offsetting of Amounts Related to Certain Contracts, and permits companies to offset fair value amounts recognized for cash collateral receivables or payables against fair value amounts recognized for net derivative positions executed with the same counterparty under the same master netting arrangement. In accordance with the provisions of FSP FIN 39-1, the Company offset cash collateral receivables and payables against net derivative positions as of May 31, 2008. The adoption of FSP FIN 39-1 on December 1, 2007 did not have a material impact on the Company s condensed consolidated financial statements.

Dividends on Share-Based Payment Awards. In June 2007, the Emerging Issues Task Force (EITF) reached consensus on Issue No. 06-11, Accounting for Income Tax Benefits of Dividends on Share-Based Payment Awards (EITF Issue No. 06-11). EITF Issue No. 06-11 requires that the tax benefit related to dividend equivalents paid on restricted stock units that are expected to vest be recorded as an increase to additional paid-in capital. The Company currently accounts for this tax benefit as a reduction to its income tax provision. EITF Issue No. 06-11 is to be applied prospectively for tax benefits on dividends declared in fiscal years beginning after December 15, 2007. The Company does not expect the adoption of EITF Issue No. 06-11 to have a material impact on the Company s condensed consolidated financial statements.

Business Combinations. In December 2007, the FASB issued SFAS No. 141(R), Business Combinations (SFAS No. 141(R)). SFAS 141(R) requires the acquiring entity in a business combination to recognize the full fair value of assets acquired and liabilities assumed in the transaction (whether a full or partial acquisition); establishes the acquisition-date fair value as the measurement objective for all assets acquired and liabilities assumed; requires expensing of most transaction and restructuring costs; and requires the acquirer to disclose to investors and other users all of the information needed to evaluate and understand the nature and financial effect of the business combination. SFAS No. 141(R) applies to all transactions or other events in which the Company obtains control of one or more businesses, including those sometimes referred to as true mergers or mergers of equals and combinations achieved without the transfer of consideration, for example, by contract alone or through the lapse of minority veto rights. SFAS No. 141(R) applies prospectively to business combinations for which the acquisition date is on or after December 1, 2009.

Noncontrolling Interests. In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements an amendment of Accounting Research Bulletin No. 51 (SFAS No. 160). SFAS No. 160 requires reporting entities to present noncontrolling (minority) interests as equity (as opposed to as a liability or mezzanine equity) and provides guidance on the accounting for transactions between an entity

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and noncontrolling interests. SFAS No. 160 applies prospectively as of December 1, 2009, except for the presentation and disclosure requirements which will be applied retrospectively for all periods presented. The Company is currently evaluating the potential impact of adopting SFAS No. 160.

ASF Framework. In December 2007, the American Securitization Forum (ASF) issued the Streamlined Foreclosure and Loss Avoidance Framework for Securitized Subprime Adjustable Rate Mortgage Loans (the ASF Framework). The overall purpose of the ASF Framework is to provide recommended guidance for servicers to streamline borrower evaluation procedures and to facilitate the effective use of all forms of foreclosure and loss prevention efforts, including refinancings, forbearances, workout plans, loan modifications, deeds-in-lieu and short sales or short payoffs. The ASF Framework is focused on subprime first-lien adjustable rate residential mortgages loans that have an initial fixed rate period of 36 months or less, are included in securitized pools, were originated between January 1, 2005 and July 31, 2007, and have an initial interest rate reset date between January 1, 2008 and July 31, 2010 (subprime ARM loans).

The ASF Framework categorizes the population of subprime ARM loans into three segments. Segment 1 includes current loans, as defined, where the borrower is likely to be able to refinance into an available mortgage product. It is expected that borrowers in this category should refinance their loans, if they are unable or unwilling to meet their reset payment. Segment 2 includes current loans where the borrower is unlikely to be able to refinance and meet specific criteria related to Fair Isaac Corporation (or FICO) scores and the expected payment increase due to the initial adjustment of the interest rate. Borrowers in this segment are eligible for a fast track loan modification under which the interest rate will be kept at the existing rate, generally for five years following the upcoming reset. The ASF Framework indicates that for Segment 2 loans, the servicer can presume that the borrower would be unable to pay pursuant to the original terms of the loan after the interest rate reset, and thus, borrower default on the loan is reasonably foreseeable in absence of a modification. Segment 3 includes loans where the borrower is not current or which do not otherwise qualify for Segment 1 or Segment 2. For loans in this category, the servicer will determine the appropriate loss mitigation approach in a manner consistent with the applicable servicing standard in the transaction documents, but without employing the fast track procedures described under Segment 2.

In January 2008, the Office of Chief Accountant (the OCA) of the Securities and Exchange Commission (the SEC) issued a letter (the OCA Letter) addressing accounting issues that may be raised by the ASF Framework. The OCA letter concluded that the SEC would not object to continuing off-balance sheet accounting treatment for QSPEs that hold Segment 2 subprime ARM loans modified pursuant to the ASF Framework.

For those current loans that are accounted for off-balance sheet that are modified, but not as part of the ASF Framework above, the servicer must perform on an individual basis an analysis of the borrower and the loan to provide sufficient evidence to demonstrate that default on the loan is imminent or reasonably foreseeable.

The Company adopted the ASF Framework during the first quarter of fiscal 2008, but has not yet modified a significant volume of loans using the ASF Framework. The Company does not expect that its application of the ASF Framework will impact the off-balance sheet status of Company-sponsored QSPEs that hold Segment 2 subprime ARM loans and is currently evaluating the potential impact on its condensed consolidated statements of income. The total amount of assets owned by Company-sponsored QSPEs that hold subprime ARM loans (including those loans that are not serviced by the Company) as of May 31, 2008, was approximately $39.3 billion. Of this amount, approximately $15.0 billion relates to subprime ARM loans serviced by the Company. The Company s retained interests in Company sponsored QSPEs that hold subprime ARM loans totaled approximately $68 million as of May 31, 2008.

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Transfers of Financial Assets and Repurchase Financing Transactions. In February 2008, the FASB issued FSP FAS 140-3, Accounting for Transfers of Financial Assets and Repurchase Financing Transactions (FSP FAS No. 140-3). The objective of FSP FAS 140-3 is to provide implementation guidance on accounting for a transfer of a financial asset and repurchase financing. Under the guidance in FSP FAS 140-3, there is a presumption that an initial transfer of a financial asset and a repurchase financing are considered part of the same arrangement (*i.e.,* a linked transaction) for purposes of evaluation under SFAS No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities (SFAS No. 140). If certain criteria are met, however, the initial transfer and repurchase financing shall not be evaluated as a linked transaction and shall be evaluated separately under SFAS No. 140. FSP FAS 140-3 is effective for the Company on December 1, 2008. The Company is currently evaluating the potential impact of adopting FSP FAS 140-3.

Disclosures about Derivative Instruments and Hedging Activities. In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities (SFAS No. 161). SFAS No. 161 amends and expands the disclosure requirements of SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities , and requires entities to provide enhanced qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair values and amounts of gains and losses on derivative contracts, and disclosures about credit-risk-related contingent features in derivative agreements. SFAS No. 161 will be effective for the Company s fiscal 2009 interim and annual consolidated financial statements.

Determination of the Useful Life of Intangible Assets. In April 2008, the FASB issued FSP FAS 142-3, Determination of the Useful Life of Intangible Assets (FSP FAS 142-3). FSP FAS 142-3 removes the requirement of SFAS No. 142, Goodwill and Other Intangible Assets (SFAS No. 142) for an entity to consider, when determining the useful life of an acquired intangible asset, whether the intangible asset can be renewed without substantial cost or material modifications to the existing terms and conditions associated with the intangible asset. FSP FAS 142-3 replaces the previous useful-life assessment criteria with a requirement that an entity considers its own experience in renewing similar arrangements. If the entity has no relevant experience, it would consider market participant assumptions regarding renewal. FSP FAS 142-3 is effective for the Company on December 1, 2009. The Company is currently evaluating the potential impact of adopting FSP FAS 142-3.

Earnings Per Share. In June 2008, the FASB issued FSP EITF 03-6-1, Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities (FSP EITF 03-6-1). FSP EITF 03-6-1 addresses whether instruments granted in share-based payment transactions are participating securities prior to vesting and, therefore, need to be included in the earnings allocation in computing earnings per share under the two-class method as described in SFAS No. 128, Earnings per Share. Under the guidance in FSP EITF 03-6-1, unvested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and shall be included in the computation of earnings per share pursuant to the two-class method. FSP EITF 03-6-1 is effective for the Company on December 1, 2009. All prior-period earnings per share data presented shall be adjusted retrospectively. Early application is not permitted. The Company is currently evaluating the potential impact of adopting FSP EITF 03-6-1.

QSPEs. In April 2008, the FASB voted to eliminate QSPEs from the guidance in SFAS No. 140. Although the revised standard has not been finalized, this change may have a significant impact on the Company s condensed consolidated financial statements as the Company may be required to consolidate assets previously sold to a QSPE, and may not be able to derecognize assets sold to similar types of structures after the revised standard is issued. This proposed revision could be effective as early as December 2008.

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In connection with the proposed changes to SFAS No. 140, the FASB also is proposing three key changes to the consolidation model in FASB Interpretation No. 46, as revised (FIN 46R), Consolidation of Variable Interest Entities. First, the FASB will now include former QSPEs in the scope of FIN 46R. In addition, the FASB supports amending FIN 46R to change the method of analyzing which party to a VIE should consolidate the VIE to a primarily qualitative determination of control instead of the current risks and rewards model. Finally, the proposed amendment is expected to require all VIEs and their primary beneficiaries to be reevaluated quarterly. The current rules require reconsideration only when specified reconsideration events occur.

The Company will be evaluating the impact of these changes on the Company s condensed consolidated financial statements once the actual guidelines are finalized.

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2. Fair Value Disclosures.

Fair Value Measurements.

The Company s assets and liabilities recorded at fair value have been categorized based upon a fair value hierarchy in accordance with SFAS No. 157. See Note 1 for a discussion of the Company s policies regarding this hierarchy.

The following fair value hierarchy tables present information about the Company s assets and liabilities measured at fair value on a recurring basis as of May 31, 2008 and November 30, 2007:

Assets and Liabilities Measured at Fair Value on a Recurring Basis as of May 31, 2008

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Counterparty and Cash Collateral Netting	Balance as of May 31, 2008
			(dollars in millions)		
Assets					
Cash and securities deposited with clearing organizations or segregated under federal and other regulations or requirements	$ 15,270	$	$	$	$ 15,270
Financial instruments owned:					
U.S. government and agency securities	8,231	17,993	274		26,498
Other sovereign government obligations	26,530	5,909	28		32,467
Corporate and other debt	91	101,177	29,675		130,943
Corporate equities	81,608	6,246	1,221		89,075
Derivative contracts(1)	2,264	130,429	25,276	(65,664)	92,305
Investments	839	1,892	12,720		15,451
Physical commodities		3,654			3,654
Total financial instruments owned	119,563	267,300	69,194	(65,664)	390,393
Securities received as collateral	20,320	5,204	4		25,528
Intangible assets(2)		344			344
Liabilities					
Commercial paper and other short-term borrowings	$	$ 6,427	$	$	$ 6,427
Deposits		35			35
Financial instruments sold, not yet purchased:					
U.S. government and agency securities	10,700	578			11,278
Other sovereign government obligations	12,219	6,814			19,033
Corporate and other debt	10	5,898	876		6,784
Corporate equities	46,026	486	120		46,632
Derivative contracts(1)	2,582	109,338	11,127	(45,608)	77,439
Physical commodities		582			582
Total financial instruments sold, not yet purchased	71,537	123,696	12,123	(45,608)	161,748

Obligation to return securities received as collateral	20,320	5,204	4		25,528
Other secured financings		24,906	3,331		28,237
Long-term borrowings		39,687	5,815		45,502

(1) For positions with the same counterparty that cross over the levels of the fair value hierarchy, both counterparty netting and cash collateral netting are included in the column titled Counterparty and Cash Collateral Netting . For contracts with the same counterparty, counterparty netting among positions classified within the same level is included within that level.

(2) Amount represents mortgage servicing rights (MSRs) accounted for at fair value (see Note 4).

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(UNAUDITED)

Assets and Liabilities Measured at Fair Value on a Recurring Basis as of November 30, 2007

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Counterparty and Cash Collateral Netting	Balance as of November 30, 2007
			(dollars in millions)		
Assets					
Cash and securities deposited with clearing organizations or segregated under federal and other regulations or requirements	$ 31,354	$	$	$	$ 31,354
Financial instruments owned:					
U.S. government and agency securities	11,038	12,189	660		23,887
Other sovereign government obligations	15,834	5,743	29		21,606
Corporate and other debt	223	110,443	37,058		147,724
Corporate equities	82,592	3,549	1,236		87,377
Derivative contracts(1)	4,526	90,654	21,601	(39,778)	77,003
Investments	953	249	13,068		14,270
Physical commodities		3,096			3,096
Total financial instruments owned	115,166	225,923	73,652	(39,778)	374,963
Securities received as collateral	68,031	14,191	7		82,229
Intangible assets(2)		428			428
Liabilities					
Commercial paper and other short-term borrowings	$	$ 3,068	$	$	$ 3,068
Deposits		3,769			3,769
Financial instruments sold, not yet purchased:					
U.S. government and agency securities	8,208	13			8,221
Other sovereign government obligations	9,633	5,994			15,627
Corporate and other debt	16	6,454	1,122		7,592
Corporate equities	29,948	935	16		30,899
Derivative contracts(1)	7,031	86,968	15,663	(38,058)	71,604
Physical commodities		398			398
Total financial instruments sold, not yet purchased	54,836	100,762	16,801	(38,058)	134,341
Obligation to return securities received as collateral	68,031	14,191	7		82,229
Other secured financings		25,451	2,321		27,772
Long-term borrowings		37,994	398		38,392

(1) For positions with the same counterparty that cross over the levels of the fair value hierarchy, both counterparty netting and cash collateral netting are included in the column titled Counterparty and Cash Collateral Netting . For contracts with the same counterparty, counterparty netting among positions classified within the same level is included within that level.

(2) Amount represents MSRs accounted for at fair value (see Note 4).

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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The following tables present additional information about Level 3 assets and liabilities measured at fair value on a recurring basis. Level 3 instruments may be hedged with instruments classified in Level 1 and Level 2. As a result, the realized and unrealized gains and losses for assets and liabilities within the Level 3 category presented in the tables below do not reflect the related realized or unrealized gains and losses on hedging instruments that have been classified by the Company within the Level 1 and/or Level 2 categories. Additionally, both observable and unobservable inputs may be used to determine the fair value of positions that the Company has classified within the Level 3 category. As a result, the unrealized gains and losses for assets and liabilities within the Level 3 category presented in the tables below may include changes in fair value that were attributable to both observable (*e.g.*, changes in market interest rates) and unobservable (*e.g.*, changes in unobservable long-dated volatilities) inputs.

Changes in Level 3 Assets and Liabilities Measured at Fair Value on a Recurring Basis for the Three Months Ended May 31, 2008

	Beginning Balance	Realized Gains or (Losses)(1)	Unrealized Gains or (Losses)(1)	Total Realized and Unrealized Gains or (Losses)(1)	Purchases, Sales, Other Settlements and Issuances, net	Net Transfers In and/or (Out) of Level 3	Ending Balance
				(dollars in millions)			
Assets							
Financial instruments owned:							
U.S. government and agency securities	$ 581	$ (8)	$ (8)	$ (16)	$ (245)	$ (46)	$ 274
Other sovereign government obligations	15	4	(5)	(1)		14	28
Corporate and other debt(2)(3)	31,622	29	(1,563)	(1,534)	(1,824)	1,411	29,675
Corporate equities	1,957	(110)	18	(92)	(548)	(96)	1,221
Net derivative contracts(2)(3)(4)	15,841	5	(2,536)	(2,531)	3,967	(3,128)	14,149
Investments	12,070	(6)	(160)	(166)	845	(29)	12,720
Securities received as collateral	13				(9)		4
Liabilities							
Financial instruments sold, not yet purchased:							
Corporate and other debt	$ 604	$ 71	$ 353	$ 424	$ 730	$ (34)	$ 876
Corporate equities	552	(16)	(200)	(216)	(394)	(254)	120
Obligation to return securities received as collateral	13				(9)		4
Other secured financings	1,616				1,715		3,331
Long-term borrowings	5,964	(8)	155	147	34	(36)	5,815

(1) Realized and unrealized gains (losses) are primarily included in Principal transactions trading in the condensed consolidated statements of income. Unrealized gains (losses) relate to Level 3 assets and liabilities still held by the Company at May 31, 2008.

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(UNAUDITED)

(2) The net losses from Corporate and other debt were primarily due to writedowns on certain asset-backed securities and collateralized debt obligation (CDO) cash positions.

The net losses from Net derivative contracts were primarily driven by bespoke basket default swaps, writedowns on super senior CDO positions and losses from proprietary trading.

These results are only a component of the overall trading strategies of these businesses and do not take into consideration any related financial instruments that have been classified by the Company within the Level 1 and/or Level 2 categories. For example, the Company recorded gains on single name credit default swaps recorded in Level 2 Net derivative contracts.

(3) The Company reclassified certain Corporate and other debt from Level 2 to Level 3. These reclassifications included transfers primarily related to certain commercial mortgage backed securities, commercial whole loans and corporate loans and loan commitments. The reclassifications were due to a reduction in the volume of recently executed transactions and market price quotations for these instruments such that the inputs for these instruments became unobservable. Partially offsetting the reclassifications to Level 3 were reclassifications from Level 3 to Level 2 of certain Corporate and other debt. These reclassifications included transfers primarily related to corporate loans and loan commitments as some liquidity re-entered the market for these specific positions and inputs for these instruments became observable. The Company reclassified certain OTC derivatives from Level 3 to Level 2. These reclassifications included transfers primarily related to tranche index default swaps as inputs became observable.

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

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

	Beginning Balance	Realized Gains or (Losses)(1)	Unrealized Gains or (Losses)(1)	Total Realized and Unrealized Gains or (Losses)(1)	Purchases, Sales, Other Settlements and Issuances, net	Net Transfers In and/or (Out) of Level 3	Ending Balance
	(dollars in millions)						
Assets							
Financial instruments owned:							
U.S. government and agency securities	$ 148	$ (4)	$	$ (4)	$ (73)	$ (8)	$ 63
Other sovereign government obligations	911	(6)	(19)	(25)	(862)		24
Corporate and other debt	36,351	(1,060)	(152)	(1,212)	88	37	35,264
Corporate equities	1,239	(93)	181	88	188	(11)	1,504
Net derivative contracts(2)	276	(252)	1,513	1,261	116	265	1,918
Investments	6,176	289	565	854	1,611	(113)	8,528
Other assets	2,268		36	36	142		2,446
Liabilities							
Financial instruments sold, not yet purchased:							
Corporate and other debt	$ 68	$ (92)	$ (3)	$ (95)	$ (219)	$ 145	$ 89
Corporate equities	15	5	(15)	(10)	38		63
Other secured financings	6,088				2,260		8,348
Long-term borrowings	544	(1)	(50)	(51)	(149)		446

(1) Realized and unrealized gains (losses) are included in Principal transactions trading in the condensed consolidated statements of income except for amounts of $852 million and $2 million related to Financial instruments owned investments, which are included in Principal transactions investments and Other revenues, respectively. In addition, $36 million related to Other assets is associated with DFS and included in discontinued operations. Unrealized gains (losses) relate to Level 3 asset and liabilities still held by the Company at May 31, 2007.

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

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

Changes in Level 3 Assets and Liabilities Measured at Fair Value on a Recurring Basis for the Six Months Ended May 31, 2008

	Beginning Balance	Realized Gains or (Losses)(1)	Unrealized Gains or (Losses)(1)	Total Realized and Unrealized Gains or (Losses)(1)	Purchases, Sales, Other Settlements and Issuances, net	Net Transfers In and/or (Out) of Level 3	Ending Balance
				(dollars in millions)			
Assets							
Financial instruments owned:							
U.S. government and agency securities	$ 660	$ (2)	$ 45	$ 43	$ (374)	$ (55)	$ 274
Other sovereign government obligations	29	3	(5)	(2)	1		28
Corporate and other debt(2)(3)	37,058	1,236	(4,976)	(3,740)	(6,238)	2,595	29,675
Corporate equities	1,236	(96)	15	(81)	271	(205)	1,221
Net derivative contracts(2)(4)	5,938	217	5,855	6,072	5,031	(2,892)	14,149
Investments(5)	13,068	(1)	(239)	(240)	1,625	(1,733)	12,720
Securities received as collateral	7				(3)		4
Liabilities							
Financial instruments sold, not yet purchased:							
Corporate and other debt(2)	$ 1,122	$ 51	$ (146)	$ (95)	$ (305)	$ (36)	$ 876
Corporate equities	16	(29)	(292)	(321)	33	(250)	120
Obligation to return securities received as collateral	7				(3)		4
Other secured financings	2,321				1,010		3,331
Long-term borrowings(6)	398	(8)	13	5	5,590	(168)	5,815

(1) Realized and unrealized gains (losses) are primarily included in Principal transactions trading in the condensed consolidated statements of income. Unrealized gains (losses) relate to Level 3 assets and liabilities still held by the Company at May 31, 2008.

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

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

(3) The Company reclassified certain Corporate and other debt from Level 2 to Level 3 because certain significant inputs for the fair value measurement became unobservable. These reclassifications included transfers primarily related to corporate loans and loan commitments. The Company reclassified certain OTC derivatives from Level 3 to Level 2. These reclassifications included transfers primarily related to tranche index default swaps as inputs became observable.

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

(5) The Company reclassified investments from Level 3 to Level 2 because certain significant inputs for the fair value measurement were identified and, therefore, became observable.

(6) Amounts included in the Purchases, sales, other settlements and issuances, net column primarily relates to the issuance of junior subordinated debentures related to China Investment Corporation investment (see Note 9).

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(UNAUDITED)

Changes in Level 3 Assets and Liabilities Measured at Fair Value on a Recurring Basis for the Six Months Ended May 31, 2007

	Beginning Balance	Realized Gains or (Losses)(1)	Unrealized Gains or (Losses)(1)	Total Realized and Unrealized Gains or (Losses)(1)	Purchases, Sales, Other Settlements and Issuances, net	Net Transfers In and/or (Out) of Level 3	Ending Balance
				(dollars in millions)			
Assets							
Financial instruments owned:							
U.S. government and agency securities	$ 2	$ (4)	$ (6)	$ (10)	$ 79	$ (8)	$ 63
Other sovereign government obligations	162	3	7	10	(148)		24
Corporate and other debt(2)	33,941	(1,001)	(216)	(1,217)	2,546	(6)	35,264
Corporate equities	1,040	(208)	333	125	358	(19)	1,504
Net derivative contracts(2)(3)	30	(760)	2,568	1,808	(219)	299	1,918
Investments(4)	3,879	306	1,128	1,434	3,341	(126)	8,528
Securities received as collateral	40				(40)		
Other assets	2,154		32	32	260		2,446
Liabilities							
Financial instruments sold, not yet purchased:							
Corporate and other debt(2)	$ 185	$ (103)	$	$ (103)	$ (386)	$ 187	$ 89
Corporate equities	9	(4)	(6)	(10)	39	5	63
Obligation to return securities received as collateral	40				(40)		
Other secured financings	4,724				3,624		8,348
Long-term borrowings	464	(6)	(98)	(104)	(122)		446

(1) Realized and unrealized gains (losses) are included in Principal transactions trading in the condensed consolidated statements of income except for amounts of $1,423 million and $11 million related to Financial instruments owned investments, which are included in Principal transactions investments and Other revenues. In addition, the $32 million related to Other assets is associated with DFS and included in discontinued operations. Unrealized gains (losses) relate to Level 3 assets and liabilities still held by the Company at May 31, 2007.

(2) The net gains from Net derivative contracts and net losses from Corporate and other debt resulted from market movements primarily associated with credit products and various credit linked instruments, respectively. Such results are only a component of the overall trading strategies of the credit products business, and do not take into consideration any related financial instruments that have been classified by the Company within Level 1 and/or Level 2 categories.

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

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

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Fair Value Option.

The following tables present gains and (losses) due to changes in fair value for items measured at fair value pursuant to the fair value option election for the quarters and six month periods ended May 31, 2008 and 2007. In addition to the amounts below, as discussed in Note 1, all of the instruments within Financial instruments owned or Financial instruments sold, not yet purchased are measured at fair value, either through the election of SFAS No. 159 or as required by other accounting pronouncements. Changes in the fair value of these instruments are recorded in Principal transactions trading and Principal transactions investments revenues.

Three months ended May 31, 2008	Principal Transactions: Trading	Net Interest Revenue	Gains (losses) Included in the Three Months Ended May 31, 2008
		(dollars in millions)	
Commercial paper and other short-term borrowings	$ (57)	$	$ (57)
Deposits	(3)		(3)
Long-term borrowings	(80)	(330)	(410)

Three months ended May 31, 2007	Principal Transactions: Trading	Net Interest Revenue	Gains (losses) Included in the Three Months Ended May 31, 2007
		(dollars in millions)	
Commercial paper and other short-term borrowings	$ (95)	$ (5)	$ (100)
Deposits	(3)		(3)
Long-term borrowings	(160)	(129)	(289)

Six months ended May 31, 2008	Principal Transactions: Trading	Net Interest Revenue	Gains (losses) Included in the Six Months Ended May 31, 2008
		(dollars in millions)	
Commercial paper and other short-term borrowings	$ 151	$ (2)	$ 149
Deposits	(9)		(9)
Long-term borrowings	384	(528)	(144)

Six months ended May 31, 2007	Principal Transactions: Trading	Net Interest Revenue	Gains (losses) Included in the Six Months Ended May 31, 2007
		(dollars in millions)	
Commercial paper and other short-term borrowings	$ (100)	$ (5)	$ (105)
Deposits	1		1
Long-term borrowings	(24)	(178)	(202)

As of May 31, 2008 and November 30, 2007, the aggregate contractual principal amount of loans for which the fair value option was elected exceeded the fair value of such loans by approximately $28,984 million and $28,880 million, respectively. The aggregate fair value of loans that were 90 or more days past due as of May 31, 2008 and November 30, 2007 was $3,404 million and $6,588 million, respectively. The aggregate contractual principal amount of such loans 90 or more days past due exceeded their fair value by approximately $21,444 million and $23,501 million at May 31, 2008 and November 30, 2007, respectively. This difference in amount primarily emanates from the Company s distressed debt trading business, which purchases distressed debt at amounts well below par.

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For the quarter and six month period ended May 31, 2008, changes in the fair value of loans for which the fair value option was elected that were attributable to changes in instrument-specific credit spreads were a gain of $346 million and a loss of $1,292 million, respectively. Instrument-specific credit losses were determined by excluding the non-credit components of gains and losses, such as those due to changes in interest rates. For the quarter and six month period ended May 31, 2007, changes in the fair value of loans for which the fair value option was elected that were attributable to changes in instrument-specific credit spreads were estimated to be an immaterial unrealized loss.

For the quarter and six month period ended May 31, 2008, the estimated changes in the fair value of the Company s short-term and long-term borrowings, including structured notes and junior subordinated debentures, for which the fair value option was elected that were attributable to changes in instrument-specific credit spreads were gains of approximately $99 million and $996 million, respectively. The gains were attributable to the widening of the Company s credit spreads and was determined based upon observations of the Company s secondary bond market spreads. For the quarter and six month period ended May 31, 2007, the estimated changes in the fair value of the Company s short-term and long-term borrowings, including structured notes and junior subordinated debentures, for which the fair value option was elected that were attributable to changes in instrument-specific credit spreads were not material. As of May 31, 2008 and November 30, 2007, the aggregate contractual principal amount of long-term debt instruments for which the fair value option was elected exceeded the fair value of such instruments by approximately $3,321 million and $1,572 million, respectively.

The estimated change in the fair value of other liabilities for which the fair value option was elected that was attributable to changes in instrument-specific credit spreads were gains of approximately $156 million and $114 million, respectively, in the quarter and six month period ended May 31, 2008. The gains were primarily related to leveraged loan contingent commitments. The gains were generally determined based on the differential between estimated expected client yields at May 31, 2008 and contractual yields. For the quarter and six month period ended May 31, 2007, the estimated changes in the fair value of other liabilities for which the fair value option was elected that were attributable to changes in instrument-specific credit spreads were not material.

3. Collateralized Transactions.

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

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(UNAUDITED)

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

	At May 31, 2008	At November 30, 2007
	(dollars in millions)	
Financial instruments owned:		
U.S. government and agency securities	$ 6,199	$ 7,134
Other sovereign government obligations	5,946	333
Corporate and other debt	37,337	32,530
Corporate equities	5,010	1,133
Total	$ 54,492	$ 41,130

The Company enters into reverse repurchase agreements, repurchase agreements, securities borrowed and securities loaned transactions to, among other things, acquire securities to cover short positions and settle other securities obligations, to accommodate customers needs and to finance the Company s inventory positions. The Company also engages in securities financing transactions for customers through margin lending. Under these agreements and transactions, the Company either receives or provides collateral, including U.S. government and agency securities, other sovereign government obligations, corporate and other debt, and corporate equities. The Company receives collateral in the form of securities in connection with reverse repurchase agreements, securities borrowed and derivative transactions, and customer margin loans. In many cases, the Company is permitted to sell or repledge these securities held as collateral and use the securities to secure repurchase agreements, to enter into securities lending and derivative transactions or for delivery to counterparties to cover short positions. At May 31, 2008 and November 30, 2007, the fair value of securities received as collateral where the Company is permitted to sell or repledge the securities was $953 billion and $948 billion, respectively, and the fair value of the portion that had been sold or repledged was $711 billion and $708 billion, respectively.

The Company additionally receives securities as collateral in connection with certain securities for securities transactions in which the Company is the lender. In instances where the Company is permitted to sell or repledge these securities, the Company reports the fair value of the collateral received and the related obligation to return the collateral in the condensed consolidated statements of financial condition. At May 31, 2008 and November 30, 2007, $26 billion and $82 billion, respectively, were reported as Securities received as collateral and an Obligation to return securities received as collateral in the condensed consolidated statements of financial condition. Collateral received in connection with these transactions that was subsequently repledged was approximately $23 billion and $72 billion at May 31, 2008 and November 30, 2007, 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

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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.

4. Securitization Activities and Variable Interest Entities.

Securitization Activities. The Company engages in securitization activities related to commercial and residential mortgage loans, U.S. agency collateralized mortgage obligations, corporate bonds and loans, municipal bonds and other types of financial assets. Special purpose entities (SPEs), also known as VIEs, are typically used in such securitization transactions. The Company does not consolidate certain securitization vehicles, commonly known as QSPEs, if they meet certain criteria regarding the types of assets and derivatives they may hold, the types of sales they may engage in and the range of discretion they may exercise in connection with the assets they hold. The determination of whether an SPE meets the criteria to be a QSPE requires considerable judgment, particularly in evaluating whether the permitted activities of the SPE are significantly limited and in determining whether derivatives held by the SPE are passive and nonexcessive. See Note 1 for further information on QSPEs.

The following table presents the total assets of and retained interests in QSPEs to which the Company acting as principal, has transferred assets and received sales treatment:

	At May 31, 2008	
	QSPE Assets	Retained Interests
	(dollars in millions)	
Residential mortgage loans	$ 74,662	$ 1,055
Commercial mortgage loans	115,109	662
U.S. agency collateralized mortgage obligations	29,869	228
Other	3,826	
Total	$ 223,466	$ 1,945

Transferred assets are carried at fair value prior to securitization, 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. Net gains at the time of securitization were not material in the six month period ended May 31, 2008.

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The following tables present information on the Company s residential mortgage loan, commercial mortgage loan and U.S. agency collateralized mortgage obligation securitization transactions. Key economic assumptions and the sensitivity of the current fair value of the retained interests to immediate 10% and 20% adverse changes in those assumptions as of May 31, 2008 and November 30, 2007 were as follows (dollars in millions):

At May 31, 2008:

	Residential Mortgage Loans	Commercial Mortgage Loans	U.S. Agency Collateralized Mortgage Obligations
Investment grade retained interests	$ 831	$ 524	$ 228
Non-investment grade retained interests	224	138	
Total retained interests (carrying amount/fair value)	$ 1,055	$ 662	$ 228
Weighted average life (in months)	66	37	50
Range	1.3 - 230	2.5 - 114	1.8 - 264
Weighted average discount rate (per annum)	17.14%	10.65%	7.61%
Range	3.00 - 99.20%	2.00 - 27.17%	0.46 - 50.43%
Impact on fair value of 10% adverse change	$ (31)	$ (13)	$ (4)
Impact on fair value of 20% adverse change	$ (59)	$ (26)	$ (8)
Weighted average credit losses(1)(2)	12.37%	8.18%	0.00%
Range	0.00 - 25.00%	0.00 - 24.87%	0.00 - 0.00%
Impact on fair value of 10% adverse change	$ (22)	$ (8)	$
Impact on fair value of 20% adverse change	$ (42)	$ (15)	$
Weighted average prepayment speed assumption (PSA)(3)	831		277
Range	0 - 1,200PSA		167 - 522PSA
Impact on fair value of 10% adverse change(4)	$ (18)	$	$ (4)
Impact on fair value of 20% adverse change(4)	$ (35)	$	$ (9)

(1) Residential mortgage loans credit loss rate stated in terms of cumulative loss rate. Commercial mortgage loans credit loss rate stated in terms of annualized loss rate.
(2) Credit losses are computed only on positions for which expected credit loss is either a key assumption in the determination of fair value or is not reflected in the discount rate.
(3) Commercial mortgage loans typically contain provisions that either prohibit or economically penalize the borrower from prepaying the loan for a specified period of time.
(4) Amounts for residential mortgage loans exclude positive valuation effects from immediate 10% and 20% changes.

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At November 30, 2007:

	Residential Mortgage Loans	Commercial Mortgage Loans	U.S. Agency Collateralized Mortgage Obligations
Investment grade retained interests	$ 2,048	$ 678	$ 826
Non-investment grade retained interests	1,167	406	
Total retained interests (carrying amount/fair value)	$ 3,215	$ 1,084	$ 826
Weighted average life (in months)	49	57	51
Range	1-322	0.5-139	1-271
Weighted average discount rate (per annum)	12.55%	8.48%	6.04%
Range	1.12 - 74.10%	3.00 - 16.83%	0.75 - 18.12%
Impact on fair value of 10% adverse change	$ (114)	$ (14)	$ (16)
Impact on fair value of 20% adverse change	$ (218)	$ (28)	$ (31)
Weighted average credit losses(1)(2)	4.52%	3.24%	0.00%
Range	0.00 - 12.00%	0.00 - 13.69%	0.00 - 0.00%
Impact on fair value of 10% adverse change	$ (215)	$ (5)	$
Impact on fair value of 20% adverse change	$ (371)	$ (10)	$
Weighted average prepayment speed assumption(PSA)(3)	1,173		301
Range	188 - 2,250PSA		167 - 718PSA
Impact on fair value of 10% adverse change(4)	$ (118)	$	$ (7)
Impact on fair value of 20% adverse change(4)	$ (194)	$	$ (19)

(1) Residential mortgage loans credit loss rate stated in terms of cumulative loss rate. Commercial mortgage loans credit loss rate stated in terms of annualized loss rate.
(2) Credit losses are computed only on positions for which expected credit loss is either a key assumption in the determination of fair value or is not reflected in the discount rate.
(3) Commercial mortgage loans typically contain provisions that either prohibit or economically penalize the borrower from prepaying the loan for a specified period of time.
(4) Amounts for residential mortgage loans exclude positive valuation effects from immediate 10% and 20% changes.

The weighted average assumptions and parameters used initially to value retained interests in relation to securitizations that were still held by the Company as of May 31, 2008 were as follows:

	Residential Mortgage Loans	Commercial Mortgage Loans	U.S. Agency Collateralized Mortgage Obligations
Weighted average life (in months)	72	48	60
Weighted average discount rate (rate per annum)	9.28%	7.07%	6.21%
Weighted average credit losses(1)(2)	0.33%	1.63%	
Weighted average prepayment speed assumptions	1,634PSA		281PSA

(1) Residential mortgage loans credit loss rate stated in terms of cumulative loss rate. Commercial mortgage loans credit loss rate stated in terms of annualized loss rate.
(2) Credit losses are computed only on positions for which expected credit loss is either a key assumption in the determination of fair value or is not reflected in the discount rate.

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The tables above do 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 independently 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.

During the six month periods ended May 31, 2008 and 2007, the Company received proceeds from new securitization transactions of $6.2 billion and $33.7 billion, respectively, and cash flows from retained interests in securitization transactions of $2.1 billion and $3.2 billion, respectively.

Variable Interest Entities. FIN 46R applies to certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. The primary beneficiary of a VIE is the party that absorbs a majority of the entity s expected losses, receives a majority of its expected residual returns or both, as a result of holding variable interests. The Company consolidates entities in which it is the primary beneficiary. For those entities deemed to be QSPEs (as defined in SFAS No. 140), the Company does not consolidate the entity. See Note 1 regarding the characteristics of QSPEs.

The Company is involved with various entities in the normal course of business that may be deemed to be VIEs. The Company s variable interests in VIEs include debt and equity interests, commitments, guarantees and derivative instruments. The Company s involvement with VIEs arises primarily from:

Purchased, sold and retained interests in connection with market making and securitization activities.

Guarantees issued and residual interests retained in connection with municipal bond securitizations.

Loans and investments made to VIEs that hold debt, equity, real estate or other assets.

Derivatives entered into with variable interest entities.

Structuring of credit linked notes or other asset-repackaged notes designed to meet the investment objectives of clients.

Other structured transactions designed to provide enhanced, tax-efficient yields to the Company or its clients.

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The following table presents information about the Company s total assets and maximum exposure to loss associated with VIEs as of May 31, 2008 which the Company consolidates. The Company generally accounts for the assets held by the entities as Financial instruments owned and the liabilities of the entities as Other secured financings in the condensed consolidated statements of financial condition (dollars in millions):

		At May 31, 2008 Maximum Exposure to Loss in Consolidated VIEs			
	VIE Assets That the Company Consolidates	Debt and Equity Interests	Derivatives	Commitments and Guarantees	Total
Mortgage and asset-backed securitizations	$ 5,814	$ 1,566	$ 5	$	$ 1,571
Municipal bond trusts	826			833	833
Credit and real estate	5,404	3,978	2,312		6,290
Commodities financing	1,057		235		235
Other structured transactions	14,903	13,256		9	13,265
	$ 28,004	$ 18,800	$ 2,552	$ 842	$ 22,194

The following table presents information about the Company s total assets and maximum exposure to loss associated with non-consolidated VIEs as of May 31, 2008 in which the Company had significant variable interests (dollars in millions):

		At May 31, 2008 Maximum Exposure to Loss in Non-consolidated VIEs			
	VIE Assets That the Company Does not Consolidate	Debt and Equity Interests	Derivatives	Commitments and Guarantees	Total
Mortgage and asset-backed securitizations	$ 6,715	$ 88	$ 68	$	$ 156
Municipal bond trusts	432	275		80	355
Credit and real estate	9,176	4,916	722	11	5,649
Other structured transactions	10,923	2,185		498	2,683
	$ 27,246	$ 7,464	$ 790	$ 589	$ 8,843

The Company s maximum exposure to loss often differs from the carrying value of the VIE s assets. The maximum exposure to loss is dependent on the nature of the Company s variable interest in the VIEs and is limited to the notional amounts of certain liquidity facilities, other credit support, total return swaps, written put options, and the fair value of certain other derivatives and investments the Company has made in the VIEs. Where notional amounts are utilized in quantifying maximum exposure related to derivatives, such amounts do not reflect writedowns already recorded by the Company. The Company s maximum exposure to loss does not include the offsetting benefit of any financial instruments that the Company may utilize to hedge these risks associated with the Company s variable interests.

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Mortgage Servicing Rights. The Company may retain servicing rights to certain mortgage loans that are sold through its securitization activities. These transactions create an asset referred to as MSRs, which totaled approximately $344 million as of May 31, 2008 and are included within Intangible assets in the condensed consolidated statements of financial condition.

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

5. Derivative Contracts.

In the normal course of business, the Company enters into a variety of derivative contracts related to financial instruments and commodities. The Company uses these instruments for trading and investment purposes, as well as for asset and liability management. These instruments generally represent future commitments to swap interest payment streams, exchange currencies, or purchase or sell commodities and other financial instruments on specific terms at specified future dates. Many of these products have maturities that do not extend beyond one year, although swaps, options and equity warrants typically have longer maturities. For further discussion of these matters, refer to Note 6 to the consolidated financial statements for the fiscal year ended November 30, 2007 included in the Form 10-K.

Future changes in interest rates, foreign currency exchange rates or the fair values of the financial instruments, commodities or indices underlying these contracts ultimately may result in cash settlements exceeding fair value amounts recognized in the condensed consolidated statements of financial condition. The amounts in the following table represent the fair value of exchange traded and OTC options and other contracts (including interest rate, foreign exchange, and other forward contracts and swaps) for derivatives for trading and investment and for asset and liability management, net of offsetting positions in situations where netting is appropriate. The asset amounts are not reported net of non-cash collateral, which the Company obtains with respect to certain of these transactions to reduce its exposure to credit losses. In accordance with the provisions of FSP FIN 39-1, the Company offsets cash collateral receivables and payables of $30 billion and $50 billion, respectively, against net derivative positions as of May 31, 2008.

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.

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The Company s derivatives (both listed and OTC), net of cash collateral, as of May 31, 2008 and November 30, 2007 are summarized in the table below, showing the fair value of the related assets and liabilities by product:

	At May 31, 2008		At November 30, 2007	
Product Type	**Assets**	**Liabilities**	**Assets**	**Liabilities**
	(dollars in millions)			
Interest rate and currency swaps, interest rate options, credit derivatives and other fixed income securities contracts	$ 40,548	$ 20,857	$ 33,804	$ 19,515
Foreign exchange forward contracts and options	7,454	6,914	7,755	9,372
Equity securities contracts (including equity swaps, warrants and options)	18,583	26,924	19,913	27,887
Commodity forwards, options and swaps	25,720	22,744	15,531	14,830
Total	$ 92,305	$ 77,439	$ 77,003	$ 71,604

6. Goodwill and Net Intangible Assets.

Changes in the carrying amount of the Company s goodwill and intangible assets for the six month period ended May 31, 2008 were as follows:

	Institutional Securities	Global Wealth Management Group	Asset Management	Total
	(dollars in millions)			
Goodwill:				
Balance at November 30, 2007	$ 1,555	$ 297	$ 1,172	$ 3,024
Foreign currency translation adjustments	(31)	11		(20)
Goodwill acquired during the period and other	28		(3)	25
Goodwill disposed of during the period and other(1)	(2)	(39)		(41)
Balance at May 31, 2008	$ 1,550	$ 269	$ 1,169	$ 2,988

(1) Global Wealth Management Group activity primarily represents goodwill disposed of in connection with the Company s sale of Morgan Stanley Wealth Management S.V., S.A.U. (see Note 15).

Due to the deterioration in the broader credit markets, the Company performed an interim impairment test of goodwill in the first and second quarters of fiscal 2008, which did not result in an impairment.

Institutional Securities	Global Wealth Management Group	Asset Management	Total
(dollars in millions)			

Intangible Assets:				
Amortizable intangible assets at November 30, 2007	$ 386	$	$ 233	$ 619
Foreign currency translation adjustments	(2)			(2)
Intangible assets acquired during the period and other	26		2	28
Intangible assets disposed of during the period and other(1)	(54)		(4)	(58)
Amortization expense	(24)		(5)	(29)
Amortizable intangible assets at May 31, 2008	332		226	558
Mortgage servicing rights(see Note 4)	344			344
Balance at May 31, 2008	$ 676	$	$ 226	$ 902

(1) Institutional Securities activity primarily represents intangible assets disposed of in connection with the Company s sale of a controlling interest in a previously consolidated commodities subsidiary.

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7. Long-Term Borrowings.

Long-term borrowings as of May 31, 2008 consisted of the following (dollars in millions):

	U.S. Dollar	Non-U.S. Dollar	At May 31, 2008
Due in 1 year	$ 28,788	$ 6,298	$ 35,086
Due in 2 years	17,013	7,840	24,853
Due in 3 years	16,825	9,699	26,524
Due in 4 years	8,576	8,279	16,855
Due in 5 years	6,678	19,523	26,201
Due in 6 years	6,446	17,374	23,820
Due in 7 years	3,771	570	4,341
Due in 8 years	5,031	7,135	12,166
Due in 9 years	8,915	7,400	16,315
Due in 10 years	8,911	3,375	12,286
Thereafter	8,368	3,909	12,277
Total	$ 119,322	$ 91,402	$ 210,724

The Company s long-term borrowings included the following components:

	At May 31, 2008	At November 30, 2007
	(dollars in millions)	
Senior debt	$ 196,230	$ 181,733
Subordinated debt	4,027	4,015
Junior subordinated debentures	10,467	4,876
Total	$ 210,724	$ 190,624

During the six month period ended May 31, 2008, the Company issued notes with a carrying value at quarter-end aggregating $37.2 billion, including non-U.S. dollar currency notes aggregating $11.5 billion. During the six month period ended May 31, 2008, $22.8 billion of notes were repaid.

The weighted average maturity of the Company s long-term borrowings, based upon stated maturity dates, was approximately 6.3 years at May 31, 2008.

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8. Commitments, Guarantees and Contingencies.

Commitments.

The Company s commitments associated with letters of credit and other financial guarantees obtained to satisfy collateral requirements, investment activities, corporate lending and financing arrangements, and mortgage lending as of May 31, 2008 are summarized below by period of expiration. Since commitments associated with these instruments may expire unused, the amounts shown do not necessarily reflect the actual future cash funding requirements:

	Years to Maturity				Total
	Less than 1	1-3	3-5	Over 5	May 31, 2008
	(dollars in millions)				
Letters of credit and other financial guarantees obtained to satisfy collateral requirements	$ 10,373	$ 178	$	$ 1	$ 10,552
Investment activities	1,138	473	21	695	2,327
Primary lending commitments(1)	10,909	9,040	25,093	6,929	51,971
Secondary lending commitments(1)	130	65	276	148	619
Commitments for secured lending transactions	2,432	3,436	2,440	85	8,393
Commitments to enter into reverse repurchase agreements	60,871				60,871
Commercial and residential mortgage-related commitments(1)	4,454				4,454
Underwriting commitments	10,818				10,818
Other commitments(2)	146	13	2	433	594
Total	$ 101,271	$ 13,205	$ 27,832	$ 8,291	$ 150,599

(1) These commitments are recorded at fair value within Financial instruments owned and Financial instruments sold, not yet purchased in the condensed consolidated statements of financial condition (see Note 2).

(2) Other commitments include amounts related to a forward purchase agreement entered into by the Company with a client in connection with a leveraged financing arrangement.

Letters of Credit and Other Financial Guarantees Obtained to Satisfy Collateral Requirements. The Company has outstanding letters of credit and other financial guarantees issued by third-party banks to certain of the Company s counterparties. The Company is contingently liable for these letters of credit and other financial guarantees, which are primarily used to provide collateral for securities and commodities borrowed and to satisfy various margin requirements in lieu of depositing cash or securities with these counterparties.

Investment Activities. The Company enters into commitments associated with its real estate, private equity and principal investment activities, which include alternative products.

Lending Commitments. Primary lending commitments are those which are originated by the Company whereas secondary lending commitments are purchased from third parties in the market. The commitments include lending commitments that are made to investment grade and non-investment grade companies in connection with corporate lending and other business activities.

Commitments for Secured Lending Transactions. Secured lending commitments are extended by the Company to companies and are secured by real estate or other physical 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.

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Commitments to Enter into Reverse Repurchase Agreements. The Company enters into forward starting securities purchased under agreements to resell (agreements that have a trade date as of or prior to May 31, 2008 and settle subsequent to quarter end) that are primarily secured by collateral from U.S. government agency securities and other sovereign government obligations.

Commercial and Residential Mortgage-Related Commitments. The Company enters into forward purchase contracts involving residential mortgage loans, residential mortgage loan commitments to individuals and residential home equity lines of credit. In addition, the Company enters into commitments to originate commercial and residential mortgage loans.

Underwriting Commitments. The Company enters into certain underwriting commitments, in which it is committed to subscribe for shares where the shares are not otherwise subscribed.

Other Commitments. Other commitments generally include commercial loan commitments to small businesses and commitments related to securities-based lending activities in connection with the Company s Global Wealth Management Group business segment.

Guarantees.

The table below summarizes certain information regarding the Company s obligations under guarantee arrangements as of May 31, 2008:

	Maximum Potential Payout/Notional Years to Maturity					Carrying Amount (Asset)/	
Type of Guarantee	**Less than 1**	**1-3**	**3-5**	**Over 5**	**Total**	**Liability**	**Collateral/ Recourse**
				(dollars in millions)			
Notional amount of derivative contracts	$ 1,077,553	$ 1,247,297	$ 2,596,015	$ 2,243,746	$ 7,164,611	$ 240,367	$ 47
Standby letters of credit and other financial guarantees issued(1)	1,011	1,066	2,404	4,081	8,562	(118)	4,698
Market value guarantees	5			654	659	62	145
Liquidity facilities(2)	17,790	1,326	818	342	20,276	23	19,940
General partner guarantees	47	113	40	285	485	15	

(1) Approximately $1.6 billion of standby letters of credit are also reflected in the Commitments table above in primary and secondary lending commitments.
(2) The maximum potential payout amount includes liquidity facilities to asset-backed commercial paper conduits of $707 million.

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

Derivative Contracts. Certain derivative contracts meet the accounting definition of a guarantee, including certain written options, contingent forward contracts and credit default swaps. Although the Company s derivative arrangements do not specifically identify whether the derivative counterparty retains the underlying asset, liability or equity security, the Company has disclosed information regarding all derivative contracts that

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could meet the accounting definition of a guarantee. The maximum potential payout for certain derivative contracts, such as written interest rate caps and written foreign currency options, cannot be estimated, as increases in interest or foreign exchange rates in the future could possibly be unlimited. Therefore, in order to provide information regarding the maximum potential amount of future payments that the Company could be required to make under certain derivative contracts, the notional amount of the contracts has been disclosed. In certain situations, collateral may be held by the Company for those contracts that meet the definition of a guarantee. Generally, the Company sets collateral requirements by counterparty so that the collateral covers various transactions and products and is not allocated specifically to individual contracts. Therefore, the collateral amount disclosed in the table above only includes contracts where the specific collateral can be identified.

The Company records all derivative contracts at fair value. 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.

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

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

Liquidity Facilities. The Company has entered into liquidity facilities with SPEs and other counterparties, whereby the Company is required to make certain payments if losses or defaults occur. Primarily, the Company acts as liquidity provider to municipal bond securitization SPEs and for standalone municipal bonds in which the holders of beneficial interests issued by these SPEs or the holders of the individual bonds, respectively, have the right to tender their interests for purchase by the Company on specified dates at a specified price. The Company often may have recourse to the underlying assets held by the SPEs in the event payments are required under such liquidity facilities as well as make-whole or recourse provisions with the trust sponsors.

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.

Other Guarantees and Indemnities.

In the normal course of business, the Company provides a variety of other guarantees and indemnifications, which are described below.

Trust Preferred Securities. The Company has established Morgan Stanley Trusts for the limited purpose of issuing trust preferred securities to third parties and lending the proceeds to the Company in exchange

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for junior subordinated debentures. The Company has directly guaranteed the repayment of the trust preferred securities to the holders thereof to the extent that the Company has made payments to a Morgan Stanley Trust on the junior subordinated debentures. In the event that the Company does not make payments to a Morgan Stanley Trust, holders of such series of trust preferred securities would not be able to rely upon the guarantee for payment of those amounts. The Company has not recorded any liability in the condensed consolidated financial statements for these guarantees and believes that the occurrence of any events (*i.e.*, nonperformance on the part of the paying agent) that would trigger payments under these contracts is remote. See Note 13 to the consolidated financial statements for the fiscal year ended November 30, 2007 included in the Form 10-K for details on the Company s junior subordinated debentures.

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

Exchange/Clearinghouse Member Guarantees. The Company is a member of various U.S. and non-U.S. exchanges and clearinghouses that trade and clear securities and/or futures contracts. Associated with its membership, the Company may be required to pay a proportionate share of the financial obligations of another member who may default on its obligations to the exchange or the clearinghouse. While the rules governing different exchange or clearinghouse memberships vary, in general the Company s guarantee obligations would arise only if the exchange or clearinghouse had previously exhausted its resources. 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.

Securitized Asset Guarantees. As part of the Company s Institutional Securities securitization activities, the Company provides representations and warranties that certain securitized assets conform to specified guidelines. The Company may be required to repurchase such assets or indemnify the purchaser against losses if the assets do not meet certain conforming guidelines. Due diligence is performed by the Company to ensure that asset guideline qualifications are met, and, to the extent the Company has acquired such assets to be securitized from other parties, the Company seeks to obtain its own representations and warranties regarding the assets. The maximum potential amount of future payments the Company could be required to make would be equal to the current outstanding balances of all assets subject to such securitization activities. Also, in connection with originations of residential mortgage loans under the Company s FlexSource® program, the Company may permit borrowers to pledge marketable securities as collateral instead of requiring cash down payments for the purchase of the underlying residential property. Upon sale of the residential mortgage loans, the Company may provide a surety bond that reimburses the purchasers for shortfalls in the borrowers securities accounts up to certain limits if the collateral maintained in the securities accounts (along with the associated real estate collateral) is insufficient to cover losses that purchasers experience as a result of defaults by borrowers on

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the underlying residential mortgage loans. The Company requires the borrowers to meet daily collateral calls to ensure the marketable securities pledged in lieu of a cash down payment are sufficient. At May 31, 2008 and November 30, 2007, the maximum potential amount of future payments the Company may be required to make under its surety bond was $126 million and $122 million, respectively. The Company has not recorded any contingent liability in the condensed consolidated financial statements for these representations and warranties and reimbursement agreements and believes that the probability of any payments under these arrangements is remote.

Merger and Acquisition Guarantees. The Company may, from time to time, in its role as investment banking advisor be required to provide guarantees in connection with certain European merger and acquisition transactions. If required by the regulating authorities, the Company provides a guarantee that the acquirer in the merger and acquisition transaction has or will have sufficient funds to complete the transaction and would then be required to make the acquisition payments in the event the acquirer s funds are insufficient at the completion date of the transaction. These arrangements generally cover the time frame from the transaction offer date to its closing date and, therefore, are generally short term in nature. The maximum potential amount of future payments that the Company could be required to make cannot be estimated. The Company believes the likelihood of any payment by the Company under these arrangements is remote given the level of the Company s due diligence associated with its role as investment banking advisor.

Contingencies.

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

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

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

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9. Shareholders Equity.

Regulatory Requirements. The Company is a consolidated supervised entity (CSE) as defined by the SEC. As such, the Company is subject to group-wide supervision and examination by the SEC and to minimum capital requirements on a consolidated basis and in accordance with the Basel II Accord.

MS&Co. is a registered broker-dealer and registered futures commission merchant and, accordingly, is subject to the minimum net capital requirements of the SEC, the Financial Industry Regulatory Authority and the Commodity Futures Trading Commission. MS&Co. has consistently operated in excess of these requirements. MS&Co. s net capital totaled $10,639 million at May 31, 2008, which exceeded the amount required by $7,320 million. MSIP, a London-based broker-dealer subsidiary, is subject to the capital requirements of the Financial Services Authority, and MSJS, a Tokyo-based broker-dealer subsidiary, is subject to the capital requirements of the Financial Services Agency. MSIP and MSJS consistently operated in excess of their respective regulatory capital requirements.

Under regulatory capital requirements adopted by the Federal Deposit Insurance Corporation (the FDIC) and other bank regulatory agencies, FDIC-insured financial institutions must maintain (a) 3% to 4% of Tier 1 capital, as defined, to average assets (leverage ratio), (b) 4% of Tier 1 capital, as defined, to risk-weighted assets (Tier 1 risk-weighted capital ratio) and (c) 8% of total capital, as defined, to risk-weighted assets (total risk-weighted capital ratio). At May 31, 2008, 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. (MSDP) and Cournot Financial Products LLC (Cournot), which are triple-A rated derivative products subsidiaries, maintain certain operating restrictions that have been reviewed by various rating agencies. Both entities are operated such that creditors of the Company should not expect to have any claims on either the assets of MSDP or the assets of Cournot, unless and until the obligations of such entity to its own creditors are satisfied in full. Creditors of MSDP or Cournot, respectively, should not expect to have any claims on the assets of the Company or any of its affiliates, other than the respective assets of MSDP or Cournot.

MS&Co. is required to hold tentative net capital in excess of $1 billion and net capital in excess of $500 million in accordance with the market and credit risk standards of Appendix E of Rule 15c3-1. MS&Co. is also required to notify the SEC in the event that its tentative net capital is less than $5 billion. As of May 31, 2008, MS&Co. had tentative net capital in excess of the minimum and the notification requirements.

During the second quarter of fiscal 2008, Morgan Stanley Senior Funding, Inc. (MSSF), which provides loans or lending commitments (including bridge financing) to selected corporate clients, transferred certain loans to

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Ascension Loan Vehicle, LLC (Ascension). MSSF and Ascension are both wholly owned subsidiaries of the Company. MSSF transferred such loans so that they could be securitized and, in turn, made eligible to be pledged with the Federal Reserve. Certain of the securitized interests in Ascension were transferred to Morgan Stanley Darica Funding, LLC (MSDF), a wholly owned subsidiary of the Company, during the third quarter of fiscal 2008. Ascension and MSDF, which are special purpose vehicle subsidiaries of the Company, maintain certain operating restrictions that have been reviewed by various rating agencies. Ascension and MSDF are structured as separate legal entities and operated such that creditors of the Company or any affiliate of the Company, including MSSF, but excluding Ascension and MSDF, should not reasonably expect to have any claims on the assets of Ascension and MSDF, respectively. Such assets include loans that have been sold, and participation interests that have been granted, by MSSF to Ascension in an aggregate approximate amount of $2 billion as of May 31, 2008. Such amounts may increase or decrease. Securitized interests in Ascension were transferred to MSDF in the aggregate approximate amount of $460 million during the third quarter of fiscal 2008. Creditors of Ascension and MSDF should not reasonably expect to have any claims on the assets of the Company or any of its affiliates, including MSSF, other than the assets of Ascension and MSDF, respectively.

Treasury Shares. During the six month period ended May 31, 2008, the Company did not purchase any of its common stock through the open market share repurchase program. During the six month period ended May 31, 2007, the Company purchased approximately $2.6 billion of its common stock through open market purchases at an average cost of $79.57 per share.

China Investment Corporation Investment. In December 2007, the Company sold Equity Units which included contracts to purchase Company common stock to a wholly owned subsidiary of China Investment Corporation (CIC), for approximately $5,579 million. CIC s ownership in the Company s common stock, including the maximum number of shares of common stock to be received by CIC upon settlement of the stock purchase contracts, will be 9.9% or less of the Company s total shares outstanding based on the total shares that were outstanding on November 30, 2007. CIC is a passive financial investor and has no special rights of ownership nor a role in the management of the Company. A substantial portion of the investment proceeds were treated as Tier 1 capital for regulatory capital purposes.

The present value of the future contract adjustment payments due under the stock purchase contracts was approximately $400 million and was recorded in Other liabilities and accrued expenses with a corresponding decrease recorded in Paid-in capital, a component of Shareholders equity in the Company s condensed consolidated statement of financial condition in the first quarter of fiscal 2008. The other liability balance related to the stock purchase contracts will accrete over the term of the stock purchase contract using the effective yield method with a corresponding charge to Interest expense. When the contract adjustment payments are made under the stock purchase contracts, they will reduce the other liability balance.

For a more detailed summary of the Equity Units, including the junior subordinated debentures issued to support trust common and trust preferred securities and the stock purchase contracts, refer to Note 28 to the consolidated financial statements for the fiscal year ended November 30, 2007 included in the Form 10-K.

Prior to the issuance of common stock upon settlement of the stock purchase contract, the impact of the Equity Units is reflected in the Company s earnings per diluted common share using the treasury stock method, as defined by SFAS No. 128, Earnings Per Share. Under the treasury stock method, the number of shares of common stock included in the calculation of earnings per diluted common share are calculated as the excess, if any, of the number of shares expected to be issued upon settlement of the stock purchase contract based on the

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average market price for the last 20 days of the reporting period, less the number of shares that could be purchased by the Company with the proceeds to be received upon settlement of the contract at the average closing price for the reporting period.

Dilution of net income per share occurs (i) in reporting periods when the average closing price of common shares is over $57.6840 per share or (ii) in reporting periods when the average closing price of common shares for a reporting period is between $48.0700 and $57.6840 and is greater than the average market price for the last 20 days ending three days prior to the end of such reporting period.

There was no dilutive impact for the quarter ended May 31, 2008. The dilutive impact for the six month period ended May 31, 2008 was approximately 128,000 shares.

10. Earnings per Common Share.

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

	Three Months Ended May 31,		Six Months Ended May 31,	
	2008	2007	2008	2007
Basic EPS:				
Income from continuing operations	$ 1,026	$ 2,363	$ 2,577	$ 4,677
Net gain on discontinued operations		219		577
Preferred stock dividend requirements	(14)	(17)	(31)	(34)
Net income applicable to common shareholders	$ 1,012	$ 2,565	$ 2,546	$ 5,220
Weighted average common shares outstanding	1,038	997	1,029	1,003
Earnings per basic common share:				
Income from continuing operations	$ 0.97	$ 2.35	$ 2.47	$ 4.63
Gain on discontinued operations		0.22		0.58
Earnings per basic common share	$ 0.97	$ 2.57	$ 2.47	$ 5.21
Diluted EPS:				
Net income applicable to common shareholders	$ 1,012	$ 2,565	$ 2,546	$ 5,220
Weighted average common shares outstanding	1,038	997	1,029	1,003
Effect of dilutive securities:				
Stock options and restricted stock units	29	49	34	49
Weighted average common shares outstanding and common stock equivalents	1,067	1,046	1,063	1,052

Earnings per diluted common share:				
Income from continuing operations	$ 0.95	$ 2.24	$ 2.40	$ 4.41
Gain on discontinued operations		0.21		0.55
Earnings per diluted common share	$ 0.95	$ 2.45	$ 2.40	$ 4.96

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

	Three Months Ended May 31,		Six Months Ended May 31,	
	2008	2007	2008	2007
	(shares in millions)			
Number of antidilutive securities (including stock options and restricted stock units) outstanding at end of period	78	17	78	18

In addition, for information on the dilutive impact related to CIC, see Note 9.

Cash dividends declared per common share were $0.27 and $0.54 for the quarter and six month periods ended May 31, 2008 and 2007, respectively.

11. Employee Benefit Plans.

The Company maintains various pension and benefit plans for eligible employees.

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

	Three Months Ended May 31,		Six Months Ended May 31,	
	2008	2007	2008	2007
	(dollars in millions)			
Service cost, benefits earned during the period	$ 28	$ 29	$ 56	$ 58
Interest cost on projected benefit obligation	36	33	73	66
Expected return on plan assets	(33)	(31)	(65)	(62)
Net amortization of actuarial loss	8	10	16	20
Net amortization of prior-service credit	(2)	(2)	(5)	(5)
Net periodic benefit expense	$ 37	$ 39	$ 75	$ 77

12. Income Taxes.

The Company adopted FIN 48 on December 1, 2007 and recorded a cumulative effect adjustment of approximately $92 million as a decrease to the opening balance of Retained earnings as of December 1, 2007.

The total amount of unrecognized tax benefits as of the date of adoption of FIN 48 was approximately $2.7 billion. Of this total, approximately $1.7 billion (net of federal benefit of state issues, competent authority and foreign tax credit offsets) represents the amount of unrecognized tax benefits that, if recognized, would favorably affect the effective tax rate in future periods.

The Company recognizes the accrual of interest related to unrecognized tax benefits in Provision for income taxes in the condensed consolidated statements of income. The Company recognizes the accrual of penalties (if any) related to unrecognized tax benefits in income before income taxes. The amount of penalties accrued is immaterial. Interest expense included in income taxes as of December 1, 2007 was approximately $223 million, net of federal and state income tax benefits.

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It is reasonably possible that significant changes in the gross balance of unrecognized tax benefits may occur within the next twelve months. It is difficult to estimate the range of such changes; however, the Company does not expect that any change in the gross balance of unrecognized tax benefits would have a material impact on its effective tax rate over the next twelve months.

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

The following are the major tax jurisdictions in which the Company and its affiliates operate and the earliest tax year subject to examination:

Jurisdiction	Tax Year
United States	1999
New York State and City	2002
Hong Kong	2002
United Kingdom	2004
Japan	2004

13. Segment Information.

The Company structures its segments primarily based upon the nature of the financial products and services provided to customers and the Company s management organization. The Company provides a wide range of financial products and services to its customers in each of its business segments: Institutional Securities, Global Wealth Management Group and Asset Management. For further discussion of the Company s business segments, see Note 1.

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

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

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

Three Months Ended May 31, 2008	Institutional Securities	Global Wealth Management Group	Asset Management	Intersegment Eliminations	Total
			(dollars in millions)		
Net revenues excluding net interest	$ 3,749	$ 2,200	$ 512	$ (55)	$ 6,406
Net interest	(124)	236	(24)	16	104
Net revenues	$ 3,625	$ 2,436	$ 488	$ (39)	$ 6,510