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MORGAN STANLEY
Form 10-K
January 29, 2008
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the fiscal year ended November 30, 2007

Commission File Number 1-11758

(Exact name of Registrant as specified in its charter)

Delaware

(State or other jurisdiction of
incorporation or organization)

1585 Broadway

New York, NY 10036
(Address of principal executive
offices, including zip code)

36-3145972

(I.R.S. Employer Identification No.)

(212) 761-4000

(Registrant's telephone number,
including area code)

Name of exchange on

which registered

Title of each class

Securities registered pursuant to Section 12(b) of the Act:

Common Stock, \$0.01 par value

Depository Shares, each representing 1/1,000th interest in a share of Floating Rate Non-Cumulative Preferred Stock, Series A, \$0.01 par value

6¼% Capital Securities of Morgan Stanley Capital Trust III (and Registrant's guaranty with respect thereto)

6¼% Capital Securities of Morgan Stanley Capital Trust IV (and Registrant's guaranty with respect thereto)

5¾% Capital Securities of Morgan Stanley Capital Trust V (and Registrant's guaranty with respect thereto)

6.60% Capital Securities of Morgan Stanley Capital Trust VI (and Registrant's guaranty with respect thereto)

6.60% Capital Securities of Morgan Stanley Capital Trust VII (and Registrant's guaranty with respect thereto)

6.45% Capital Securities of Morgan Stanley Capital Trust VIII (and Registrant's guaranty with respect thereto)

SPARQS® due March 20, 2008; SPARQS due April 20, 2008; SPARQS due May 20, 2008; SPARQS due June 20, 2008 (3 issuances); SPARQS due July 20, 2008; SPARQS due August 20, 2008; SPARQS due September 20, 2008; SPARQS due October 20, 2008; SPARQS due January 20, 2009 (2 issuances); SPARQS due February 20, 2009

Exchangeable Notes due December 30, 2008; Exchangeable Notes due December 30, 2010; Exchangeable Notes due June 30, 2011

Callable Index-Linked Notes due December 30, 2008

BRIDGESSM due August 30, 2008; BRIDGES due December 30, 2008; BRIDGES due February 28, 2009; BRIDGES due March 30, 2009; BRIDGES due June 30, 2009; BRIDGES due July 30, 2009; BRIDGES due August 30, 2009; BRIDGES due October 30, 2009; BRIDGES due December 30, 2009; BRIDGES due June 15, 2010

Capital Protected Notes due June 30, 2008; Capital Protected Notes due September 30, 2008; Capital Protected Notes due December 30, 2008; Capital Protected Notes due December 30, 2009; Capital Protected Notes due April 20, 2010; Capital Protected Notes due July 20, 2010 (2 issuances); Capital Protected Notes due August 30, 2010; Capital Protected Notes due October 30, 2010; Capital Protected Notes due January 30, 2011; Capital Protected Notes due February 20, 2011; Capital Protected Notes due March 30, 2011 (2 issuances); Capital Protected Notes due June 30, 2011; Capital Protected Notes due August 20, 2011; Capital Protected Notes due October 30, 2011 (2 issuances); Capital Protected Notes due December 30, 2011; Capital Protected Notes due September 30, 2012

Capital Protected Notes due September 1, 2010

HITSSSM due February 20, 2008; HITS due March 20, 2008; HITS due April 20, 2008

MPSSM due December 30, 2008; MPS due December 30, 2009; MPS due February 1, 2010; MPS due June 15, 2010; MPS due December 30, 2010 (2 issuances); MPS due March 30, 2012

New York Stock Exchange

New York Stock Exchange

New York Stock Exchange

New York Stock Exchange

New York Stock Exchange

New York Stock Exchange

New York Stock Exchange

New York Stock Exchange

American Stock Exchange

American Stock Exchange

American Stock Exchange

American Stock Exchange

American Stock Exchange

The NASDAQ Stock Market LLC

American Stock Exchange

American Stock Exchange

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MPS due March 30, 2009	The NASDAQ Stock Market LLC
Stock Participation Notes due September 15, 2010; Stock Participation Notes due December 30, 2010	American Stock Exchange
Bear Market PLUS due February 20, 2008; Bear Market PLUS due April 20, 2008; Bear Market PLUS due July 20, 2008	American Stock Exchange
Outperformance PLUS due December 20, 2008	American Stock Exchange
PLUS SM due March 20, 2008 (3 issuances); PLUS due April 30, 2008 (2 issuances); PLUS due May 20, 2008; PLUS due October 20, 2008; PLUS due December 20, 2008 (4 issuances); PLUS due January 20, 2009 (3 issuances); PLUS due February 20, 2009; PLUS due June 30, 2009	American Stock Exchange
PLUS due June 20, 2008; PLUS due August 20, 2008; PLUS due November 20, 2008; PLUS due December 20, 2008; PLUS due January 20, 2009; PLUS due September 30, 2009	The NASDAQ Stock Market LLC
PROPELS SM due December 30, 2011 (3 issuances)	American Stock Exchange
Protected Absolute Return Barrier Notes due December 20, 2008; Protected Absolute Return Barrier Notes due July 20, 2008; Protected Absolute Return Barrier Notes due September 20, 2008; Protected Absolute Return Barrier Notes due October 20, 2008; Protected Absolute Return Barrier Notes due June 20, 2009 (2 issuances); Protected Absolute Return Barrier Notes due July 20, 2009	American Stock Exchange
Strategic Total Return Securities due December 17, 2009; Strategic Total Return Securities due March 30, 2010; Strategic Total Return Securities due July 30, 2011(2 issuances); Strategic Total Return Securities due January 15, 2012	American Stock Exchange
Strategic Total Return Securities due October 30, 2011	The NASDAQ Stock Market LLC
BOXES SM due October 30, 2031; BOXES due January 30, 2032	American Stock Exchange Philadelphia Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:

Targeted Income Strategic Total Return Securities due October 30, 2011	The NASDAQ Stock Market LLC
MPS SM due March 30, 2009	The NASDAQ Stock Market LLC

Indicate by check mark if Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. YES x NO "

Indicate by check mark if Registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. YES " NO x

Indicate by check mark whether 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 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

Indicate by check mark whether Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Exchange Act Rule 12b-2. Large accelerated filer x Accelerated filer " Non-accelerated filer "

Indicate by check mark whether Registrant is a shell company (as defined in Exchange Act Rule 12b-2). YES " NO x

As of May 31, 2007, the aggregate market value of the common stock of Registrant held by non-affiliates of Registrant was approximately \$88,843,773,992.03. This calculation does not reflect a determination that persons are affiliates for any other purposes.

As of January 11, 2008, there were 1,104,587,663 shares of Registrant's common stock, \$0.01 par value, outstanding.

Documents Incorporated By Reference: Portions of Registrant's definitive proxy statement for its annual stockholders' meeting to be held on April 8, 2008 are incorporated by reference in Part III of this Form 10-K.

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ANNUAL REPORT ON FORM 10-K

for the fiscal year ended November 30, 2007

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Forward-Looking Statements

We have included or incorporated by reference into this report, and from time to time may make in our public filings, press releases or other public statements, certain statements, including (without limitation) those under **Legal Proceedings** in Part I, Item 3, **Management's Discussion and Analysis of Financial Condition and Results of Operations** in Part II, Item 7 and **Quantitative and Qualitative Disclosures about Market Risk** in Part II, Item 7A, that may constitute **forward-looking statements** within the meaning of the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. In addition, our management may make forward-looking statements to analysts, investors, representatives of the media and others. These forward-looking statements are not historical facts and represent only Morgan Stanley's beliefs regarding future events, many of which, by their nature, are inherently uncertain and beyond our control.

The nature of Morgan Stanley's business makes predicting the future trends of our revenues, expenses and net income difficult. The risks and uncertainties involved in our businesses could affect the matters referred to in such statements and it is possible that our actual results may differ from the anticipated results indicated in these forward looking statements. Important factors that could cause actual results to differ from those in the forward-looking statements include (without limitation):

the credit ratings assigned to Morgan Stanley;

the effect of political and economic conditions and geopolitical events;

the effect of market conditions, including in the global equity and credit markets and with respect to corporate, commercial and residential lending;

the availability and cost of capital;

the level and volatility of equity prices, commodity prices and interest rates, currency values and other market indices;

the actions and initiatives of current and potential competitors;

the impact of current, pending and future legislation, regulation and regulatory and legal actions in the U.S. and worldwide;

our reputation;

investor sentiment;

the potential effects of technological changes; and

other risks and uncertainties detailed under **Competition** and **Regulation** in Part I, Item 1, **Risk Factors** in Part I, Item 1A, and elsewhere throughout this report.

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Accordingly, you are cautioned not to place undue reliance on forward-looking statements, which speak only as of the date on which they are made. Morgan Stanley undertakes no obligation to update publicly or revise any forward-looking statements to reflect the impact of circumstances or events that arise after the dates they are made, whether as a result of new information, future events or otherwise except as required by applicable law. You should, however, consult further disclosures Morgan Stanley may make in future filings of its Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q and Current Reports on Form 8-K and any amendments thereto or in future press releases or other public statements.

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Part I

Item 1. Business.

Overview.

Morgan Stanley is a global financial services firm that, through its subsidiaries and affiliates, provides its products and services to a large and diversified group of clients and customers, including corporations, governments, financial institutions and individuals. Morgan Stanley was originally incorporated under the laws of the State of Delaware in 1981, and its predecessor companies date back to 1924. Morgan Stanley conducts its business from its headquarters in and around New York City, its regional offices and branches throughout the U.S. and its principal offices in London, Tokyo, Hong Kong and other world financial centers. At November 30, 2007, Morgan Stanley had 48,256 employees worldwide. Unless the context otherwise requires, the terms Morgan Stanley, the Company, we, us and our mean Morgan Stanley and its consolidated subsidiaries.

Financial information concerning Morgan Stanley, our business segments and geographic regions for each of the fiscal years ended November 30, 2007, November 30, 2006 and November 30, 2005 is included in the consolidated financial statements and the notes thereto in Financial Statements and Supplementary Data in Part II, Item 8.

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:

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Composite Certificate of Incorporation;

Bylaws;

Charters for our Audit Committee, Compensation, Management Development and Succession Committee and Nominating and Governance Committee;

Corporate Governance Policies;

Policy Regarding Communication with the Board of Directors;

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Policy Regarding Director Candidates Recommended by Shareholders;

Policy Regarding Corporate Political Contributions;

Policy Regarding Shareholder Rights Plan;

Code of Ethics and Business Conduct; and

Integrity Hotline.

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

Business Segments.

Morgan Stanley 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 business segments follows.

Institutional Securities includes capital raising; financial advisory services, including advice on mergers and acquisitions, restructurings, real estate and project finance; corporate lending; sales, trading, financing and market-making activities in equity 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 fund of funds, and merchant banking, which includes real estate, private equity and infrastructure, to institutional and retail clients through proprietary and third-party retail distribution channels, intermediaries and Morgan Stanley's institutional distribution channel. Asset Management also engages in investment activities.

On June 30, 2007, the Company completed the spin-off of Discover Financial Services (the Discover Spin-off).

Institutional Securities.

Morgan Stanley provides financial advisory and capital-raising services to a diverse group of corporate and other institutional clients globally, primarily through wholly owned subsidiaries that include Morgan Stanley & Co. Incorporated (MS&Co.), Morgan Stanley & Co. International plc, Morgan Stanley Japan Securities Co., Ltd. and Morgan Stanley Asia Limited. These and other subsidiaries also conduct sales and trading activities worldwide, as principal and agent, and provide related financing services on behalf of institutional investors.

Investment Banking.

Capital Raising. Morgan Stanley manages and participates in public offerings and private placements of debt, equity and other securities worldwide. Morgan Stanley is a leading underwriter of common stock, preferred stock and other equity-related securities, including convertible securities and American Depositary Receipts (ADRs).

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Morgan Stanley is a leading underwriter of fixed income securities, including investment grade debt, non-investment grade instruments, mortgage-related and other asset-backed securities, tax-exempt securities and commercial paper and other short-term securities.

Financial Advisory Services. Morgan Stanley provides corporate and other institutional clients globally with advisory services on key strategic matters, such as mergers and acquisitions, divestitures, corporate defense strategies, joint ventures, privatizations, recapitalizations, spin-offs, corporate restructurings, shareholder relations, tender offers, exchange offers and leveraged buyouts. Morgan Stanley also provides advice concerning rights offerings, dividend policy, valuations, foreign exchange exposure, financial risk management strategies and financial planning. In addition, Morgan Stanley furnishes advice and services regarding project financings and provides advisory services in connection with the purchase, sale, leasing and financing of real estate.

Corporate Lending. Morgan Stanley provides to selected corporate clients through subsidiaries (including Morgan Stanley Bank) loans or lending commitments, including bridge financing. These loans and commitments have varying terms, may be senior or subordinated and/or secured or unsecured, are generally contingent upon representations, warranties and contractual conditions applicable to the borrower and may be syndicated, hedged or traded by Morgan Stanley.* The borrowers may be rated investment grade or non-investment grade.

Sales and Trading Activities.**

Morgan Stanley conducts sales, trading, financing and market-making activities on securities and futures exchanges and in over-the-counter (OTC) markets around the world. Morgan Stanley's Institutional Securities business includes Equity and Proprietary Trading; Interest Rates, Credit and Currencies; Commodities and Clients and Services.

Equity and Proprietary Trading. Morgan Stanley acts as principal (including as a market maker) and agent in executing transactions globally in equity and equity-related products, including common stock, ADRs, global depositary receipts and exchange-traded funds.

Morgan Stanley's equity derivatives sales, trading and market-making activities cover equity-related products globally, including equity swaps, options, warrants and futures overlying individual securities, indices and baskets of securities and other equity-related products. Morgan Stanley also issues and makes a principal market in equity-linked products to institutional and individual investors, including principal-protected securities.

Morgan Stanley has several dedicated trading groups which engage in proprietary trading and investing activities utilizing multiple strategies across various cash and derivative asset classes including, among others, equity securities, quantitative and program driven strategies, commodities, currencies, interest rates, emerging markets, bonds, loans, corporate credit, as well as mortgage-related and other asset-backed securities.

Interest Rates, Credit and Currencies. Morgan Stanley trades, makes markets and takes long and short proprietary positions in fixed income securities and related products globally, including, among other products, investment and non-investment grade corporate debt, distressed debt, bank loans, U.S. and other sovereign securities, emerging market bonds and loans, convertible bonds, collateralized debt obligations and securities issued by structured investment vehicles, mortgage-related and other asset-backed securities and real estate loan products, municipal securities, preferred stock and commercial paper, money market and other short-term securities. Morgan Stanley is a primary dealer of U.S. government securities and a member of the selling groups

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- * Revenues and expenses associated with the trading of syndicated loans are included in Sales and Trading Activities.
- ** The description set forth under Sales and Trading Activities reflects organizational changes implemented since December 2007. See also Risk Management in Part II, Item 7A for a description of Morgan Stanley's trading risk management structure, policies and procedures.

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that distribute various U.S. agency and other debt securities. Morgan Stanley is a primary dealer or market-maker of government securities in numerous European, Asian and emerging market countries.

Morgan Stanley trades, makes markets and takes long and short proprietary positions in listed futures and OTC swaps, forwards, options and other derivatives referencing, among other things, interest rates, currencies, investment grade and non-investment grade corporate credits, loans, bonds, U.S. and other sovereign securities, emerging market bonds and loans, credit indexes, asset-backed security indexes, property indexes, mortgage-related and other asset-backed securities and real estate loan products.

Morgan Stanley is a market-maker in foreign currencies. Most of Morgan Stanley's foreign exchange business relates to major foreign currencies such as Yen, Euro, Sterling, Swiss francs and Canadian dollars. Morgan Stanley trades on a principal basis in the spot, forward, option and futures markets and takes proprietary positions in such currencies.

Through the use of repurchase and reverse repurchase agreements, Morgan Stanley acts as an intermediary between borrowers and lenders of short-term funds and provides funding for various inventory positions. Morgan Stanley also provides financing to customers for commercial and residential real estate loan products and other securitizable asset classes.

Morgan Stanley advises on investment and liability strategies and assists corporations in their debt repurchases and tax planning. Morgan Stanley structures debt securities and derivatives with risk/return factors designed to suit client objectives, including using repackaged asset and other structured vehicles through which clients can restructure asset portfolios to provide liquidity or reconfigure risk profiles.

Commodities. Morgan Stanley trades as principal and maintains long and short proprietary trading positions in the spot, forward and futures markets in several commodities, including metals (base and precious), agricultural products, crude oil, oil products, natural gas, electric power, emission credits, coal, freight, liquefied natural gas (LNG) and related products and indices. Morgan Stanley is a market-maker in exchange-traded options and futures and OTC options and swaps on commodities, and offers counterparties hedging programs relating to production, consumption, reserve/inventory management and structured transactions, including energy-contract securitizations. Morgan Stanley is an electricity power marketer in the U.S. and owns five electricity generating facilities in the U.S. and Europe.

Morgan Stanley owns TransMontaigne Inc. and its subsidiaries, a group of companies operating in the refined petroleum products marketing and distribution business, and the Heidmar Group of companies, which provide international marine transportation and U.S. marine logistics services.

Clients and Services. Morgan Stanley provides financing services, including prime brokerage, which offers, among other services, consolidated clearance, settlement, custody, financing and portfolio reporting services to clients trading multiple asset classes. Morgan Stanley also engages in principal securities lending with clients, institutional lenders and other broker-dealers. In addition, Morgan Stanley's institutional distribution and sales activities are overseen and coordinated through Clients and Services.

Other Activities.

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Benchmark Indices and Risk Management Analytics. As of November 30, 2007, Morgan Stanley's majority-owned subsidiary, MSCI Inc. (MSCI), calculates and distributes over 100,000 international and U.S. equity benchmark indices (including the MSCI World and EAFE Indices) covering 56 countries, and has a historical database spanning over 35 years that includes fundamental and valuation data on thousands of equity securities in developed and emerging market countries. MSCI also calculates and distributes over 200 hedge fund indices. MSCI's subsidiary, Barra, Inc., is a leading provider of risk analytic tools and services to investors to help them

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analyze, measure and manage portfolio and firm-wide investment risk. The initial public offering of shares of MSCI began trading on the New York Stock Exchange on November 15, 2007. After this offering, Morgan Stanley continues to own in excess of 80 percent of MSCI.

Research. Morgan Stanley's global research department (Research) consists of economists, strategists and industry analysts. Research engages in equity and fixed income research activities and produces reports and studies on the U.S. and global economy, financial markets, portfolio strategy, technical market analyses, individual companies and industry developments. Research examines worldwide trends covering numerous industries and individual companies, the majority of which are located outside of the U.S. Research provides analysis and forecasts relating to economic and monetary developments that affect matters such as interest rates, foreign currencies, securities, derivatives and economic trends. Research provides analytical support and publishes reports on asset-backed securities and the markets in which such securities are traded. Research reports and data are disseminated to investors through third party distributors, proprietary internet sites such as Client Link and Morgan Stanley's sales forces.

Investments. Morgan Stanley from time to time makes investments that represent business facilitation or principal investing activities. Business facilitation investments are strategic investments undertaken by Morgan Stanley to facilitate core business activities. Principal investing activities are capital commitments provided to public and private companies, funds and other entities generally for proprietary purposes to maximize total returns to Morgan Stanley. Morgan Stanley expects to make additional principal investments over time. These principal investment activities are conducted within the investment banking and sales and trading areas in Institutional Securities.

Morgan Stanley sponsors and manages investment vehicles and separate accounts for clients seeking exposure to private equity, real estate-related and other alternative investments. Morgan Stanley may also invest in and provide capital to such investment vehicles. See also Asset Management.

Operations and Information Technology.

Morgan Stanley's Operations and Information Technology departments provide the process and technology platform that supports Institutional Securities sales and trading activity, including post-execution trade processing and related internal controls over activity from trade entry through settlement and custody, such as asset servicing. This is done for proprietary and customer transactions in listed and OTC transactions in commodities, equity and fixed income securities, including both primary and secondary trading, as well as listed, OTC and structured derivatives in markets around the world. This activity is undertaken through Morgan Stanley's own facilities, through membership in various clearing and settlement organizations, and through agreements with unaffiliated third parties.

Global Wealth Management Group.

Morgan Stanley's Global Wealth Management Group provides comprehensive financial services to clients through a network of approximately 8,400 global representatives in approximately 500 locations globally, including over 450 U.S. locations at fiscal year end. As of November 30, 2007, Morgan Stanley had \$758 billion in client assets. On April 1, 2007, Morgan Stanley merged its primary broker-dealer for Global Wealth Management Group, Morgan Stanley DW Inc., into MS&Co. Upon completion of the merger, MS&Co. became Morgan Stanley's principal U.S. broker-dealer.

Clients.

Global Wealth Management Group professionals serve individual investors and small-to-medium size businesses and institutions with an emphasis on ultra high net worth, high net worth and affluent investors. In the U.S., products and services are delivered through three principal channels. Specialized private wealth management

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investment representative teams located in dedicated offices provide sophisticated investment solutions and services for ultra high net worth individuals, families and foundations. Financial advisors located in branches across the U.S. provide solutions designed to accommodate individual investment objectives, risk tolerance and liquidity needs for ultra high net worth, high net worth and affluent investors. Call centers are available to meet the needs of emerging affluent clients. Outside the U.S., Morgan Stanley offers financial services to clients in Europe, the Middle East, Asia and Latin America.

Products and Services.

Morgan Stanley's Global Wealth Management Group provides clients with a comprehensive array of financial solutions, including Morgan Stanley's products and services, and products and services from third party providers, such as insurance companies and mutual fund families. Morgan Stanley offers brokerage and investment advisory services covering various investment alternatives, including equities, options, futures, foreign currencies, precious metals, fixed income securities, mutual funds, structured products, alternative investments, unit investment trusts, managed futures, separately managed accounts and mutual fund asset allocation programs. Morgan Stanley also offers financial and wealth planning services, including education savings programs, as well as annuity and other insurance products. In addition, Morgan Stanley offers several cash management services, including cash sweeps, debit cards and checkwriting, as well as lending products, including securities based lending and a mortgage referral program, which provides residential mortgages and home equity lines of credit originated through Morgan Stanley's affiliated entities. Morgan Stanley's BusinessScapes program offers cash management and commercial credit solutions to qualified small and medium businesses in the U.S. Morgan Stanley provides individual and corporate retirement solutions, including IRAs and 401(k) plans and U.S. stock plan services to corporate executives and businesses. Morgan Stanley also offers trust and fiduciary services to individual and corporate clients.

Morgan Stanley's Global Wealth Management Group offers its clients a variety of ways to establish a relationship and conduct business, including brokerage accounts with transaction-based pricing and investment advisory accounts with asset-based fee pricing. The Active Assets Account[®] offers clients brokerage and cash management services in one account. Clients can also choose a fee-based, separately managed account managed by affiliated or unaffiliated professional asset managers.

Operations and Information Technology.

Morgan Stanley's Operations and Information Technology departments provide the process and technology platform that supports the activities of Morgan Stanley's Global Wealth Management Group from trade capture through clearance, settlement and custody, including asset servicing as well as bank deposit and loan processing through Morgan Stanley's affiliated banks. These activities are undertaken through Morgan Stanley's own facilities, through memberships in various clearing and settlement organizations, and through agreements with unaffiliated third parties.

Asset Management.

Morgan Stanley Investment Management is one of the largest global asset management organizations of any full-service securities firm and offers individual and institutional clients a diverse array of equity, fixed income and alternative investments and merchant banking strategies. Morgan Stanley had \$597 billion of assets under management or supervision as of November 30, 2007. Morgan Stanley's asset management activities are principally conducted under the Morgan Stanley and Van Kampen brands. Portfolio managers located in the U.S., Europe, Japan, Singapore and India manage investment products ranging from money market funds to equity, taxable and tax-exempt fixed income funds and alternative investment and merchant banking products in developed and emerging markets. Morgan Stanley offers clients various investment styles, such as value, growth, core, fixed income and asset allocation; global investments; active and passive management; and diversified and

concentrated portfolios.

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Morgan Stanley offers a range of alternative investment and merchant banking products for institutional investors and high net worth individuals. Morgan Stanley's alternative investments platform includes hedge funds, funds of hedge funds, funds of private equity funds and portable alpha overlays, including FrontPoint Partners LLC, a leading provider of absolute return strategies with approximately \$8.5 billion in assets under management, and minority stakes in Lansdowne Partners and Avenue Capital Group. Morgan Stanley's Merchant Banking Division, formed in 2007, includes Morgan Stanley's real estate investing business, private equity funds and infrastructure investing group. Morgan Stanley typically acts as general partner of, and investment adviser to, its alternative investment and merchant banking funds and typically commits to invest a minority of the capital of such funds with subscribing investors contributing the majority.

Institutional Investors.

Morgan Stanley provides asset management products and services to institutional investors worldwide, including pension plans, corporations, private funds, non-profit organizations, foundations, endowments, governmental agencies, insurance companies and banks. Products and services are available to institutional investors primarily through separate accounts, U.S. mutual funds and other pooled vehicles. Morgan Stanley Investment Management also sub-advises funds for various unaffiliated financial institutions and intermediaries. A global sales force and a team dedicated to covering the investment consultant industry serve institutional investors.

Individual Investors.

Morgan Stanley offers open-end and alternative investment funds and separately managed accounts to individual investors through affiliated and unaffiliated broker-dealers, banks, insurance companies and financial planners. Closed-end funds managed by Morgan Stanley or Van Kampen are available to individual investors through affiliated and unaffiliated broker-dealers. A small number of unaffiliated broker-dealers account for a substantial portion of Van Kampen open-end fund sales. Morgan Stanley also sells Van Kampen funds through numerous retirement plan platforms. Internationally, Morgan Stanley distributes traditional investment products to individuals outside the U.S. through non-proprietary distributors, and alternative investment products are distributed through affiliated broker-dealers.

Operations and Information Technology.

Morgan Stanley's Operations and Information Technology departments provide or oversee the process and technology platform required to support its asset management business. Support activities include transfer agency, mutual fund accounting and administration, transaction processing and certain fiduciary services, on behalf of institutional, retail and intermediary clients. These activities are undertaken through Morgan Stanley's own facilities, through membership in various clearing and settlement organizations, and through agreements with unaffiliated third parties.

Competition.

All aspects of Morgan Stanley's businesses are highly competitive and Morgan Stanley expects them to remain so. Morgan Stanley competes in the U.S. and globally for clients, market share and human talent in all aspects of its business segments. Morgan Stanley's competitive position depends on its reputation and the quality of its products, services and advice. Morgan Stanley's ability to sustain or improve its competitive position also depends substantially on its ability to continue to attract and retain qualified employees while managing compensation and other costs. Morgan Stanley competes with commercial banks, insurance companies, sponsors of mutual funds, hedge funds, energy companies and

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other companies offering financial services in the U.S., globally and through the internet.

Institutional Securities and Global Wealth Management Group.

Morgan Stanley's competitive position depends on innovation, execution capability and relative pricing. Morgan Stanley competes directly in the U.S. and globally with other securities and financial services firms and broker-dealers, and with others on a regional or product basis.

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Morgan Stanley's ability to access capital at competitive rates (which is generally dependent on Morgan Stanley's credit ratings) and to commit capital efficiently, particularly in its capital-intensive underwriting and sales, trading, financing and market-making activities, also affects its competitive position. Corporate clients continue to request that Morgan Stanley provide loans or lending commitments in connection with certain investment banking activities.

Over time, certain sectors of the financial services industry have become more concentrated, as financial institutions involved in a broad range of financial services industries have been acquired by or merged into other firms. This convergence could result in Morgan Stanley's competitors gaining greater capital and other resources, such as the ability to offer a broader range of products and services and geographic diversity. It is possible that competition may become even more intense as Morgan Stanley continues to compete with financial institutions that may be larger, or better capitalized, or may have a stronger local presence and longer operating history in certain areas. Many of these firms have greater capital than Morgan Stanley and have the ability to offer a wide range of products and services that may enhance their competitive position and could result in pricing pressure in our businesses. The complementary trends in the financial services industry of consolidation and globalization present, among other things, technological, risk management, regulatory and other infrastructure challenges that require effective resource allocation in order for Morgan Stanley to remain competitive.

Morgan Stanley has experienced intense price competition in some of its businesses in recent years. In particular, the ability to execute securities trades electronically on exchanges and through other automated trading markets has increased the pressure on trading commissions. The trend toward direct access to automated, electronic stock markets will likely continue. It is possible that Morgan Stanley will experience competitive pressures in these and other areas in the future as some of its competitors may seek to obtain market share by reducing prices.

Asset Management.

Competition in the asset management industry is affected by several factors, including Morgan Stanley's reputation, investment objectives, quality of investment professionals, performance of investment products relative to peers and an appropriate benchmark index, advertising and sales promotion efforts, fee levels, the effectiveness of and access to distribution channels, and the types and quality of products offered. Morgan Stanley's alternative investment products, such as private equity funds, real estate and hedge funds, compete with similar products offered by both alternative and traditional asset managers.

Regulation.

Most aspects of Morgan Stanley's business are subject to stringent regulation by U.S. federal and state regulatory agencies and securities exchanges and by non-U.S. government agencies or regulatory bodies and securities exchanges. Aspects of Morgan Stanley's public disclosure, corporate governance principles, internal control environment and the roles of auditors and counsel are subject to the Sarbanes-Oxley Act of 2002 and related regulations and rules of the SEC and the NYSE.

New laws or regulations or changes to existing laws and regulations (including changes in the interpretation or enforcement thereof) either in the U.S. or elsewhere could materially adversely affect Morgan Stanley's financial condition or results of operations. As a global financial institution, to the extent that different regulatory regimes impose inconsistent or iterative requirements on the conduct of its business, Morgan Stanley faces complexity and additional costs in its compliance efforts.

Consolidated Supervision and Revised Capital Standards.

Effective December 1, 2005, Morgan Stanley became a consolidated supervised entity (CSE) as defined by the SEC. As such, Morgan Stanley is subject to group-wide supervision and examination by the SEC and to minimum capital requirements on a consolidated basis. Morgan Stanley's European regulated entities implemented Basel II capital standards on January 1, 2008. Morgan Stanley continues to work with its regulators on the implementation of the CSE rules and Basel II capital standards.

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Anti-Money Laundering.

Morgan Stanley's Anti-Money Laundering (AML) program is coordinated on an enterprise-wide basis. In the U.S., for example, the USA PATRIOT Act of 2001 (the USA PATRIOT Act) imposes significant obligations on financial institutions to detect and deter money laundering and terrorist financing activity, including requiring banks, broker-dealers and mutual funds to identify and verify customers that maintain accounts. The USA PATRIOT Act also mandates that certain types of financial institutions monitor and report suspicious activity to appropriate law enforcement or regulatory authorities. An institution subject to the USA PATRIOT Act also must designate an AML compliance officer, provide employees with training on money laundering prevention, and undergo an annual, independent audit to assess the effectiveness of its AML program. Outside the U.S., applicable laws and regulations similarly subject designated types of financial institutions to AML requirements. Morgan Stanley has implemented policies, procedures and internal controls that are designed to comply with these AML requirements.

Protection of Client Information.

Many aspects of Morgan Stanley's business are subject to increasingly comprehensive legal requirements concerning the use and protection of certain client information, including those adopted pursuant to the Gramm-Leach-Bliley Act of 1999 and the Fair and Accurate Credit Transactions Act of 2003 in the U.S., the European Union Data Protection Directive in the EU and various laws in Asia, including the Japanese Personal Information (Protection) Law, the Hong Kong Personal Data (Protection) Ordinance and the Australian Privacy Act. Morgan Stanley has adopted measures in response to such requirements.

Institutional Securities and Global Wealth Management Group.

Broker-Dealer Regulation. MS&Co. is registered as a broker-dealer with the SEC and in all 50 states, the District of Columbia, Puerto Rico and the U.S. Virgin Islands, and is a member of self-regulatory organizations, including the Financial Industry Regulatory Authority (FINRA) and securities exchanges, including the NYSE. Broker-dealers are subject to laws and regulations covering all aspects of the securities business, including sales and trading practices, securities offerings, publication of research reports, use of customers' funds and securities, capital structure, record-keeping and retention and the conduct of their directors, officers, representatives and other associated persons. Broker-dealers are also regulated by securities administrators in those states where they do business. Violations of the laws and regulations governing a broker-dealer's actions could result in censures, fines, the issuance of cease-and-desist orders, revocation of licenses or registrations, the suspension or expulsion from the securities industry of such broker-dealer or its officers or employees, or other similar consequences by both federal and state securities administrators.

Margin lending by broker-dealers is regulated by the Federal Reserve Board's restrictions on lending in connection with customer and proprietary purchases and short sales of securities, as well as securities borrowing and lending activities. Broker-dealers are also required by the National Association of Securities Dealers, Inc. and NYSE rules to impose maintenance requirements on the value of securities contained in margin accounts. In many cases, Morgan Stanley's broker-dealer subsidiaries' margin policies are more stringent than these rules.

Morgan Stanley conducts some of its government securities activities through Morgan Stanley Market Products Inc., a FINRA member registered as a government securities broker-dealer with the SEC and in certain states. The Department of Treasury has promulgated regulations concerning, among other things, capital adequacy, custody and use of government securities and transfers and control of government securities subject to repurchase transactions. The rules of the Municipal Securities Rulemaking Board, which are enforced by FINRA, govern the municipal securities activities of Morgan Stanley.

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As registered U.S. broker-dealers, certain subsidiaries of Morgan Stanley, including MS&Co., are subject to the SEC's net capital rule and the net capital requirements of various securities exchanges. Many non-U.S. securities exchanges and regulatory authorities either have imposed or are proposing rules relating to capital requirements

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applicable to Morgan Stanley's non-U.S. broker-dealer subsidiaries. These rules, which specify minimum capital requirements, are generally designed to measure general financial integrity and liquidity and require that at least a minimum amount of net assets be kept in relatively liquid form. See also Consolidated Supervision and Revised Capital Standards above and Note 16 in Notes to Consolidated Financial Statements in Part II, Item 8. Rules of FINRA and other self-regulatory organizations also impose limitations and requirements on the transfer of member organizations' assets.

Compliance with the capital requirements may limit Morgan Stanley's operations requiring the intensive use of capital. Such requirements restrict Morgan Stanley's ability to withdraw capital from its broker-dealer subsidiaries, which in turn may limit its ability to pay dividends, repay debt or redeem or purchase shares of its own outstanding stock. Any change in such rules or the imposition of new rules affecting the scope, coverage, calculation or amount of capital requirements, or a significant operating loss or any unusually large charge against capital, could adversely affect Morgan Stanley's ability to pay dividends or to expand or maintain present business levels. In addition, such rules may require Morgan Stanley to make substantial capital infusions into one or more of its broker-dealer subsidiaries in order for such subsidiaries to comply with such rules, either in the form of cash or subordinated loans made in accordance with the requirements of the SEC's net capital rule.

Regulation of Certain Commodities Activities. The commodities activities in the Institutional Securities business segment are subject to extensive and evolving energy, commodities, environmental, health and safety, and other governmental laws and regulations in the U.S. and abroad. Intensified scrutiny of certain energy markets by U.S. federal, state and local authorities in the U.S. and abroad and the public has resulted in increased regulatory and legal enforcement and remedial proceedings involving energy companies, including those engaged in power generation and liquid hydrocarbons trading. The EU has increased its focus on the energy markets, which has resulted in increased regulation of companies participating in the energy markets, including those engaged in power generation and liquid hydrocarbons trading.

Terminal facilities and other assets relating to Morgan Stanley's commodities activities are also subject to environmental laws both in the U.S. and abroad. In addition, pipeline, transport and terminal operations are subject to state laws in connection with the cleanup of hazardous substances that may have been released at properties currently or previously owned or operated by us or locations to which we have sent wastes for disposal.

Additional Regulation of U.S. Entities. As a registered futures commission merchant, MS&Co. is subject to the net capital requirements of, and its activities are regulated by, the Commodity Futures Trading Commission (the CFTC) and various commodity exchanges. Certain subsidiaries of Morgan Stanley are registered with the CFTC as commodity trading advisors and/or commodity pool operators. Morgan Stanley's futures and options-on-futures businesses are also regulated by the National Futures Association (the NFA), a registered futures association, of which MS&Co. and certain of its affiliates are members. Violations of the rules of the CFTC, the NFA or the commodity exchanges could result in remedial actions including fines, registration restrictions or terminations, trading prohibitions or revocations of commodity exchange memberships.

Morgan Stanley Bank, through which Morgan Stanley conducts certain financing and lending activities, is an industrial bank chartered under the laws of the State of Utah. It has deposits that are eligible for insurance by the Federal Deposit Insurance Corporation (FDIC) in accordance with FDIC rules and is subject to comprehensive regulation and periodic examination by the Utah Department of Financial Institutions and the FDIC. Morgan Stanley Bank is not considered a bank under the Bank Holding Company Act of 1956, as amended (the BHCA).

Morgan Stanley Trust National Association, a wholly owned subsidiary, is a federally chartered national bank whose activities are limited to fiduciary activities, primarily personal trust services. It is subject to comprehensive regulation and periodic examination by the Office of the Comptroller of the Currency. Morgan Stanley Trust National Association is not FDIC-insured and is not considered a bank for purposes of the BHCA.

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Morgan Stanley Trust, a wholly owned subsidiary which conducts certain transfer agency, sub-accounting and other activities, is a federally chartered savings bank whose activities are subject to comprehensive regulation and periodic examination by the Office of Thrift Supervision (OTS). As a result of its ownership of Morgan Stanley Trust, Morgan Stanley is registered with the OTS as a unitary savings and loan holding company (SLHC) and subject to regulation and examination by the OTS as a SLHC. Subsidiaries of Morgan Stanley, including Morgan Stanley Trust, are registered transfer agents subject to regulation and examination by the SEC. Morgan Stanley Trust has deposits that are eligible for insurance by the FDIC.

Non-U.S. Regulation. Morgan Stanley's businesses are also regulated extensively by non-U.S. regulators, including governments, securities exchanges, commodity exchanges, self-regulatory organizations, central banks and regulatory bodies, especially in those jurisdictions in which Morgan Stanley maintains an office. As Morgan Stanley continues to expand its business internationally, including in Europe, Latin America, Asia and the Middle East, it will become subject to regulation in the jurisdictions in which it conducts business. Certain Morgan Stanley subsidiaries are regulated as broker-dealers under the laws of the jurisdictions in which they operate. Subsidiaries engaged in banking and trust activities outside the U.S. are regulated by various government agencies in the particular jurisdiction where they are chartered, incorporated and/or conduct their business activity. For instance, the Financial Services Authority and several U.K. securities and futures exchanges, including the London Stock Exchange and Euronext.liffe regulate the Company's activities in the U.K.; the Deutsche Borse AG and the Bundesanstalt für Finanzdienstleistungsaufsicht (the Federal Financial Supervisory Authority) regulate its activities in the Federal Republic of Germany; the Swiss Federal Banking Commission regulates its activities in Switzerland; the Comisión Nacional del Mercado de Valores (C.N.M.V.) regulates its activities in Spain; the Financial Services Agency, the Bank of Japan, the Japanese Securities Dealers Association and several Japanese securities and futures exchanges, including the Tokyo Stock Exchange, the Osaka Securities Exchange and the Tokyo International Financial Futures Exchange, regulate its activities in Japan; the Hong Kong Securities and Futures Commission, the Hong Kong Exchanges and Clearing Limited regulate its operations in Hong Kong; and the Monetary Authority of Singapore and the Singapore Exchange Limited regulate its business in Singapore.

Research. Both U.S. and non-U.S. regulators continue to focus on research conflicts of interest. Research-related regulations have been implemented in many jurisdictions and are proposed or under consideration in other jurisdictions. New and revised requirements resulting from these regulations and the global research settlement with U.S. Federal and state regulators (to which Morgan Stanley is a party) have necessitated the development or enhancement of corresponding policies and procedures.

Asset Management.

The majority of subsidiaries related to Morgan Stanley's asset management activities and others, including MS&Co., are registered as investment advisers with the SEC, and, in certain states, some employees or representatives of subsidiaries are registered as investment adviser representatives. Many aspects of Morgan Stanley's asset management activities are subject to federal and state laws and regulations primarily intended to benefit the investor or client. These laws and regulations generally grant supervisory agencies and bodies broad administrative powers, including the power to limit or restrict Morgan Stanley from carrying on its asset management activities in the event that it fails to comply with such laws and regulations. Sanctions that may be imposed for such failure include the suspension of individual employees, limitations on Morgan Stanley engaging in various asset management activities for specified periods of time, the revocation of registrations, other censures and fines.

Morgan Stanley's Asset Management business is also regulated outside the U.S. For example, the Financial Services Authority regulates Morgan Stanley's business in the U.K.; the Financial Services Agency regulates Morgan Stanley's business in Japan; the Securities and Exchange Board of India regulates Morgan Stanley's business in India; and the Monetary Authority of Singapore regulates Morgan Stanley's business in Singapore.

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Executive Officers of Morgan Stanley.

The executive officers of Morgan Stanley and their ages and titles as of January 28, 2008 are set forth below. Business experience for the past five years is provided in accordance with SEC rules.

John J. Mack (63). Chairman of the Board of Directors and Chief Executive Officer (since June 2005). Chairman of Pequot Capital Management (June 2005). Co-Chief Executive Officer of Credit Suisse Group (January 2003 to June 2004). President, Chief Executive Officer and Director of Credit Suisse First Boston (July 2001 to June 2004). President and Chief Operating Officer of Morgan Stanley (May 1997 to March 2001).

Walid Chammah (53). Co-President (since December 2007). Chairman and Chief Executive Officer of Morgan Stanley International (since July 2007). Head of Investment Banking (August 2005 to July 2007) and Head of Global Capital Markets (July 2002 to August 2005).

James Gorman (49). Co-President (since December 2007). Co-Head of Strategic Planning (since October 2007) and President and Chief Operating Officer of the Global Wealth Management Group (since February 2006). Head of Corporate Acquisitions Strategy & Research at Merrill Lynch & Co., Inc. (Merrill Lynch) (July 2005 to August 2005) and President of the Global Private Client business at Merrill Lynch (December 2002 to July 2005).

Colm Kelleher (50). Executive Vice President and Chief Financial Officer and Co-Head of Strategic Planning (since October 2007). Head of Global Capital Markets (February 2006 to October 2007). Co-Head of Fixed Income Europe (May 2004 to February 2006). Head of Fixed Income Sales Europe (December 2000 to May 2004).

Gary G. Lynch (57). Executive Vice President and Chief Legal Officer (since October 2005). Global General Counsel (October 2001 to October 2005) of Credit Suisse First Boston. Executive Vice Chairman (July 2004 to October 2005) and Vice Chairman (December 2002 to July 2004) of Credit Suisse First Boston and member of the Executive Board (July 2004 to July 2005) of Credit Suisse Group. Partner at the law firm of Davis Polk & Wardwell (September 1989 to October 2001).

Thomas R. Nides (46). Executive Vice President, Chief Administrative Officer and Secretary (since September 2005). Worldwide President and Chief Executive Officer of Burson-Marsteller (November 2004 to August 2005). Chief Administrative Officer of Credit Suisse First Boston (June 2001 to June 2004).

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Item 1A. Risk Factors.

Liquidity Risk.

Liquidity and funding risk refers to the risk that Morgan Stanley will be unable to finance its operations due to a loss of access to the capital markets or difficulty in liquidating its assets. Liquidity and funding risk also encompasses the ability of Morgan Stanley to meet its financial obligations without experiencing significant business disruption or reputational damage that may threaten its viability as a going concern. For more information on how we monitor and manage liquidity and funding risk, see Management's Discussion and Analysis of Results of Operations Liquidity and Capital Resources in Part II, Item 7 below.

Liquidity is essential to our businesses and we rely on external sources to finance a significant portion of our operations.

Liquidity is essential to our businesses. Our liquidity could be substantially negatively affected by an inability to raise funding in the long-term or short-term debt capital markets or the equity capital markets or an inability to access the secured lending markets. Factors that we cannot control, such as disruption of the financial markets or negative views about the financial services industry generally, could impair our ability to raise funding. In addition, our ability to raise funding could be impaired if lenders develop a negative perception of our long-term or short-term financial prospects. Such negative perceptions could be developed if we incur large trading losses, we are downgraded or put on negative watch by the rating agencies, we suffer a decline in the level of our business activity, regulatory authorities take significant action against us, or we discover serious employee misconduct or illegal activity, among other reasons. If we are unable to raise funding using the methods described above, we would likely need to liquidate unencumbered assets, such as our investment and trading portfolios, to meet maturing liabilities. We may be unable to sell some of our assets, or we may have to sell assets at a discount from market value, either of which could adversely affect our results of operations.

Our borrowing costs and access to the debt capital markets depend significantly on our credit ratings.

The cost and availability of unsecured financing generally are dependent on our short-term and long-term credit ratings. Factors that are significant to the determination of our credit ratings or otherwise affect our ability to raise short-term and long-term financing include the level and volatility of our earnings; our relative competitive position in the markets in which we operate; our geographic and product diversification; our ability to retain key personnel; our risk profile; our risk management policies; our cash liquidity; our capital adequacy; our corporate lending credit risk; and legal and regulatory developments. A deterioration in any of these factors or combination of these factors may lead rating agencies to downgrade our credit ratings, thereby increasing our cost of obtaining unsecured funding.

Our debt ratings also can have a significant impact on certain trading revenues, particularly in those businesses where longer term counterparty performance is critical, such as OTC derivative transactions, including credit derivatives and interest rate swaps. In connection with certain OTC trading agreements and certain other agreements associated with the Institutional Securities business segment, we may be required to provide additional collateral to certain counterparties in the event of a credit ratings downgrade.

We are a holding company and depend on payments from our subsidiaries.

We depend on dividends, distributions and other payments from our subsidiaries to fund dividend payments and to fund all payments on our obligations, including debt obligations. Regulatory and other legal restrictions may limit our ability to transfer funds freely, either to or from our subsidiaries. In particular, many of our subsidiaries, including our broker-dealer subsidiaries, are subject to laws and regulations that authorize regulatory bodies to block or reduce the flow of funds to the parent holding company, or that prohibit such transfers altogether in certain circumstances. These laws and regulations may hinder our ability to access funds that we may need to make payments on our obligations.

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If our liquidity and funding policies are not adequate, we may be unable to access sufficient financing.

Our liquidity and funding policies have been designed to ensure that we maintain sufficient liquid financial resources to continue to conduct our business for an extended period in a stressed liquidity environment. If our liquidity and funding policies are not adequate or we do not adhere to the policies, we may be unable to access sufficient financing to service our financial obligations when they come due, which could have a material adverse franchise or business impact.

Market Risk.

Market risk refers to the risk that a change in the level of one or more market prices of commodities or securities, rates, indices, implied volatilities (the price volatility of the underlying instrument imputed from option prices), correlations or other market factors, such as liquidity, will result in losses for a position or portfolio. For more information on how we monitor and manage market risk, see **Market Risk** in Part II, Item 7A herein.

Our results of operations may be materially affected by market fluctuations and by economic and other factors.

The amount, duration and range of our market risk exposures have been increasing over the past several years, and may continue to do so. Our results of operations may be materially affected by market fluctuations due to economic and other factors. Results of operations in the past have been, and in the future may continue to be, materially affected by many factors of a global nature, including political, economic and market conditions; the availability and cost of capital; the liquidity of global markets; the level and volatility of equity prices, commodity prices and interest rates; currency values and other market indices; technological changes and events; the availability and cost of credit; inflation; natural disasters; acts of war or terrorism; investor sentiment and confidence in the financial markets; or a combination of these or other factors. In addition, legislative, legal and regulatory developments related to our businesses potentially could increase costs, thereby affecting results of operations. These factors also may have an impact on our ability to achieve our strategic objectives.

The results of our Institutional Securities business segment, particularly results relating to our involvement in primary and secondary markets for all types of financial products, are subject to substantial fluctuations due to a variety of factors, such as those enumerated above that we cannot control or predict with great certainty. These fluctuations impact results by causing variations in new business flows and in the fair value of securities and other financial products. Fluctuations also occur due to the level of global market activity, which, among other things, affects the size, number and timing of investment banking client assignments and transactions and the realization of returns from our principal investments. During periods of unfavorable market or economic conditions, the level of individual investor participation in the global markets may also decrease, which would negatively impact the results of our Global Wealth Management Group business segment. In addition, fluctuations in global market activity could impact the flow of investment capital into or from assets under management or supervision and the way customers allocate capital among money market, equity, fixed income or other investment alternatives, which could negatively impact our Asset Management business segment.

We may experience further writedowns of our financial instruments and other losses related to volatile and illiquid market conditions.

The Company recorded \$9.4 billion in mortgage-related writedowns in the fourth quarter of fiscal 2007, including \$7.8 billion relating to our U.S. subprime trading positions and \$1.6 billion relating to other mortgage-related products, such as commercial mortgage-backed securities,

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ALT-A and other loans, conduit and non-performing loans and European non-conforming loans, and an impairment charge related to mortgage-related securities portfolios in our domestic subsidiary banks. We continue to have exposure to these markets and products and as market conditions continue to evolve the fair value of these mortgage-related instruments could further deteriorate. In addition, recent market volatility has made it extremely difficult to value certain of our

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securities. Subsequent valuations, in light of factors then prevailing, may result in significant changes in the values of these securities in future periods. In addition, at the time of any sales and settlements of these securities, the price we ultimately realize will depend on the demand and liquidity in the market at that time and may be materially lower than their current fair value. Any of these factors could require us to take further writedowns in the value of our securities portfolio, which may have an adverse effect on our results of operations in future periods.

The results for fiscal 2007 included other losses primarily related to the illiquid market conditions that existed during the second half of fiscal 2007. These included losses reflecting mark-to-market valuations associated with loans and loan commitments largely related to acquisition financing to non-investment grade companies. The Company's leveraged finance business originates and distributes loans and commitments, and intends to distribute its current positions; however, this may take longer than in the past and is dependent on liquidity reentering the market and additional writedowns of these loans and commitments may occur. The valuation of these commitments could change in future periods depending on, among other things, the extent that they are renegotiated or repriced or the associated acquisition transaction does not occur.

Other areas of our business which to date have not been adversely affected by the illiquidity in our mortgage and lending businesses could be adversely affected if the current conditions in the credit market spread to other sectors.

Holding large and concentrated positions may expose us to losses.

Concentration of risk may reduce revenues or result in losses in our market-making, proprietary trading, investing, block trading, underwriting and lending businesses in the event of unfavorable market movements. We commit substantial amounts of capital to these businesses, which often results in us taking large positions in the securities of, or make large loans to, a particular issuer or issuers in a particular industry, country or region. Moreover, the trend in all major capital markets is towards larger and more frequent commitments of capital in many of these activities, and we expect this trend to continue.

Markets may experience periods of high volatility accompanied by reduced liquidity.

Financial markets are susceptible to severe events evidenced by rapid depreciation in asset values accompanied by a reduction in asset liquidity, such as the asset price deterioration in the U.S. subprime residential mortgage market. Under these extreme conditions, hedging and other risk management strategies may not be as effective at mitigating trading losses as they would be under more normal market conditions. Moreover, under these conditions market participants are particularly exposed to trading strategies employed by many market participants simultaneously and on a large scale, such as crowded trades. Morgan Stanley's risk management and monitoring processes seek to quantify and mitigate risk to more extreme market moves. Severe market events have historically been difficult to predict, however, and Morgan Stanley could realize significant losses if unprecedented extreme market events were to occur, as illustrated by recent results in our subprime mortgage-related proprietary trading.

We may incur significant losses in the real estate sector.

We finance and acquire principal positions in a number of real estate and real estate-related products for our own account, for investment vehicles managed by affiliates in which we also may have a significant investment, for separate accounts managed by affiliates and for major participants in the commercial and residential real estate markets, and originate loans secured by commercial and residential properties. We also securitize and trade in a wide range of commercial and residential real estate and real estate-related whole loans, mortgages and other real estate

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and commercial assets and products, including residential and commercial mortgage-backed securities. These businesses could be adversely affected by a downturn in the real estate sector.

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Credit Risk.

Credit risk refers to the risk of loss arising from borrower or counterparty default when a borrower, counterparty or obligor does not meet its obligations. For more information on how we monitor and manage credit risk, see **Credit Risk** in Part II, Item 7A herein.

We are exposed to the risk that third parties that are indebted to us will not perform their obligations.

We incur significant, single-name credit risk exposure through the Institutional Securities business segment. This risk may arise, for example, from entering into swap or other derivative contracts under which counterparties have long-term obligations to make payments to us and by extending credit to our clients through various credit arrangements. We incur individual consumer credit risk in the Global Wealth Management Group business segment through margin and non-purpose loans to individual investors, which are collateralized by securities.

The amount, duration and range of our credit exposures have been increasing over the past several years, and may continue to do so. In recent years, we have significantly expanded our use of swaps and other derivatives and we may continue to do so. Corporate clients are increasingly seeking loans or lending commitments from us in connection with investment banking and other assignments. In addition, we have experienced, due to competitive factors, increased pressure to assume longer-term credit risk, to provide swaps and lending commitments to counterparties and borrowers with lower credit quality, to extend credit against less liquid collateral and to price derivatives instruments more aggressively based on the credit risks that we take. As a clearing member firm, we finance our customer positions and we could be held responsible for the defaults or misconduct of our customers. Although we regularly review our credit exposures, default risk may arise from events or circumstances that are difficult to detect or foresee.

Defaults by another larger financial institution could adversely affect financial markets generally.

The commercial soundness of many financial institutions may be closely interrelated as a result of credit, trading, clearing or other relationships between the institutions. As a result, concerns about, or a default or threatened default by, one institution could lead to significant market-wide liquidity problems, losses or defaults by other institutions. This is sometimes referred to as **systemic risk** and may adversely affect financial intermediaries, such as clearing agencies, clearing houses, banks, securities firms and exchanges, with which we interact on a daily basis, and therefore could adversely affect Morgan Stanley.

Operational Risk.

Operational risk refers to the risk of financial or other loss, or potential damage to a firm's reputation, arising from inadequate or failed internal processes, people, resources, systems or from external events (e.g., external or internal fraud, legal and compliance risks, damage to physical assets, etc.). Morgan Stanley may incur operational risk across its full scope of business activities, including revenue-generating activities (e.g., sales and trading) and support functions (e.g., information technology and facilities management). As such, Morgan Stanley may incur operational risk in each of its businesses, as well as within the control groups. For more information on how we monitor and manage operational risk, see **Operational Risk** in Part II, Item 7A herein.

We are subject to operational risk and an operational event could adversely affect our businesses.

Our businesses are highly dependent on our ability to process, on a daily basis, a large number of transactions across numerous and diverse markets in many currencies. In general, the transactions we process are increasingly complex. We perform the functions required to operate our different businesses either by ourselves or through agreements with third parties. We rely on the ability of our employees, our internal systems and systems at technology centers operated by third parties to process a high volume of transactions. We also face the risk of operational failure or termination of any of the clearing agents, exchanges, clearing houses or other financial

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intermediaries we use to facilitate our securities transactions. In the event of a breakdown or improper operation of our or third party's systems or improper action by third parties or employees, we could suffer financial loss, an impairment to our liquidity, a disruption of our businesses, regulatory sanctions or damage to our reputation.

Despite the business contingency plans we have in place, our ability to conduct business may be adversely affected by a disruption in the infrastructure that supports our business and the communities where we are located. This may include a disruption involving physical site access, terrorist activities, disease pandemics, electrical, communications or other services used by Morgan Stanley, its employees or third parties with whom we conduct business.

Legal Risk.

Legal risk refers to the risk of non-compliance with applicable legal and regulatory requirements and standards. Legal risk also includes contractual and commercial risk such as the risk that a counterparty's performance obligations will be unenforceable. For more information on how we monitor and manage legal risk, see **Legal Risk** in Part II, Item 7A herein.

The financial services industry faces substantial litigation and regulatory risks, and we may face damage to our reputation and legal liability.

We have been named, from time to time, as a defendant in various legal actions, including arbitrations, class actions, and other litigation, arising in connection with our 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.

We are also involved, from time to time, in other reviews, investigations and proceedings (both formal and informal) by governmental and self-regulatory agencies regarding our business, including, among other things, accounting and operational matters, certain of which may result in adverse judgments, settlements, fines, penalties, injunctions or other relief. The number of these investigations and proceedings has increased in recent years with regard to many firms in the financial services industry, including us. Like any large corporation, we are also subject to risk from potential employee misconduct, including non-compliance with policies and improper use or disclosure of confidential information. Substantial legal liability or significant regulatory action against us could materially adversely affect our business, financial condition or results of operations or cause us significant reputational harm, which could seriously harm our business. For more information regarding legal proceedings in which we are involved see **Legal Proceedings** in Part I, Item 3 herein.

We are subject to extensive regulation in the jurisdictions in which we conduct our businesses.

We are subject to extensive regulation globally and face the risk of significant intervention by regulatory authorities in the jurisdictions in which we conduct our businesses. Among other things, we could be fined, prohibited from engaging in some of our business activities or subject to limitations or conditions on our business activities. Significant regulatory action against us could have material adverse financial effects, cause significant reputational harm to us, or harm our business prospects. New laws or regulations or changes in the enforcement of existing laws or regulations applicable to our clients may also adversely affect our business. For more information regarding the regulatory environment in which we operate, see **Regulation** in Part I, Item 1 herein.

Our commodities activities subject us to extensive regulation, potential catastrophic events and environmental risks and regulation that may expose us to significant costs and liabilities.

In connection with the commodities activities in our Institutional Securities business segment, we engage in the production, storage, transportation, marketing and trading of several commodities, including metals (base and precious), agricultural products, crude oil, oil products, natural gas, electric power, emission credits, coal, freight,

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LNG and related products and indices. In addition, we own five electricity generating facilities in the U.S. and Europe; TransMontaigne Inc. and its subsidiaries, a group of companies operating in the refined petroleum products marketing and distribution business; and the Heidmar Group of companies, which provide international marine transportation and U.S. marine logistics services. As a result of these activities, we are subject to extensive and evolving energy, commodities, environmental, health and safety, and other governmental laws and regulations. For example, liability may be incurred without regard to fault under certain environmental laws and regulations for the remediation of contaminated areas. Our commodities business also exposes us to the risk of unforeseen and catastrophic events, including natural disasters, leaks, spills, explosions, release of toxic substances, fires, accidents on land and at sea, wars, and terrorist attacks that could result in personal injuries, loss of life, property damage, and suspension of operations.

Although we have attempted to mitigate our pollution and other environmental risks by, among other measures, adopting appropriate policies and procedures for power plant operations, monitoring the quality of petroleum storage facilities and transport vessels and implementing emergency response programs, these actions may not prove adequate to address every contingency. In addition, insurance covering some of these risks may not be available, and the proceeds, if any, from insurance recovery may not be adequate to cover liabilities with respect to particular incidents. As a result, our financial condition and results of operations may be adversely affected by these events.

We also expect the other laws and regulations affecting our commodities business to increase in both scope and complexity. During the past several years, intensified scrutiny of certain energy markets by federal, state and local authorities in the U.S. and abroad and the public has resulted in increased regulatory and legal enforcement, litigation and remedial proceedings involving companies engaged in the activities in which we are engaged. For example, the EU has increased its focus on the energy markets which has resulted in increased regulation of companies participating in the energy markets, including those engaged in power generation and liquid hydrocarbons trading. We may incur substantial costs in complying with current or future laws and regulations and our overall businesses and reputation may be adversely affected by the current legal environment. In addition, failure to comply with these laws and regulations may result in substantial civil and criminal fines and penalties.

Potential conflicts of interest are increasing and a failure to appropriately deal with conflicts of interest could adversely affect our businesses.

Our reputation is one of our most important assets. As we have expanded the scope of our businesses and our client base, we increasingly have to address potential conflicts of interest, including those relating to our proprietary activities. For example, conflicts may arise between our position as a financial advisor in a merger transaction and a principal investment we hold in one of the parties to the transaction. In addition, hedge funds and private equity funds are an increasingly important portion of our client base, and also compete with us in a number of our businesses. We have procedures and controls that are designed to address various conflicts of interest. However, identifying and managing potential conflicts of interest can be complex and difficult and our reputation could be damaged if we fail, or appear to fail, to deal appropriately with conflicts of interest. In addition, the SEC and other federal and state regulators have increased their scrutiny of potential conflicts of interest. It is possible that potential or perceived conflicts could give rise to litigation or enforcement actions, which may lead to our clients being less willing to enter into transactions in which such a conflict may occur, which will adversely affect our businesses.

Competitive Environment.

We face strong competition from other financial services firms, which could lead to pricing pressures that could materially adversely affect our revenue and profitability.

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The financial services industry and all of our businesses are intensely competitive, and we expect them to remain so. We compete with commercial banks, insurance companies, sponsors of mutual funds, hedge funds, energy companies and other companies offering financial services in the U.S., globally and through the internet. We

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compete on the basis of several factors, including transaction execution, capital or access to capital, products and services, innovation, reputation and price. Over time, certain sectors of the financial services industry have become considerably more concentrated, as financial institutions involved in a broad range of financial services have been acquired by or merged into other firms. This convergence could result in our competitors gaining greater capital and other resources, such as a broader range of products and services and geographic diversity. We may experience pricing pressures as a result of these factors and as some of our competitors seek to increase market share by reducing prices. For more information regarding the competitive environment in which we operate, see *Competition* in Part I, Item 1 herein.

Our ability to retain and attract qualified employees is critical to the success of our business and the failure to do so may materially adversely affect our performance.

Our people are our most important resource and competition for qualified employees is intense. In order to attract and retain qualified employees, we must compensate such employees at market levels. Typically, those levels have caused employee compensation to be our greatest expense as compensation is highly variable and changes with performance. If we are unable to continue to attract and retain qualified employees, or do so at rates necessary to maintain our competitive position, or if compensation costs required to attract and retain employees become more expensive, our performance, including our competitive position, could be materially adversely affected.

Automated trading markets may adversely affect our business and may increase competition.

We have experienced intense price competition in some of our businesses in recent years. In particular, the ability to execute securities trades electronically on exchanges and through other automated trading markets has increased the pressure on trading commissions. The trend toward direct access to automated, electronic stock markets will likely continue. It is possible that we will experience competitive pressures in these and other areas in the future as some of our competitors may seek to obtain market share by reducing prices.

International Risk.

We are subject to numerous political, economic, legal, operational, franchise and other risks as a result of our international operations which could adversely impact our businesses in many ways.

We are subject to political, economic, legal, operational, franchise and other risks that are inherent in operating in many countries, including risks of possible nationalization, expropriation, price controls, capital controls, exchange controls and other restrictive governmental actions, as well as the outbreak of hostilities or political and governmental instability. In many countries, the laws and regulations applicable to the securities and financial services industries are uncertain and evolving, and it may be difficult for us to determine the exact requirements of local laws in every market. Our inability to remain in compliance with local laws in a particular market could have a significant and negative effect not only on our business in that market but also on our reputation generally. We are also subject to the enhanced risk that transactions we structure might not be legally enforceable in all cases.

We have expanded, and continue to look at opportunities to expand, in the emerging markets. Various emerging market countries have experienced severe economic and financial disruptions, including significant devaluations of their currencies, capital and currency exchange controls, high rates of inflation and low or negative growth rates in their economies. Crime and corruption, as well as issues of security and personal safety, also exist in certain of these countries. These conditions could adversely impact our businesses and increase volatility in

financial markets generally.

The emergence of a pandemic or other widespread health emergency, or concerns over the possibility of such an emergency, could create economic and financial disruptions in emerging markets and other areas throughout the world, and could lead to operational difficulties (including travel limitations) that could impair our ability to manage our businesses around the world.

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Acquisition Risk.

We may be unable to fully capture the expected value from acquisitions, joint ventures and minority stakes.

We expect to grow in part through acquisitions, joint ventures and minority stakes. To the extent we make acquisitions or enter into combinations or joint ventures, we face numerous risks and uncertainties combining or integrating the relevant businesses and systems, including the need to combine accounting and data processing systems and management controls and to integrate relationships with clients and business partners. In the case of joint ventures and minority stakes, we are subject to additional risks and uncertainties in that we may be dependent upon, and subject to liability, losses or reputational damage relating to, systems, controls and personnel that are not under our control. In addition, conflicts or disagreements between us and our joint venture partners may negatively impact the benefits to be achieved by the joint venture. There is no assurance that our recent acquisitions or any business we acquire in the future will be successfully integrated and result in all of the positive benefits anticipated. If we are not able to integrate successfully our past and future acquisitions, there is a risk that our results of operations may be materially and adversely affected.

Risk Management.

Our hedging strategies and other risk management techniques may not be fully effective in mitigating our risk exposure in all market environments or against all types of risk.

We have devoted significant resources to develop our risk management policies and procedures and expect to continue to do so in the future. Nonetheless, our hedging strategies and other risk management techniques may not be fully effective in mitigating our risk exposure in all market environments or against all types of risk, including risks that are unidentified or unanticipated. Some of our methods of managing risk are based upon our use of observed historical market behavior. As a result, these methods may not predict future risk exposures, which could be significantly greater than the historical measures indicate (*e.g.*, recent events in the U.S. subprime residential mortgage market). Management of operational, legal and regulatory risks requires, among other things, policies and procedures to record properly and verify a large number of transactions and events, and these policies and procedures may not be fully effective. For more information on how we monitor and manage market and certain other risks, see [Risk Management](#) [Market Risk](#) in Part II, Item 7A herein.

Item 1B. Unresolved Staff Comments.

Morgan Stanley, like other well-known seasoned issuers, from time to time receives written comments from the staff of the SEC regarding its periodic or current reports under the Exchange Act. There are no comments that remain unresolved that Morgan Stanley received not less than 180 days before the end of its fiscal year to which this report relates that Morgan Stanley believes are material.

Table of Contents**Item 2. Properties.**

Morgan Stanley has offices, operations and processing centers and warehouse facilities located throughout the U.S., and certain subsidiaries maintain offices and other facilities in international locations. Morgan Stanley's properties that are not owned are leased on terms and for durations that are reflective of commercial standards in the communities where these properties are located. Morgan Stanley believes the facilities it owns or occupies are adequate for the purposes for which they are currently used and are well maintained. Our principal offices consist of the following properties:

Location	Owned/ Leased	Lease Expiration	Approximate Square Footage as of November 30, 2007*
U.S. Locations			
1585 Broadway New York, New York <i>(Global Headquarters and Institutional Securities Headquarters)</i>	Owned	N/A	894,390 square feet
522 Fifth Avenue New York, New York <i>(Asset Management Headquarters)</i>	Owned	N/A	581,242 square feet
2000 Westchester Avenue Purchase, New York <i>(Global Wealth Management Group Headquarters)</i>	Owned	N/A	590,303 square feet
New York, New York <i>(Several locations)</i>	Leased	2008 - 2018	2,238,726 square feet
One Pierrepont Plaza Brooklyn, New York	Leased	2013	456,686 square feet
Jersey City, New Jersey <i>(Several locations)</i>	Leased	2008 - 2012	499,350 square feet
International Locations			
25 Cabot Square, Canary Wharf	Owned**	N/A	450,150 square feet

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(London Headquarters)

Canary Wharf	Leased	2013 - 2038	957,378 square feet
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(Several locations)

1 Austin Road	Leased	2019	356,630 square feet
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Kowloon Station, West Kowloon

(Hong Kong Headquarters)

Sapporo s Yebisu Garden Place, Ebisu, Shibuya-ku	Leased	Option to cancel in 2008, or at any time thereafter	396,314 square feet
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(Tokyo Headquarters)

* The indicated total aggregate square footage leased does not include space occupied by Morgan Stanley securities branch offices.

** Morgan Stanley holds the freehold interest in the land and building.

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Item 3. Legal Proceedings.

In addition to the matters described below, in the normal course of business, Morgan Stanley 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.

Morgan Stanley is also involved, from time to time, in other reviews, investigations and proceedings (both formal and informal) by governmental and self-regulatory agencies regarding Morgan Stanley'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.

Morgan Stanley 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, Morgan Stanley 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, Morgan Stanley 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 consolidated financial condition of Morgan Stanley, although the outcome of such matters could be material to Morgan Stanley's operating results and cash flows for a particular future period, depending on, among other things, the level of Morgan Stanley's revenues or income for such period.

Coleman Litigation.

In May 2003, Coleman (Parent) Holdings Inc. (CPH) filed a complaint against Morgan Stanley in the Circuit Court of the Fifteenth Judicial Circuit for Palm Beach County, Florida relating to the 1998 merger between The Coleman Company, Inc. and Sunbeam, Inc. (Sunbeam). The complaint, as amended, alleged that CPH was induced to agree to the transaction with Sunbeam based on certain financial misrepresentations, and it asserted claims against Morgan Stanley for aiding and abetting fraud, conspiracy and punitive damages. Shortly before trial, which commenced in April 2005, the trial court granted, in part, a motion for entry of a default judgment against Morgan Stanley and ordered that portions of CPH's complaint, including those setting forth CPH's primary allegations against Morgan Stanley, be read to the jury and deemed established for all purposes in the action. In May 2005, the jury returned a verdict in favor of CPH and awarded CPH \$604 million in compensatory damages and \$850 million in punitive damages. In June 2005, the trial court issued a final judgment in favor of CPH in the amount of \$1,578 million, which included prejudgment interest and excluded certain payments received by CPH in settlement of related claims against others.

In March 2007, the District Court of Appeal for the Fourth District of Florida (the Court of Appeal) issued an opinion reversing the trial court's award for compensatory and punitive damages and remanding the matter to the trial court for entry of judgment for Morgan Stanley. In June 2007, the Court of Appeal's opinion became final when the Court of Appeal issued an order denying CPH's motions for rehearing, rehearing *en banc* and for certification of certain questions for review by the Florida Supreme Court (the Supreme Court). On December 12, 2007, the Supreme Court denied CPH's request for review of the Court of Appeal's decision, directing judgment in favor of Morgan Stanley.

IPO Fee Litigation.

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Starting in late 1998, purported class actions, later captioned *In re Public Offering Fee Antitrust Litigation* (the purchaser actions) and *In re Issuer Plaintiff Initial Public Offering Fee Antitrust Litigation* (the issuer actions), were initiated in the U.S. District Court for the Southern District of New York (the SDNY) against

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Morgan Stanley and numerous other underwriters. The consolidated proceedings, one on behalf of purchasers and the other on behalf of issuers of certain shares in initial public offerings (IPOs), allege that defendants conspired to fix the underwriters' spread at 7% in IPOs of U.S. companies in the \$20 million to \$80 million range in violation of Section 1 of the Sherman Act. The complaints seek treble damages and injunctive relief. Plaintiffs' claims for damages in the purchaser actions have been dismissed, but the claims for injunctive relief remain and plaintiffs' claims in the issuer actions for damages and injunctive relief remain. Plaintiffs moved for class certification in both actions, and defendants opposed that motion in May 2005. In October 2005, plaintiffs moved for summary judgment, which defendants opposed. In May 2006, plaintiffs filed a petition pursuant to Federal Rule of Civil Procedure 23(f) for leave to appeal the SDNY's denial of class certification and in September 2007, the U.S. Court of Appeals for the Second Circuit (the Second Circuit) reversed the SDNY's decision and remanded the case back to the district court for further consideration of class certification issues. On remand, plaintiffs filed a motion for class certification on October 17, 2007.

IPO Allocation Matters.

Beginning in March 2001, numerous purported class actions, now captioned *In re Initial Public Offering Securities Litigation*, were filed in the SDNY against certain issuers of IPO securities, certain individual officers of those issuers, Morgan Stanley and other underwriters of those IPOs, purportedly on behalf of purchasers of stock in the IPOs or the aftermarket. These complaints allege that defendants required customers who wanted allocations of hot IPO securities to pay undisclosed and excessive underwriters' compensation in the form of increased brokerage commissions and to buy shares of securities offered in the IPOs after the IPOs were completed at escalating price levels higher than the IPO price (a practice plaintiffs refer to as laddering), and claim violations of the federal securities laws, including Sections 11 and 12(a)(2) of the Securities Act of 1933 (the Securities Act) and Section 10(b) of the Exchange Act. Some of the complaints also allege that continuous buy recommendations by the defendants' research analysts improperly increased or sustained the prices at which the securities traded after the IPOs. In February 2003, the underwriter defendants' joint motion to dismiss was denied, except as to certain specified offerings. In December 2006, the Second Circuit reversed the SDNY's grant of class certification, and ruled that these cases could not be certified for class treatment. In August 2007, plaintiffs filed second consolidated amended class action complaints, which purport to amend the allegations in light of the Second Circuit's reversal of the SDNY's decision approving the cases to proceed as class actions. Plaintiffs again seek certification of classes.

In October 2007, numerous derivative actions, purportedly brought on behalf of certain issuers of IPO securities, were filed in the U.S. District Court for the Western District of Washington against Morgan Stanley and other underwriters of those IPOs. The actions seek to recover short swing profits allegedly generated in violation of Section 16(b) of the Exchange Act.

Late Trading and Market Timing.

Starting in July 2003, Morgan Stanley received subpoenas and requests for information from various regulatory and governmental agencies, including the SEC, the NYSE and various states, in connection with industry-wide investigations of broker-dealers and mutual fund complexes relating to possible late trading and market timing of mutual funds. In December 2007, Morgan Stanley settled all claims with the SEC concerning late trading and market timing of mutual funds in the retail system over the period from January 2002 to August 2003. Under the terms of the settlement, Morgan Stanley will, among other things, be censured and pay a monetary fine.

Subprime-related Matters.

Morgan Stanley is responding to subpoenas and requests for information from certain regulatory and governmental entities concerning the origination, purchase, securitization and servicing of subprime and non-subprime residential mortgages and related issues. Morgan Stanley has

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also been named as a defendant in various civil litigation matters related to the subprime and non-subprime residential mortgage business, including

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purported class actions related to Morgan Stanley's role as an underwriter of certain preferred stock offerings for New Century Financial Corp. and Countrywide Financial Corp. and certain offerings of mortgage pass through certificates for a subsidiary of Countrywide Financial Corp., and other related matters.

A shareholder derivative lawsuit was filed in the SDNY during November 2007 asserting claims related in large part to losses caused by certain subprime-related trading positions and related matters, but no complaint has been served. In December 2007, several purported class action complaints were filed in SDNY asserting claims on behalf of participants in Morgan Stanley's 401(k) plan and employee stock ownership plan against Morgan Stanley and other parties, including certain present and former directors and officers, under the Employee Retirement Income Security Act of 1974. The complaints relate in large part to subprime-related losses, and allege, among other things, that Morgan Stanley stock was not a prudent investment and that risks associated with Morgan Stanley stock and Morgan Stanley's financial condition were not adequately disclosed.

The following matters were terminated during the quarter ended November 30, 2007:

Global Wealth Management Group Employment Matters.

Wage and Hour Matters. Complaints raising allegations of unpaid overtime and unlawful wage deductions were filed against Morgan Stanley in New Jersey, New York, Connecticut, Texas, Florida, Illinois, California and Ohio seeking damages on behalf of certain current and former employees. In October 2006, Morgan Stanley reached agreement to resolve these claims on behalf of the individual claimants as well as other potential class members nationwide. In November 2006, for purposes of executing the settlement, a consolidated amended complaint captioned *Steinberg, et al. v. Morgan Stanley* was filed in the U.S. District Court for the Southern District of California (SDC). In December 2006, the Judicial Panel on Multi-District Litigation issued an order centralizing the various matters pending across the country in the SDC.

Gender Matters. In June 2006, Morgan Stanley was named in two purported class actions alleging gender discrimination under state and federal law. On October 24, 2007, the U.S. District Court for the District of Columbia granted final approval to the settlement reached in *Joanne Augst-Johnson v. Morgan Stanley*. The approved settlement resolved all of the class-wide and individual plaintiffs' claims and included, among other things, a payment to the settlement fund and certain programmatic relief. All similar class wide claims raised in the second purported gender class action captioned *Daisy Jaffe et al. v. Morgan Stanley* were subsumed by the *Augst-Johnson* settlement.

Item 4. Submission of Matters to a Vote of Security Holders.

There were no matters submitted to a vote of security holders during the fourth quarter of our fiscal year ended November 30, 2007.

Table of Contents**Part II****Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.**

Morgan Stanley's common stock trades on the NYSE under the symbol MS. At January 23, 2008, Morgan Stanley had approximately 94,469 holders of record; however, Morgan Stanley believes the number of beneficial owners of common stock exceeds this number.

The table below sets forth, for each of the last eight fiscal quarters, the low and high sales prices per share of Morgan Stanley's common stock as reported by Bloomberg Financial Markets and the amount of any cash dividends declared per share of Morgan Stanley's common stock.

	Low Sale Price	High Sale Price	Dividends
Fiscal 2007:			
Fourth Quarter	\$ 47.56	\$ 69.87	\$ 0.27
Third Quarter*	\$ 54.90	\$ 90.95	\$ 0.27
Second Quarter	\$ 70.30	\$ 87.44	\$ 0.27
First Quarter	\$ 73.04	\$ 84.66	\$ 0.27
Fiscal 2006:			
Fourth Quarter	\$ 65.26	\$ 80.00	\$ 0.27
Third Quarter	\$ 54.52	\$ 69.50	\$ 0.27
Second Quarter	\$ 57.58	\$ 66.00	\$ 0.27
First Quarter	\$ 55.89	\$ 62.15	\$ 0.27

* On June 30, 2007, Morgan Stanley completed the Discover Spin-off. Prior to the Discover Spin-off, the Low Sale Price and the High Sale Price for the Third Quarter were \$82.73 and \$90.95, respectively.

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The table below sets forth the information with respect to purchases made by or on behalf of Morgan Stanley of its common stock during the fourth quarter of our fiscal year ended November 30, 2007.

Issuer Purchases of Equity Securities

(dollars in millions, except per share amounts)

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased As Part of Publicly Announced Plans or Programs (C)	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs
Month #1 (September 1, 2007 - September 30, 2007)				
Share Repurchase Program (A)		N/A		\$ 2,787
Employee Transactions (B)	2,348,230	\$ 62.89	N/A	N/A
Month #2 (October 1, 2007 - October 31, 2007)				
Share Repurchase Program (A)	2,830,092	\$ 63.32	2,830,092	\$ 2,608
Employee Transactions (B)	29,705	\$ 66.34	N/A	N/A
Month #3 (November 1, 2007 - November 30, 2007)				
Share Repurchase Program (A)	6,364,081	\$ 52.93	6,364,081	\$ 2,271
Employee Transactions (B)	98,592	\$ 53.65	N/A	N/A
Total				
Share Repurchase Program (A)	9,194,173	\$ 56.13	9,194,173	\$ 2,271
Employee Transactions (B)	2,476,527	\$ 62.56	N/A	N/A

- (A) On December 19, 2006, Morgan Stanley announced that its Board of Directors authorized the repurchase of up to \$6 billion of Morgan Stanley's outstanding stock under a new share repurchase program (the "Share Repurchase Program"). The Share Repurchase Program is a program for capital management purposes that considers, among other things, business segment capital needs, as well as equity-based compensation and benefit plan requirements. The Share Repurchase Program has no set expiration or termination date.
- (B) Includes: (1) shares delivered or attested to in satisfaction of the exercise price and/or tax withholding obligations by holders of employee stock options (granted under employee stock compensation plans) who exercised options; (2) restricted shares withheld (under the terms of grants under employee stock compensation plans) to offset tax withholding obligations that occur upon vesting and release of restricted shares; and (3) shares withheld (under the terms of grants under employee stock compensation plans) to offset tax withholding obligations that occur upon the delivery of outstanding shares underlying restricted stock units. Morgan Stanley's employee stock compensation plans provide that the value of the shares delivered or attested, or withheld, shall be valued using the fair market value of Morgan Stanley common stock on the date the relevant transaction occurs, using a valuation methodology established by Morgan Stanley.
- (C) Share purchases under publicly announced programs are made pursuant to open-market purchases, Rule 10b5-1 plans or privately negotiated transactions (including with employee benefit plans) as market conditions warrant and at prices Morgan Stanley deems appropriate.

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Stock performance graph. The following graph compares the cumulative total shareholder return (rounded to the nearest whole dollar) of our common stock, the S&P 500 Stock Index (S&P 500) and the S&P 500 Diversified Financials Index (S5DIVF) for our last five fiscal years. The graph assumes a \$100 investment at the closing price on November 30, 2002 and reinvestment of dividends on the respective dividend payment dates without commissions. Historical prices are adjusted to reflect the Discover Spin-off completed on June 30, 2007. This graph does not forecast future performance of our common stock.

Table of Contents**Item 6. Selected Financial Data.****MORGAN STANLEY****SELECTED FINANCIAL DATA**

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

	2007	2006	Fiscal Year 2005	2004	2003
Income Statement Data:					
Revenues:					
Investment banking	\$ 6,368	\$ 4,755	\$ 3,843	\$ 3,341	\$ 2,440
Principal transactions:					
Trading	3,206	11,805	7,377	5,512	6,262
Investments	3,262	1,807	1,128	721	170
Commissions	4,682	3,770	3,331	3,235	2,861
Asset management, distribution and administration fees	6,519	5,238	4,915	4,436	3,784
Interest and dividends	60,083	42,776	25,987	16,719	13,685
Other	1,208	585	496	332	245
Total revenues	85,328	70,736	47,077	34,296	29,447
Interest expense	57,302	40,897	23,552	13,977	11,826
Net revenues	28,026	29,839	23,525	20,319	17,621
Non-interest expenses:					
Compensation and benefits	16,552	13,986	10,749	9,320	7,892
Other	8,033	6,750	6,711	5,482	4,659
September 11 th related insurance recoveries, net			(251)		
Total non-interest expenses	24,585	20,736	17,209	14,802	12,551
Income from continuing operations before losses from unconsolidated investees, income taxes, dividends on preferred securities subject to mandatory redemption and cumulative effect of accounting change, net	3,441	9,103	6,316	5,517	5,070
Losses from unconsolidated investees	47	40	311	328	279
Provision for income taxes	831	2,728	1,473	1,384	1,305
Dividends on preferred securities subject to mandatory redemption				45	154
Income from continuing operations before cumulative effect of accounting change, net	2,563	6,335	4,532	3,760	3,332
Discontinued operations:					
Net gain from discontinued operations	1,024	1,666	559	1,129	696
Provision for income taxes	378	529	201	403	241
Net gain on discontinued operations	646	1,137	358	726	455
Cumulative effect of accounting change, net			49		

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Net income	\$ 3,209	\$ 7,472	\$ 4,939	\$ 4,486	\$ 3,787
Preferred stock dividend requirements	\$ 68	\$ 19	\$	\$	\$
Earnings applicable to common shareholders(1)	\$ 3,141	\$ 7,453	\$ 4,939	\$ 4,486	\$ 3,787

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	2007	2006	Fiscal Year 2005	2004	2003
Per Share Data:					
Earnings per basic common share:					
Income from continuing operations	\$ 2.49	\$ 6.25	\$ 4.32	\$ 3.48	\$ 3.10
Gain on discontinued operations	0.64	1.13	0.33	0.67	0.42
Cumulative effect of accounting change, net			0.05		
Earnings per basic common share	\$ 3.13	\$ 7.38	\$ 4.70	\$ 4.15	\$ 3.52
Earnings per diluted common share:					
Income from continuing operations	\$ 2.37	\$ 5.99	\$ 4.19	\$ 3.40	\$ 3.04
Gain on discontinued operations	0.61	1.08	0.33	0.66	0.41
Cumulative effect of accounting change, net			0.05		
Earnings per diluted common share	\$ 2.98	\$ 7.07	\$ 4.57	\$ 4.06	\$ 3.45
Book value per common share	\$ 28.56	\$ 32.67	\$ 27.59	\$ 25.95	\$ 22.93
Dividends per common share	\$ 1.08	\$ 1.08	\$ 1.08	\$ 1.00	\$ 0.92
Balance Sheet and Other					
Operating Data:					
Total assets	\$ 1,045,409	\$ 1,121,192	\$ 898,835	\$ 747,578	\$ 603,022
Consumer loans, net		22,915	21,966	19,166	18,362
Total capital(2)	191,085	162,134	125,891	110,793	82,769
Long-term borrowings(2)	159,816	126,770	96,709	82,587	57,902
Shareholders equity	31,269	35,364	29,182	28,206	24,867
Return on average common shareholders equity	8.9%	23.5%	17.3%	16.8%	16.5%
Average common and equivalent shares(1)	1,001,878,651	1,010,254,255	1,049,896,047	1,080,121,708	1,076,754,740

(1) Amounts shown are used to calculate earnings per basic common share.

(2) These amounts exclude the current portion of long-term borrowings and include Capital Units and junior subordinated debt issued to capital trusts.

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Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Introduction.

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

Institutional Securities includes capital raising; financial advisory services, including advice on mergers and acquisitions, restructurings, real estate and project finance; corporate lending; sales, trading, financing and market-making activities in equity 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 fund of funds, and merchant banking, which includes real estate, private equity and infrastructure, to institutional and retail clients through proprietary and third-party retail distribution channels, intermediaries and the Company's institutional distribution channel. Asset Management also engages in investment activities.

The Company's results of operations for the 12 months ended November 30, 2007 (fiscal 2007), November 30, 2006 (fiscal 2006) and November 30, 2005 (fiscal 2005) are discussed below.

Discontinued Operations.

On June 30, 2007, the Company completed the spin-off (the Discover Spin-off) of Discover Financial Services (DFS) to its shareholders. DFS results are included within discontinued operations for all periods presented through the date of the Discover Spin-off. The results of Quilter Holdings Ltd. (Quilter), Global Wealth Management Group's former mass affluent business in the U.K., are reported as discontinued operations for all periods presented through its sale on February 28, 2007. The results of the Company's aircraft leasing business, which was sold on March 24, 2006, are also reported as discontinued operations through its date of sale. See Note 22 to the consolidated financial statements.

Table of Contents**Results of Operations.****Executive Summary.****Financial Information.**

	Fiscal Year		
	2007	2006	2005
Net revenues (dollars in millions):			
Institutional Securities	\$ 16,149	\$ 21,110	\$ 15,497
Global Wealth Management Group	6,625	5,512	5,047
Asset Management	5,493	3,453	3,219
Intersegment Eliminations	(241)	(236)	(238)
Consolidated net revenues	\$ 28,026	\$ 29,839	\$ 23,525
Income before taxes (dollars in millions)(1):			
Institutional Securities	\$ 817	\$ 7,721	\$ 4,609
Global Wealth Management Group	1,155	508	591
Asset Management	1,467	851	1,030
Intersegment Eliminations	2	23	86
Consolidated income before taxes	\$ 3,441	\$ 9,103	\$ 6,316
Consolidated net income (dollars in millions)	\$ 3,209	\$ 7,472	\$ 4,939
Earnings applicable to common shareholders (dollars in millions)(2)	\$ 3,141	\$ 7,453	\$ 4,939
Earnings per basic common share:			
Income from continuing operations	\$ 2.49	\$ 6.25	\$ 4.32
Gain on discontinued operations	0.64	1.13	0.33
Cumulative effect of accounting change, net			0.05
Earnings per basic common share	\$ 3.13	\$ 7.38	\$ 4.70
Earnings per diluted common share:			
Income from continuing operations	\$ 2.37	\$ 5.99	\$ 4.19
Gain on discontinued operations	0.61	1.08	0.33
Cumulative effect of accounting change, net			0.05
Earnings per diluted common share	\$ 2.98	\$ 7.07	\$ 4.57
Regional net revenues (dollars in millions)(3):			
Americas	\$ 12,150	\$ 18,803	\$ 15,375
Europe, Middle East and Africa	10,008	7,762	5,711
Asia	5,868	3,274	2,439
Consolidated net revenues	\$ 28,026	\$ 29,839	\$ 23,525

Statistical Data.

Book value per common share(4)	\$ 28.56	\$ 32.67	\$ 27.59
Average common equity (dollars in billions)(5):			
Institutional Securities	\$ 23.9	\$ 18.0	\$ 14.6
Global Wealth Management Group	1.7	3.0	3.4
Asset Management	3.5	2.4	1.8
Unallocated capital	2.9	3.1	2.9
Total from continuing operations	32.0	26.5	22.7
Discontinued operations	3.2	5.2	5.8
Total	\$ 35.2	\$ 31.7	\$ 28.5

Table of Contents*Statistical Data (Continued).*

	2007	Fiscal Year 2006	2005
Return on average common equity(5):			
Consolidated	9%	23%	17%
Institutional Securities	4%	30%	24%
Global Wealth Management Group	41%	11%	11%
Asset Management	26%	21%	36%
Effective income tax rate from continuing operations	24.5%	30.1%	24.5%
Worldwide employees (excluding DFS employees of 13,186 in 2006 and 13,495 in 2005)	48,256	43,124	39,723
Consolidated assets under management or supervision by asset class (dollars in billions):			
Equity	\$ 355	\$ 307	\$ 272
Fixed income	127	111	105
Money market	108	89	83
Alternatives(6)	109	61	43
Subtotal	699	568	503
Unit trusts	15	14	12
Other(7)	61	63	48
Total assets under management or supervision(8)	775	645	563
Share of minority interest assets(9)	7	4	
Total	\$ 782	\$ 649	\$ 563
Institutional Securities (dollars in billions):			
Mergers and acquisitions completed transactions(10):			
Global market volume	\$ 1,280.6	\$ 730.5	\$ 522.7
Market share	35.4%	25.4%	24.3%
Rank	1	3	3
Mergers and acquisitions announced transactions(10):			
Global market volume	\$ 1,339.4	\$ 973.9	\$ 726.0
Market share	31.8%	28.9%	29.5%
Rank	2	2	2
Global equity and equity-related issues(10):			
Global market volume	\$ 64.7	\$ 57.2	\$ 45.9
Market share	7.4%	8.0%	8.7%
Rank	5	4	3
Global debt issues(10):			
Global market volume	\$ 361.2	\$ 409.9	\$ 347.2
Market share	5.4%	5.8%	5.7%
Rank	6	6	5
Global initial public offerings(10):			
Global market volume	\$ 24.1	\$ 22.6	\$ 14.7
Market share	7.8%	8.4%	8.9%
Rank	3	2	2
Pre-tax profit margin(11)	5%	37%	30%

Table of Contents*Statistical Data (Continued).*

	2007	Fiscal Year 2006	2005
Global Wealth Management Group:			
Global representatives	8,429	7,944	9,434
Annualized net revenue per global representative (dollars in thousands)(12)	\$ 811	\$ 651	\$ 502
Client assets by segment (dollars in billions):			
\$10 million or more	\$ 247	\$ 199	\$ 156
\$1 million \$10 million	275	243	215
Subtotal \$1 million or more	522	442	371
\$100,000 \$1 million	179	177	177
Less than \$100,000	23	27	32
Client assets excluding corporate and other accounts	724	646	580
Corporate and other accounts	34	30	29
Total client assets	\$ 758	\$ 676	\$ 609
Fee-based assets as a percentage of total client assets(13)	27%	29%	27%
Client assets per global representative (dollars in millions)(14)	\$ 90	\$ 85	\$ 65
Bank deposits (dollars in billions)(15)	\$ 26.2	\$ 13.3	\$ 1.7
Pre-tax profit margin(11)	17%	9%	12%
Asset Management:			
Assets under management or supervision (dollars in billions)(16)	\$ 597	\$ 496	\$ 443
Percent of fund assets in top half of Lipper rankings(17)	49%	40%	61%
Pre-tax profit margin(11)	27%	25%	32%

- (1) Amounts represent income from continuing operations before losses from unconsolidated investees, income taxes and cumulative effect of accounting change, net.
- (2) Earnings applicable to common shareholders are used to calculate earnings per share information. Fiscal 2007 and fiscal 2006 include a preferred stock dividend of \$68 million and \$19 million, respectively.
- (3) Reflects the regional view of the Company's consolidated net revenues, on a managed basis, based on the following methodology: Institutional Securities: investment banking client location, equity capital markets client location, debt capital markets revenue recording location, sales and trading trading desk location. Global Wealth Management Group: global representative location. Asset Management: client location, except for the merchant banking business, which is based on asset location.
- (4) Book value per common share equals common shareholders' equity of \$30,169 million at November 30, 2007, \$34,264 million at November 30, 2006 and \$29,182 million at November 30, 2005, divided by common shares outstanding of 1,056 million at November 30, 2007, 1,049 million at November 30, 2006 and 1,058 million at November 30, 2005.
- (5) The computation of average common equity for each business segment is based upon an economic capital model that estimates the amount of equity capital required to support the businesses and their risk-generating activities through the business cycle while simultaneously satisfying regulatory, rating agency and investor minimum requirements. The economic capital model will evolve over time in response to changes in the business and regulatory environment and to improvements in modeling techniques in order to reflect the capital required to support business activities. The effective tax rates used in the computation of segment return on average common equity were determined on a separate entity basis.
- (6) Amounts reported for Alternatives reflect the Company's invested equity in those funds and include a range of alternative investment products such as real estate funds, hedge funds, private equity funds, funds of hedge funds and funds of private equity funds.
- (7) Amounts include assets under management or supervision associated with the Global Wealth Management Group business segment.
- (8) Revenues and expenses associated with these assets are included in the Company's Asset Management, Global Wealth Management Group and Institutional Securities business segments.
- (9) Amounts represent Asset Management's proportional share of assets managed by entities in which it owns a minority interest.
- (10) Source: Thomson Financial, data as of January 8, 2008. The data for fiscal 2007, fiscal 2006 and fiscal 2005 are for the periods from January 1 to December 31, 2007, January 1 to December 31, 2006 and January 1 to December 31, 2005, respectively, as Thomson Financial presents these data on a calendar-year basis.
- (11) Percentages represent income from continuing operations before losses from unconsolidated investees, income taxes and cumulative effect of accounting change, net, as a percentage of net revenues.
- (12) Annualized net revenue per global representative amounts equal Global Wealth Management Group's net revenues divided by the quarterly average global representative headcount for the periods presented.
- (13) The decline in fee-based assets as a percent of total client assets largely reflected the termination on October 1, 2007 of the Company's fee-based (fee in lieu of commission) brokerage program pursuant to a court decision vacating a Securities and Exchange Commission (SEC) rule that permitted fee-based brokerage. Client assets that were in the fee-based program primarily moved to commission-based brokerage accounts, or at the election of some clients, into

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other fee-based advisory programs, including Morgan Stanley Advisory, a new nondiscretionary account launched in August 2007.

- (14) Client assets per global representative equal total period-end client assets divided by period-end global representative headcount.
- (15) Bank deposits are held at certain of the Company's Federal Deposit Insurance Corporation (the FDIC) insured depository institutions for the benefit of retail clients through their accounts.
- (16) Amounts include Asset Management's proportional share of assets managed by entities in which it owns a minority interest.
- (17) Source: Lipper, one-year performance excluding money market funds as of November 30, 2007, November 30, 2006 and November 30, 2005, respectively.

Table of Contents***Fiscal 2007 Performance.***

Company Results. The Company recorded net income of \$3,209 million in fiscal 2007, a 57% decrease from \$7,472 million in the prior year. Net revenues (total revenues less interest expense) declined 6% to \$28,026 million in fiscal 2007. During the fourth quarter of fiscal 2007, the Company recorded \$9.4 billion in mortgage-related writedowns resulting from an unfavorable subprime mortgage-related trading strategy and the continued deterioration and lack of market liquidity for subprime and other mortgage-related instruments. Included in the \$9.4 billion were writedowns of \$7.8 billion related to U.S. subprime trading positions, principally super senior derivative positions in collateralized debt obligations (CDOs). These derivative positions were entered into primarily by the Company's proprietary trading group. The remaining writedowns of \$1.6 billion related to other mortgage-related instruments, which included \$1.2 billion relating to commercial mortgage-backed securities (CMBS), ALT-A (a residential mortgage loan categorization that falls between prime and subprime) and other loans, conduit and non-performing loans, European non-conforming loans and an impairment charge of \$437 million related to mortgage-related securities portfolios in the Company's domestic subsidiary banks. The results for fiscal 2007 also included losses of approximately \$700 million that reflected mark-to-market valuations associated with loans and loan commitments largely related to acquisition financing to non-investment grade companies (see Impact of Credit Market Events herein).

Non-interest expenses increased 19% to \$24,585 million from the prior year primarily due to higher compensation costs. Diluted earnings per share were \$2.98 compared with \$7.07 a year ago. Compensation and benefits expense increased 18%, primarily reflecting higher incentive-based compensation accruals due to higher net revenues in certain of the Company's businesses. Diluted earnings per share from continuing operations were \$2.37 compared with \$5.99 last year. The return on average common equity in fiscal 2007 was 8.9% compared with 23.5% in the prior year. The return on average common equity from continuing operations for fiscal 2007 was 7.8% compared with 23.8% last year.

Results for fiscal 2007 also included a gain of \$168 million (\$109 million after-tax) in discontinued operations related to the sale of Quilter on February 28, 2007. Results for fiscal 2006 included a loss of \$125 million (\$75 million after-tax) related to the sale of the Company's aircraft leasing business (see Note 22 to the consolidated financial statements). In addition, pre-tax results for fiscal 2007 included the \$360 million reversal of the Coleman litigation reserve (see Other Matters Coleman Litigation herein). Results for fiscal 2006 included non-cash incremental compensation expenses of approximately \$260 million for stock-based awards granted to retirement-eligible employees (see Note 2 to the consolidated financial statements).

The Company's effective income tax rate from continuing operations was 24.5% in fiscal 2007 compared with 30.1% in fiscal 2006. The decrease primarily reflected lower earnings that increased the effect of permanent differences. Fiscal 2006's income tax provision included an income tax benefit of \$242 million resulting from the resolution of a federal tax audit. Excluding the benefits from the federal tax audit, the Company's effective income tax rate from continuing operations in fiscal 2006 would have been 32.8%.

At fiscal year-end, the Company had 48,256 employees worldwide compared with 43,124 (excluding DFS employees) at the prior year-end.

Subsequent to the 2007 fiscal year-end, in December 2007, the Company sold equity units (the Equity Units) to a wholly owned subsidiary of the China Investment Corporation Ltd. (CIC) for approximately \$5,579 million (see Liquidity and Capital Resources China Investment Corporation Investment herein).

Institutional Securities. Institutional Securities recorded income from continuing operations before losses from unconsolidated investees and income taxes of \$817 million, an 89% decrease from a year ago. Net revenues declined 24% to \$16,149 million as record results in equity sales

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and trading, advisory and underwriting were more than offset by lower results in fixed income sales and trading. Non-interest expenses increased 15% to \$15,332 million, reflecting higher compensation costs and non-compensation expenses. Non-compensation expenses increased 24% as higher costs associated with higher levels of business activity, business investment

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and operating expenses associated with TransMontaigne Inc. (TransMontaigne), the Heidmar Group of companies (Heidmar) and Saxon Capital, Inc. (Saxon) were partially offset by the reversal of the Coleman Litigation reserve.

Investment banking revenues rose 31% from last year to \$5,538 million. Underwriting revenues rose 21% from last year to \$2,997 million. Advisory fees from merger, acquisition and restructuring transactions were \$2,541 million, an increase of 45% from fiscal 2006.

Fixed income sales and trading revenues were \$650 million, down 93% from a year ago. The decrease was driven by significant losses in credit products and lower results in commodities, partially offset by record results in interest rate and currency products. The decline in credit product revenues primarily reflected the mortgage-related writedowns (see Impact of Credit Market Events herein). Commodity revenues decreased primarily due to lower trading results from oil liquids, electricity and natural gas products. Fiscal 2006 also benefited from revenue recognized on structured transactions. Interest rate and currency product revenues benefited from stronger revenues in interest rate, emerging markets and foreign exchange products.

Equity sales and trading revenues increased 38% to a record \$8,658 million. Record international results contributed to record revenues from derivative products and prime brokerage and strong results in cash products.

Sales and trading revenues also benefited in fiscal 2007 from the widening of the Company's credit spreads on financial instruments that are accounted for at fair value.

In fiscal 2007, other sales and trading losses of approximately \$1,242 million reflected loans and loan commitments largely related to event-driven lending to non-investment grade companies and the impairment charge related to mortgage-related securities portfolios in the Company's domestic subsidiary banks (see Impact of Credit Market Events Subsidiary Banks herein).

Principal transaction net investment revenues increased 35% to \$1,459 million in fiscal 2007. Fiscal 2007's results primarily related to realized and unrealized net gains associated with certain of the Company's investments and higher revenues from the Company's investments in passive limited partnership interests associated with the Company's real estate funds. The increase also reflected higher revenues primarily related to the appreciation of investments related to certain employee deferred compensation plans.

Global Wealth Management Group. Global Wealth Management Group recorded income from continuing operations before income taxes of \$1,155 million, up 127% from the prior year. Net revenues were \$6,625 million, a 20% increase over a year ago, primarily reflecting higher revenues from increased underwriting activity, higher asset management revenues reflecting growth in fee-based products and higher net interest revenue from growth in the bank deposit program. Total non-interest expenses were \$5,470 million, a 9% increase from a year ago. Compensation and benefits expense increased 15%, primarily reflecting higher incentive-based compensation accruals due to higher net revenues. Non-compensation costs decreased 2%, primarily reflecting lower charges for legal and regulatory matters and continued cost discipline across the business. Total client assets increased to \$758 billion, up 12% from the prior fiscal year-end. In addition, client assets in fee-based accounts increased 3% from a year ago to \$201 billion and decreased as a percentage of total client assets to 27% from last year's 29%. The decline in fee-based assets as a percent of total client assets largely reflected the termination on October 1, 2007 of the Company's fee-based (fee in lieu of commission) brokerage program pursuant to a court decision vacating an SEC rule that permitted fee-based brokerage. At fiscal year-end, the number of global representatives was 8,429, an increase of 485 from a year ago.

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Asset Management. Asset Management recorded income before income taxes of \$1,467 million, a 72% increase from last year. Net revenues of \$5,493 million increased 59% from the prior year, reflecting significantly higher investment revenues, primarily in the merchant banking business, which includes the real estate, private equity and infrastructure businesses. The increase primarily reflected higher revenues associated with the appreciation of investments related to employee deferred compensation and co-investment plans. The

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increase was also due to higher asset management, distribution and administration fees primarily due to an increase in assets under management, a more favorable asset mix and higher performance fees due to growth in the alternatives business, including FrontPoint Partners (FrontPoint), which was acquired in December 2006. Principal transaction net investment gains for the year were \$1,774 million compared with \$669 million a year ago. Non-interest expenses increased 55% from the prior year to \$4,026 million. Compensation and benefits expense increased, primarily due to expenses associated with certain deferred compensation plans, higher levels of business investment and higher incentive-based compensation accruals associated with increased net revenues. Non-compensation expenses increased primarily due to increased business activity, including activity from FrontPoint. Assets under management or supervision within Asset Management of \$597 billion were up \$101 billion, or 20%, from last year, primarily due to market appreciation and positive net customer inflows.

Global Market and Economic Conditions in Fiscal 2007.

In the U.S., the moderate pace of economic growth that occurred during the first half of fiscal 2007 slowed during the second half of fiscal 2007, primarily reflecting the significant and broad-based illiquidity in the residential real estate and credit markets. Concerns about the impact of subprime loans caused the subprime-related and broader credit markets to deteriorate considerably over the course of the third and fourth quarters of fiscal 2007, with increased volatility, significant spread widening and lower levels of liquidity and price transparency for certain products. The U.S. unemployment rate at the end of fiscal 2007 increased to 4.7% from 4.5% at the end of fiscal 2006. Conditions in the U.S. equity markets were also volatile, and major equity market indices rose during the first half of fiscal 2007 while declining during the second half of fiscal 2007, primarily as a result of mixed corporate earnings and the developments in the credit markets. The Federal Reserve Board (the Fed) left rates unchanged during the first half of the year. In the third quarter, the Fed lowered the discount rate by 0.50%, and in the fourth quarter, the Fed lowered both the benchmark interest rate and discount rate by an aggregate of 0.75%. The Fed acted in order to provide additional liquidity and stability to the financial markets and to contain the negative economic impact related to the residential real estate and credit markets. The Fed had not changed the benchmark interest rate since June 2006. In December 2007, the Fed lowered both the benchmark interest rate and the discount rate by 0.25% and the U.S. unemployment rate increased to 5.0%. In January, the Fed lowered both the benchmark interest rate and the discount rate by 0.75%.

In Europe, economic growth continued to be strong, reflecting momentum in domestic demand and exports. Corporate business surveys indicated, however, that growth in Europe may be slowing. Major equity market indices in Europe increased during fiscal 2007, primarily due to strong corporate earnings, merger and acquisition activity and generally favorable economic conditions, which more than offset the difficult conditions in the credit markets in the second half of fiscal 2007. The European Central Bank raised the benchmark interest rate by an aggregate of 0.75% in fiscal 2007. The Bank of England raised the benchmark interest rate by an aggregate of 0.75% in fiscal 2007 but subsequently reduced the benchmark interest rate by 0.25% in December 2007.

In Japan, moderate economic growth continued to be driven by exports and domestic demand. The level of unemployment also remained relatively low. Japanese equity market indices decreased during fiscal 2007 primarily due to tighter global credit conditions. The Bank of Japan raised the benchmark interest rate from 0.25% to 0.50% during fiscal 2007. Economies elsewhere in Asia expanded, particularly in China, which benefited from strength in exports, domestic demand for capital projects and continued globalization. In China, equity market indices rose during fiscal 2007. The People's Bank of China raised the benchmark lending rate by an aggregate of 1.17% in fiscal 2007.

Business Segments.

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

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As a result of treating certain intersegment transactions as transactions with external parties, the Company includes an Intersegment Eliminations category to reconcile the segment results to the Company's consolidated results. Income before taxes in Intersegment Eliminations represents the effect of timing differences associated with the revenue and expense recognition of commissions paid by Asset Management to Global Wealth Management Group associated with sales of certain products and the related compensation costs paid to Global Wealth Management Group's global representatives. Income before income taxes recorded in Intersegment Eliminations was \$2 million, \$23 million and \$86 million in fiscal 2007, fiscal 2006 and fiscal 2005, respectively. Included in the results of Intersegment Eliminations for fiscal 2007 is a \$25 million advisory fee related to the Discover Spin-off that was eliminated in consolidation. In addition, the results in Institutional Securities for fiscal 2006 included a \$30 million advisory fee related to the Company's sale of the aircraft leasing business that was eliminated in consolidation.

Table of Contents**INSTITUTIONAL SECURITIES****INCOME STATEMENT INFORMATION**

	Fiscal 2007	Fiscal 2006	Fiscal 2005
	(dollars in millions)		
Revenues:			
Investment banking	\$ 5,538	\$ 4,228	\$ 3,394
Principal transactions:			
Trading	2,740	11,326	6,915
Investments	1,459	1,081	593
Commissions	3,262	2,606	2,160
Asset management, distribution and administration fees	103	73	20
Interest and dividends	59,131	42,106	25,439
Other	983	444	334
Total revenues	73,216	61,864	38,855
Interest expense	57,067	40,754	23,358
Net revenues	16,149	21,110	15,497
Total non-interest expenses	15,332	13,389	10,888
Income from continuing operations before losses from unconsolidated investees, income taxes and cumulative effect of accounting change, net	817	7,721	4,609
Losses from unconsolidated investees	47	40	311
Income tax (benefit) provision	(170)	2,212	852
Income from continuing operations before cumulative effect of accounting change, net	\$ 940	\$ 5,469	\$ 3,446

Investment Banking. Investment banking revenues are derived from the underwriting of securities offerings and fees from advisory services. Investment banking revenues were as follows:

	Fiscal 2007	Fiscal 2006	Fiscal 2005
	(dollars in millions)		
Advisory fees from merger, acquisition and restructuring transactions	\$ 2,541	\$ 1,753	\$ 1,395
Equity underwriting revenues	1,570	1,059	905
Fixed income underwriting revenues	1,427	1,416	1,094
Total investment banking revenues	\$ 5,538	\$ 4,228	\$ 3,394

Investment banking revenues increased 31% in fiscal 2007 and reached record levels. The increase was due to higher revenues from merger, acquisition and restructuring activities and equity underwriting transactions. In fiscal 2006, investment banking revenues increased 25%,

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primarily reflecting higher revenues from merger, acquisition and restructuring activities and fixed income and equity underwriting transactions.

In fiscal 2007, advisory fees from merger, acquisition and restructuring transactions increased 45% to a record \$2,541 million. Advisory fees in fiscal 2007 reflected a strong volume of transaction activity, particularly during the first half of fiscal 2007. In fiscal 2006, advisory fees from merger, acquisition and restructuring transactions increased 26% to \$1,753 million, primarily reflecting a strong volume of transaction activity.

Equity underwriting revenues increased 48% to a record \$1,570 million in fiscal 2007. Equity underwriting revenues increased 17% to \$1,059 million in fiscal 2006. Both periods reflected higher global industry-wide equity and equity-related activity. Fiscal 2006 reflected a strong volume of initial public offerings.

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Fixed income underwriting revenues increased 1% to \$1,427 in fiscal 2007 and increased 29% to \$1,416 million in fiscal 2006. Fiscal 2007 revenues reflected strong revenues from underwriting investment grade corporate products, as corporate issuers sought longer-term financings due to market turmoil in the fixed income credit markets. The increase in fiscal 2006 was primarily due to an increase in underwriting revenues from non-investment grade and investment grade products as the level of issuer refinancings rose due to record levels of maturing debt. Acquisition-related financing resulting from a strong market for merger and acquisition activity contributed to the increase in both fiscal 2007 and fiscal 2006.

At the end of fiscal 2007, the backlog of merger, acquisition and restructuring transactions and equity underwriting transactions remained relatively strong despite current market conditions. The backlog of fixed income underwriting transactions was lower for non-investment grade products while the backlog of fixed income underwriting transactions was higher for investment-grade products, as compared with the end of fiscal 2006. The backlog of merger, acquisition and restructuring transactions and equity and fixed income underwriting transactions is subject to the risk that transactions may not be completed due to challenging or unforeseen economic and market conditions, adverse developments regarding one of the parties to the transaction, a failure to obtain required regulatory approval or a decision on the part of the parties involved not to pursue a transaction.

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

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

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

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

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

Total sales and trading revenues decreased 47% in fiscal 2007 and increased 37% in fiscal 2006. The decrease in fiscal 2007 reflected lower fixed income revenues and other sales and trading losses, partially offset by higher equity sales and trading revenues. Sales and trading revenues were adversely affected by the difficult market conditions that existed during the second half of fiscal 2007. The credit markets deteriorated considerably over the course of the latter half of the year with increased volatility, significant spread widening, lower levels of liquidity and

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reduced price transparency. These factors affected the subprime mortgage markets, including the market for collateralized debt obligations, and other structured credit product markets, leveraged lending

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markets and the effectiveness of hedging strategies. This credit environment adversely impacted the Company's credit sales and trading and corporate lending activities. In addition, such conditions contributed to increased volatility and systematic risk reduction in the equity markets, which adversely affected the Company's quantitative trading strategies.

Sales and trading revenues included the following:

	Fiscal 2007(1)	Fiscal 2006(1)	Fiscal 2005(1)
	(dollars in millions)		
Equity	\$ 8,658	\$ 6,281	\$ 4,810
Fixed income	650	9,291	6,571
Other	(1,242)	(288)	(225)
Total sales and trading revenues	\$ 8,066	\$ 15,284	\$ 11,156

- (1) Amounts include Principal transactions-trading, Commissions and Net interest revenues. Equity and fixed income sales and trading revenues include certain funding costs that were not previously allocated to those businesses. Other sales and trading net revenues primarily include net losses from loans and closed pipeline commitments related to investment banking, corporate lending and other corporate activities. All prior-year amounts have been reclassified to conform to the current year's presentation.

Equity sales and trading revenues increased 38% to a record \$8,658 million in fiscal 2007, benefiting from record international revenues. The increase was driven by record revenues from derivative products and prime brokerage and higher revenues from equity cash and financing products, partially offset by trading losses in quantitative strategies resulting from unfavorable positioning. Revenues from derivative products benefited from strong customer flows. Prime brokerage generated record revenues, reflecting continued growth in global client asset balances. Higher revenues from financing products were primarily due to higher commission revenues driven by strong market volumes. Equity sales and trading revenues also benefited from the widening of the Company's credit spreads on financial instruments that are accounted for at fair value, including, but not limited to, those for which the fair value option was elected pursuant to the Statement of Financial Accounting Standards (SFAS) No. 159, The Fair Value Option for Financial Assets and Financial Liabilities (SFAS No. 159) on December 1, 2006 (see Note 3 to the consolidated financial statements). Revenues increased by approximately \$390 million due to the widening of the Company's credit spreads during the year resulting from the decrease in the fair value of certain of the Company's long-term and short-term borrowings, such as structured notes, for which the fair value option was elected.

Equity sales and trading revenues increased 31% to a then record \$6,281 million in fiscal 2006. The increase was broad based and included higher revenues from derivatives and equity cash products, financing products, prime brokerage and principal trading strategies. Derivative revenues increased due to strong customer flows, although volatility in the global equity markets continued to be generally low. Revenues from equity cash products reflected higher market volumes, particularly in Europe and Asia. Financing product revenues also benefited from increased client activity. Prime brokerage generated record revenues, reflecting continued growth in global client asset balances. Global equity markets generally trended higher and created favorable opportunities for principal trading strategies. Although commission revenues increased, revenues continued to be affected by intense competition, particularly in the U.S., and a continued shift toward electronic trading.

Fixed income sales and trading revenues decreased 93% to \$650 million in fiscal 2007. Fiscal 2007 results reflected significant losses in credit products and lower results in commodities, partially offset by record results in interest rate and currency products. Credit product revenues decreased \$9.4 billion, primarily reflecting mortgage-related writedowns of \$7.8 billion, reflecting the deterioration in value of U.S. subprime trading positions, principally super senior derivative positions in CDOs entered into primarily by the Company's proprietary trading group. Spread widening, lower liquidity and higher volatility resulted in lower origination, securitization and trading results across most credit product groups and also adversely affected the performance

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of the Company's hedging strategies. The Company's residential and commercial mortgage loan activities contributed to the significant decline in credit product revenues, reflecting the difficult market conditions referred to above, as well as continued concerns in the subprime mortgage loan sector. See *Impact of Credit Market Events* herein, detailing the Company's direct U.S. subprime mortgage-related exposures at November 30, 2007.

Interest rate and currency product revenues increased 63% in fiscal 2007, reflecting higher revenues from interest rate, emerging markets and foreign exchange products. Commodity revenues decreased 33%, primarily due to lower trading results from oil liquids, electricity and natural gas products and lower revenues recognized on structured transactions. Fixed income sales and trading revenues also benefited from the widening of the Company's credit spreads on financial instruments that are accounted for at fair value, including, but not limited to, those for which the fair value option was elected (see Note 3 to the consolidated financial statements). The decrease in the fair value of certain of the Company's long-term and short-term borrowings, such as structured notes, for which the fair value option was elected, which was attributable to the widening of the Company's credit spreads during the year, increased revenues by approximately \$450 million (see Note 3 to the consolidated financial statements). Fixed income sales and trading revenues also benefited from gains on interest rate derivatives.

Fixed income sales and trading revenues increased 41% to a record \$9,291 million in fiscal 2006. The increase was driven by record results from commodities, credit products, and interest rate and currency products. Commodities revenues increased 112% due to strong results from electricity, natural gas products and oil liquids. Credit product revenues increased 52%, primarily due to significantly improved corporate credit trading and strength in residential and commercial securitized products. Interest rate and currency products decreased 1%. Both commodity and interest rate and currency products benefited from revenues recognized on structured transactions as a result of increased observability of market value in accordance with Emerging Issues Task Force (EITF) Issue No. 02-3, *Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities* (EITF Issue No. 02-3). With the adoption of SFAS No. 157, *Fair Value Measurements* (SFAS No. 157) on December 1, 2006, the Company no longer applies the revenue recognition criteria of EITF Issue No. 02-3 (see Note 2 to the consolidated financial statements).

In addition to the equity and fixed income sales and trading revenues discussed above, sales and trading revenues include the net revenues from the Company's corporate lending activities. In fiscal 2007, other sales and trading losses of approximately \$1.2 billion primarily reflected approximately \$700 million of mark-to-market valuations associated with loans and commitments largely related to acquisition financing to non-investment grade companies and the impairment charge related to securities in the Company's domestic subsidiary banks (see *Impact of Credit Market Events - Subsidiary Banks* herein). The losses included markdowns of leveraged loan commitments associated with acquisition financing transactions that were accepted by the borrower but not yet closed. These losses were primarily related to the illiquid market conditions that existed during third quarter of fiscal 2007. The valuation of these commitments could change in future periods depending on, among other things, the extent that they are renegotiated or repriced or if the associated acquisition transaction does not occur. In addition, the Company's leveraged finance business originates and distributes loans and commitments and intends to distribute its current positions; however, this could take longer than in the past and is dependent on liquidity re-entering the market. Subsequent to November 30, 2007, there has been further widening in credit spreads for non-investment grade loans that, if sustained, will result in additional writedowns for these loans and commitments. The fair value measurement of loan commitments takes into account certain fee income that is attributable to the contingent commitment contract. For further information about the Company's corporate lending activities, see Item 7A, *Quantitative and Qualitative Disclosures about Market Risk - Credit Risk*. In fiscal 2006, revenues from corporate lending activities decreased by approximately \$50 million from fiscal 2005, reflecting the impact of mark-to-market valuations on a higher level of new loans made during the year.

Principal Transactions-Investments. The Company's investments generally are held for appreciation and to facilitate other business activities. It is not possible to determine when the Company will realize the value of such

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investments since, among other factors, such investments generally are subject to significant sales restrictions. Moreover, estimates of the fair value of the investments may involve significant judgment and may fluctuate significantly over time in light of business, market, economic and financial conditions generally or in relation to specific transactions.

Principal transaction net investment revenues aggregating \$1,459 million were recognized in fiscal 2007 as compared with \$1,081 million in fiscal 2006 and \$593 million in fiscal 2005. The increase in fiscal 2007 was primarily related to realized and unrealized net gains associated with certain of the Company's investments, including Grifols S.A. and Bovespa Holdings S.A., and higher revenues from the Company's investments in passive limited partnership interests associated with the Company's real estate funds. The increase in fiscal 2007 also reflected higher revenues primarily due to the appreciation of investments related to certain employee deferred compensation plans. The increase in fiscal 2006 was primarily related to net gains associated with the Company's investments.

Other. Other revenues consist primarily of revenues from providing benchmark indices and risk management analytics associated with MSCI Inc. (see Note 23 to the consolidated financial statements). Other revenues also include revenues related to the operation of pipelines, terminals and barges and the distribution of refined petroleum products associated with TransMontaigne, the marine transportation and logistics services associated with Heidmar, revenues associated with Saxon, a servicer and originator of residential mortgages (see Note 23 to the consolidated financial statements) and a commodities-related strategic investment.

Other revenues increased 121% in fiscal 2007 and 33% in fiscal 2006. The increase in both fiscal 2007 and fiscal 2006 was primarily attributable to revenues related to the operation of pipelines, terminals and barges and the distribution of refined petroleum products associated with TransMontaigne and higher sales of benchmark indices and risk management analytic products. The increase in fiscal 2007 was also due to higher revenues associated with Saxon and from the sale of a commodities-related strategic investment.

Non-Interest Expenses. Non-interest expenses increased 15% in fiscal 2007. Compensation and benefits expense increased 10%, primarily reflecting higher incentive-based compensation accruals for certain businesses. The increase also reflected higher costs associated with certain employee deferred compensation plans, partially offset by Institutional Securities share (\$190 million) of the incremental compensation expense related to equity awards to retirement-eligible employees in the first quarter of fiscal 2006 (see Note 2 to the consolidated financial statements). Excluding compensation and benefits expense, non-interest expenses increased 24%, reflecting increased levels of business activity and expenses associated with acquired businesses. Occupancy and equipment expense increased 33%, primarily due to higher rent and occupancy costs in Europe, Asia and the U.S. Brokerage, clearing and exchange fees increased 30%, primarily reflecting substantially increased equity and fixed income trading activity. Marketing and business development expense increased 27%, primarily due to a higher level of business activity. Professional services expense increased 6%, primarily due to higher legal and consulting costs related to increased business activity. Other expenses increased 50%, reflecting costs associated with TransMontaigne, Heidmar and Saxon, partially offset by lower net litigation accruals. Fiscal 2007 results included a reversal of the \$360 million legal accrual related to the Company's favorable outcome from the Coleman litigation. Fiscal 2006 included legal accruals related to the pending settlement of General American litigation, which was partially offset by a favorable outcome related to the LVMH litigation.

Non-interest expenses increased 23% in fiscal 2006. Compensation and benefits expense increased 36%, primarily reflecting higher incentive-based compensation costs resulting from higher net revenues. Fiscal 2006 also included Institutional Securities share (\$190 million) of incremental compensation expense related to equity awards to retirement-eligible employees while fiscal 2005 included Institutional Securities share (\$193 million) of the costs associated with senior management changes (see Other Matters Senior Management Compensation Charges herein). Excluding compensation and benefits expense, non-interest expenses remained relatively unchanged. Occupancy and equipment expense decreased 6%, primarily due to a \$71 million charge that was recorded in the first quarter of fiscal 2005 for the correction in the method of accounting for certain real

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estate leases (see Note 26 to the consolidated financial statements). Brokerage, clearing and exchange fees increased 32%, primarily reflecting increased equity and fixed income trading activity. Professional services expense increased 18%, primarily due to higher legal and consulting costs, reflecting increased levels of business activity. Other expenses decreased 48% due to lower charges for legal and regulatory matters. Fiscal 2006 reflected a net reduction in legal accruals of approximately \$40 million related to the IPO Allocation Matters litigation, the LVMH litigation and the settlement of the General American litigation. Other expenses in fiscal 2005 included legal accruals of \$360 million related to the Coleman litigation and approximately \$170 million related to the Parmalat settlement and the IPO Allocation Matters litigation.

Table of Contents**GLOBAL WEALTH MANAGEMENT GROUP****INCOME STATEMENT INFORMATION**

	Fiscal 2007	Fiscal 2006	Fiscal 2005
	(dollars in millions)		
Revenues:			
Investment banking	\$ 625	\$ 428	\$ 320
Principal transactions:			
Trading	598	487	467
Investments	29	57	2
Commissions	1,433	1,168	1,196
Asset management, distribution and administration fees	3,067	2,757	2,601
Interest and dividends	1,221	1,004	650
Other	163	130	143
Total revenues	7,136	6,031	5,379
Interest expense	511	519	332
Net revenues	6,625	5,512	5,047
Total non-interest expenses	5,470	5,004	4,456
Income from continuing operations before income taxes and cumulative effect of accounting change, net	1,155	508	591
Provision for income taxes	459	167	199
Income from continuing operations before cumulative effect of accounting change, net	\$ 696	\$ 341	\$ 392

Investment Banking. Global Wealth Management Group investment banking includes revenues from the distribution of equity and fixed income securities, including initial public offerings, secondary offerings, closed-end funds and unit trusts. Revenues also include fees earned from offerings underwritten by the Institutional Securities business segment. Investment banking revenues increased 46% and 34% in fiscal 2007 and fiscal 2006, respectively. The increase in fiscal 2007 was driven by strong underwriting activity across equity, fixed income and unit trust products. The increase in fiscal 2006 was primarily due to higher revenues from equity-related offerings and unit trust products.

Principal Transactions Trading. Principal transactions include revenues from customers' purchases and sales of financial instruments in which the Company acts as principal and gains and losses on the Company's inventory positions held, primarily to facilitate customer transactions. Principal transaction trading revenues increased 23% in fiscal 2007 primarily due to higher revenues from derivative products, municipal and corporate fixed income securities and foreign exchange products. The increase was also due to higher revenues primarily associated with the appreciation of investments related to certain employee deferred compensation plans. In fiscal 2006, principal transaction trading revenues increased 4%, primarily reflecting higher revenue from foreign exchange products, equity linked notes and municipal fixed income securities, partially offset by lower revenues from corporate and government fixed income products and other securities.

Principal Transactions Investments. Principal transaction net investment revenues were \$29 million in fiscal 2007 compared with \$57 million in fiscal 2006 and \$2 million in fiscal 2005. The results in fiscal 2007 reflected lower net gains from certain of the Company's investments in exchanges and memberships. The results in fiscal 2006 were primarily related to realized and unrealized gains on the Company's investments in

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Bolsas y Mercados Españoles and the New York Stock Exchange.

Commissions. Commission revenues primarily arise from agency transactions in listed and OTC equity securities and sales of mutual funds, futures, insurance products and options. Commission revenues increased

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23% in fiscal 2007 and decreased 2% in fiscal 2006. The increase in fiscal 2007 reflected higher levels of client activity. The decrease in fiscal 2006 largely reflected lower revenues from equity products, which was related to lower agency activity with customers due, in part, to growth in other product areas, including investment banking and asset management.

Asset Management, Distribution and Administration Fees. Asset management, distribution and administration fees include revenues from individual investors electing a fee-based pricing arrangement and fees for investment management, account services and administration. The Company also receives shareholder servicing fees and fees for services it provides in distributing certain open-ended mutual funds and other products. Mutual fund distribution fees are based on either the average daily fund net asset balances or average daily aggregate net fund sales and are affected by changes in the overall level and mix of assets under management or supervision.

Asset management, distribution and administration fees increased 11% in fiscal 2007 and 6% in fiscal 2006. In both fiscal years, the increase was driven by higher client asset balances in fee-based accounts. Client assets in fee-based accounts rose 3% to \$201 billion at November 30, 2007 and represented 27% of total client assets versus 29% at November 30, 2006. The decline in fee-based assets as a percent of total client assets largely reflected the termination on October 1, 2007 of the Company's fee-based (fee in lieu of commission) brokerage program pursuant to a court decision vacating an SEC rule that permitted fee-based brokerage. Client assets that were in the fee-based program primarily moved to commission-based brokerage accounts, or, at the election of some clients, into other fee-based advisory programs, including Morgan Stanley Advisory, a new nondiscretionary account launched in August 2007. Client assets in fee-based accounts rose 18% to \$195 billion at November 30, 2006 and increased as a percentage of total client assets to 29% of total client assets from 27% at November 30, 2005.

Total client asset balances increased to \$758 billion at November 30, 2007 from \$676 billion at November 30, 2006 primarily due to higher client inflows and market appreciation. Client asset balances in households greater than \$1 million increased to \$522 billion at November 30, 2007 from \$442 billion at November 30, 2006 and \$371 billion at November 30, 2005.

Net Interest. Interest and dividend revenues and interest expense are a function of the level and mix of total assets and liabilities, including customer bank deposits and margin loans and securities borrowed and securities loaned transactions. Net interest revenues increased 46% and 53% in fiscal 2007 and fiscal 2006, respectively. The increase in both periods was primarily due to increased customer account balances in the bank deposit program that was launched in November 2005. Balances in the bank deposit program rose to \$26.2 billion at November 30, 2007 from \$13.3 billion at November 30, 2006.

Other. Other revenues primarily include customer account service fees and other miscellaneous revenues. Other revenues increased 25% in fiscal 2007 and decreased 9% in fiscal 2006. In fiscal 2007, the increase primarily reflected higher service fees and higher other miscellaneous revenues. In fiscal 2006, the decrease primarily reflected lower service fees.

Non-Interest Expenses. Non-interest expenses increased 9% in fiscal 2007, primarily reflecting an increase in compensation and benefits expense, partially offset by lower non-compensation expenses primarily due to lower charges for legal and regulatory matters and continued cost discipline across the business. Compensation and benefits expense increased 15%, primarily reflecting higher incentive-based compensation accruals due to higher net revenues and investments in the business, partially offset by Global Wealth Management Group's share (\$50 million) of the incremental compensation expense related to equity awards to retirement-eligible employees in the first quarter of fiscal 2006 (see Note 2 to the consolidated financial statements). Excluding compensation and benefits expense, non-interest expenses decreased 2%. Occupancy and equipment expense increased 6% primarily due to leasehold improvements and higher rental costs. Information processing and communications expense decreased 8% primarily due to lower computing costs. Marketing and business development expense increased 39% primarily due to costs associated with the Company's advertising campaign. Other expenses

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decreased 20%, primarily resulting from a reduction in costs associated with legal and regulatory matters, which included an insurance reimbursement related to a litigation matter.

Non-interest expenses increased 12% in fiscal 2006. Fiscal 2005 included a reduction in non-interest expenses related to Global Wealth Management Group's share (\$198 million) of the insurance settlement related to the events of September 11, 2001 (see Note 25 to the consolidated financial statements). Compensation and benefits expense increased 15%, primarily reflecting higher incentive-based compensation costs. In addition, fiscal 2006 expenses included Global Wealth Management Group's share (\$50 million) of the incremental compensation expense related to equity awards to retirement-eligible employees, including new hires (see Note 2 to the consolidated financial statements), while fiscal 2005 included Global Wealth Management Group's share (\$48 million) of the costs associated with senior management changes (see Other Matters Senior Management Compensation Charges herein). Excluding compensation and benefits expense and the insurance settlement, non-interest expenses decreased 4%. Occupancy and equipment expense decreased 6% primarily due to a \$29 million charge for the correction in the method of accounting for certain real estate leases that was recorded in the first quarter of fiscal 2005 (see Note 26 to the consolidated financial statements). Professional services expense increased 15%, largely due to higher sub-advisory fees associated with growth in fee-based assets and higher costs for outside legal counsel. Other expenses decreased 20%, primarily resulting from lower costs associated with legal and regulatory matters. During fiscal 2006 and fiscal 2005, the Company recorded legal and regulatory expenses of approximately \$105 million and \$170 million, respectively, related to ongoing regulatory, employment and branch litigation matters.

Table of Contents**ASSET MANAGEMENT****INCOME STATEMENT INFORMATION**

	Fiscal 2007	Fiscal 2006	Fiscal 2005
	(dollars in millions)		
Revenues:			
Investment banking	\$ 264	\$ 138	\$ 133
Principal transactions:			
Trading	(129)		
Investments	1,774	669	533
Commissions	23	25	29
Asset management, distribution and administration fees	3,524	2,574	2,462
Interest and dividends	74	48	87
Other	75	26	26
Total revenues	5,605	3,480	3,270
Interest expense	112	27	51
Net revenues	5,493	3,453	3,219
Total non-interest expenses	4,026	2,602	2,189
Income before income taxes and cumulative effect of accounting change, net	1,467	851	1,030
Provision for income taxes	541	340	391
Income before cumulative effect of accounting change, net	\$ 926	\$ 511	\$ 639

Investment Banking. Asset Management generates investment banking revenues primarily from the acquisition of investments in real estate funds and the underwriting of unit trust products. Investment banking revenues increased 91% in fiscal 2007 and 4% in fiscal 2006. The increase in fiscal 2007 primarily reflected higher revenues from certain real estate products. The increase in fiscal 2006 primarily reflected higher revenues from real estate products and higher equity unit trust sales, partially offset by a lower volume of fixed income unit trust sales.

Principal Transactions-Trading. In fiscal 2007, the Company recognized losses of \$129 million related to structured investment vehicles. See Impact of Credit Market Events Structured Investment Vehicles herein for further discussion.

Principal Transactions-Investments. Asset Management principal transaction investment revenues consist primarily of gains and losses on the Company's investments in alternative investment products.

Principal transaction net investment gains aggregating \$1,774 million were recognized in fiscal 2007 as compared with \$669 million in fiscal 2006. The results in both fiscal years were primarily related to investments associated with the Company's real estate products and private equity portfolio, including employee deferred compensation plans and co-investment plans.

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

Asset Management, Distribution and Administration Fees. Asset Management, distribution and administration fees include revenues generated from the management and supervision of assets, performance-

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based fees relating to certain funds, and separately managed accounts and fees relating to the distribution of certain open-ended mutual funds. Asset Management fees arise from investment management services the Company provides to investment vehicles pursuant to various contractual arrangements. The Company receives fees primarily based upon mutual fund daily average net assets or based on monthly or quarterly invested equity for other vehicles. Performance-based fees are earned on certain funds as a percentage of appreciation earned by those funds and, in certain cases, are based upon the achievement of performance criteria. These fees are normally earned annually and are recognized on a monthly or quarterly basis.

Asset management, distribution and administration fees increased 37% in fiscal 2007 and 5% in fiscal 2006. The increase in fiscal 2007 was primarily due to higher fund management and administration fees resulting from an increase in assets and a more favorable asset mix. The increase was also due to higher performance fees from the alternatives business, including those associated with FrontPoint, which the Company acquired in December 2006 (see Note 23 to the consolidated financial statements). The increase in fiscal 2006 was due to higher fund management and administration fees, partially offset by lower distribution fees. The higher management and administration fees in fiscal 2007 and fiscal 2006 were associated with increases in average assets under management of 20% and 6%, respectively.

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

	At November 30,			Average for		
	2007	2006	2005	Fiscal 2007	Fiscal 2006	Fiscal 2005
	(dollars in billions)					
Assets under management or supervision by distribution channel:						
Americas Retail Morgan Stanley brand	\$ 64	\$ 63	\$ 63	\$ 64	\$ 64	\$ 64
Americas Retail Van Kampen brand	99	94	88	99	90	84
Americas Intermediary(1)	68	58	48	65	51	45
U.S. Institutional	128	100	96	116	97	97
Non-U.S.	132	93	69	111	80	64
Total long-term assets under management or supervision	491	408	364	455	382	354
Institutional money markets/liquidity	68	49	33	57	39	33
Retail money markets	31	35	46	33	40	49
Total money markets	99	84	79	90	79	82
Total assets under management or supervision	590	492	443	545	461	436
Share of minority interest assets(2)	7	4		6		
Total	\$ 597	\$ 496	\$ 443	\$ 551	\$ 461	\$ 436
Assets under management or supervision by asset class:						
Equity	\$ 265	\$ 239	\$ 218	\$ 256	\$ 228	\$ 207
Fixed income	102	94	91	97	91	96
Money market	99	84	79	90	79	82
Alternatives(3)	109	61	43	87	50	40
Subtotal	575	478	431	530	448	425
Unit trusts	15	14	12	15	13	11
Total assets under management or supervision	590	492	443	545	461	436
Share of minority interest assets(2)	7	4		6		

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Total	\$ 597	\$ 496	\$ 443	\$ 551	\$ 461	\$ 436
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- (1) Americas Intermediary channel primarily represents client flows through defined contribution, insurance and bank trust platforms.
- (2) Amounts represent Asset Management's proportional share of assets managed by entities in which it owns a minority interest.
- (3) The alternatives asset class includes a range of investment products, such as real estate funds, hedge funds, private equity funds, funds of hedge funds and funds of private equity funds.

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Activity in Asset Management's assets under management or supervision during fiscal 2007 and fiscal 2006 were as follows:

	Fiscal 2007	Fiscal 2006
	(dollars in billions)	
Balance at beginning of period	\$ 496	\$ 443
Net flows by distribution channel:		
Americas Retail Morgan Stanley brand	(4)	(9)
Americas Retail Van Kampen brand		(2)
Americas Intermediary(1)	4	8
U.S. Institutional	3	(13)
Non-U.S.	22	6
Net inflows/(outflows) excluding money markets	25	(10)
Money market net flows:		
Institutional	15	13
Retail	(5)	(12)
Total money market net flows	10	1
Market appreciation/other	56	58
Total net increase	91	49
Acquisitions	7	
Net increase in share of minority interest assets(2)	3	4
Balance at end of period	\$ 597	\$ 496

(1) Americas Intermediary channel primarily represents client flows through defined contribution, insurance and bank trust platforms.

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

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

Other. Other revenues increased 188% in fiscal 2007 primarily due to revenues associated with Lansdowne Partners (Lansdowne), a London-based investment manager, and Avenue Capital Group (Avenue), a New York-based investment manager, which the Company acquired minority stakes in the fourth quarter of fiscal 2006 (see Note 23 to the consolidated financial statements). Other revenues remained flat in fiscal 2006.

Non-Interest Expenses. Non-interest expenses increased 55% in fiscal 2007, primarily reflecting an increase in compensation and benefits expense. Compensation and benefits expense increased 81% in fiscal 2007, primarily reflecting higher incentive-based compensation accruals due to higher net revenues. The increase in fiscal 2007 was also due to expenses associated with certain employee deferred compensation plans, partially offset by Asset Management's share (\$20 million) of the incremental compensation expense related to equity awards to retirement-eligible employees that was recorded in the first quarter of fiscal 2006 (see Note 2 to the consolidated financial statements). Excluding compensation and benefits expense, non-interest expenses increased 24%. Occupancy and equipment expenses increased 29%.

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primarily due to higher rental costs associated with business growth. Brokerage, clearing and exchange fees increased 10% primarily due to increased fee sharing, increased assets under management and higher commission expenses associated with the launching of new products. These increases were offset by a decrease in the deferred commission amortization. Information processing and communications expense increased 21% primarily due to higher licensing fees associated with the acquisition of FrontPoint. Professional services expense increased 47% primarily due to higher sub-advisory fees related to the acquisition of FrontPoint. Other expenses increased 47% primarily due to an insurance reimbursement received in fiscal 2006 related to certain legal matters and an increase in other miscellaneous expenses.

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Non-interest expenses increased 19% in fiscal 2006. Fiscal 2005 included a reduction in non-interest expenses from Asset Management's share (\$43 million) of the insurance settlement related to the events of September 11, 2001 (see Note 25 to the consolidated financial statements). Compensation and benefits expense increased 37% in fiscal 2006, primarily reflecting higher incentive-based compensation costs as well as the impact of new hires. In addition, fiscal 2006 included Asset Management's share (\$20 million) of the incremental compensation expense related to equity awards to retirement-eligible employees (see Note 2 to the consolidated financial statements), while fiscal 2005 included Asset Management's share (\$41 million) of the costs associated with senior management changes (see Other Matters Senior Management Compensation Charges herein). Excluding compensation and benefits expense and the insurance settlement, non-interest expenses were unchanged. Brokerage, clearing and exchange fees decreased 14%, primarily reflecting lower amortization expense associated with certain open-ended funds. The decrease in amortization expense reflected a lower level of deferred costs in recent periods due to a decrease in sales of certain open-ended funds. Marketing and business development expense increased 11% primarily due to higher advertising and marketing costs.

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Impact of Credit Market Events.

Overview.

The Company recorded \$9.4 billion in mortgage-related writedowns in the fourth quarter of fiscal 2007 resulting from an unfavorable subprime mortgage-related trading strategy and the continued deterioration and lack of market liquidity for subprime and other mortgage-related instruments. Included in the \$9.4 billion were writedowns of \$7.8 billion related to U.S. subprime trading positions, principally super senior derivative positions in CDOs. These derivative positions were entered into primarily by the Company's proprietary trading group (see U.S. ABS CDO Exposures). As the credit markets in general, and the mortgage markets in particular, declined dramatically in the fourth quarter, increases in the implied cumulative losses in the subprime mortgage market, coupled with the illiquid nature of the Company's trading positions, led to a significant deterioration in value in its subprime-related trading positions. A summary of the Company's U.S. subprime trading positions, writedowns and remaining net exposures is further detailed in the table on page 53 and is discussed in U.S. Subprime Mortgage-Related Exposures herein.

The \$9.4 billion of fourth quarter writedowns also included an impairment charge of \$437 million related to mortgage-related securities portfolios in the Company's domestic subsidiary banks (see Subsidiary Banks herein) and \$1.2 billion related to CMBS, ALT-A (a residential mortgage loan categorization that falls between prime and subprime) and other loans, conduit and non-performing loans and European non-conforming loans. The Company continues to have exposure to these markets and instruments, and, as market conditions continue to evolve, the fair value of these other mortgage-related instruments could further deteriorate.

The valuation methodology used for these instruments incorporated a variety of inputs, including prices observed from the execution of a limited number of trades in the marketplace; ABX and similar indices that track the performance of a series of credit default swaps based on subprime mortgages; and other market information, including data on remittances received and updated cumulative loss data on the underlying mortgages. For a further discussion of the Company's risk management policies and procedures see Quantitative and Qualitative Disclosures about Market Risk Risk Management in Part II, Item 7A.

For further discussion regarding the Company's involvement with other U.S. subprime-related activities, see Special Purpose Entities and Variable Interest Entities and Other Exposures to Subprime Lenders.

The results for fiscal 2007 also included losses of approximately \$700 million primarily recorded in the third quarter of fiscal 2007 that reflected mark-to-market valuations associated with loans and loan commitments largely related to acquisition financing to non-investment grade companies. The losses included markdowns of leveraged loan commitments associated with acquisition financing transactions that were accepted by the borrower but not yet closed. These losses were primarily related to the illiquid market conditions that existed during the second half of fiscal 2007. The valuation of these commitments could change in future periods depending on, among other things, the extent that they are renegotiated or repriced or the associated acquisition transaction does not occur. In addition, the Company's leveraged finance business originates and distributes loans and commitments, and intends to distribute its current positions; however, this could take longer than in the past and is dependent on liquidity re-entering the market. Subsequent to November 30, 2007, there has been further widening in credit spreads for non-investment grade loans that, if sustained, will result in additional writedowns for these loans and commitments. For further information about the Company's corporate lending activities, see Item 7A, Quantitative and Qualitative Disclosures about Market Risk Credit Risk.

The Company also recognized losses of \$129 million in the fourth quarter of fiscal 2007 related to structured investment vehicles (see Structured Investment Vehicles herein).

U.S. Subprime Mortgage-Related Exposures.

The Company's U.S. subprime mortgage-related trading positions consist of those related to U.S. ABS CDOs and other mortgage-related exposures arising from investments in subprime loans, from asset-backed securities

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that, in whole or in part, are backed by subprime mortgage loans, and from derivatives referencing subprime mortgages or subprime mortgage-backed securities.

Subprime mortgages are loans secured by real property made to a borrower (or borrowers) with a diminished or impaired credit rating or with a limited credit history. A borrower's credit history is reflected in his credit report and routinely converted into a numerical credit score often referred to as a Fair Isaac Corporation (or FICO) score. Generally, a loan made to a borrower with a low FICO score or other credit score has historically been considered as subprime. Loans to borrowers with higher FICO scores may be subprime if the loan exhibits other high-risk factors. Such risk factors may include loans where: (a) the loan has a high loan-to-value ratio or combined loan-to-value ratios; (b) the borrower has reduced or limited income documentation; (c) the borrower has a high debt-to-income ratio; (d) the occupancy type for the loan is other than the borrower's primary residence. There are many other risk factors, including borrowers who have purchased multiple properties or have taken previous equity withdrawal (cash out) refinancings within the last 12 to 24 month period, non-arm's length purchase transactions and unsupported or high-risk collateral properties, among others. Subprime mortgage-related securities are those securities that derive a significant portion of their value from subprime loans.

U.S. ABS CDO Exposures.

The Company purchases interests in and enters into derivatives with ABS CDOs. CDOs provide credit risk exposure to a portfolio of asset-backed securities (cash CDOs) or a reference portfolio of securities (synthetic CDOs). The underlying or reference portfolios consist primarily of residential mortgage-backed securities. The CDOs to which the Company has exposure are primarily structured and underwritten by third parties, although the Company also structures and underwrites CDOs, for which it receives structuring and/or distribution fees, and does from time to time retain interests in such CDOs.

The Company's primary exposure to ABS CDOs is to synthetic CDOs that hold or are referenced to collateral with ratings of BBB+, BBB or BBB- (mezzanine CDOs). The majority of the Company's writedowns in the fourth quarter related to super senior credit default swaps referencing such mezzanine CDOs that were entered into primarily by the Company's proprietary trading group. Under these credit default swap arrangements, the Company can be required to make payments in the event that securities in the referenced portfolios default or experience other credit events such as rating agency downgrades. (The characterization of these credit default swaps as super senior derives from their seniority in the capital structure of the synthetic CDO.) The Company also has exposure to ABS CDOs via other types of credit default swaps, direct investments in CDO securities, and retained interests in CDOs that the Company has underwritten. In determining the fair value of the Company's ABS CDO-related instruments the Company took into consideration prices observed from the execution of a limited number of transactions and data for relevant benchmark instruments in synthetic subprime markets. Despite the fact that actual defaults on swap obligations have not yet been realized, the fair value of such positions has experienced significant declines, as a result of a deterioration of value in the benchmark instruments as well as market developments. These losses, as well as the Company's net CDO exposures, are quantified in the U.S. subprime-related exposures table below.

Other U.S. Subprime Mortgage-Related Exposures.

The Company also has exposure to the U.S. subprime mortgage market via investments in subprime mortgage loans and ABS that are backed in whole or in part by subprime mortgage loans and via derivatives referencing subprime mortgages or subprime mortgage-backed securities. With respect to whole loans, the Company purchases pools of mortgage loans from third-party originators and also originates mortgage loans through its retail, wholesale and conduit channels and typically disposes of such loans by securitizing them. The Company typically retains certain lower-rated securities of such securitizations, often referred to as residual tranche securities. The Company's other subprime mortgage-related trading exposures are quantified in the table below.

The Company's interests in U.S. subprime-related exposures are carried at fair value with changes recognized in earnings.

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The following table provides a summary of the Company's direct U.S. subprime trading exposures (excluding amounts related to mortgage-related securities portfolios in the Company's domestic subsidiary banks (see "Subsidiary Banks" herein)) as of and for the fiscal year ended November 30, 2007. The Company utilizes various methods of evaluating risk in its trading and other portfolios, including monitoring Net Exposure. Net Exposure is defined as potential loss to the Company over a period of time in an event of 100% default of the referenced loan, assuming zero recovery. The value of these positions remains subject to mark-to-market volatility. Positive net exposure amounts indicate potential loss (long position) in a default scenario. Negative net exposure amounts indicate potential gain (short position) in a default scenario. Net Exposure does not take into consideration the risk of counterparty default. See "Quantitative and Qualitative Disclosures about Market Risk - Credit Risk" in Part II, Item 7A for a further description of how credit risk is monitored. Actual losses could exceed the amount of Net Exposure.

	Statement of Financial Condition 11/30/07(1)	Profit and (Loss) Three Months Ended	Profit and (Loss) 12 Months Ended	Net Exposure 11/30/07
	November 30, 2007 (dollars in billions)			
<i>Super Senior Derivative Exposure:</i>				
Mezzanine	\$ (8.7)	\$ (7.1)	\$ (9.3)	\$ 3.9
CDO squared(3)	(0.1)	(0.1)	(0.1)	0.1
Total ABS CDO super senior derivative exposure	\$ (8.8)	\$ (7.2)	\$ (9.4)	\$ 4.0
<i>Other CDO Exposure:</i>				
ABS CDO CDS	\$ 2.7	\$ 1.3	\$ 2.3	\$ (1.5)
ABS CDO bonds	1.1	(0.5)	(0.8)	1.1
Total other CDO exposure	\$ 3.8	0.8	1.5	(0.4)
Subtotal ABS CDO-related exposure(2)	\$ (5.0)	\$ (6.4)	\$ (7.9)	\$ 3.6
<i>U.S. Subprime Mortgage-Related Exposure:</i>				
Loans	\$ 0.6	\$ (0.1)	\$ (0.2)	\$ 0.6
Total rate-of-return swaps			0.1	
ABS bonds	2.7	(2.9)	(3.8)	2.7
ABS CDS	7.8	1.6	5.0	(5.1)
Subtotal U.S. subprime mortgage-related exposure	\$ 11.1	\$ (1.4)	\$ 1.1	\$ (1.8)
Total U.S. subprime trading exposure	\$ 6.1	\$ (7.8)	\$ (6.8)	\$ 1.8

- (1) Statement of financial condition amounts are presented on a net asset/liability basis and do not take into account any netting of cash collateral against these positions. In addition, these amounts reflect counterparty netting to the extent that there are positions with the same counterparty that are subprime-related; they do not reflect any counterparty netting to the extent that there are positions with the same counterparty that are not subprime related. The \$6.1 billion is reflected in the Company's consolidated statement of financial condition as follows: Financial instruments owned of \$15.3 billion and Financial instruments sold, not yet purchased of \$9.2 billion.
- (2) In determining the fair value of the Company's ABS super senior CDO-related exposures the Company took into consideration prices observed from the execution of a limited number of transactions and data for relevant benchmark instruments in synthetic subprime markets. Deterioration of value in the benchmark instruments as well as market developments have led to significant declines in the estimates of fair value. These declines reflected increased implied losses across this portfolio. These implied loss levels are consistent with losses in the range between 13% - 20% implied by the ABX indices. These cumulative loss levels, at a severity rate of 50%, imply defaults in the range of 43% - 50% for 2005 and 2006 outstanding mortgages.
- (3) Refers to CDOs where the collateral is comprised entirely of another CDO security.

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Subsidiary Banks.

The securities portfolios of Morgan Stanley Bank (Utah) and Morgan Stanley Trust FSB (collectively, the subsidiary banks) include certain subprime-related securities. The portfolios contain no subprime whole loans, subprime residuals or CDOs.

At November 30, 2007, the securities portfolios totaled \$9.9 billion consisting primarily of AAA-rated ABS and residential mortgage-backed securities. Of the total amount, \$5.5 billion were subprime mortgage-related securities.

The securities in the subsidiary domestic banks portfolios were previously classified as securities available for sale in accordance with SFAS No. 115, Accounting for Certain Investments in Debt and Equity Securities (SFAS No. 115). In the fourth quarter of fiscal 2007, the Company determined that it no longer intends to hold these securities until the fair value of the securities recovers to a level that exceeds their initial cost. Accordingly, the Company recorded an other-than-temporary impairment charge of \$437 million in Principal transactions-trading revenues in the consolidated statement of income on its portfolio of securities available for sale in the fourth quarter of fiscal 2007 and reclassified the portfolios to Financial instruments owned in the consolidated statement of financial condition effective November 30, 2007.

Special Purpose Entities and Variable Interest Entities.

The Company's involvement with special purpose entities (SPEs) and variable interest entities (VIEs) is discussed in Note 5 to the consolidated financial statements and Critical Accounting Policies Special Purpose Entities herein. In relation to subprime loans and subprime-backed securities, the Company's involvement with SPEs/VIEs consists primarily of the following:

Engaging in securitization activities related to subprime loans and subprime-backed securities;

Acting as an underwriter of beneficial interests issued by securitization vehicles;

Transferring whole loans into SPEs/VIEs;

Holding one or more classes of securities issued by such securitization vehicles (including residual tranche securities) and possibly entering into derivative agreements with such securitization vehicles;

Purchasing and selling (in both a market-making and a proprietary-trading capacity) subprime-backed securities issued by SPEs/VIEs, whether such vehicles are sponsored by the Company or not;

Entering into derivative transactions with SPEs/VIEs (not sponsored by the Company) that hold subprime-related assets;

Providing warehouse financing to CDOs and collateralized loan obligations (CLOs);

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Entering into derivative agreements with non-SPE/VEs, whose value is derived from securities issued by SPEs/VEs;

Servicing assets held by SPEs/VEs or holding servicing rights related to assets held by SPEs/VEs that are serviced by others under subservicing arrangements;

Serving as an asset manager to various investment funds that may invest in securities that are backed, in whole or in part, by subprime loans.

Other Exposures to Subprime Lenders.

The Company provides warehouse financing to entities collateralized by residential mortgage loans. Under these lines of credit arrangements, the Company requires those entities to provide collateral in excess of the monies advanced. The Company values the collateral on a regular basis to ensure that the value of the collateral exceeds the value of the monies advanced in accordance with the collateral agreements. The Company does not carry amounts lent under such arrangements at fair value but instead carries such amounts at amortized cost. In

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addition, the Company does not fair value its commitments under such arrangements. The Company evaluates its exposure and any potential impairment under such arrangements, whether funded or committed, in accordance with SFAS No. 5, Accounting for Contingencies (SFAS No. 5).

In addition, the Company had entered into derivative and lending arrangements with a third-party-sponsored commercial paper conduit that provides warehouse financing to subprime lenders, where such derivative and lending arrangements are linked to the performance of the conduit's loans to the subprime lenders. At November 30, 2007, exposure related to these arrangements was approximately \$300 million. These arrangements were satisfactorily settled and terminated in December 2007. The Company had no further subprime-related commitments to the third-party-sponsored commercial paper conduit as of November 30, 2007. The Company does not sponsor any commercial paper conduits.

Structured Investment Vehicles.

Structured investment vehicles (SIVs) are unconsolidated entities that issue various capital notes and debt instruments to fund the purchase of assets. While the Company does not sponsor or serve as asset manager to any unconsolidated SIVs, the Company does serve as investment advisor to certain unconsolidated money market funds (the Funds) that have investments in securities issued by SIVs. In 2007, widespread illiquidity in the commercial paper market led to market value declines and rating agency downgrades of many securities issued by SIVs, some of which were held by the Funds. As a result, the Company purchased approximately \$900 million of such securities from the Funds during the year at amortized cost, which resulted in losses to the Company of \$129 million. The carrying value of the purchased securities still held by the Company as of November 30, 2007 was \$543 million. Such positions are reflected at fair value, and presented in Financial instruments owned Corporate and other debt in the consolidated statement of financial condition. Subsequent to November 30, 2007, the Company purchased approximately \$160 million of additional securities from the Funds and recorded losses of approximately \$40 million on these securities. The Company was not obligated to purchase any of these securities and has no obligation to purchase any additional securities from the Funds in the future. The Funds continue to have investment in securities issued by SIVs, with an aggregate face value of \$8.2 billion as of November 30, 2007 (\$5.4 billion as of January 18, 2008.) These securities have been issued by SIVs that are predominately bank-sponsored, and meet the requirements and investment criteria to continue to be held by the Funds.

Monoline Insurers.

Monoline insurers (Monolines) provide credit enhancement to capital markets transactions. The current credit environment severely affected the capacity of such financial guarantors. The Company's exposure to Monolines is limited to bonds that are insured by Monolines and as counterparties to derivative contracts. The aggregate direct exposure to Monolines at November 30, 2007 was \$3.7 billion primarily including ABS bonds of \$1.5 billion in the Subsidiary Banks' portfolio (see Subsidiary Banks) that are collateralized by first and second lien subprime mortgages enhanced by financial guarantees, \$1.3 billion in insurance municipal bond securities and \$800 million in net counterparty exposure.

Table of Contents**Other Matters.**

The following matters are discussed in the Company's notes to the consolidated financial statements. For further information on these matters, please see the applicable note:

	Note
Accounting Developments:	
<i>Limited Partnerships</i>	2
<i>Accounting for Certain Hybrid Financial Instruments</i>	2
<i>Accounting for Servicing of Financial Assets</i>	2
<i>Accounting for Uncertainty in Income Taxes</i>	2
<i>Fair Value Measurements</i>	2
<i>Employee Benefit Plans</i>	2
<i>Fair Value Option</i>	2
<i>Offsetting of Amounts Related to Certain Contracts</i>	2
<i>Investment Company Accounting</i>	2
<i>Dividends on Share-Based Payment Awards</i>	2
<i>Business Combinations</i>	2
<i>Noncontrolling Interests</i>	2
Tax Matters	20
Discontinued Operations	22
Business and Other Acquisitions and Dispositions and Sale of Minority Interest	23
Staff Accounting Bulletin No. 108	24
Insurance Settlement	25
Lease Adjustment	26

Stock-Based Compensation.

The Company early adopted SFAS No. 123R, Share-Based Payment (SFAS No. 123R) using the modified prospective approach as of December 1, 2004. For further information on SFAS No. 123R, see Note 2 to the consolidated financial statements.

Additionally, based on interpretive guidance related to SFAS No. 123R in the first quarter of fiscal 2006, the Company changed its accounting policy for expensing the cost of anticipated fiscal 2006 year-end equity awards that were granted to retirement-eligible employees in the first quarter of fiscal 2007. Effective December 1, 2005, the Company accrues the estimated cost of these awards over the course of the current fiscal year rather than expensing the awards on the date of grant.

As a result, fiscal 2006 stock-based compensation expense primarily included the following costs:

amortization of fiscal 2003 year-end awards;

amortization of fiscal 2004 year-end awards;

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amortization of fiscal 2005 year-end awards to non-retirement eligible employees;

the full cost of fiscal 2005 year-end awards to retirement eligible employees (made in December 2005); and

the full cost of fiscal 2006 year-end awards to retirement eligible employees (made in December 2006).

Fiscal 2007 stock-based compensation expense primarily included the following costs:

amortization of fiscal 2004 year-end awards;

amortization of fiscal 2005 year-end awards to non-retirement eligible employees;

amortization of fiscal 2006 year-end awards to non-retirement eligible employees; and

the full cost of fiscal 2007 year-end awards to retirement eligible employees (made in December 2007).

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Fiscal 2003 and fiscal 2004 year-end awards are generally amortized over three and four years, while fiscal 2005 and fiscal 2006 year-end awards are generally amortized over two and three years.

Senior Management Compensation Charges.

Compensation and benefits expense in fiscal 2005 included charges for certain members of senior management related to severance and new hires, which increased non-interest expenses by approximately \$282 million. These compensation charges were allocated to the Company's business segments as follows: Institutional Securities (\$193 million), Global Wealth Management Group (\$48 million) and Asset Management (\$41 million).

Coleman Litigation.

In May 2003, Coleman (Parent) Holdings Inc. (CPH) filed a complaint against Morgan Stanley in the Circuit Court of the Fifteenth Judicial Circuit for Palm Beach County, Florida relating to the 1998 merger between The Coleman Company, Inc. and Sunbeam, Inc. In June 2005, the trial court issued a final judgment in favor of CPH in the amount of \$1,578 million, which included prejudgment interest and excluded certain payments received by CPH in settlement of related claims against others. In June 2005, Morgan Stanley filed a notice of appeal with the District Court of Appeal for the Fourth District of Florida (the Court of Appeal) and posted a supersedeas bond, which automatically stayed execution of the judgment pending appeal.

In March 2007, the Court of Appeal issued an opinion reversing the trial court's award for compensatory and punitive damages and remanding the matter to the trial court for entry of judgment for Morgan Stanley. In June 2007, the Court of Appeal's opinion became final when the Court of Appeal issued an order denying CPH's motions for rehearing, rehearing *en banc* and for certification of certain questions for review by the Florida Supreme Court (the Supreme Court). In June 2007, the trial court issued an order cancelling the supersedeas bond that Morgan Stanley had posted. In July 2007, CPH filed a petition with the Supreme Court asking that court to review the Court of Appeal's decision (Petition for Review). On December 12, 2007, the Supreme Court issued an order denying CPH's Petition for Review.

The Company believes, after consultation with outside counsel, that the Supreme Court's decision to deny the Petition for Review has effectively ended CPH's civil claim against the Company. Effective November 30, 2007, the Company reversed the \$360 million reserve previously established for the Coleman litigation under SFAS No. 5.

Defined Benefit Pension and Other Postretirement Plans.

Contributions. The Company made contributions of \$131 million and \$84 million (excluding \$30 million in fiscal 2006 relating to DFS and Quilter) to its U.S. and non-U.S. defined benefit pension plans in fiscal 2007 and fiscal 2006, respectively. These contributions were funded with cash from operations.

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The Company determines the amount of its pension contributions to its funded plans by considering several factors including the level of plan assets relative to plan liabilities, expected plan liquidity needs and expected future contribution requirements. The Company's policy is to fund at least the amounts sufficient to meet minimum funding requirements under applicable employee benefit and tax regulations (for example in the U.S., the minimum required contribution under the Employee Retirement Income Security Act of 1974, or ERISA). At November 30, 2007, there were no minimum required ERISA contributions for the Company's U.S. pension plan that is qualified under Section 401(a) of the Internal Revenue Code (the U.S. Qualified Plan). Liabilities for benefits payable under certain postretirement and unfunded supplementary plans are accrued by the Company and are funded when paid to the beneficiaries.

Expense. In accordance with U.S. GAAP, the Company recognizes the compensation cost of an employee's pension benefits (including prior-service cost) over the employee's estimated service period. This process involves making certain estimates and assumptions, including the discount rate and the expected long-term rate of return on plan assets.

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The assumed discount rate, which is intended to reflect the rates at which pension benefits could be effectively settled, is used to measure the projected and accumulated benefit obligations and to calculate the service cost and interest cost. For fiscal 2007, the assumed discount rate for all U.S. plans was selected by the Company, in consultation with its independent actuaries, using a pension discount yield curve based on the characteristics of the U.S. Qualified Plan liabilities. The pension discount yield curve represents spot discount yields based on duration implicit in a representative broad based Aa corporate bond universe of high-quality fixed income investments. It includes only bonds of reasonable issue size and excludes certain types of bonds, such as callable bonds. As of November 30, 2007, the Company's U.S. Qualified Plan represented 82% of the total liabilities of its U.S. pension and postretirement plans combined. The assumed discount rate for the defined benefit portion of its U.K. pension plan was selected by the Company using a pension discount yield curve based on the characteristics of the U.K. defined benefit pension liabilities. As of November 30, 2007, the defined benefit portion of the Company's U.K. pension plan represented 59% of the total liabilities of its non-U.S. pension plans combined. For all other non-U.S. pension plans, the Company set the assumed discount rates based on the nature of liabilities, local economic environments and available bond indices.

The expected long-term rate of return on assets represents the Company's best estimate of the long-term return on plan assets and generally was estimated by adjusting the previous year's rate by the difference in the weighted average return of the underlying long-term expected returns on the different asset classes, based on the target asset allocations, taking into consideration estimated expenses and the benefits of diversification and rebalancing the portfolio. This rate is expected to remain the same from one year to the next unless there is a significant change in the target asset allocation, the fees and expenses paid by the plan or market conditions.

As of November 30, 2007, the Company's U.S. Qualified Plan represented 90% of the total assets of its U.S. and non-U.S. pension plans combined. The Company, in consultation with its independent investment consultants and actuaries, determined the expected long-term rate of return on its U.S. Qualified Plan assets would remain at 6.75% for fiscal 2007 (see Note 19 to the consolidated financial statements). There was no significant change in the fees paid by the plan or the underlying market outlook since September 2006. To better align the duration of plan assets with the duration of plan liabilities, in May 2007, the U.S. Qualified Plan's target asset allocation policy was changed from 45%/55% equity/fixed income to 30%/70% equity/fixed income. The effects of this change will be reflected in fiscal 2008, and the impact is not expected to be material to the Company's consolidated results of operations. The preliminary expected long-term rate of return on U.S. Qualified Plan assets is 6.50% for fiscal 2008.

The Company's expected long-term rate of return on assets for its U.S. Qualified Plan was based on the following target asset allocation:

	Target Investment Mix	Expected Annual Return(1)
Domestic equity:		
Large capitalization	12%	8.1%
Small capitalization	3%	8.4%
International equity	15%	8.4%
Fixed income:		
Long-term government/corporate	70%	5.4%

(1) These returns do not include the impact of diversification on the overall expected portfolio return.

Each year, the Company compares its initial estimate of the expected long-term rate of return on assets for the U.S. Qualified Plan (and adjusts, if necessary) with a portfolio return calculator model (the "Portfolio Model") that produces a range of expected returns for the portfolio. Return assumptions used are forward-looking gross returns that are not developed solely by an examination of historical returns. The Portfolio Model begins with the current U.S. Treasury yield curve, recognizing that expected returns on bonds are heavily influenced by the current level of yields. Corporate bond spreads and equity risk premiums, based on current market conditions, are

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then added to develop the return expectations for each asset class. The resulting expected portfolio investment is then adjusted downward to reflect an assumed load for expenses, which include investment and transaction fees that typically are paid from plan assets, added to the cost basis or subtracted from sale proceeds, as well as administrative expenses paid from plan assets.

The Company uses the expected long-term rate of return on plan assets to compute the expected return on assets component of pension expense. For the U.S. Qualified Plan, expected returns are computed based on a market-related value of assets. The market-related value of assets is a smoothed actuarial value of assets equal to a moving average of market values in which investment income is recognized over a five-year period. The market-related value of assets must be no greater than 120% and no less than 80% of the market value of assets. Investment income equal to the expected return on the plan's assets as calculated for the prior year's expense is recognized immediately. Any difference between the actual investment income (on a market-value basis) and the expected return is recognized over a five-year period in accordance with SFAS No. 87, *Employers' Accounting for Pensions* (SFAS No. 87).

Other assumptions, including mortality rates, long-term salary growth and employee turnover rates, are set by the Company in consultation with its independent actuaries. These assumptions are tested every year by monitoring gains and losses, performing assumption studies as needed, and monitoring Company objectives and actuarial trends. These assumptions are adjusted whenever necessary.

The Company amortizes (as a component of pension expense) unrecognized net gains and losses over the average future service of active participants (5 to 20 years depending upon the plan) to the extent that the gain/loss exceeds 10% of the greater of the projected benefit obligation or the market-related value of plan assets. The loss amortization component for the U.S. and the non-U.S. pension plans was \$41 million for fiscal 2007 (28% of pension expense) and \$51 million for fiscal 2006 (32% of pension expense).

Impact of SFAS No. 158. In September 2006, the Financial Accounting Standards Board (FASB) issued SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*, an amendment of FASB Statements No. 87, 88, 106, and 132(R) (SFAS No. 158). Among other items, SFAS No. 158 required recognition of the overfunded or underfunded status of the Company's defined benefit and postretirement plans as an asset or liability in the consolidated financial statements for the fiscal year ending November 30, 2007. The Company recorded an after-tax charge of \$208 million (\$347 million pre-tax) to Shareholders' equity upon the adoption of this requirement. SFAS No. 158 also requires the measurement of defined benefit and postretirement plan assets and obligations as of the end of the fiscal year. SFAS No. 158's requirement to use the fiscal year-end date as the measurement date is effective for fiscal years ending after December 15, 2008. The Company expects to early adopt a fiscal year-end measurement date for its fiscal year ending November 30, 2008 and currently expects to record an after-tax charge of approximately \$15 million to Shareholders' equity upon adoption.

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Critical Accounting Policies.

The Company's consolidated financial statements are prepared in accordance with U.S. GAAP, which requires the Company to make estimates and assumptions (see Note 1 to the consolidated financial statements). The Company believes that of its accounting policies (see Note 2 to the consolidated financial statements), the following may involve a higher degree of judgment and complexity.

Fair Value.

Financial Instruments Measured at Fair Value. A significant number of the Company's financial instruments are carried at fair value with changes in fair value recognized in earnings each period. The Company makes estimates regarding valuation of assets and liabilities measured at fair value in preparing the consolidated financial statements. These assets and liabilities include:

Financial instruments owned and Financial instruments sold, not yet purchased;

Securities received as collateral and Obligation to return securities received as collateral;

Certain Commercial paper and other short-term borrowings, primarily structured notes;

Certain Deposits;

Other secured financings; and

Certain Long-term borrowings, primarily structured debt.

Fair Value Measurement Definition and Hierarchy. The Company adopted the provisions of SFAS No. 157, effective December 1, 2006. SFAS No. 157 defines fair value 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, including market, income and/or cost 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 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:

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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.

Assets and liabilities utilizing Level 1 inputs include exchange-traded equity securities and listed derivatives that are actively traded, most U.S. Government securities and certain other sovereign government obligations.

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

Assets and liabilities utilizing Level 2 inputs include: exchange-traded equity securities and listed derivatives that are not actively traded; most OTC derivatives; restricted stock; corporate and municipal bonds; certain corporate loans and loan commitments; certain high-yield debt; certain residential and commercial mortgage loans; certain mortgage-backed securities (MBS), asset-backed securities (ABS), and CDO securities; retained interests in certain securitization transactions; structured notes; physical commodities; and mortgage servicing rights.

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

Assets and liabilities utilizing Level 3 inputs include: certain corporate loans and loan commitments; certain commercial whole loans; certain mortgage loans; certain high-yield debt; distressed debt (i.e., securities of issuers encountering financial difficulties, including bankruptcy or insolvency); certain MBS, ABS and CDO securities; retained interests in certain securitization transactions; investments in real estate funds; private equity investments; and complex over-the-counter derivatives (including certain foreign currency options; long-dated commodity options and swaps; certain mortgage-related credit default swaps; derivative interests in mortgage-related CDOs; and basket credit default swaps).

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 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 who holds the asset or owes the liability 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 3 to the consolidated financial statements for further information about the Company's financial assets and liabilities that are accounted for at fair value.

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 fair value 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 are 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 and market liquidity. These adjustments are applied on a consistent basis and are based upon observable inputs where available.

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-

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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, will 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 certain credit default swaps where direct trading activity or quotes are unobservable. 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 secondary and primary market activity in the cash CDO and synthetic CDO market. 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. These instruments involve significant unobservable inputs and are categorized in Level 3 of the fair value hierarchy.

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.

Prior to the adoption of SFAS No. 157, the Company followed the provisions of EITF Issue No. 02-3. Under EITF Issue No. 02-3, recognition of day one profit at inception of an OTC derivative contract was prohibited unless the fair value of the contract was based on a valuation technique incorporating observable market data. With the adoption of SFAS No. 157, the Company is no longer applying the revenue recognition criteria of EITF Issue No. 02-3.

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.

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.

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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

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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.

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 also holds 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.

U.S. Agency Securities. U.S. agency securities include To-be-announced (TBA) securities and mortgage pass-through certificates. TBA securities are liquid and have quoted market prices. Fair value of mortgage pass-through certificates is determined via a simulation model, which considers different rate scenarios and historical activity to calculate a spread to the comparable TBA security. U.S. agency securities are categorized in Level 2 of the fair value hierarchy.

Commercial Mortgage-Backed Securities 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. Included in this category are certain interest-only securities, which, in the absence of market prices, are valued as a function of observable whole bond prices and cash flow values of principal-only bonds using current market assumptions at the measurement date. CMBS and ABS are categorized in Level 3 if external prices 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 as 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

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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.

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 investment in private equity and real estate funds. The transaction price is used as the best estimate of fair value at inception. When evidence supports a change to the carrying value from the transaction price, adjustments are made to reflect expected exit values. Ongoing reviews by Company management are 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.

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.

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, 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.

Reclasses from Level 2 to Level 3. During the fourth quarter of fiscal 2007, the Company reclassified approximately \$7.0 billion of funded assets and \$279 million of net derivative contracts from Level 2 to Level 3 because certain significant inputs for the fair value measurement became unobservable. These reclasses were primarily related to the continued market and liquidity deterioration in the mortgage markets. The most material transfers to Level 3 were in commercial whole loans, residuals from residential securitizations, interest-only commercial mortgage and agency bonds as well as commercial and residential credit default swaps.

Fair Value Control Processes. The Company employs control processes to validate the fair value of its financial instruments, including those derived from pricing models. These control processes are designed to assure that the values used for financial reporting are based on observable inputs wherever possible. In the event that observable inputs are not available, the control processes are designed to assure that the valuation approach utilized is appropriate and consistently applied and that the assumptions are reasonable. These control processes include reviews of the pricing model's theoretical soundness and appropriateness by Company personnel with relevant expertise who are independent from the trading desks. Additionally, groups independent from the trading divisions within the Financial Control, Market Risk and Credit Risk Departments participate in the review and validation of the fair values generated from pricing models, as appropriate. Where a pricing model is used to determine fair value, recently executed comparable transactions and other observable market data are considered for purposes of validating assumptions underlying the model.

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Consistent with market practice, the Company has individually negotiated agreements with certain counterparties to exchange collateral (margining) based on the level of fair values of the derivative contracts they have executed. Through this margining process, one party or both parties to a derivative contract provides the other party with information about the fair value of the derivative contract to calculate the amount of collateral required. This sharing of fair value information provides additional support of the Company's recorded fair value

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for the relevant OTC derivative products. For certain OTC derivative products, the Company, along with other market participants, contributes derivative pricing information to aggregation services that synthesize the data and make it accessible to subscribers. This information is then used to evaluate the fair value of these OTC derivative products.

Legal, Regulatory and Tax Contingencies.

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

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

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

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

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

See Notes 2, 15 and 20 to the consolidated financial statements for additional information on legal proceedings and tax examinations.

Special Purpose Entities.

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The Company enters into a variety of transactions with special purpose entities, primarily in connection with securitization activities. The Company engages in securitization activities related to commercial and residential mortgage loans, U.S. agency collateralized mortgage obligations, corporate bonds and loans, municipal bonds

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and other types of financial instruments. In most cases, these SPEs are deemed to be variable interest entities. Unless a VIE is determined to be a qualifying special purpose entity (QSPE), the Company is required under accounting guidance to perform an analysis of each VIE at the date upon which the Company becomes involved with it to determine whether the Company is the primary beneficiary of the VIE, in which case the Company must consolidate the VIE. QSPEs are not consolidated.

In accordance with accounting guidance, the Company reassesses whether it is the primary beneficiary of a VIE upon the occurrence of certain reconsideration events. If the Company's initial assessment results in a determination that it is not the primary beneficiary of a VIE, then the Company reassesses this determination upon the occurrence of:

Changes to the VIE's governing documents or contractual arrangements in a manner that reallocates the obligation to absorb the expected losses or the right to receive the expected residual returns of the VIE between the current primary beneficiary and the other variable interest holders, including the Company.

Acquisition by the Company of additional variable interests in the VIE.

If the Company's initial assessment results in a determination that it is the primary beneficiary, then the Company reassesses this determination upon the occurrence of:

Changes to the VIE's governing documents or contractual arrangements in a manner that reallocates the obligation to absorb the expected losses or the right to receive the expected residual returns of the VIE between the current primary beneficiary and the other variable interest holders, including the Company.

A sale or disposition by the Company of all or part of its variable interests in the VIE to unrelated parties.

The issuance of new variable interests by the VIE to parties unrelated to the Company.

The determination of whether an SPE meets the accounting requirements of a QSPE requires significant judgment, particularly in evaluating whether the permitted activities of the SPE are significantly limited and in determining whether derivatives held by the SPE are passive and nonexcessive. In addition, the analysis involved in determining whether an entity is a VIE, and in determining the primary beneficiary of a VIE, requires significant judgment (see Note 5 to the consolidated financial statements).

Certain Factors Affecting Results of Operations.

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

factors that could affect the Company's business, see Risk Factors in Part I, Item 1A.

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Liquidity and Capital Resources.

The Company's senior management establishes the overall liquidity and capital policies of the Company. Through various risk and control committees, the Company's senior management reviews business performance relative to these policies, monitors the availability of alternative sources of financing, and oversees the liquidity and interest rate and currency sensitivity of the Company's asset and liability position. These committees, along with the Company's Treasury Department and other control groups, also assist in evaluating, monitoring and controlling the impact that the Company's business activities have on its consolidated balance sheet, liquidity and capital structure, thereby helping to ensure that its business activities are integrated with the Company's liquidity and capital policies. For a description of the Company's other principal risks and how they are monitored and managed, see "Quantitative and Qualitative Disclosures about Market Risk - Risk Management" in Part II, Item 7A.

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

The Balance Sheet.

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

The Company's total assets decreased to \$1,045,409 million at November 30, 2007 from \$1,121,192 million at November 30, 2006. The decrease was primarily due to decreases in securities borrowed, securities purchased under agreements to resell and the completion of the Discover Spin-off (see Note 22 to the consolidated financial statements), partially offset by an increase in cash and securities deposited with clearing organizations and securities received as collateral.

Within the sales and trading related assets and liabilities, there are transactions attributable to securities financing activities. Securities financing assets and liabilities as of November 30, 2007 were \$587 billion and \$559 billion, respectively. Securities financing transactions include repurchase and resale agreements, securities borrowed and loaned transactions, securities received as collateral and obligation to return securities received, customer receivables/payables and related segregated customer cash.

Securities financing assets and liabilities include matched book transactions with minimal market, credit and/or liquidity risk. These matched book transactions are to accommodate customers, as well as to obtain securities for the settlement and finance of inventory positions. The customer receivable/payable portion of the securities financing transactions includes customer margin loans, collateralized by customer owned securities, and customer cash, which is segregated in order to satisfy regulatory requirements. The Company's exposure on these transactions is limited by collateral maintenance policies, which in turn limits the Company's credit exposure to customers. Included within securities financing assets was \$82 billion that, in accordance with SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities" (SFAS No. 140) represented equal and offsetting assets and liabilities for fully collateralized non-cash loan transactions.

Balance sheet leverage ratios are one indicator of capital adequacy when viewed in the context of a company's overall liquidity and capital policies. The Company views the adjusted leverage ratio as a more relevant measure

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of financial risk when comparing financial services firms and evaluating leverage trends. The Company has adopted a definition of adjusted assets that excludes certain self-funded assets considered to have minimal market, credit and/or liquidity risk. These low-risk assets generally are attributable to the Company's matched book and securities lending businesses. Adjusted assets are calculated by reducing gross assets by aggregate resale agreements and securities borrowed less non-derivative short positions and assets recorded under certain provisions of SFAS No. 140 and FASB Interpretation No. 46 (revised December 2003) Consolidation of Variable Interest Entities (FIN 46R). Gross assets are also reduced by the full amount of cash and securities deposited with clearing organizations or segregated under federal and other regulations or requirements. The adjusted leverage ratio reflects the deduction from shareholders' equity of the amount of equity used to support goodwill and intangible assets (as the Company does not view this amount of equity as available to support its risk capital needs). In addition, the Company views junior subordinated debt issued to capital trusts as a component of its capital base given the inherent characteristics of the securities. These characteristics include the long-dated nature (e.g., some have final maturity at issuance of 30 years extendible at the Company's option by a further 19 years; others have a 60-year final maturity at issuance), the Company's ability to defer coupon interest for up to 20 consecutive quarters and the subordinated nature of the obligations in the capital structure. The Company also receives rating agency equity credit for these securities. Excluding the \$82 billion of assets and liabilities recorded in accordance with SFAS No. 140 would reduce the leverage ratio from 32.6x to 30.0x.

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

	Balance at		Average Month-End Balance	
	November 30, 2007	November 30, 2006	Fiscal 2007(1)	Fiscal 2006(2)
	(dollars in millions, except ratio data)			
Total assets	\$ 1,045,409	\$ 1,121,192	\$ 1,202,065	\$ 1,022,269
Less: Securities purchased under agreements to resell	(126,887)	(175,787)	(176,973)	(183,490)
Securities borrowed	(239,994)	(299,631)	(279,729)	(274,807)
Add: Financial instruments sold, not yet purchased	134,341	183,119	172,075	157,678
Less: Derivative contracts sold, not yet purchased	(71,604)	(57,491)	(59,869)	(47,176)
Subtotal	741,265	771,402	857,569	674,474
Less: Cash and securities deposited with clearing organizations or segregated under federal and other regulations or requirements(3)	(61,608)	(29,565)	(41,357)	(41,644)
Assets recorded under certain provisions of SFAS No. 140 and FIN 46R	(110,001)	(100,236)	(132,141)	(82,992)
Goodwill and net intangible assets(4)	(4,071)	(3,443)	(3,924)	(2,894)
Adjusted assets	\$ 565,585	\$ 638,158	\$ 680,147	\$ 546,944
Common equity	\$ 30,169	\$ 34,264	\$ 35,235	\$ 31,740
Preferred equity	1,100	1,100	1,100	423
Shareholders' equity	31,269	35,364	36,335	32,163
Junior subordinated debt issued to capital trusts	4,876	4,884	4,878	3,875
Subtotal	36,145	40,248	41,213	36,038
Less: Goodwill and net intangible assets(4)	(4,071)	(3,443)	(3,924)	(2,894)
Tangible shareholders' equity	\$ 32,074	\$ 36,805	\$ 37,289	\$ 33,144
Leverage ratio(5)	32.6x	30.5x	32.2x	30.8x
Adjusted leverage ratio(6)	17.6x	17.3x	18.2x	16.5x

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- (1) Average balances for fiscal 2007 were calculated based upon month-end balances from November 2006 through November 2007. Average common equity was adjusted for the Discover Spin-off.
- (2) The results for the Company and for the Institutional Securities business segment for the first two quarters of fiscal 2006 were adjusted (see Note 24 to the consolidated financial statements).
- (3) In the second quarter of fiscal 2007, the adjusted assets calculation was revised in order to reduce gross assets by the full amount of cash and securities deposited with clearing organizations or segregated under federal and other regulations or requirements. All prior periods have been restated to conform with the current presentation.
- (4) Effective December 1, 2006, mortgage servicing rights have been included in net intangible assets. Amounts as of November 30, 2006 have been reclassified to conform with the current presentation.
- (5) Leverage ratio equals total assets divided by tangible shareholders' equity.
- (6) Adjusted leverage ratio equals adjusted assets divided by tangible shareholders' equity.

Activity in Fiscal 2007.

The Company's total capital consists of shareholders' equity, long-term borrowings (debt obligations scheduled to mature in more than 12 months) and junior subordinated debt issued to capital trusts. At November 30, 2007, total capital was \$191,085 million, an increase of \$28,951 million from November 30, 2006. The Company redeemed all \$66 million of its outstanding Capital Units on February 28, 2007.

During the 12 months ended November 30, 2007, the Company issued senior notes with a carrying value aggregating \$76.1 billion, including non-U.S. dollar currency notes aggregating \$35.2 billion. In connection with the note issuances, the Company has entered into certain transactions to obtain floating interest rates based primarily on short-term London Interbank Offered Rates (LIBOR) trading levels. At November 30, 2007, the aggregate outstanding principal amount of the Company's Senior Indebtedness (as defined in the Company's senior debt indentures) was approximately \$207 billion (including guaranteed obligations of the indebtedness of subsidiaries). The weighted average maturity of the Company's long-term borrowings, based upon stated maturity dates, was approximately 5.5 years at November 30, 2007. Subsequent to fiscal year-end and through December 31, 2007, the Company's long-term borrowings (net of repayments) increased by approximately \$10 billion. In addition, in December 2007, the Company sold Equity Units to a wholly owned subsidiary of CIC for approximately \$5,579 million. See China Investment Corporation Investment herein.

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China Investment Corporation Investment.

In December 2007, the Company sold Equity Units which include contracts to purchase Company common stock (see *Stock Purchase Contracts* herein) to a wholly owned subsidiary of 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 outstanding on November 30, 2007. CIC will be a passive financial investor and will have no special rights of ownership nor a role in the management of the Company. A substantial portion of the investment proceeds will be treated as Tier 1 capital for regulatory capital purposes.

Each stock purchase contract mandatorily settles in Company common stock at prices between \$48.0700 and \$57.6840. The maximum number of shares to be issued upon settlement of the stock purchase contracts included in the Equity Units is approximately 116,063,000. The stock purchase contracts settle for Company common stock on August 17, 2010, subject to adjustment. Each Equity Unit will pay a fixed annual payment rate of 9% payable quarterly.

As described below, the Equity Units consist of interests in trust preferred securities issued by Morgan Stanley Capital Trust A (*Series A Trust*), Morgan Stanley Capital Trust B (*Series B Trust*) or Morgan Stanley Capital Trust C (*Series C Trust*) (each a *Morgan Stanley Trust* and, collectively, the *Trusts*) and stock purchase contracts issued by the Company. The only assets held by the Series A Trust, Series B Trust and Series C Trust are junior subordinated debentures issued by the Company.

Equity Units.

Each Equity Unit has a stated amount of \$1,000 per unit consisting of:

- (i) an undivided beneficial ownership interest in a trust preferred security of Series A Trust, Series B Trust or Series C Trust with an initial liquidation amount of \$1,000; and
- (ii) a stock purchase contract relating to the common stock, par value of \$0.01 per share, of the Company.

Junior Subordinated Debentures Issued to Support Trust Common and Trust Preferred Securities.

In the first quarter of fiscal 2008, the Company issued junior subordinated debt securities due no later than February 17, 2042 for a total of \$5,579,173,000 in exchange for \$5,579,143,000 in aggregate proceeds from the sale of the trust preferred securities by the Trusts and \$30,000 in trust common securities issued equally by the Trusts. The Company elected to fair value the junior subordinated debentures pursuant to SFAS No. 159. The common and trust preferred securities of the Trusts, totaling approximately \$5,579 million, represent undivided beneficial ownership interests in the assets of the Trusts, have no stated maturity and must be redeemed upon the redemption or maturity of the corresponding series of junior subordinated debt securities the sole assets of the respective Trusts. The Series A Trust, Series B Trust and Series C Trust will make quarterly distributions on the trust common and trust preferred securities at an annual rate of 6%.

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The trust common securities, which are held by the Company, represent an interest in the Trusts and are recorded as an equity method investment in the Company's consolidated statement of financial condition. The Trusts are VIEs in accordance with FIN 46R and the Company does not consolidate its interests in the Trusts as it is not the primary beneficiary of any of the Trusts.

The Company has directly guaranteed the repayment of the trust preferred securities to the holders thereof to the extent that there are funds available in the Trusts. If the Company does not make payments on the junior subordinated debentures owned by a Morgan Stanley Trust, such Morgan Stanley Trust will not be able to pay any amounts payable in respect of the trust preferred securities issued by it and will not have funds legally available for that purpose. In that event, holders of such series of trust preferred securities would not be able to

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rely upon the guarantee for payment of those amounts. The guarantee will remain in place until the redemption price of all of the trust preferred securities is paid, the amounts payable with respect to the trust preferred securities upon liquidation of the Morgan Stanley Trusts are paid or the junior subordinated debentures are distributed to the holders of all the trust preferred securities. The tr